



U.S. Department of Energy
Office of Inspector General
Office of Audits and Inspections

SPECIAL REPORT

Selected Recipients of Maryland
Weatherization Assistance Program Funds

DOE/IG-0942

July 2015



Department of Energy
Washington, DC 20585

July 30, 2015

MEMORANDUM FOR THE SECRETARY

FROM: 
Gregory H. Friedman
Inspector General

SUBJECT: INFORMATION: Special Report: "Selected Recipients of Maryland Weatherization Assistance Program Funds"

BACKGROUND

The Department of Energy's Weatherization Assistance Program (Program) provides weatherization grants to states, territories, Indian tribes, and the District of Columbia to improve the energy efficiency of low-income family homes. The Program allocates funds to these entities based on an established formula. Since 2009, the State of Maryland has received approximately \$74 million in weatherization funding, including \$64 million provided from the \$5 billion in *American Recovery and Reinvestment Act of 2009* weatherization funding received by the Department.

In Maryland, the Department of Housing and Community Development (DHCD) administers the Program through 19 local weatherization agency subgrantees (local agencies) comprised of 11 nonprofit agencies and 8 local governments. Local agencies provide weatherization services by county, using Program funds as well as funding from other sources. These local agencies use their own in-house crews and the services of contractors in the performance of weatherization activities.

In December 2013, the Office of Inspector General received a complaint containing allegations of unethical and improper accounting practices by two local agencies in DHCD's Program: C&O Conservation, Inc. (C&O) and Maryland Energy Conservation, Inc. (MEC). The complaint also included one of MEC's contractors, House Warmers, LLC (House Warmers). In response, we initiated an audit to determine whether these subrecipients had effectively and efficiently managed Program funds.

RESULTS OF AUDIT

Several serious aspects of the allegation were substantiated. We determined that:

- C&O and MEC engaged in improper and, in our view, unethical accounting practices. We concluded that approximately \$1.5 million in reimbursements to C&O and MEC from April 2009 to December 2013 were either abusive, expressly unallowable,

potentially unallowable, and/or unsupported. The costs that we are questioning included \$910,000 in payments in excess of actual costs for C&O, which are prohibited under 10 CFR 600.127(c), *Allowable Costs (Fee or Profit)*, for nonprofit financial assistance subrecipients. We identified a series of improper accounting practices constituting abuse that contributed to the reimbursement of billings in excess of costs. These practices included the addition of unsupported surcharges for weatherization work, claims in excess of actual costs, and unreasonable labor costs. Our questioned costs also included \$291,000 in other expressly or potentially unallowable costs and \$312,000 in unsupported costs reimbursed to C&O and MEC.

- C&O and MEC engaged in related-party transactions, which were highly troubling and resulted in potentially unallowable costs. In addition to the amounts mentioned above, we questioned about \$275,000 in program support and administrative costs involving related parties at C&O and MEC. We found that C&O and MEC's boards of directors included employees and multiple members of the controlling family, leading us to conclude that the boards lacked the independence necessary to render decisions in an objective manner without undue influence by individual directors who may possess a bias or other private interest. Given the lack of independence on the boards, family members and executive employees had the ability to substantially influence the actions of their respective organizations, such as approving their own compensation and conducting business with inside directors and related parties. Specifically, C&O engaged in related-party warehouse and vehicle lease arrangements that did not comply with Office of Management and Budget (OMB) Circular A-122, *Cost Principles for Non-Profit Organizations*, regulations related to less-than-arm's-length transactions. Furthermore, C&O and MEC made questionable compensation payments to related parties, and MEC circumvented DHCD's internal controls through payments made to related-party contractors such as House Warmers.
- C&O used Program funds for the personal benefit of inside directors, which included potentially unallowable and misclassified personal credit card expenses. These expenses are included in our questioned costs noted previously. Of great concern, we found that construction on a C&O inside director's home was funded in part with Program funds.

These problems took place in an environment in which the State of Maryland DHCD had very specific responsibilities for Program oversight, including internal control and safeguard policies and procedures for C&O, MEC, and House Warmers.

Contributing Factors

Although personal responsibility was at its core, the audit disclosed an operating environment that allowed significant deficiencies in subgrantee accounting systems. We determined that C&O's accounting system was inadequate for tracking Federal awards and that MEC's accounting system also had significant deficiencies. We found that C&O's accounting system did not properly identify direct Program costs as required by Federal regulations. Additionally, although C&O maintained inventory in a warehouse, it lacked a cost accounting system to adequately account for inventory usage. Further, C&O and MEC were unable to provide

statements of Program income that reconciled to actual payments made by DHCD. Finally, C&O and MEC did not maintain labor records in accordance with Federal regulations and could not provide sufficient evidence to support all Program costs.

DHCD's Program oversight was inadequate and did not meet Weatherization Program mandates. Specifically, we noted that DHCD lacked policies or practices for reconciling fixed-price and rate-based payments made to local agencies to their actual labor and materials costs, proper recordkeeping for training and technical assistance expenditures, scrutinizing related-party transactions, and reconciling indirect payments to actual program support costs.

Additionally, the subgrantee accounting deficiencies did not provide the visibility necessary for DHCD to assess labor or materials costs expended for the personal benefit of inside directors. As a result, potentially unallowable personal credit card expenses included in our questioned costs, as well as unquantifiable costs of construction on a C&O director's home, were not detected.

Finally, we found that DHCD's audit monitoring and resolution process was not effective. Specifically, DHCD did not ensure that repeat findings in C&O and MEC audits had been resolved. Additionally, weaknesses had not been resolved even though we brought almost identical issues to the attention of the State in our previous audit report *The Department of Energy's Weatherization Assistance Program Funded under the American Recovery and Reinvestment Act for the State of Maryland* (OAS-RA-13-07, January 2013). Furthermore, DHCD did not ensure that required C&O and MEC audits were completed in a timely manner.

Due to the significant deficiencies in both C&O and MEC's accounting systems and the nature of some related-party business arrangements, we were unable to substantiate or disprove several of the allegations we reviewed.

Impact and Path Forward

Overall, we questioned about \$1.8 million in Program payments to C&O and MEC for program benefit, program support, administrative, and training and technical assistance costs (see Appendix 1). The audit also disclosed serious shortcomings in Maryland's oversight of the Weatherization Program. We conservatively estimated that had the funds we questioned been properly used, as many as 100 additional homes could have been weatherized for Maryland's low-income residents. Just as troubling, this experience could undermine the Weatherization Program, raising serious questions as to future funding.

As a result of issues identified in our audit, the Department took action in February 2015 to debar C&O, House Warmers, and several related parties from Government contracting and Government-approved subcontracting for 3 years. While these actions are promising, additional effort is needed to ensure that weatherization funds are appropriately expended only on home improvements for Maryland's low-income households. Accordingly, we made recommendations designed to improve the financial management of Maryland's use of Program funds.

MANAGEMENT RESPONSE

The Department and DHCD concurred with the report's recommendations. Although we considered many of management's corrective actions, both taken and planned, to be responsive to our recommendations, there are several unresolved differences between the Department and DHCD's planned actions. Contrary to the Department's response that such action had taken place, DHCD had stated that it had not hired an independent auditor to assess its six largest subgrantees. In our discussion with the Department regarding DHCD's response, the Department clarified that although DHCD had not hired an independent auditor, the Department plans to require DHCD to do so by August 15, 2015. However, DHCD officials informed us that while it does plan to assess C&O and MEC, it has not agreed to hire an independent auditor. We recommend that the Department and DHCD collaborate to resolve differences in their stated approaches.

Management's comments and our response are summarized and more fully discussed in the body of the report. Management's formal comments are included in Appendixes 4 and 5.

