

MONITORING PRACTICES OF CENTERS OF EXCELLENCE PROJECTS**MARCH 13, 2014, 10:35 A.M.****GOVERNMENT FINANCE COMMITTEE****ROUGH RIDER ROOM, STATE CAPITAL, BISMARCK****REPRESENTATIVE JEFF DELZER, CHAIRMAN****JOLYNNE TSCHETTER, PH.D. – COMMERCIALIZATION MANAGER, ND DEPARTMENT OF COMMERCE**

Good morning, Mr. Chairman and members of the committee, my name is Jolynne Tschetter, and I serve as the Commercialization Manager for the North Dakota Department of Commerce. I'm here today to provide an overview of the monitoring practices of Centers of Excellence projects and to provide information to any requirements for the repayment of grant funds if a project fails or does not produce the expected result.

The Centers of Excellence Commission and the Centers of Excellence program were established during the 59th Legislative Session. N.D.C.C. Chapter 15-69 established a six member Centers of Excellence Commission consisting of three Economic Development Foundation members and three State Board of Higher Education members. This law directs the Commission to meet as necessary to monitor centers for compliance with award requirements and review changes in assertions made in center applications. As a condition for receipt of funds under this chapter, a center agrees to provide the State Board of Higher Education, Economic Development Foundation, and Budget Section with annual audits on all funds distributed to the center under this chapter. The annual audits must be provided until the completion of the Commission's postaward monitoring of the center which can range from six to ten years following center designation.

The monitoring process for centers have evolved overtime. For example, the legislature made changes in 2007 that transferred responsibility to provide assistance to the Commission from the University System to the Department of Commerce, as well as gave the Commission the responsibility to conduct postaward monitoring. The Commission also made changes to the monitoring policies and procedures to address State Auditor recommendations in 2009.

The Centers of Excellence monitoring process involves at least quarterly contacts with each of the award recipients. This includes an annual functional review, a site visit, quarterly updates and a review by a third party auditor.

Since 2006, approved Centers have been required to annually file Functional Reviews with the Commission. The Functional Review consists of a comprehensive review of the Center activities in areas including:

1. Documentation of required \$2:\$1 matching funds;
2. Documentation of the leverage of other funds received since the application was approved
3. Benefits of the project to the economy of North Dakota (job creation, internships, other benefits to the private sector);
4. Benefits to the university (patent applications filed, royalties or revenues to the university from the private sector, SBIR/STTR activity, additional activities with the private sector partner, enhancements to university reputation);
5. Increase in R&D from EPSCoR because of Center activities;
6. Overview of project timeline and any deviations from the timeline that have occurred;

7. Fostering entrepreneurship (start-up company development, partnering with early stage North Dakota companies, recruitment of companies to the state, expansion of existing North Dakota businesses);
8. Progress towards sustainability of the Center after expenditure of state funds;
9. Reporting of any substantial variations from the application (all changes reported in this section should have had prior approval from the Commission through the filing of SFN 59921 with the Department of Commerce); and
10. Reporting of any collaborations with other institutions of higher education resulting from Center activities

Following completion and submission of the annual Functional Review, universities engage third party auditors to complete Agreed-Upon Procedures to review the information and documentation. Copies of the Agreed-upon Procedures Final Reports are filed with the Department of Commerce. Any deficiencies noted in the Agreed-Upon Procedures are remedied either through filing of a corrected Functional Review or changes to the procedures at the University. In addition to the Agreed-Upon Procedures, a full financial audit of the Center is required after the second full fiscal year of operation and after all state funds have been expended.

Documentation of the Scope of Work for the Agreed-Upon Procedures has been included as Exhibit A.

Functional Reviews are currently submitted by Centers in the third quarter of the calendar year and cover a reporting period of the previous Fiscal Year.

Site visits are conducted of Centers annually, typically in the fall of each year by staff from the Office of Innovation and Entrepreneurship and may be attended by other Commerce staff interested in learning about activities in the different Centers. The purpose of the site visit changes over time. Early site visits often focus on policies and procedures of the program, introductions to faculty and staff working on the project, tours of facilities, etc. Over time, the site visits focus more on sustainability of the center, issues identified in the Functional Review that may not be resolved, follow up on any findings of the Agreed-Upon Procedures and updates of Center activities since the beginning of the Fiscal Year.

