

Financial Audit Division Report

**Special Review: Office of
Environmental Assistance Grant to
Benchmark Outdoor Products, Inc.**



Financial Audit Division

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- Promote Accountability,
- Strengthen Legislative Oversight, and
- Support Good Financial Management.

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OFFICE OF THE LEGISLATIVE AUDITOR
State of Minnesota • James Nobles, Legislative Auditor

Senator Ann H. Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Art Dunn, Executive Director
Office of Environmental Assistance

Mr. Jim Donaghue, President
Benchmark Outdoor Products, Inc.
Zeroflex, Inc.

We have conducted a special review of the use of state grant funds by Benchmark Outdoor Products, Inc. (Benchmark), a manufacturer of park and recreation items, for the period June 15, 2001, through February 27, 2004. In June 2001, the Office of Environmental Assistance (OEA) awarded a \$98,400 state environmental assistance grant to Benchmark. OEA paid Benchmark a total of \$88,720 for the grant. OEA contacted us after declaring the agreement with Benchmark in default, because of concerns about grant contract noncompliance. OEA also suspected that Benchmark had inappropriately spent state funds. Based on the preliminary information, we decided to conduct a special review of the Benchmark grant.

We concluded that Benchmark Outdoor Products, Inc. misspent the \$88,720 in state grant funds it received and did not fulfill the provisions of the grant agreement. We question whether Benchmark had the financial resources necessary to provide required match for the state grant funding and complete the project as presented in its grant application. We think Benchmark misrepresented the project status in its reports to OEA. We also concluded that OEA missed several opportunities to exercise due diligence and appropriately monitor the grant project.

Pursuant to *Minnesota Statutes*, Section 3.975, we have referred this report to the offices of the Attorney General and the Ramsey County Attorney. The Office of the Attorney General has the responsibility to ensure recovery of state funds and, in fulfilling that role, may negotiate the propriety of individual claims. The county attorney may cause criminal proceedings to be initiated as the evidence may warrant.

This report is intended for the information of the Legislative Audit Commission and the management of the Office of Environmental Assistance. This restriction is not intended to limit the distribution of this report, which was released as a public document on July 7, 2005.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen
Deputy Legislative Auditor

Report Signed On: July 1, 2005

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Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

| | |
|-------------------------|-----------------------------|
| Claudia Gudvangen, CPA | Deputy Legislative Auditor |
| Tom Donahue, CPA | Audit Manager |
| Marla Conroy, CPA, CISA | Director of Investigations |
| Sonya Johnson, CPA | Team Leader, Investigations |

Exit Conference

We discussed the results of the audit with the following staff of the Office of Environmental Assistance at an exit conference held on June 29, 2005:

| | |
|--------------|------------------------------|
| Art Dunn | Director |
| Bill Sierks | Strategic Operations Manager |
| Mary Palmer | Fiscal Officer |
| Wayne Gjerde | Market Development |
| Rick Patraw | Supervisor |

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Report Summary

Key Findings:

- Benchmark Outdoor Products, Inc. misspent nearly \$89,000 in state grant funds and never completed the project for which funds were awarded. (Finding 1, page 6)
- The Office of Environmental Assistance missed opportunities to fully review and monitor the Benchmark grant status because it did not follow some provisions of *Minnesota Rules* or the grant agreement. (Finding 2, page 9)

The report contained two findings relating to misuse of state grant funds.

Audit Scope:

In response to a request from the Office of Environmental Assistance, we conducted a special review of Benchmark Outdoor Products, Inc.'s use of state grant funds for the period June 2001 through February 2004.

Background:

Benchmark Outdoor Products, Inc. is a private company that manufactures plastic lumber products. The Office of Environmental Assistance (OEA) awarded Benchmark \$98,400 in grant funds to produce a mold to expand the company's plastic lumber product line.