Attachments

cc: Deputy Secretary
Under Secretary for Science and Energy
Assistant Secretary for Energy Efficiency and Renewable Energy
Chief of Staff

SPECIAL REPORT: SELECTED RECIPIENTS OF MARYLAND WEATHERIZATION ASSISTANCE PROGRAM FUNDS

TABLE OF CONTENTS

Special Report

Details of Finding	1
Recommendations	13
Management Response and Auditor Comments	14

Appendices

1. Summary of Questioned Costs.....	16
2. Objective, Scope, and Methodology	17
3. Prior Reports	19
4. Department of Energy Management Comments.....	20
5. State of Maryland Management Comments	23

SELECTED RECIPIENTS OF MARYLAND WEATHERIZATION ASSISTANCE PROGRAM FUNDS

DETAILS OF FINDING

Our audit substantiated three of nine allegations we reviewed that were outlined in a complaint received by the Office of Inspector General. The complaint pertained to two of the State of Maryland's (State) local weatherization agencies (local agencies), C&O Conservation, Inc. (C&O) and Maryland Energy Conservation, Inc. (MEC), and one of MEC's contractors, House Warmers, LLC (House Warmers). Overall, we questioned about \$1.8 million in reimbursement claims for the Weatherization Assistance Program (Program) by C&O and MEC. Specifically, we found the following:

- C&O and MEC engaged in improper and, in our view, unethical accounting practices. As a result, we questioned approximately \$1.5 million in reimbursements that we considered to be expressly unallowable, potentially unallowable, and/or unsupported.
- C&O and MEC engaged in questionable related-party transactions resulting in potentially unallowable expenses. We questioned approximately \$275,000 in costs related to less-than-arm's-length transactions and arrangements involving inside directors (i.e., individuals concurrently serving a nonprofit organization in the capacity of employee and member of the board of directors) of C&O and MEC, their relatives, and companies owned and operated by inside directors.
- Program funds were used for the personal benefit of inside directors of C&O.

C&O and MEC, subgrantees of the Maryland Department of Housing and Community Development (DHCD), are nonprofit organizations with more than 10 years of experience in the Program. House Warmers is a for-profit entity that is a contractor to MEC and is owned and operated by two inside directors of C&O. From April 2009 to December 2013, C&O and MEC received about \$8.1 million and \$7.5 million, respectively, in Program reimbursements from DHCD. Additionally, both organizations had received Program funding as contractors, and MEC received an estimated \$4.3 million in additional Program funding via flow-through payments from other local agencies. Despite the Program deficiencies we identified, DHCD, C&O, and MEC were cooperative and responsive throughout the course of our audit.

Improper and Unethical Accounting Practices

We substantiated the allegation that C&O and MEC engaged in improper and, in our view, unethical accounting practices. Our audit of C&O and MEC's accounting records for April 2009 to December 2013 identified multiple improper accounting practices related to Program reimbursement claims. We questioned approximately \$1.5 million in reimbursements to C&O and MEC because the costs were in excess of costs considered reimbursable under the terms of the financial assistance agreement.

Payments in Excess of Actual Costs

Although specifically prohibited by Federal regulation, we found that C&O claimed and received payments from Federal awards in excess of actual costs. In particular, we found that C&O received payments from the State that exceeded actual program benefit costs (i.e., direct materials, labor, and contractor costs for installing energy efficiency retrofits for individual homes). C&O made claims for and was paid these sums even though charges in excess of actual costs are not reimbursable under 10 CFR 600.127(c), *Allowable Costs (Fee or Profit)*, for nonprofit financial assistance subrecipients. C&O provided us with a statement of revenues and expenditures that showed C&O had received revenues of about \$6.1 million from Department of Energy (Department) program benefit cost reimbursements, while actual program benefit expenditures were only about \$5.2 million. As such, we questioned the \$910,000 increment above actual costs.

As part of our audit of program benefit reimbursements, we conducted an examination of a sample of reimbursement claim documentation for energy efficiency retrofits of low-income residences (projects). We examined supporting documentation contained in C&O's project files for 80 of 1,135 Program-funded projects and identified a series of improper accounting practices, which, in our view, amounted to abuse and contributed to the \$910,000 in payments in excess of actual costs. Specifically, we found the following:

- C&O added unsupported surcharges to their reimbursement claims for energy efficiency retrofits installed by contractors. For example, we found 32 instances where C&O added an additional \$300 fee to its reimbursement claims for furnace replacements performed by its contractors even though it could not support the fee.
- C&O submitted reimbursement claims in excess of actual costs for contracted air infiltration reduction (or air leakage) work. DHCD reimbursed local agencies for reducing a home's air leakage at a rate of \$55 per 100 cubic feet per minute (CFM) without a reconciliation or true-up to actual costs. We identified 25 projects where C&O submitted reimbursement claims to the State that exceeded costs paid to its contractors. In one example, C&O submitted a Program reimbursement claim for \$198.55 although its contractor had only invoiced \$77, resulting in a \$121.55 surcharge. As part of its quality control inspection, C&O would reperform the contractor's air leakage reduction measurement. According to C&O personnel, measurements often differ and can be affected by factors such as the weather. If C&O's measurement resulted in a higher reduction than the contractor's measurement, C&O would increase its reimbursement claim to the State based on the higher air infiltration reduction measurement. These additional claims were ultimately passed on to the Department. In addition to reimbursement claims for CFM reduction units in excess of contractor billings, we noted several instances where C&O submitted claims at the State's standard rate even though the contractor was billing C&O at a lesser rate. For instance, a contractor billed C&O for similar work at a rate of \$40 per 100 CFM, which C&O billed to the State at \$55 per 100 CFM. This \$15 per 100 CFM markup represented a payment in excess of actual costs specifically prohibited by 10 CFR 600.127, *Allowable Costs*.

-
- C&O submitted reimbursement claims for the installation of higher efficiency rated (and more expensive) insulation than was actually installed and billed by its contractors. We identified 33 projects where C&O submitted reimbursement claims to the State for contracted insulation that did not represent the appropriate energy efficiency rating (R-value) and cost of the insulation installed. In one example, C&O's contractor installed 562 units of R-19 insulation at a per-unit cost of \$0.44 for a total cost of \$247.28; however, C&O submitted a reimbursement claim to the State for this installation as R-38 insulation at a per-unit cost of \$1.70 and a total cost of \$955.40, resulting in a reimbursement of about \$708 in excess of actual cost.
 - C&O submitted reimbursement claims based on potentially unreasonable fixed fees for replacement and installation of common household energy efficiency items such as faucet aerators, compact fluorescent lamp (CFL) bulbs, showerheads, and carbon monoxide/smoke detectors. C&O used the fixed fee in lieu of submitting claims based on actual labor and material costs. For example, the fixed fee for the installation of a CFL bulb was \$8.33, which covered the \$1.99 cost of the light bulb and allowed for \$6.34 in labor costs, an amount we considered potentially excessive given the minimal time and labor necessary to screw a light bulb into an existing socket. Furthermore, C&O had maintained inventory in its warehouse but did not maintain a cost accounting system to adequately account for inventory usage and breakage. In our previous report *The Department of Energy's Weatherization Assistance Program Funded under the American Recovery and Reinvestment Act for the State of Maryland* (OAS-RA-13-07, January 2013), we reported similar issues with another of Maryland's local agencies, noting that in effect, the local agency had received about \$9 in excess of cost for each CFL bulb installed.

The risks of abuse and payments in excess of actual costs will remain high in the absence of DHCD requirements for the performance of a reconciliation or true-up of subgrantee payments based on fixed prices or fees.

Other Unallowable Costs

We questioned an additional \$291,000 in potentially unallowable and expressly unallowable costs at C&O and MEC that were related to a variety of items. Specifically, we questioned the following as potentially unallowable:

- About \$130,000 in C&O "Supplies – Other" expenses financed with inside directors' personal credit cards, which included travel charges for unauthorized training and technical assistance (T&TA) costs (i.e., costs associated with Program-related training and certifications for agency personnel and contractors), multiple meals without documented justifications or participants lists, and other transactions not clearly identifiable as legitimate program expenses. Our testing identified about \$45,000 in credit card expenses posted to C&O's general ledger "Supplies – Other" account even though the charges included expenses that did not appear to be related to materials or supplies purchases.

