PORTLAND CLEAN ENERGY COMMUNITY BENEFITS FUND

Bureau of Planning and Sustainability

Date: January 3, 2021

To: Portland Clean Energy Fund Committee

From: PCEF Staff

Subject: Draft risk assessment approach for grant evaluation

Reporting by The Oregonian in December 2021 related to a recent grant award by the Portland Clean Energy Fund (PCEF) exposed some blind spots in the program's grant review process. This memo outlines approaches to mitigating potential performance and/or financial fraud risk to the PCEF program in the future, including an additional review phase to mitigate these potential hazards for current grant applications[1].

The PCEF program already follows standard best practices for review in government grantmaking in nearly every aspect. The program conducts similar due diligence as other public grantmaking programs across the nation. The primary exception is that, in addition to funding well-established organizations with a track record of success, PCEF also awards funding to new and emerging organizations. The program's past review processes have not required additional due diligence for new or emerging organizations.

> The PCEF Application review process linked here describes the grant review process and related due diligence steps. Specific due diligence within the each of the steps of application review is listed at the end of the memo in Appendix A on page 5.

While the current due diligence and grant review approach is suitable for established organizations with a demonstrated track record implementing projects similar to their proposed project, the PCEF program requires an additional review process for grant proposals where a track record may be limited or unrelated to the proposed project. The following describes some, but not all, of those circumstances:

1. **A new or emerging organization in which individual staff members have demonstrated experience implementing similar projects is applying for a PCEF grant.** Risks to the program that must be addressed:
    - Performance risk: Despite individual experience, organizations may lack critical infrastructure (e.g., staff capacity, data management systems, financial management systems, internal controls) to successfully implement the project.

[1] PCEF closed two requests for proposals (RFP) on November 30, 2021 where more than 140 Oregon nonprofit organizations submitted 160+ applications requesting more than $250 million in funding.

There is also performance risk if individual or organization experience is mischaracterized and/or significantly exaggerated.
- Financial fraud risk: New or emerging organizations may have inexperienced board members and/or executive staff to ensure sufficient internal controls. This presents greater opportunities for financial fraud such as check fraud, embezzlement, nonexistent employees, expense fraud, misappropriation of funds for personal use, false vendor schemes, kickbacks from vendors, and/or theft of cash or assets, etc.

2. **An established organization is applying for funds to implement a project for which project staff have limited-to-no relevant experience.** Risks to the program that must be addressed:
    - Performance risk: Despite the organization having established systems in place (i.e., strong board oversight, internal controls), project staff's lack of relevant experience may pose significant risk to successful project implementation.

3. **An established organization with experience relevant to the proposed project is requesting annualized funding that is greater than X times its annual budget.**
    - Performance risk: The organization's infrastructure and staff capacity may not be capable of managing the increased scale of implementation without significant impacts to the project timeline, budget, and/or performance.

Mitigating performance and/or financial fraud risk

There are numerous existing elements of PCEF's grant review and management practices that address performance and/or financial fraud risk. In the grant review (i.e., prior to the grant being awarded), performance risk is addressed throughout the proposal evaluation, which includes a review of the key project team members to ensure critical expertise and competencies exist within the team. Within grant management (i.e., after the grant is awarded), financial fraud risk is mitigated through the managed disbursement of funds on a quarterly basis as project work is completed, with invoices reconciled against receipts and other relevant documentation. However, there remain additional practices the program should consider to further mitigate these risks.

For each of the three circumstances described in the prior section, approaches to mitigating performance and/or financial fraud risk are listed below:

1. **A new or emerging organization in which individual staff members have demonstrated experience implementing similar projects is applying for a PCEF grant.**
    a. Conduct reference checks on key staff (performance risk).

   b. Ensure organization has an active and engaged board with appropriate governance structure/roles (financial fraud risk).
   c. Limit grant size and/or scope to allow organization to develop a positive track record with a down-scoped project (performance risk, financial fraud risk).

2. **An established organization is applying for funds to implement a project for which project staff have limited-to-no relevant experience.**
   a. Limit grant size and/or scope to allow organization to develop a positive track record with a down-scoped project (performance risk).