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Benchmark Outdoor Products, Inc.**

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Chapter 1. Introduction

In June 2001, the Office of Environmental Assistance (OEA) awarded a grant of \$98,400 to Benchmark Outdoor Products, Inc. (Benchmark) for development and testing of a new mold to expand the company's plastic lumber product line. In June 2003, OEA agreed to amend the grant agreement and assign the grant to Zeroflex, Inc., another company established by Benchmark's owner. The assignment noted that Benchmark had ceased doing business and was unable to complete the project funded by the grant agreement. OEA extended the two-year grant period to December 31, 2003. The amendment also assigned \$9,950 of the grant funds to a vendor who was to make the new product mold. On January 13, 2004, Zeroflex identified project delays and requested another amendment to the grant agreement extending the end date to February 27, 2004. On March 15, 2004, OEA sent a Notice of Default to the president of Zeroflex, Inc. and the defunct Benchmark Outdoor Products, Inc.

OEA subsequently notified the Office of the Legislative Auditor that it suspected Benchmark unlawfully used the \$88,720 of state environmental assistance grant funding it received. Based on the information obtained from OEA, we decided to investigate the matter further and issue this report.

Background

The Office of Environmental Assistance offers assistance to businesses, local governments, schools, community organizations, and individuals to solve environmental problems. The office provides grants and loans to encourage the implementation of innovative environmental programs, such as developing markets for recycled materials. All applications for an OEA grant go through a two-step process. Applicants first submit pre-proposals for review by OEA staff. If approved, the applicant is invited to submit a more detailed full proposal.

In October 2000, Benchmark Outdoor Products, Inc. (Benchmark) submitted a pre-proposal requesting \$250,000 in grant funds. The project involved production of a mold and associated marketing efforts to expand the company's plastic lumber production line. OEA invited Benchmark to submit a more detailed full proposal. In that proposal, Benchmark requested \$196,900 in grant funds with a corresponding match of \$196,900 from the company. In February 2001, OEA awarded \$98,400 in grant funds to Benchmark, contingent on a grant agreement being negotiated and signed. Benchmark's president, Jim Donaghue and vice president, Pat Donaghue, signed the agreement on June 15, 2001. Shortly after that, Jim Donaghue retired and his sons took over the business. In May 2002, Jim Donaghue took the company back because of financial and operational concerns.

The project work plan, which was incorporated in the grant agreement, identified the following project objective:

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The grantee, Benchmark Outdoor Products, Inc. (Benchmark) will increase its utilization of post consumer high-density polyethylene plastics (HDPE) by expanding its Zeroflex plastic lumber product line. This expansion entails the production of an additional mold and associated marketing efforts....

The grant agreement required Benchmark to commit matching funds of at least 50 percent of eligible project costs and to ensure that sufficient funding was available to complete the project. Table 1-1 shows the grant project budget.

Table 1-1
Benchmark Outdoor Products, Inc.
Environmental Assistance Grant
Project Budget

| <u>Task</u> | <u>State Grant</u> | <u>Company Match</u> | <u>Total</u> |
|-------------------------------------|--------------------|----------------------|------------------|
| Development and Testing of New Mold | \$98,400 | \$145,400 | \$243,800 |
| Development of Marketing Materials | 0 | 29,333 | 29,333 |
| Marketing | 0 | 120,667 | 120,667 |
| Total | <u>\$98,400</u> | <u>\$295,400</u> | <u>\$393,800</u> |

Source: Office of Environmental Assistance grant agreement with Benchmark Outdoor Products, Inc.

OEA disbursed a total of \$88,720 to Benchmark from June 2001 through February 2003. We discuss the company's use of these grant funds and OEA's administration of the grant in Chapter 2.

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Chapter 2. Use of State Grant Funds

Chapter Conclusions

Benchmark Outdoor Products, Inc. misspent the \$88,720 of state grant funds it received. It was never able to complete the project for which grant funds were awarded. We question whether Benchmark ever had the financial resources necessary to match the state grant and complete the project as presented in its application for grant funds. We think Benchmark misrepresented the project status in its interim and final reports to OEA. Benchmark's accounting records were not complete and did not separately identify grant-related activity or support reported expenditures.

The Office of Environmental Assistance (OEA) missed several opportunities to question Benchmark's ability to complete the project because it did not comply with Minnesota Rules or some provisions of its grant agreement with Benchmark.