-
- About \$43,000 in MEC credit card charges that included fuel and maintenance costs charged to the Program. We identified maintenance charges related to the inside director's personal vehicle. The inside director stated that fuel for the personal vehicle was also charged to the Program, but mileage logs were not maintained for this mixed personal and Program use vehicle as would be necessary to determine the allocation of allowable fuel and maintenance costs. The credit card expenses also included charges for other MEC vehicles, but the inside director could not differentiate between credit card charges associated with organization-owned and personal vehicles.
 - About \$36,000 and \$6,000 in depreciation expenses at C&O and MEC, respectively, for unauthorized vehicles. Contrary to the requirements of the 10 CFR 440.18, *Allowable Expenditures*, both C&O and MEC purchased vehicles without required approval from the Department and then charged depreciation from the unauthorized vehicles to the award. Furthermore, during our audit, C&O and MEC did not provide accurate depreciation schedules to support their general ledger records. Consequently, we questioned all depreciation expenses incurred from 2009 through 2013.

We also questioned the following expenses as expressly unallowable per Office of Management and Budget (OMB) Circular A-122, *Cost Principles for Non-Profit Organizations*:

- About \$36,000 in C&O warehouse lease costs improperly allocated to the Program. From November 2009 to December 2012, C&O had sublet more than a quarter of its leased warehouse space to other entities, while continuing to charge the entire lease to the indirect cost pool.
- About \$15,000 in over-recovered costs for vehicles leased from inside directors by C&O. The payments in this case exceeded the terms of the lease agreements.
- About \$13,000 in over-recovered program benefit costs by MEC. MEC had recorded this over-recovery in its general ledger account named "Due to State of Maryland-overpayment." Although MEC had been aware of this over-recovery, it had not notified the State or attempted to return the funds prior to our site visit, a period exceeding 22 months. DHCD recovered these funds from MEC immediately after we brought this issue to its attention.
- About \$8,000 in bad debt expenses related to reimbursement claims that C&O had written off and then charged to the Program, a practice prohibited by OMB Circular A-122 cost principles.
- About \$4,000 in donations to the school of a C&O inside director's child. This cost was misclassified under "Supplies – Other."

We were unable to substantiate an allegation that C&O had used Program funding to pay for personal travel of inside directors. However, in regard to questioned personal credit card charges previously noted, we did find that inside directors traveled to multiple out-of-state trainings and

charged these expenses to their personal credit cards without DHCD's preapproval, a practice which is not in accordance with DHCD's defined business practices. Furthermore, at the time of our review, C&O had not disclosed this travel to Program officials and had misclassified these travel expenses by recording them in its "Supplies – Other" general ledger account.

Unsupported Costs

Our audit identified about \$312,000 in unsupported costs at C&O and MEC. Specifically, for C&O we questioned the following:

- About \$154,000 for inadequately supported projects completed by C&O's in-house weatherization crews. We examined supporting documentation contained in C&O's project files for 80 of 1,135 Program-funded projects, and we identified 45 projects that were not supported by vendor invoices or cost accounting records necessary to support Program costs. Furthermore, C&O did not maintain a cost accounting system or the supporting documentation necessary to identify material costs for these projects or to determine per-unit costs of the installed energy efficiency retrofits on its reimbursement claims, as required by Federal regulations.
- About \$24,000 for unsupported contractor expenses related to program benefits provided to homeowners who had their homes weatherized. Our audit identified 17 projects contracted by C&O with incomplete supporting documentation.
- About \$14,000 in program support (i.e., indirect costs necessary to support the program, but not readily identifiable to work on an individual home) costs corresponding to the \$24,000 in unsupported contractor benefit expenses noted immediately above.
- About \$4,000 in unsupported expenses posted to C&O's general ledger.
- About \$58,000 in T&TA expenses charged to the Program. Neither C&O nor DHCD were able to provide supporting documentation for C&O's T&TA expenses; therefore, we question all reported T&TA expenses reimbursed under the Program.

Specifically, for MEC we questioned the following:

- About \$31,000 for unsupported program benefits expenses. We examined supporting documentation contained in MEC's project files for 155 of 1,913 Program-funded projects, and we identified 20 projects contracted by MEC with incomplete supporting documentation.
- About \$8,000 in program support costs corresponding to the \$31,000 in unsupported program benefit expenses noted immediately above.
- About \$19,000 in T&TA expenses charged to the Program. We found that DHCD and MEC had not maintained adequate evidence to support travel and training expenses

funded under the Program. MEC had not provided travel vouchers for the majority of its T&TA reimbursement requests. Additionally, T&TA mileage expenses were not supported by reimbursement requests from the individual employees to whom these expenses were attributed. About \$8,000 in T&TA costs were unsupported and the remaining questioned costs of about \$11,000 were only supported by credit card statements.

Questionable Related-Party Transactions

We substantiated allegations that C&O and MEC engaged in questionable related-party transactions. We questioned approximately \$275,000 overall, or about \$176,000 and \$99,000 at C&O and MEC, respectively, in program support and administrative costs involving related parties. In addition, we identified several less-than-arm's-length business arrangements. C&O and MEC's boards of directors included employees and multiple related family members. Given this lack of independence on the boards, family members and executive employees had the ability to substantially influence the actions of their respective organizations, such as approving their own compensation or conducting business with inside directors and related parties. We found that C&O's board of directors lacked independence from inside directors, which included two directors who were executives and married to each other. C&O's board of directors included one MEC employee, as well. During the same period, family members related to the married C&O board members held a controlling majority on MEC's board of directors, including two directors who were executive employees. We also identified multiple employees at MEC who were related to board members. In addition, C&O had business arrangements with the married inside directors and their businesses, House Warmers and 327 East Wilson Blvd, LLC. The married C&O inside directors were the sole employees of their general contracting business, House Warmers. MEC contracted Program work to this related-party contractor, as well.

Warehouse Lease Arrangements

We questioned \$60,000 in unallowable warehouse lease expenses at C&O. C&O leased warehouse space from 327 East Wilson Blvd, LLC, a company owned by the two married inside directors of C&O. Further, C&O sublet a portion of the warehouse space to MEC. We questioned this amount based on rules set forth in OMB Circular A-122, *Cost Principles for Non-Profit Organizations*, which limits allowable costs under a less-than-arm's-length lease to the costs the organization would have incurred had the organization owned the property. We questioned the estimated lease cost in excess of the estimated cost of ownership.

Vehicle Lease Arrangements

We questioned a total of about \$77,000 in potentially unallowable vehicle lease costs paid to C&O, based on the rules set forth in OMB Circular A-122, *Cost Principles for Non-Profit Organizations*. Rental costs under less-than-arm's-length arrangements are allowable only up to the amount that would be allowed had the nonprofit organization continued to own the property. This amount would include expenses such as depreciation or use allowance, maintenance, taxes,

and insurance. Also, we found that C&O did not maintain the records necessary to allocate these lease costs relative to the Program benefit for the inside directors' personal use vehicles, as required by OMB cost principles. Specifically, we questioned the following:

- About \$46,000 for personal vehicles that two inside directors leased to C&O. During the period of April 2009 to December 2013, two inside directors had leased their own personal use vehicles to C&O and did not maintain mileage logs to substantiate the proportion of usage attributable to personal and Program use for these vehicles.
- About \$16,000 in excessive monthly lease payments from C&O to House Warmers for a box truck, during the period of September 2012 through December 2013. These charges were far in excess of allowable 5-year, straight-line depreciation. For instance, House Warmers purchased the box truck for \$6,500 then charged the Program \$18,000 over 15 months.
- About \$15,000 in excessive daily lease payments from C&O to House Warmers for the same box truck and a pick-up truck, during the period of July 2012 through September 2012. These expenses were also misclassified in the "Supplies – Other" account. The daily charged rate exceeded the allowable daily depreciation rate by more than 2,500 percent and 300 percent respectively.

Labor Cost

We identified unreasonable compensation arrangements with related parties at both C&O and MEC:

- We questioned about \$39,000 in regular and overtime compensation paid to a C&O inside director in 2012. The inside director, who served as an executive employee of C&O, was awarded a pay increase of more than 79 percent of the inside director's hourly rate. We questioned the compensation resulting from this rate increase, as we concluded an increase of this magnitude was unreasonable under OMB cost principles.
- We questioned about \$99,000 in compensation paid to a spouse of an inside director of MEC for the period of April 2009 to December 2013. The inside director's spouse had received compensation for administrative work performed primarily out of their home office. This employee was compensated at an hourly rate more than 50 percent higher than that of the nearest counterpart in the organization and that of the median rate for administrative assistants reported by the Bureau of Labor Statistics.

