



U.S. ENVIRONMENTAL PROTECTION AGENCY
OFFICE OF INSPECTOR GENERAL

Catalyst for Improving the Environment

Attestation Report

Costs Claimed Under EPA Grant XP9468195 Awarded to the City of Flowood, Mississippi

Report No. 10-4-0013

October 27, 2009



Report Contributors:

Richard Howard
Yeon Kim
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Abbreviations

A&E	Architectural and Engineering
CFR	Code of Federal Regulations
EPA	U.S. Environmental Protection Agency
FAR	Federal Acquisition Regulation
FSR	Financial Status Report
OIG	Office of Inspector General
SAAP	Special Appropriation Act Project
SRF	State Revolving Fund

Cover photo: City of Flowood pump station. (Photo taken by OIG staff in March 2009)



At a Glance

Catalyst for Improving the Environment

Why We Did This Review

The U.S. Environmental Protection Agency (EPA) Office of Inspector General (OIG) conducts reviews of earmarked grants known as Special Appropriation Act Projects issued to local and tribal governments. The City of Flowood, Mississippi, was selected for review.

Background

Region 4 awarded Grant No. XP9468195 to the City of Flowood, Mississippi (grantee), on February 10, 1995. The purpose of the grant was to provide federal assistance of \$7,679,032 to fund the construction of the Hogg Creek Interceptor pipeline segment. EPA funded 69.86 percent of the eligible project costs and the grantee funded 30.14 percent.

For further information, contact our Office of Congressional, Public Affairs and Management at (202) 566-2391.

To view the full report, click on the following link:
www.epa.gov/oig/reports/2010/20091027-10-4-0013.pdf

Costs Claimed Under EPA Grant XP9468195 Awarded to the City of Flowood, Mississippi

What We Found

The grantee did not perform a cost analysis or negotiate a fair and reasonable profit as a separate element of the contract price as required under Title 40 Code of Federal Regulations (CFR) 31.36(f). As a result, we questioned \$1,755,157 in unsupported architectural and engineering (A&E) costs claimed. The grantee will need to repay \$896,224 of grant funds. The grantee also did not have its own written procurement procedures and did not maintain records sufficient to detail the procurement of the A&E contract.

What We Recommend

We recommend that the EPA Region 4 Regional Administrator:

1. Require the grantee to provide the documentation demonstrating that it performed a cost analysis for the A&E contract at the time of negotiation. If the grantee is unable to do so, EPA should recover the federal share of questioned A&E costs of \$896,224.
2. Require the grantee to develop written procurement procedures in accordance with 40 CFR 31.36(b)(1).
3. Require the grantee to incorporate the procurement record keeping requirements in 40 CFR 31.36 (b)(9) into its written procurement procedures, and comply with those requirements.

The grantee agreed with the recommendations to develop written procurement and record keeping procedures. However, the grantee did not agree with the questioned A&E costs and stated that it had performed the equivalent of the required cost analysis for its A&E contract.



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

OFFICE OF
INSPECTOR GENERAL

October 27, 2009

MEMORANDUM

SUBJECT: Costs Claimed Under EPA Grant XP9468195
Awarded to the City of Flowood, Mississippi
Report No. 10-4-0013

A handwritten signature in black ink, reading "Robert K. Adachi", is positioned above the "FROM:" field.

FROM: Robert K. Adachi
Director of Forensic Audits

TO: A. Stanley Meiburg
Acting Regional Administrator
EPA Region 4

This report contains a time-critical issue the Office of Inspector General (OIG) identified. This report represents the opinion of the OIG and does not necessarily represent the final position of the U.S. Environmental Protection Agency (EPA). EPA managers will make final determinations on matters in this report.

The estimated cost of this report – calculated by multiplying the project's staff days by the applicable daily full cost billing rates in effect at the time – is \$81,847.

Action Required

In accordance with EPA Manual 2750, Chapter 3, Section 6(f), you are required to provide us your proposed management decision for resolution of the findings contained in this report before you formally complete resolution with the recipient. Your proposed decision is due in 120 days, or on February 24, 2010. To expedite the resolution process, please e-mail an electronic version of your proposed management decision to adachi.robert@epa.gov.