3. **An established organization with experience relevant to the proposed project is requesting annualized funding that is greater than X times its annual budget.**
   a. If the proposal is for program implementation (i.e., training X workers, retrofitting X homes), down-scope project to allow organization to scale growth at a reasonable pace (performance risk).
   b. If the proposal is for one-time infrastructure development (i.e., retrofit building occupied by organization, install solar on building occupied by organization), require organization to have an experienced developer and/or owner's representative to manage project implementation.

Evaluating and mitigating performance and financial fraud risk for applications currently under review

Staff will complete the initial eligibility, technical, financial, and threshold review of 160+ grant proposals in mid-January. We will need to finalize the process and approach for conducting additional review to address the risks described above by January 21 in order to prevent further delays in the grant review process.

A draft approach to conducting additional review may look like the following:

1. Proposals will be called in for additional review if they meet any of the following criteria:
   a. Are requesting annualized grant funds that exceed X times the average of their previous three years of revenues;
   b. Are requesting grant funds for area where organization and/or key staff have limited relevant experience to proposed project;
   c. Are less than three years old as a nonprofit organization; or
   d. Financial review raises significant concern.
2. Staff will characterize whether the risk being evaluated is related to performance and/or financial fraud risk based on information provided in the application.

3. Depending on the relevant risks, applicant organizations may be asked to provide the following information for further review:
    a. **Performance risk:**
        i. Examples of work the organization has successfully completed that are similar in size and scope to the one they are applying for, along with references that can verify the work and its successful completion.
        ii. Examples of work lead project staff have successfully completed that are similar in size and scope to the one they are applying for, along with references that can verify the work and its successful completion.
    b. **Financial fraud risk:**
        i. Information related to board governance, including by-laws, meeting minutes, and/or other information that can help staff understand whether there is an active and engaged board with appropriate governance structure/roles. Confirmation to include conversation with board chair.

Based on risk evaluation, staff may propose any of the following as a condition of advancing in the review:

1. Down-scope project to reduce the size of the project;
2. Shift proposal to a planning grant to better define project;
3. Require relevant additional third-party oversight for duration of grant (i.e., owner's rep, third party financial mgmt);
4. Require firm stage gates in Grant Agreement that include performance review before proceeding to next step; and/or
5. Prohibit advance payments or reduction of advance payment allowed in Grant Agreement.

The draft approaches outlined in this memo can further mitigate potential performance and/or financial fraud hazards related to grants currently under review. The approaches herein are designed to accommodate grants that have already been submitted. Once implemented, it will be important to assess the risk evaluation approach in order to inform future RFPs as some of these risks may also be mitigated in the RFP design.

Appendix A: Specific due diligence conducted in the existing application review:

In addition to reviewing information submitted a given proposal (organizational background, project scope, project team, GHG/environmental/social outcomes, workforce/contractor equity goals, budget) and asking clarifying questions, the following due diligence is conducted:

- Nonprofit eligibility of the applicant organization confirmed with the:
    - Oregon Secretary of State Nonprofit Registry
        - Checked to ensure that organization is registered, is Active status and not on the Disqualified Charities List.
    - Federal IRS tax-exempt organization look up by EIN / Name
        - Checked to ensure that organization has a tax-exempt declaration letter / 990 forms
- Affirmation that applicant attested the organization:
    - Has or plans to acquire required insurance
    - Does not have any tax liens
- Technical review of proposed project:
    - Conducted by staff and partners with subject matter expertise, the technical review is pass/fail. Applications that do not pass technical review are not considered for funding.
    - Technical review considerations:
        - Appropriateness of the technology for the proposed purpose.
        - Appropriateness of size and scope of project for proposed purpose.
        - Budget directly related to the proposed technology (physical improvement or installation) is feasible and appropriate.
        - Ability to meet requirements for permits, site access, compliance with relevant regulations, etc.
        - Technical knowledge needed to successfully implement the proposed project exists on the project team or there is a reasonable plan to secure (note that this last consideration is not pass/fail; applicants can be supported in bringing on technical knowledge needed if funding is awarded).
- Financial review of applicant organization:
    - Review organization financial documents and answers to financial management practices to assess the financial health of organization.
    - Variables considered in financial review include: how long the organization has been operating; variances in income and expenditures across years; net income; net assets; board oversite; process for approving expenditures; financial policies and procedures and controls; and external audit findings.
    - Financial review is not part of the application score but is available to the review panel and helps to inform management of the project should the application be awarded funding.