While we did not substantiate an allegation that another inside director had received excessive compensation through executive salaries paid by C&O, a determination of total compensation was obscured by the less-than-transparent nature of this inside director's business arrangements with C&O and MEC. In particular, this inside director had received compensation through 327 East Wilson Blvd, LLC, and House Warmers, both of which had received revenues from C&O and MEC's Program funding. Additionally, the inside director was compensated through the aforementioned personal vehicle lease arrangements.

Due to inadequate records, we were unable to substantiate allegations that MEC had fraudulently compensated family members where no work was ever performed, or that MEC had charged the Program for services that MEC employees allegedly provided to both C&O and House Warmers. We found that C&O and MEC's labor records did not comply with the requirements of OMB Circular A-122, *Cost Principles for Non-Profit Organizations*. Contrary to rules set forth in OMB Circular A-122, neither MEC nor C&O's labor records reflected the distribution of activity of each employee. Labor records did not distinguish between labor categories such as direct (program benefits) or indirect (program support, administrative, and T&TA) functions, nor did they distinguish between work on Federal and State funded programs.

Funding Used for Personal Benefit

We substantiated the allegation that Program funds were used for the personal benefit of inside directors of C&O, which included the previously mentioned potentially unallowable and misclassified personal credit card expenses. Due to C&O's inadequate labor records and lack of a cost accounting system, we were unable to quantify the monetary impact of renovation work on an inside director's home. Specifically, renovations on a C&O inside director's home were funded in part with Program funds. During interviews conducted at both C&O and MEC, inside directors from both organizations stated that training involving insulation and drywall work was completed on the home of a C&O inside director and that the labor for the training was charged to the Program. According to the C&O inside director who received the services on his home, all materials were purchased by him personally. These claims could not be verified, as C&O did not have an adequate cost accounting or inventory system to make that determination. Furthermore, C&O and MEC's labor records were not kept in accordance with Federal regulations; thus, their records were inadequate to identify the cost of labor attributed to training in any instance.

Previously Recovered Program Support Payments

We found that DHCD had previously recovered about \$243,000 in unallowable program support payments made by MEC to related parties. Direct costs charged to the award are required to be submitted through DHCD's Hancock Energy Software (HES) system, a Web-based program management system used by DHCD and its local agencies to manage the Program and approve direct program benefit costs. However, when House Warmers submitted claims for administrative fees to MEC as direct costs, MEC did not include these costs as part of the direct costs submitted into the HES system, effectively circumventing DHCD's internal controls. This reduced DHCD's ability to review these costs for reasonableness and allowability. Additionally, MEC did not obtain advanced DHCD approval to include these administrative fees in its program support costs, as required by DHCD guidelines. We also noted that C&O received program support payments from MEC. In 2013, DHCD identified and recovered these payments as part of its recovery of about \$436,000 in unsubstantiated program support payments made to MEC.

Contributing Factors

We found that the identified issues occurred primarily because of deficiencies in subgrantee accounting systems, as well as weaknesses in DHCD's financial oversight and audit monitoring and resolution process.

Subgrantee Accounting Systems

Deficient subgrantee accounting systems were a major contributor to issues identified in our report. We determined that C&O's accounting system was inadequate for tracking Federal awards and expenditures and lacked controls for properly identifying unallowable costs. MEC's accounting system also had similar deficiencies. It became apparent at the beginning of our audit that C&O's accounting system was inadequate for tracking Federal awards when it was unable to produce a basic statement of Federal income and expenditures for our review. We requested a statement showing all funding and expenditures, by program, in April of 2014; however, C&O was unable to provide it until June of 2014. Furthermore, the Program income on the statements of funding and expenditures provided by C&O and MEC did not reconcile to actual payments made by DHCD. Ultimately, we found that C&O's accounting system did not properly identify direct Program costs as required by Federal regulations. Additionally, although C&O maintained inventory in a warehouse, it lacked a cost accounting system to adequately account for inventory usage. Finally, C&O and MEC did not maintain labor records in accordance with Federal regulations and could not provide sufficient evidence to support all Program costs.

Additionally, the subgrantee accounting deficiencies did not provide the visibility necessary for DHCD to assess unallowable labor or materials costs expended for the personal benefit of inside directors. As a result, potentially unallowable personal credit card expenses included in our questioned costs, as well as unquantifiable costs of construction on a C&O director's home, were not detected.

C&O and MEC failed to make necessary improvements to their accounting systems despite knowledge of their inadequacies. Independent auditors had reported similar findings related to C&O and MEC's accounting systems in multiple OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, reports. It is ultimately the responsibility of the local agencies to correct known deficiencies and to comply with all applicable regulations and guidance.

DHCD Financial Oversight

Weaknesses in DHCD's Program oversight were another contributing factor to improper payments to C&O and MEC. Specifically, we noted that DHCD lacked policies or practices for the following:

- Reconciling fixed-price and rate-based payments made to local agencies to their actual labor and materials costs. While DHCD's practice of using fixed prices and rates may increase cost certainty and claim processing efficiency, in the absence of reconciliation

to actual costs, these types of reimbursement policies are susceptible to fraud, abuse, and improper payment. As previously stated, subgrantees are prohibited from receiving payments in excess of costs on Federal awards.

- Proper recordkeeping of T&TA expenditures.
- Scrutinizing related-party transactions. DHCD did not review C&O and MEC's less-than-arm's-length transactions even though single audit reports, copies of which had been furnished to State officials, provided details of related-party transactions that should have triggered a review of such costs.
- Reconciling indirect payments to actual program support costs. While DHCD tracked program support costs in its HES system, this system did not reconcile to the general ledger. This deficiency decreased DHCD's ability to effectively reconcile program support payments made to the local agencies to actual costs and may have increased the State's dependence on the local agencies to provide accounting data necessary for oversight.

DHCD Audit Monitoring and Resolution Process

Our audit called into question the adequacy of DHCD's audit monitoring and resolution process. We found that DHCD did not have policies to govern the review and/or follow up on external audit findings. We observed issues during our fieldwork that were similar to those identified in our previous audit report *The Department of Energy's Weatherization Assistance Program Funded under the American Recovery and Reinvestment Act for the State of Maryland* (OAS-RA-13-07, January 2013). In particular, our 2013 report noted excessive costs on the installation of CFL bulbs. During our fieldwork, these issues remained unresolved, and a C&O inside director stated that they were unaware that this was an issue. Additionally, our previous report questioned all program support payments to DHCD local agencies and recommended that they be resolved, which should have required reconciliation of program support payments to actual costs. In 2013, the Department closed the recommendation. While it appears that DHCD attempted to resolve \$9.56 million in questioned costs from our previous audit report, we found the implementation of management's stated corrective actions to be inadequate. Specifically, during our current audit, we identified that C&O, one of DHCD's subgrantees, had not reconciled its program support payments to actual program support costs, an action that should have been necessary to ensure resolution of a portion of the questioned costs in our previous report.

Furthermore, independent auditors noted findings similar to ours in multiple years in single audits performed for C&O and MEC. DHCD is required to ensure that local agencies maintain accounting systems adequate for handling Federal awards to include ensuring the resolution of audit findings. Our review found that many of the independent auditor's findings were recurring and remained unresolved. For instance, the following recurring findings were reported in recent single audit reports that were available prior to our review:

-
- C&O and MEC had not maintained appropriate documentation for all disbursements.
 - C&O and MEC's accounting records were not maintained in accordance with generally accepted accounting principles (GAAP).
 - MEC did not have the resources to draft financial statements in accordance with GAAP either on staff or through an independent contractor.
 - MEC did not address apparent or actual conflicts of interest in its procurement policy.
 - C&O and MEC did not maintain supporting documentation to prove they followed their own procurement policies.
 - Inside directors and family members occupied the controlling majority on MEC board of directors; thus, MEC's board was not independent.