Benchmark received nearly \$89,000 in state grant funds for development and testing of a new mold to be used in its plastic lumber business. The company was to provide \$145,400 in matching funds for that phase of its project. Also, the project budget incorporated in the grant agreement showed that Benchmark would provide an additional \$150,000 to develop marketing material and market the product.

The grant agreement provided for disbursement of a percentage of the grant funds to Benchmark within 30 days after OEA had approved certain documents. Table 2-1 shows the date and basis for payments to Benchmark.

Table 2-1
Grant Funds Disbursed by OEA to Benchmark
2001-2004

| <u>Date</u> | <u>Basis</u> | <u>Contract Percentage</u> | <u>Amount Paid</u> |
|-----------------------------------|----------------------------|----------------------------|--------------------|
| June 2001 | Evidence of Matching Funds | 50% | \$49,200 |
| December 2001 | Interim Report | 30% | 29,520 |
| February 2003 ^(Note 1) | Final Report | 20% | 10,000 |
| Total Disbursed | | | <u>\$88,720</u> |

(Note 1): The grant contract provided that the final 20 percent of the grant award (\$19,680) would be paid after Benchmark submitted a final report. In February 2003, OEA disbursed \$10,000 to Benchmark (which the Department of Revenue seized because the company owed delinquent payroll taxes.) In July 2003, OEA disbursed \$9,680 to B.M.E. Tool., which was identified in the grant agreement as a project participant. B.M.E. Tool subsequently returned the state warrant to the agency stating the company had not performed any work related to the grant project.

Source: Grant contract and amendments and the Minnesota Accounting and Procurement System.

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Objective and Methodology

Our primary objective in conducting this special review was to answer the following questions:

- Did Benchmark fulfill the project expectations and expend public funds in accordance with grant contract provisions?
- Did OEA adequately administer and monitor the grant project?

To answer these questions, we interviewed OEA staff and reviewed its accounting and program records and correspondence files to gain an understanding of the grant award process and the requirements of the grant agreement with Benchmark. We reviewed the pre-proposal and final proposal submitted by Benchmark to OEA, the grant agreement with Benchmark, including attachments and subsequent amendments, and the support for grant payments, including Benchmark's interim and final reports. We interviewed Jim Donaghue, the president of Benchmark and subpoenaed the company's bank account and accounting records. We also subpoenaed the bank account records of Lustre Wood, Inc., another company owned by Mr. Donaghue. We reviewed incorporation documents on file with the Minnesota Secretary of State's Office for Benchmark Outdoor Products, Inc., Lustre Wood, Inc., and Zeroflex, Inc., all companies owned by Jim Donaghue and located at the same address. We also interviewed the president of B.M.E. Tool, a company identified in the work plan as a project participant. We did not, however, conduct a complete audit of Benchmark Outdoor Products, Inc. or any affiliated company's financial records.

We identified significant concerns about Benchmark's use of state grant funds, as discussed in Finding 1. In addition, we question OEA's administration of the grant project, as discussed in Finding 2.

Findings and Recommendations

1. Benchmark Outdoor Products, Inc. misspent nearly \$89,000 in state grant funds and never completed the project for which funds were awarded.

Benchmark used state funds for costs that were not related to the purpose of the grant. Benchmark's accounting records were incomplete, and the company could not identify grant-related expenditures. In addition, the company could not provide evidence that it had performed any tasks under the grant agreement.

In our review and analysis of Benchmark's accounting records and bank account activity, we expected to find invoices and documentation supporting payments made by Benchmark for the development and testing of a new mold. We also expected to find that the new mold had been cast and substantially tested. What we found was an incomplete set of accounting records that did not provide a separate accounting of grant-related expenditures. In addition, during the grant period, there were no contracts, purchase orders, invoices, or payments for the production of a mold or any other documentation that would suggest that the mold was in development. Benchmark could not provide evidence that expenditures it reported in its interim and final

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reports to OEA related to the project. We noted that the company's check registers were not always complete or accurate and did not include certain deposits or withdrawals.