After completion of the site visits, a monitoring report of the Centers is presented to the Commission. The monitoring reports are a comprehensive overview of the Center for the Commission based upon information from the site visit, functional review, and the third party auditor's report. The monitoring reports include:

1. Date of Center approval by the Commission and Budget Section;
2. Amount of Award;
3. Amount of Award Funds Dispersed to the Center;
4. Award Funds Spent by the Center;
5. Matching Funds received from the Center;
6. Any leveraged funds received by the Center;
7. Job creation (both private sector and Center personnel not paid by state funds);
8. Progress of the Center towards the goals outlined in the approved application;
9. Progress of the Center toward goals identified in the previous year's Functional Review;
10. Any findings identified in the third party Agreed-Upon Procedures or required financial audits;
and
11. Updates on Center activities identified during the site visit.

Once a Center has been in operation for three full years, the Center is required to undergo assessment to determine if it is creating the economic impact that was projected in the application. The Commission makes this assessment after presentation of the Center's Monitoring Report by Commerce staff and any subsequent discussion. Centers are typically determined to be either meeting expectations or needing improvement. If a Center is determined to be needing improvement, the Center is made aware of the concerns of the Commission and any specific steps that need to be taken. A similar analysis is done in all subsequent years a Center is subject to post-award monitoring.

A quarterly update is filed by the Centers on or about January 31 and April 30 covering Center activities during the previous three month period. These Quarterly Updates include an update on the Center funds spent to date, a list of private sector partners actively working with the Centers during the reporting time frame, an overview of the activities being carried out at the Center and any highlights or setbacks that have happened during the reporting period. The Department of Commerce alerts the Commission to any issues identified in the quarterly update.

In addition to the formal reporting requirements of the program, the Department of Commerce and the Centers of Excellence Commission interact with the Centers as part of the process for distribution requests, budget modifications, partner change requests and timeline extensions.

The second part of my testimony is related any requirements for the repayment of grant funds if a project fails or does not produce the expected result. Neither the statute, nor the Centers of Excellence Commission policies, require repayment of grant funds if a project fails or does not produce the expected results. However, the funds are distributed in stages to allow an opportunity for the Commission to review progress prior to the release of additional funds.

In general it has been the goal of the Centers of Excellence Commission to work the Centers to secure a positive outcome for the state. As stated above after three full years of a Centers existence and every year after the Commission makes an assessment as to whether the Center is meeting its objective. In cases where the Centers are not meeting their objectives, the Commission and the Department of Commerce work with the Center to identify ways the Center can improve.

On occasion, Centers have returned funds to the state. Valley City State University returned \$200,000 of their \$1,000,000 award following the termination of the Enterprise University center. This occurred after a months-long effort by the university, the Department of Commerce, and a local economic developer in attempting to find a new private sector partner.

Mr. Chairman and members of the committee, thank you for allowing me the time to visit with you today. That concludes my testimony and I am happy to entertain any questions.

EXHIBIT A

Agreed-Upon Procedures Engagement – Scope of Work

Centers of Excellence

Centers of Excellence Enhancement Grants

Base Realignment Grants

Limited Deployment-Cooperative Airspace Project

Introduction: The Centers of Excellence (COE) program is built on the concept of partnering the capacities found in our public colleges and universities with private-sector companies. The COEs are hubs of research and development in the fields of energy, agriculture, life sciences, electronics, aerospace, and manufacturing. Objectives of the COE program include commercializing new products and services, and generating new jobs and business opportunities.

Centers of Excellence Enhancement Grants have been made available to the state’s research universities for use in infrastructure projects or enhancement of economic development and employment opportunities.

Base Realignment Grants are available to a research university or a nonprofit university-related foundation to enhance economic development and employment opportunities associated with the Grand Forks Air Force Base and economic development projects or programs to accommodate growth in proximity to or at the Grand Forks Air Force Base.

Limited Deployment-Cooperative Airspace Project (LD-CAP) have been made available to the state’s research universities for use in research, development and demonstration projects involving Automatic Dependent Surveillance-Broadcast (ADS-B) and ADS-B based “sense and avoid” technologies.

The Centers of Excellence Commission, with assistance from the North Dakota Department of Commerce, provides oversight of the COE, Enhancement Grant and Base Realignment Grant programs. The six member Commission is comprised of representatives from the North Dakota Economic Development Foundation and the State Board of Higher Education.

Background: North Dakota Century Code (NDCC) 15-69-05 and NDCC 54-65-03 stipulate that centers and recipients of Enhancement Grants and Base Realignment Grants shall agree to provide the Commission with the information necessary to monitor their postaward activities. Provisions in NDCC 15-69-05 and NDCC 54-65-03 call for centers and grant recipients to contract with an independent accountant for an agreed-upon procedures engagement annually until the Commission completes its postaward monitoring of a center or grant recipient.