We also found that DHCD did not ensure that C&O and MEC completed their single audits in a timely manner. None of C&O or MEC's single audits were completed within 9 months of year-end, as required by OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. C&O's 2012 single audit was completed in May 2014. Furthermore, as of the end of June 2014, MEC had not completed its single audits for years 2011 and 2012, years in which MEC had received more than \$1 million in Program funding.

Additionally, we found that DHCD had identified and/or resolved several issues at MEC and C&O. In 2011, DHCD hired an independent accountant to help assess whether C&O and MEC were in compliance with 10 CFR 600, *Financial Assistance Rules*. In 2012, DHCD identified and prohibited the practice of C&O adding unsupported surcharges on heating system installations reimbursed under the Program. However, DHCD neither sought recovery of C&O's unsupported surcharges nor verified that C&O had discontinued the practice of adding unsupported surcharges. During the period of September 2012 to October 2013, DHCD suspended Program work at MEC, identified and resolved about \$436,000 in unsubstantiated program support reimbursements at MEC, and aided in the improvement of the agency's inadequate accounting system.

Other Matters

Due to the significant deficiencies in both C&O and MEC's accounting systems and the less-than-transparent nature of some of their related-party business arrangements, we were unable to substantiate or disprove six of the nine allegations we reviewed. Additionally, the complaint included three additional allegations that we referred to appropriate officials because they were considered outside the scope of our audit.

As a result of issues identified in our audit, the Department took action in February 2015 to debar C&O, House Warmers, 327 East Wilson Blvd, LLC, and several related parties from Government contracting and Government-approved subcontracting for 3 years.

Impact and Path Forward

We recognize that the goal of rapidly deploying *American Recovery and Reinvestment Act of 2009* funds and ensuring that the funds were expended efficiently and effectively created management challenges. However, we found that weak fiscal controls over subgrantees, combined with deficiencies in subgrantee accounting systems, have led to the Program funding improper payments to local agencies rather than furthering the Program's goals of installing energy efficiency retrofits for low-income families. Deficiencies in these subgrantees' accounting systems increase the overall risk of misstatement and erroneous claims. Weaknesses in DHCD Program oversight increase risk of fraud, waste, abuse, and improper payments. These issues, coupled with C&O and MEC's lack of complete and accurate disclosure, have limited the ability of DHCD and the Department to monitor the subgrantees' compliance with relevant criteria for the Program. We found that C&O and MEC had received about \$1.8 million in improper payments from April 2009 to December 2013. While we understand that not all questioned costs would have ultimately been spent on weatherization efforts, we conservatively estimate that more than 100 homes could have been weatherized had the costs we questioned been available for weatherization work. Although outside our scope, we noted that issues discussed in this report continued during 2014.

With funding of approximately \$174 million in the Department's 2014 Program budget and about \$228 million in the 2015 budget request, we believe the Department has opportunities to implement financial controls designed to maximize the funding available for direct program benefit costs. Fully addressing the issues raised by independent auditors in single audit reports and recommendations in our reports should reduce the overall risk to the Program.

RECOMMENDATIONS

In the absence of immediate improvements in financial controls, the risk of fraud, waste, and abuse is increased. Accordingly, we recommend improvements to the financial management of the State of Maryland's use of Weatherization Assistance Program (Program) funds. Specifically, we recommend that the Contracting Officer for Energy Efficiency and Renewable Energy:

1. Resolve questioned costs totaling about \$1.8 million.
2. Assess the monetary impact and recoup funds, as appropriate, related to the previous recommendation on questioned program support costs from our report *The Department of Energy's Weatherization Assistance Program Funded under the American Recovery and Reinvestment Act for the State of Maryland* (OAS-RA-13-07, January 2013).
3. Implement policies and procedures to ensure the recovery, prior to award closeout, of payments made in excess of actual costs when provisional payments are based on estimated costs.

We also recommend that the Assistant Secretary for Energy Efficiency and Renewable Energy require the State of Maryland to:

4. Review Program-funded reimbursements made to C&O and MEC for the entire period of performance for improper payments and resolve any identified issues prior to closeout.
5. Assess the adequacy of subgrantee accounting systems for accounting for Federal awards.
6. Develop and implement internal controls to address oversight weaknesses including the reconciliation of fixed-price and fixed-rate payments to actual costs, the proper documentation of training and technical assistance reimbursement claims, and assessing reasonableness of less-than-arm's-length bargaining and transactions with consideration to the restraints or requirements imposed by Federal and State laws and regulations, terms, and conditions of the award and arm's-length bargaining.
7. Develop and implement policies and procedures to govern the review and follow-up on external and internal audit findings.
8. Ensure that subgrantees complete OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, audits in a timely manner and that findings are adequately addressed by management.

MANAGEMENT RESPONSE

Management Comments (Department)

Management concurred with the findings and recommendations of the report. Specifically, the Department noted that it will require DHCD to submit for approval policies and procedures for assessing the adequacy of subgrantee accounting systems for accounting for Federal awards, to reconcile provisional payments in excess of actual costs, to ensure that subgrantees complete required audits in a timely manner, and to govern the follow-up of internal and external audit findings. In addition, the Department indicated that it will require DHCD to develop and implement internal controls related to reconciling fixed-price and fixed-fee payments to actual costs, documenting T&TA expenses, and assessing reasonableness of less-than-arm's-length bargaining arrangements. Further, the Department stated that DHCD planned to hire an independent auditor to assess its six largest subgrantees. The Department also indicated that it intends to review the resulting reports to evaluate and determine the monetary impact and make a formal determination regarding whether questioned costs discussed in our current and previous reports will be disallowed. Finally, the Department will recommend that DHCD perform an audit of its financial control system and processes and will request that DHCD provide a plan for improvement.

Management's comments (Department) are included in Appendix 4.

Management Comments (DHCD)

Management concurred with our findings and recommendations. Specifically, DHCD stated that it is working with MEC to resolve more than \$200,000 in questioned costs noted in the report and is currently negotiating repayment of residual costs. Additionally, DHCD indicated that it will work with C&O to resolve the \$1.6 million in questioned costs noted in the report. Further, DHCD intends to review and reconcile payments made to MEC and C&O for the entire performance period of the award.

DHCD stated that it eliminated program support and flat-fee payments effective July 1, 2015. In the interim, DHCD noted that it was conducting quarterly reconciliations of program support payments against back-up documentation to ensure proper justification. Further, DHCD indicated that it has developed and implemented internal controls to include assessing the adequacy of subgrantee accounting systems during the annual application process, T&TA budget controls, and the implementation of a not-to-exceed price list. DHCD stated that it will include a new financial management chapter in the Program Operations Manual to address DHCD and subgrantee policies and procedures. DHCD added that the Department was advising on revisions to its subgrantee compliance and monitoring procedures, which will include the requirement for OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, audits to be obtained during the subgrantee annual monitoring visit. DHCD further stated that it will address A-133 audit findings and concerns in its subgrantee monitoring reports. DHCD anticipates the Program Operations Manual revisions will be published in August 2015. DHCD

indicated that following publication of the Manual, it will provide subgrantee training on the new financial management policies and procedures during the Maryland Weatherization Program's Annual Network Meeting.

Management's comments (DHCD) are included in Appendix 5.

AUDITOR COMMENTS

Although we considered many of management's corrective actions, both taken and planned, to be responsive to our recommendations, there are several unresolved differences between the Department and DHCD's planned actions. Contrary to the Department's response, DHCD told us that it had not hired an independent auditor. In our discussion with the Department regarding DHCD's response, the Department clarified that although DHCD had not hired an independent auditor to assess the six largest subgrantees as stated in its management response, the Department plans to require DHCD to do so by August 15, 2015. However, DHCD officials informed us that it intends to assess only C&O and MEC as DHCD considers the issues we reported on in our previous audit of the Maryland Weatherization Program to have been resolved (see DHCD Audit Monitoring and Resolution Process, page 10). We recommend that the Department and DHCD collaborate to resolve differences in their stated approaches.