Benchmark used state grant funds to pay the company's general operating expenses and make loan repayments to banks and individuals. OEA paid \$49,200 or 50 percent of the total grant award to Benchmark in June 2001. Although the grant agreement stated that the payment should be based on evidence that matching funds were available, there was no information in the grant files to show that Benchmark documented any source of matching funds. Benchmark's president endorsed the check and deposited it into a business bank account on June 29, 2001. On the same day, the company disbursed over \$63,000 from the account for items that were not related to the grant project. Table 2-2 shows Benchmark's bank account activity on June 29, 2001.

Table 2-2
Benchmark Bank Account Activity
June 29, 2001

| Deposit /Payment Type | Deposit | Withdrawals | Bank Balance |
|--------------------------|----------|-------------|--------------|
| | | | \$ 0 |
| State grant deposit | \$49,200 | | 49,200 |
| Nongrant-related deposit | 23,842 | | 73,042 |
| Repayment of bank loans | | \$43,781 | 29,261 |
| Payment to law firm | | 12,887 | 16,374 |
| Employee payroll | | 5,500 | 10,874 |
| Payment to iron company | | 1,103 | 9,771 |
| Bank fees | | 30 | 9,741 |
| Other payments | | 803 | 8,938 |

Source: Auditor prepared schedules based on the Benchmark Outdoor Products, Inc. bank statements, cancelled checks, and check registers.

On December 12, 2001, after it received and approved Benchmark's interim report, OEA disbursed the second grant payment of \$29,520 to Benchmark. The company's interim report stated, "Our mold with hot runner system is currently being produced." The report went on to say, "There were a few minor delays in the actual designing of the mold and that hot runner system." In addition, Benchmark's interim expense report identified \$10,000 paid to B.M.E. Tool as the manufacturer of the hot runner system. Although the interim report would lead one to believe that development of the mold was in progress, we found no evidence that was occurring. In fact, B.M.E. Tool¹, which was identified in the grant agreement and budget as a project participant, had no knowledge of the agreement and was not involved in development of the mold for this project.

On December 18, 2001, Pat Donaghue, Vice President of Benchmark Outdoor Products, Inc. endorsed the \$29,520 check and deposited it in a bank account for Lustre Wood, Inc., a millwork company owned by Benchmark's president, Jim Donaghue. Lustre Wood, Inc. was not named as a recipient of grant funds in the state grant agreement or mentioned as one of the project partners.

Table 2-3 shows the Lustre Wood bank account activity for December 18 - 21, 2001.

¹ Benchmark had previously contracted with B.M.E. Tool to produce a different plastic mold.

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**Table 2-3
Lustre Wood Bank Account Activity
December 18 - 21, 2001**

| <u>Deposit/Payment Type</u> | <u>Deposit</u> | <u>Withdrawals</u> | <u>Bank Balance</u> |
|-----------------------------------|----------------|--------------------|---------------------|
| | | | \$ 3,174 |
| State grant deposit | \$29,520 | | 32,694 |
| Non-grant related deposit | 425 | | 33,119 |
| Repayment of loans to individuals | | \$14,000 | 19,119 |
| Payment to cash | | 2,000 | 17,119 |
| Paid to communications company | | 1,150 | 15,969 |
| Employee reimbursement | | 1,000 | 14,969 |
| Repayment of bank loans | | 2,969 | 12,000 |
| Bank fees | | 117 | 11,883 |
| Other payments | | 6,283 | 5,600 |

Source: Auditor prepared schedules based on the Lustre Wood, Inc. bank statements, cancelled checks, and check registers.

We found no evidence that any of the payments identified in Table 2-3 related to the OEA project. By December 31, 2001, OEA had disbursed 80 percent of the grant funds to Benchmark. However, Benchmark had not used any of the grant funds for the most important component of the project, the production of a mold.