Agreed-upon procedures engagements have been utilized by the programs since the 2007-09 biennium. The initial procedures were identified by the North Dakota University System in collaboration with other stakeholders. During the 2011 legislative session, specific criteria for the agreed-upon procedures engagement were added to NDCC 15-69-05 and included in NDCC 54-65-03. The Department of Commerce compared the initial procedures to the specific criteria now identified in statute. Consideration was given to other procedures that may be necessary for the Commission to effectively monitor postaward activities of centers and grant recipients.

Objectives: The primary objective of the agreed-upon procedures engagement is to verify information and progress reported by centers and grant recipients in their respective annual functional reviews. Other objectives include verifying that: 1) state funds are spent appropriately; 2) program requirements are met; and 3) verifying aspects of a grant such as actual scope and timeline, actual expenditures of grant funds compared to the application budget, and labor charged to a grant.

In completing an agreed-upon procedures engagement on an annual basis, centers and grant recipients are complying with NDCC 15-69-05 and NDCC 54-65-03.

Each university, college, foundation, etc. must hire its own private CPA firm to complete the agreed-upon procedures and report for each Center of Excellence, Enhancement Grant and Base Realignment Grant. Internal auditors cannot be used for agreed-upon procedures engagements.

Scope of Work: This agreed-upon procedures engagement shall be conducted in accordance with the attestation standards established by the American Institute of Certified Public Accountants and the fieldwork and reporting standards applicable to attestation engagements as contained in Government Auditing Standards of the Comptroller General of the United States of America.

Findings, other than those of no instances noted, should be reported in the manner identified in the Yellow Book where applicable – criteria, condition, cause, effect, recommendation, management’s views, and planned corrective action.

The following **tasks** are to be completed under the agreed-upon procedures engagement:

1. Verify disbursed award funds were received by the center or grant recipient;
 - a. Prior to July 1, 2009 award funds were distributed by the Office of Management and Budget;
 - b. Since July 1, 2009 award funds have been distributed by the ND Department of Commerce;
2. Determine that interest earned on award proceeds was retained by the center or grant recipient;
3. Review the Matching Cash Contributions, Matching Contributions in Lieu of Cash (Cash Reserved), and Matching In-Kind Contributions reported in the Functional Review and trace them to supporting documentation and/or accounting records;
4. Verify compliance with the Centers of Excellence program matching funds requirements:
 - a. Centers are accountable to the requirements specified in NDCC 15-69 during the biennium in which they were approved;
 - b. COE Enhancement Grants, Base Realignment Grants and LD-CAP grants do not have matching funds requirements.
5. Review the Leveraged Cash Contributions, Leveraged Contributions in Lieu of Cash (Cash Reserved), and Leveraged In-Kind Contributions reported in the Functional Review and trace them to supporting documentation and/or accounting records;
6. Review the private-sector and private-sector equivalent job creation reported in the Functional Review and trace each position to supporting documentation. Verify that each job meets the qualifying criteria identified in the Functional Review:
 - a. Private-sector equivalent jobs are defined as positions at the center and university or college that are not paid by state general funds;

7. Review a sample of expenditures to verify compliance the NDCC 15-69-05.1 (use of funds) and NDCC 54-65-03.1 (use of funds);
 - a. The allowable and unallowable uses of funds identified in NDCC 15-69-01 have changed over time. Centers are accountable to the requirements specified in NDCC 15-69-05.1 during the biennium in which they were approved;
 - b. Enhancement Grants are subject to the requirements specified in Chapter 46 § 23 of the 2009 Session Laws;
 - c. Base Realignment Grants and LD-CAP grants are subject to the requirements specified in NDCC 54-65-01.
8. Review a sample of expenditures to verify expenses were approved, supported with documentation, and spent according to the scope identified in the application for funding;
9. Verify a sample of labor charged to the grant and trace it to supporting effort-reporting documentation;
10. Review the center or grant recipient's actual expenditures of award funds and compare them to the center's or grant recipient's application budget, including documentation explaining any material differences;
11. Review a sample of the center or grant recipients' expenditures reported on the Economic Impact Study Data Form (included in the Functional Review) to verify that reported expenditures were made to North Dakota entities and occurred within the specified time period.
12. Verify the center or grant recipient complied with the timeline as provided under the center's or grant recipient's application and any authorized revisions;
13. Verify the center or grant recipient complied with the scope of activities as provided under the center's or grant recipient's application and any authorized revisions.

Schedule: The agreed-upon procedures engagement is to be completed with the final report issued **no later than close of business on October 1, 2013**. Final reports should be provided to the following entities:

- State Board of Higher Education (via the system office)
- ND Economic Development Foundation (via the ND Department of Commerce)
- Budget section of the legislative management (directly)

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