In addition, in communications after its submission of formal comments, DHCD disagreed with our characterization of its policy of reimbursing local agencies for reducing a home's air leakage at a rate of \$55 per 100 CFM (see Details of Finding, page 2). DHCD considered CFM reduction to be comparable to a unit of installation and plans to continue this air sealing costs reimbursement practice at a higher CFM rate. In contrast, we view CFM reduction payments to local agencies as a fee-based payment, which would require reconciliation to actual costs. While DHCD defends its policy, DHCD stated that it would consider the Department's suggestions for reimbursing air sealing costs.

SUMMARY OF QUESTIONED COSTS

Questioned Costs	Questioned Amounts (Rounded to nearest thousand)		
	C & O Conservation, Inc.	Maryland Energy Conservation, Inc.	Combined Totals
Payments in Excess of Actual Costs	910,000	-	
Total Payments in Excess of Actual Costs	910,000	-	\$910,000
<u>Potentially Unallowable</u>			
Credit Card Expenses	130,000	43,000	
Depreciation Expenses	36,000	6,000	
<u>Unallowable</u>			
Warehouse Lease Expenses (Allocation)	36,000	-	
Over-Recovered Vehicle Leases Costs	15,000	-	
Over-Recovered Program Benefits Costs ¹	-	13,000	
Bad Debt Expenses	8,000	-	
Donations	4,000	-	
Total Other Unallowable Costs	229,000	62,000	\$291,000
Program Benefit Costs (In-house Crew)	154,000	-	
Program Benefit Costs (Contractors)	24,000	31,000	
Corresponding Program Support Costs	14,000	8,000	
General Ledger Expenses	4,000	-	
T&TA Expenses	58,000	19,000	
Total Unsupported Costs	254,000	58,000	\$312,000
Total Improper and Unethical Accounting Practices	\$1,393,000	\$120,000	\$1,513,000
Warehouse Lease Expenses	60,000	-	
Monthly Vehicle Lease Expenses (Allocation)	46,000	-	
Monthly Vehicle Lease Expenses	16,000	-	
Daily Vehicle Lease Expenses	15,000	-	
Labor Costs	39,000	99,000	
Total Questionable Related-Party Transactions	\$176,000	\$99,000	\$275,000
Total Funding Used for Personal Benefit²	-	-	-
Total Questioned Costs	\$1,569,000	\$219,000	\$1,788,000

¹Prior to the completion of our audit work, DHCD recovered this question cost.

²Due to inadequate labor records and/or lack of a cost accounting system, we were unable to quantify the monetary impact.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

The objective of this audit was to determine whether selected subrecipients effectively and efficiently managed Weatherization Assistance Program (Program) funds.

Scope

This review was conducted between March 2014 and July 2015, at the Maryland Department of Housing and Community Development (DHCD) Headquarters in Crownsville, Maryland; Maryland Energy Conservation, Inc. (MEC) in Edgewood, Maryland; and C&O Conservation, Inc. (C&O) in Hagerstown, Maryland. The scope included the management of Program funds for the period covering April 2009 through December 2013. The audit was conducted under the Office of Inspector General project number A14HQ032.

Methodology

To accomplish our audit objective, we:

- Reviewed and summarized the complaint and program background.
- Reviewed and summarized award and subgrant agreements.
- Determined the extent of select subrecipient involvement in Department of Energy (Department) programs. Commingling of multiple funding sources by other local agencies created uncertainty in our determination of Program flow-through funding to MEC.
- Reviewed DHCD monitoring reports for selected subrecipients.
- Reviewed Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, reports for DHCD and selected subrecipients.
- Reviewed relevant Federal laws and regulations and Department and DHCD guidance pertaining to the Program.
- Conducted interviews with officials at DHCD, MEC, C&O/House Warmers, and the Department's Office of Energy Efficiency and Renewable Energy (EERE).
- Performed a review of sampled project files submitted by C&O, MEC, and four other local agencies to DHCD for reimbursement. Project files were judgmentally selected from DHCD's Hancock Energy Software (HES) system based on duplicate recipient names, duplicate addresses, total cost to Program, total cost of leveraged projects, total funding from the *American Recovery and Reinvestment Act of 2009*, and total funding

from the Sustainable Energy Resources for Consumers. Additionally, consideration was given to whether they passed or failed quality assurance inspections. Based on the reconciling differences between HES and actual program benefit funding to the local agencies, our sample universe was limited to about 99.3 percent and 92.3 percent of total program benefit funding to C&O and MEC, respectively. For C&O, we selected 80 of 1,135 projects, and for MEC, we selected 155 of 1,913, which included work performed for other local agencies. Because this sample was selected judgmentally, results could not be projected to the universe of project files.

- Performed a review of sampled general ledger expenditures. General ledger expenditures were judgmentally selected based on descriptions that appeared unallowable, related to the allegation, to be related-party transactions, and provided coverage of payroll, administrative staff reimbursements, and program benefit expenses. For C&O, we selected 102 of 78,470 general ledger entries, and for MEC, we selected 40 of 24,654 general ledger entries. Because this sample was selected judgmentally, results could not be projected to the universe of expenditures.
- Performed a 100 percent review of training and technical assistance reimbursements.
- Performed a review of labor expenses reports and associated timesheets.
- Analyzed capital assets purchased with Program funding.
- Analyzed program support through general ledger testing and account reconciliation.

We conducted this performance audit in accordance with generally accepted Government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Accordingly, the audit included tests of controls and compliance with laws and regulations necessary to satisfy the audit objective. In particular, we assessed compliance with the *GPR Modernization Act of 2010* and found that performance measures were established for the Weatherization Assistance Program. Because our review was limited, it would not necessarily have disclosed all internal control deficiencies that may have existed at the time of our audit. We relied on computer-processed data to satisfy our audit objective and tested the validity of the data by vouching and tracing the referenced data to Department, DHCD, and local agency source reports and documents. We determined that the data was sufficiently reliable for the purposes of our audit objective.

An exit conference was conducted with DHCD officials on July 29, 2015. EERE officials waived an exit conference.

PRIOR REPORTS

- Examination Report on [Prince George's County Department of Housing and Community Development — Weatherization Assistance Program Funds Provided by the American Recovery and Reinvestment Act of 2009](#) (OAS-RA-13-05, January 2013). Lani Eko & Company, CPAs, PLLC, a contracted certified public accounting firm, could not express an opinion on Weatherization Assistance Program funding provided to Prince George's County Department of Housing and Community Development, a subgrantee of the Maryland Department of Housing and Community Development (DHCD). The former director of the Prince George's County Department of Housing and Community Development, who was in charge of the Weatherization Assistance Program during the time of the engagement, was investigated and pleaded guilty to conspiracy to commit extortion. Specifically, the former director was found guilty of accepting bribes in exchange for securing funding for developers.
- Examination Report on [Montgomery County Department of Housing and Community Affairs — Weatherization Assistance Program Funds Provided by the American Recovery and Reinvestment Act of 2009](#) (OAS-RA-13-06, January 2013). This examination found that Montgomery County Department of Housing and Community Affairs, a subgrantee of the DHCD, had charged \$13,000 to the Weatherization Assistance Program that should have been charged to other energy-related programs. This examination further found that Montgomery County Department of Housing and Community Affairs had not maintained adequate records to account for equipment such as blower door systems, gas detectors, and moisture meters purchased with Weatherization Assistance Program funds.
- Audit Report on [The Department of Energy's Weatherization Assistance Program Funded under the American Recovery and Reinvestment Act for the State of Maryland](#) (OAS-RA-13-07, January 2013). This audit found that the DHCD had not always managed the Weatherization Assistance Program efficiently and effectively. Specifically, Baltimore City Department of Housing and Community Development (Baltimore City) lacked documentation to support \$2.3 million charged in program support charges. Additionally, DHCD monitoring reports disclosed other local agencies had not reconciled program support expenditures to reimbursements. Auditors questioned about \$9.5 million (including the previously mentioned \$2.3 million) in estimated program support costs. This report further found that Baltimore City had not fully complied with regulations governing costs and inventory controls. In particular, Baltimore City lacked documentation to support or had erroneously billed the Weatherization Assistance Program.