In its final report on the project, dated January 30, 2003, Benchmark discussed the project status, "Work done and task to conclude the project: Minor retrofitting to mold attachment to be compatible with the press. Reconfiguration of hot runner system to accommodate both molds from the same runner." The report identified Polytec Inc. and B.M.E. Tool as participants. Again, there is no documentation of any work performed to support this reported project status.

OEA paid the final 20 percent of the grant award after it received and approved Benchmark's final project report. In February 2003, the office disbursed \$10,000 to Benchmark. The Minnesota Department of Revenue seized the funds because the company owed delinquent payroll taxes. On June 23, 2003, Jim Donaghue sought an assignment and amendment to the grant agreement. He stated, "(Benchmark) has ceased doing business and is unable to complete the project funded by the grant agreement." OEA approved the assignment to Zeroflex, Inc., which assumed Benchmark's duties under the grant agreement. Mr. Donaghue continued to assert that B.M.E. Tool was a partner in the project and that OEA should pay B.M.E. Tool \$9,950 for work performed. As discussed previously, B.M.E. Tool officials told us they were never a participant in this project. However, Benchmark owed the company over \$25,000 for work performed under prior business dealings. Based on the assertion of Mr. Donaghue, OEA sent a check for \$9,680 (the grant balance) to B.M.E. Tool in July 2003. B.M.E. Tool subsequently returned the check to OEA stating that they had not performed any work related to the grant.

On January 13, 2004, Mr. Donaghue requested, and OEA approved, a second amendment to the grant agreement that extended the grant end date from December 31, 2003, to February 27, 2004, based on Mr. Donaghue's representations that development of the mold was proceeding. However, that was not true, and on March 15, 2004, OEA sent a notice of default of the grant agreement to Zeroflex, Inc. and Benchmark Outdoor Products, Inc. The notice asked for

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documented proof of the use of grant funds for the purposes specified in the grant agreement. Mr. Donaghue was unable to provide that documentation.

Benchmark used state funds to pay outstanding bills of the company and not for the grant's intended purpose. The grant agreement clearly states that the grantee shall reimburse the State, upon demand, (1) for any amounts for which the grantee's books, records, and other documents are not sufficient to substantiate that those amounts were used by the grantee to perform the project or (2) for any amounts received by the grantee for project costs which were inaccurately reported. Since Benchmark was unable to substantiate use of the state funds for the approved project, it should repay the total grant to OEA.

Recommendation

- *The Office of Environmental Assistance should work with the Office of the Attorney General to recover \$88,720 in grant funds from Benchmark Outdoor Products, Inc. or its assignee, Zeroflex, Inc.*

2. Some Office of Environmental Assistance review and monitoring practices did not comply with *Minnesota Rules* or the grant agreement with Benchmark Outdoor Products, Inc.

OEA missed several opportunities to question Benchmark's ability to complete the project because the office did not comply with some provisions of *Minnesota Rules* or its grant agreement with the company. First, questions could have been raised when OEA reviewed the grant agreement work plan and budget. Benchmark's grant proposal requested \$196,900 in state funds to be matched by \$196,900 in company resources. The final grant award of \$98,400 was approximately 50 percent of the requested amount. As a result, Benchmark had to increase its match amount, as the total project cost remained at \$393,800. *Minnesota Rule* 9210.0830, Subpart 1, on reduced awards, states:

The director shall ask an applicant to document the impacts of reduced financial assistance before finalizing an award for less than the eligible amount requested by an applicant....Reduced funds may be awarded where the director determines:
A. grant or loan program resources are insufficient to provide full assistance to all applicants to which the director intends to make awards; or B. the applicant could undertake the project at a reduced level and still achieve project objectives.

We found no documentation in OEA files that this inquiry was made or that the impact of reduced financial assistance had been assessed by Benchmark. OEA staff told us that this requirement was met through their discussions with Benchmark that resulted in a revised project budget that was incorporated into the grant agreement.

Another opportunity for review occurred before the first grant payment was made. The grant agreement provided under Part III. A. 2.a. that, "The OEA shall disburse funds only after the Grantee has provided documentation evidencing the commitment of matching funds necessary to fund the entire project. At that time, the OEA shall disburse Fifty (50) percent of the grant funds within thirty days after the OEA approves the documentation." OEA did not follow this

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provision and issued the check within 30 days after the grant agreement was signed. OEA files did not show that it ever requested or obtained documentation from Benchmark evidencing the commitment of matching funds necessary to fund the entire project.