DEPARTMENT OF ENERGY MANAGEMENT COMMENTS



Department of Energy
Washington, DC 20585

JUL 8 2015

MEMORANDUM FOR: GREGORY II. FRIEDMAN
INSPECTOR GENERAL
OFFICE OF INSPECTOR GENERAL

FROM: KATHLEEN B. HOGAN 
DEPUTY ASSISTANT SECRETARY
ENERGY EFFICIENCY AND RENEWABLE ENERGY

SUBJECT: Response to Office of Inspector General Draft Special Report on
"Selected Recipients of Maryland Weatherization Assistance Program
Funds"

The Office of Energy Efficiency and Renewable Energy (EERE) appreciates the opportunity to review the Office of Inspector General's (OIG) June 2015 Draft Special Report entitled, "Selected Recipients of Maryland Weatherization Assistance Program Funds." EERE concurs with the findings and recommendations identified in the report.

EERE seeks to ensure compliance with Federal regulations through ongoing monitoring and communications with grantees. EERE provides guidance and support to all grantees pursuant to Code of Federal Regulations (CFR), 10 CFR 600 and 2 CFR 225 (A-87). Also when applicable, EERE will provide grantees with guidance pursuant to 2 CFR 220 (A-21), 2 CFR 230 (A-122), and 10 CFR 400.

EERE's Weatherization Assistance Program (WAP) is the nation's oldest and largest whole-house energy efficiency program, serving families living at, or below, 200 percent of the federal poverty level, with an emphasis on children, the elderly, disabled individuals, homes with high energy burden and homes with high energy use. Since 2009, the program has helped more than one million low-income families save hundreds of dollars a year on their energy bills. We recognize that even the most well run programs can benefit from an external evaluation and we appreciate the input of the OIG as we continue to enhance WAP. EERE has been working with the State of Maryland WAP program for the past several years to ensure that all corrective actions are being implemented. Specific responses to your recommendations are provided below.

OIG Recommendation 1: In the absence of immediate improvements in financial controls, the risk of fraud, waste and abuse is increased. Accordingly, we recommend improvements to the financial management of the State of Maryland's use of Weatherization Assistance Program (Program) funds. Specifically, we recommend that the Contracting Officer for Energy Efficiency and Renewable Energy resolve questioned costs totaling about \$1.8 million.



Printed with soy ink on recycled paper

EERE Response: EERE concurs with this recommendation. The State of Maryland Department of Housing and Community Development (DHCD) has hired an independent auditor to assess their six largest subgrantees including C&O Conservation, Inc. (C&O) and Maryland Energy Conservation, Inc. (MEC), and EERE is waiting on that audit report. EERE will consider information from that audit, along with the OIG's audit, to determine an exact amount of disallowed costs for DHCD to reimburse EERE. The Program will also recommend DHCD conduct an audit of its financial management controls and processes and request a plan from DHCD for improvements to ensure funds are deployed efficiently and effectively. Target date for completion: December 31, 2015.

OIG Recommendation 2: Assess the monetary impact and recoup funds, as appropriate, related to the previous recommendation on questioned program support costs from our report, The Department of Energy's Weatherization Assistance Program Funded Under the American Recovery and Reinvestment Act for the State of Maryland (OAS-RA-13-07, January 2013).

EERE Response: EERE concurs with this recommendation. Upon receipt of the DHCD's independent auditor report, EERE will assess the monetary impact and recoup funds, as appropriate, related to the previous recommendation on questioned costs of \$9.56 million in reimbursement claims for direct weatherization expenditures and program support costs incurred by DHCD's subgrantee local agencies Baltimore City Department of Housing and Community Development and Montgomery County Department of Housing and Community Affairs. Target date for completion: December 31, 2015.

OIG Recommendation 3: Implement policies and procedures to ensure the recovery, prior to award closeout, of payments made in excess of actual costs when provisional payments are based on estimated costs.

EERE Response: EERE concurs with this recommendation. EERE will require the DHCD to submit to EERE for approval, policies and procedures to reconcile provisional payments in excess of actual costs. Target date for completion: December 31, 2015.

OIG Recommendation 4: We also recommend that the Assistant Secretary for Energy Efficiency and Renewable Energy require the State of Maryland to review Program-funded reimbursements made to C&O and MEC for the entire period of performance for improper payments and resolve any identified issues prior to closeout.

EERE Response: EERE concurs with this recommendation. DHCD has hired an independent auditor to assess their six largest subgrantees including C&O and MEC, and that auditor is reviewing Program-funded reimbursements made to C&O and MEC for the entire period of performance for improper payments. EERE is waiting on that audit report, and EERE will work with the DHCD to resolve any identified issues prior to closeout. EERE will consider information from that audit, along with the OIG's audit, to determine an exact amount of disallowed costs for DHCD to reimburse EERE. Target date for completion: December 31, 2015.

OIG Recommendation 5: Require the State of Maryland to assess the adequacy of subgrantee accounting systems for accounting for Federal awards.

EERE Response: EERE concurs with this recommendation, and will require the DHCD to provide to EERE for approval, policies and procedures for assessing the adequacy of subgrantee accounting systems for accounting for Federal awards. Target date for completion: October 31, 2015.

OIG Recommendation 6: Require the State of Maryland to develop and implement internal controls to address oversight weaknesses including the reconciliation of fixed-price and fixed-rate payments to actual costs, the proper documentation of training and technical assistance reimbursement claims, and assessing reasonableness of less-than-arm's-length bargaining and transactions with consideration to the restraints or requirements imposed by Federal and State laws and regulations, terms and conditions of the award and arm's-length bargaining.

EERE Response: EERE concurs with this recommendation. EERE will require the DHCD to develop and implement internal controls related to reconciliation, documentation, and assessing reasonableness of less-than-arm's-length bargaining and transactions, and provide evidence of the internal controls to EERE. Target date for completion: December 31, 2015.

OIG Recommendation 7: Require the State of Maryland to develop and implement policies and procedures to govern the review and follow-up on external and internal audit findings.

EERE Response: EERE concurs with this recommendation. EERE will require the DHCD to develop and implement policies and procedures to govern the review and follow-up on external and internal audit findings, and provide documentation of the policies and procedures to EERE. Target date for completion: December 31, 2015.

OIG Recommendation 8: Require the State of Maryland to ensure that subgrantees complete OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, audits in a timely manner, and that findings are adequately addressed by management.

EERE Response: EERE concurs with this recommendation. EERE will require the DHCD to develop and implement policies and procedures to ensure that subgrantees complete required audits in a timely manner and that findings are adequately addressed by management, and provide documentation of the policies and procedures to EERE. Target date for completion: December 31, 2015.

STATE OF MARYLAND
MANAGEMENT COMMENTS



LARRY HOGAN
Governor

BOYD K. RUTHERFORD
Lt. Governor

KENNETH C. HOLT
Secretary

July 6, 2015

Mr. Gregory H. Friedman
Inspector General
Office of Inspector General
United States Department of Energy
1000 Independence Ave., SW
Washington, DC 20585

Re: Special Report: "Selected Recipients of Maryland Assistance Program Funds"

Dear Mr. Friedman:

The Maryland Department of Housing and Community Development (DHCD) is proud to administer the Department of Energy (DOE) Weatherization Assistance Program (WAP) in Maryland. DHCD has more than four decades of experience implementing energy efficiency housing programs, utilizing funding from State and Federal sources. DHCD has provided weatherization services to more than 20,600 limited income families; a significant portion of which has been completed in the past six years. In 2009, funding for DHCD's energy efficiency programs quadrupled with an additional \$63 million three-year grant from the DOE for the expansion of the low-income energy efficiency/weatherization efforts.

Additionally, in 2010 the DOE awarded DHCD a \$20 million Energy Efficiency and Conservation Block Grant. Also, the Public Service Commission (PSC) awarded a \$71 million grant to DHCD in 2012, allowing low income weatherization efforts to continue at a higher level throughout Maryland, resulting in lower energy usage, increased safety and more comfortable homes for low-income families.

During the period from 2009 to 2012, DHCD administered a weatherization program that impacted 12,607 households. DHCD does not dispute the report findings; we would note the rapid increase in funding outpaced the development of adequate financial controls creating a situation allowing conditions in the report to develop. While the conditions identified are serious and require rapid resolution, DHCD believes that the infractions are isolated to those identified in this report. DHCD is committed to resolving all questioned costs accurately and efficiently. DHCD has since implemented appropriate financial controls to minimize the opportunity for future risk.



OFFICE OF THE SECRETARY
MARYLAND DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT
7800 HARKINS ROAD, LANHAM, MD 20706
301-429-7461, TOLL-FREE 800-756-0119, FAX 240-334-4732



Mr. Gregory Friedman
July 6, 2015
Page 2

1. Resolve questioned costs totaling about \$1.8 million.

DHCD is working with Maryland Energy Conservation (MEC) to resolve their questioned costs identified in this report. MEC has provided documentation to substantiate most of the \$219,000 questioned costs identified. DHCD is currently negotiating with MEC a residual amount to be repaid. As we progress in these discussions with MEC we will work with DOE program and the Contracting Office to coordinate this activity and reach agreement on a resolution. DHCD will be working in the near future with C&O Conservation to resolve their \$1.6 million in questioned costs.

2. Assess the monetary impact and recoup funds, as appropriate, related to the previous recommendation on questioned program support costs from our report *The Department of Energy's Weatherization Assistance Program Funded Under the American Recovery and Reinvestment Act for the State of Maryland (OAS-RA-13-07, January 2013)*.

Payments for program support costs are being analyzed and reconciled against back-up documentation. Flat fees paid to LWAs are assessed against personnel costs and other program support costs to justify payments made and identify an amount, if any, for repayment.

3. Implement policies and procedures to ensure the recovery, prior to award closeout, of payments made in excess of actual costs when provisional payments are based on estimated costs.

DHCD has eliminated the "Program Support" cost category from the Maryland Weatherization Program. There will be no flat-fee payments made to subgrantees. All costs will be categorized as "Operations", "Admin", or "Training and Technical Assistance". All cost categories will be paid based on actual costs as justified by sufficient back-up documentation. This change takes effect July 1, 2015 with new program year contracts and is part of broader efforts to institute enhanced financial controls. Therefore, there will be no provisional payments based on estimated costs.

In August 2015, DHCD will publish a financial management chapter in the Maryland Weatherization Program Operations Manual (POM). The chapter will establish policies and best practices for subgrantee management of weatherization funds under DHCD's new guidelines. Following publication, DHCD will conduct training on new financial management practices and policies during the Maryland Weatherization Program's Annual Network Meeting.

As an interim step in the lead up to this change, DHCD has been conducting quarterly reconciliations of flat-fee Program Support payments. The reconciliation process involves DHCD staff collecting and analyzing justification for subgrantee costs incurred and charged as Program Support. Justification collected has been in the form of subgrantee general ledger, payroll documentation, and receipts for real costs incurred.

Mr. Gregory Friedman
July 6, 2015
Page 3

- 4. Review Program-funded reimbursements made to C&O and MEC for the entire period of performance for improper payments and resolve any identified issues prior to closeout.**
DHCD is reviewing and reconciling payments to C&O and MEC for the full period that C&O and MEC served as LWAs in the Maryland Weatherization Program.

- 5. Assess the adequacy of subgrantee accounting systems for accounting for Federal awards**
DHCD has built new controls into the program, starting with the initial application for funding. LWAs must apply annually. Each application shall contain a detailed description of subgrantee accounting systems and internal cost controls. DHCD assesses the adequacy of subgrantee accounting systems when considering award of weatherization funds. Specifically, DHCD assesses whether or not the subgrantee is able to segregate, track, and report on program expenditures.

Each application includes a copy of the applicant's most recent audited financial statements and a written description of staff structures and roles related to cost controls and financial management. Annual subgrantee monitoring provides an opportunity to test processes and policies. Findings and concerns are conveyed to the subgrantee in an annual monitoring report. All issues addressed in the report are to be resolved within thirty days of the report.

- 6. Develop and implement internal controls to address oversight weaknesses including the reconciliation of fixed-price and fixed-rate payments to actual costs, the proper documentation of training and technical assistance reimbursement claims, and assessing reasonableness of less-than-arm's-length bargaining and transactions with consideration to the restraints or requirements imposed by Federal and State laws and regulations, terms and conditions of the award and arm's length bargaining.**

DHCD has developed and implemented significant internal controls to avoid these occurrences in the future. Flat-fee Program Support has been eliminated as a cost category in the Maryland Weatherization Program. DHCD will only pay for actual costs as justified by substantial back-up documentation.

DHCD has implemented a not-to-exceed measure price list to control costs at the work measure level. LWAs will bill for actual costs up to, but not exceeding, the work measure costs on the price list. DHCD's Hancock software system will not allow for measures to be billed in excess of the cost limits. Receipts for supplies and equipment, along with personnel payroll records, will be requested periodically to assess the validity of measure costs billed to DHCD. During annual monitoring, DHCD will review a random sampling of these items to further assess the validity of measure costs billed. Missing documentation will need to be produced within thirty days or payments will be recaptured. This process will be documented as part of our annual review.

Mr. Gregory Friedman
July 6, 2015
Page 4

Training and Technical Assistance (T&TA) expenses will be controlled internally at DHCD. DHCD will not allocate a T&TA budget directly to the LWAs. All training must be preapproved by DHCD before the expense is incurred. Back-up justification, matching the approved expenses, will be submitted with requests for reimbursement of T&TA expenses. Payments will be made for actual costs as justified by back-up documentation and governed by the POM.

7. Develop and implement policies and procedures to govern the review and follow-up on external and internal audit findings.

The redesign of DHCD's subgrantee compliance and monitoring procedures is being completed with assistance of the DOE program staff. The monitoring tools are being redesigned to represent DOE monitoring priorities and to enforce provisions of the POM. The POM is being revised to detail responsible financial management policies and practices for DHCD and subgrantees. We anticipate publication of new procedures in August 2015. The POM establishes processes to identify and resolve issues in a timely manner.

DHCD is engaging five key staff in training on subgrantee monitoring in August 2015. The training provided will be specific to the DOE Weatherization Assistance Program. The trainer was recommended by DOE program staff and is nationally recognized as an expert on DOE subgrantee monitoring and compliance.

8. Ensure that subgrantees complete OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, audits in a timely manner, and that findings are adequately addressed by management.

LWAs will be required to have current A-133 audits performed if they meet the federal spending limit criteria. Any failure to produce a required audit within the nine months following the close of the fiscal year in question will be basis for suspension from DHCD programs.

Annual on-site subgrantee monitoring will trigger the collection and review of the A-133 audit for each LWA. Any findings or concerns noted in the A-133 will be addressed in the monitoring report issued to the subgrantee by DHCD. All issues identified in annual monitoring will be required to be resolved within thirty days of the report. Resolutions and failure to resolve findings will be documented. DHCD will work with subgrantees to resolve all issues raised by the audit. DHCD will recapture any costs that cannot be resolved.

Mr. Gregory Friedman
July 6, 2015
Page 5

DHCD is grateful for the opportunity to collaborate with DOE in service to Maryland's limited income residents. We look forward to continuing to administer this important program.

Sincerely,



Kenneth C. Holt
Secretary

KCH/mg

cc: Tiffany Robinson, Assistant Secretary, DHCD
William Ariano, Deputy Director, DHCD

FEEDBACK

The Office of Inspector General has a continuing interest in improving the usefulness of its products. We aim to make our reports as responsive as possible and ask you to consider sharing your thoughts with us.

Please send your comments, suggestions, and feedback to OIG.Reports@hq.doe.gov and include your name, contact information, and the report number. You may also mail comments to us:

Office of Inspector General (IG-12)
Department of Energy
Washington, DC 20585

If you want to discuss this report or your comments with a member of the Office of Inspector General staff, please contact our office at (202) 253-2162.