OEA disbursed the final grant payment before the project was completed. The office made the final payment after receiving a final project report from Benchmark. However, the project report stated that the project tasks were not complete. In addition, OEA disbursed \$39,250 in grant funds without obtaining required support for the expenditures. The grant agreement required Benchmark to submit receipts for nonsalary-related expenses of \$500 or more. However, OEA did not enforce this provision. By obtaining at least some supporting documentation, the office would have had some assurance that funds were used for authorized purposes.

Finally, OEA did not adequately document Benchmark's monthly reporting on the project. The grant agreement required Benchmark to submit either oral or written updates on a monthly basis. *Minnesota Rules* also require a grant recipient to provide periodic written and/or oral reports to the director on the progress and results of the project. OEA did not have evidence that Benchmark complied with the monthly reporting requirements. If OEA had enforced the monthly reporting requirement, it may have identified concerns about the project's progress earlier.

In mid-2004, as part of an internal assessment of management practices, OEA began reviewing its grant administration policies and procedures. Agency personnel have taken a comprehensive approach to address identified grant management weaknesses.

Recommendations

- *The Office of Environmental Assistance should comply with its grant contract provisions concerning grantee submission of supporting documentation and required reports.*
- *The Office of Environmental Assistance should consider disbursement of grant funds on a reimbursement basis with periodic reviews of grantee financial information.*

Minnesota Office of
Environmental  Assistance

June 30, 2005

Mr. James Nobles
Legislative Auditor
Office of the Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
St. Paul, MN 55155-1603

Dear Mr. Nobles:

Thank you for the opportunity to discuss your report on the Office of Environmental Assistance's grant to Benchmark Outdoor Products, Inc. The exit conference was helpful in clarifying the findings and recommendations in the report. I want to thank you for your assistance in investigating this grant. Also, your recommendations concerning how we can improve our grant program will be carefully considered as we continue our review of this important activity. The OEA offers the following response to the report.

1. The audit indicates that the office did not comply with the requirements in Minn. Rules pt. 9210.0830, subp. 1, to ask the applicant to document the impacts of reduced financial assistance before finalizing an award for less than the eligible amount requested by the applicant. The office believes that it complied with this rule. The office practice is to discuss with applicants the effect of reduced funds upon the project. Office staff and the applicant then prepare a revised budget that reflects the work to be performed for the final grant amount. Therefore, the impact of the reduced amount is fully documented in the project work plan and budget that is completed before the grant is awarded.

2. As your report indicates, the office has changed its procedures in order to improve the effectiveness of our grant program and assure that state grant funds are properly used. Some of the practices that are already in place include:

* The OEA has modified its payment schedule so that the grantee receives less money up front, and a larger final payment is not made until the project is completed. OEA now awards 30% of the grant amount initially, not 50%, and the final payment is 30% rather than 10%.

* For grants involving the purchase of equipment, OEA's practice is to place two names on the warrant -- the grantee and the equipment supplier.

Regional offices in Brainerd, Detroit Lakes, Duluth, Marshall and Rochester

* The OEA requires written confirmation from all entities providing matching funds on their own letterhead as a requirement to demonstrate the match funding before initial payment is made.

* OEA now has a formal status update during the project, involving an interim meeting and review with the OEA grants coordinator, the grant manager, and the grant manager's supervisor. The purpose of this meeting is to check the status of the project, identify any areas of concern, and verify compliance with grant requirements and procedures.

We will work with the Office of the Attorney General and the Ramsey County Attorney's office to recover the misspent grant funds. Thank you again for your assistance in determining that the grantee did not properly use the grant funds, and for the opportunity to comment upon your report. Please contact Bill Sierks at (651) 215-0290 or me if you have any questions about this letter.

Sincerely,

/s/ Art Dunn

Art Dunn
Director