We have no objections to the further release of this report to the public. This report will be available at <http://www.epa.gov/oig>. If you or your staff has any questions regarding this report, please contact me at (415) 947-4537 or at the above e-mail address, or Leah Nikaidoh at (513) 487-2365 or nikaidoh.leah@epa.gov.

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Introduction

Purpose

The Office of Inspector General of the U.S. Environmental Protection Agency (EPA) reviews Special Appropriation Act Project (SAAP) grants to identify issues warranting further analysis. This includes reviewing the total project costs incurred by selected grant recipients. We reviewed the SAAP grant awarded to the City of Flowood, Mississippi (grantee).

Background

Region 4 awarded Grant No. XP9468195 to the grantee on February 10, 1995. The purpose of the grant was to provide federal assistance of \$7,679,032 to fund the construction of the Hogg Creek Interceptor pipeline segment connecting to the West Rankin Regional Sewer System north of the Jackson international airport and extending easterly to the Castlewoods/Millcreek residential areas of West Rankin County, Mississippi. EPA was responsible for 69.86 percent of the eligible project costs. The grantee was responsible for matching, at a minimum, 30.14 percent of the eligible project costs. Per the Financial Status Report (FSR), project costs were \$11,464,301. The grantee was responsible for the remaining project costs of \$3,785,269 (\$11,464,301-\$7,679,032). EPA amended the grant four times resulting in a budget and project period that started February 15, 1995, and ended December 31, 2004.

Independent Attestation Report

As part of our continued oversight of SAAP grants awarded by EPA, we have examined the costs claimed by the grantee in its Financial Status Report (FSR) covering the period from February 15, 1995 to December 31, 2004. By signing the award documents, the grantee has accepted responsibility for preparing its cost claim to comply with the requirements of 40 CFR Part 31, Office of Management and Budget Circular A-87, EPA policies, and the terms and conditions of Grant No. XP9468195. Our responsibility is to express an opinion on the grantee's FSR based on our examination.

Our examination was conducted in accordance with the *Government Auditing Standards* issued by the Comptroller General of the United States, and the attestation standards established by the American Institute of Certified Public Accountants. We examined evidence about the grantee's compliance with 40 CFR Part 31, Office of Management and Budget Circular A-87, EPA policies and the terms and conditions of the grant, and performed procedures, as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

We conducted our field work from March 30, 2009, to July 29, 2009. We made a site visit to the grantee and performed the following steps:

- Reviewed the grant agreement and the amendments.
- Toured the facilities constructed under the grant.
- Reviewed the grantee's supporting documents for payment requests.
- Verified deposits of grant cash draws to the bank statements.
- Conducted interviews of grantee personnel.
- Reviewed the grantee's procurement procedures and related documents.
- Verified that the grantee met the required grant match.

We considered the grantee's internal controls over cost reporting in order to determine our audit procedures for the purpose of expressing our opinion on the FSR, and not to provide assurance on the internal controls over cost reporting. Our consideration of internal controls would not necessarily disclose all matters in the internal controls that might be material weaknesses. A material weakness is a significant deficiency or combination of significant deficiencies that results in more than a remote likelihood that a material misstatement will not be prevented or detected. A significant deficiency is a deficiency in internal controls, or combination of control deficiencies, that adversely affects the grantee's ability to initiate, authorize, record, process, or report data reliably in accordance with the applicable criteria or framework, such that there is more than a remote likelihood that a misstatement of the subject matter that is more than inconsequential will not be prevented or detected.

Our examination disclosed the following noncompliances and material weaknesses that resulted in the grantee not complying with the financial management requirements specified by Title 40 CFR Part 31. The grantee:

- Did not perform a cost analysis required by 40 CFR 31.36(f) for the architectural and engineering (A&E) service contract.
- Did not have its own written procurement procedures required by 40 CFR 31.36 (b) (1), (2), and (3).
- Did not maintain all required procurement documents required by 40 CFR 31.36(b)(9).

As a result of these issues, we were unable to determine the price reasonableness of A&E costs and have questioned \$1,755,157 of costs claimed under the grant.

In our opinion, because of the effect of the issues described above, the FSR referred to above, does not meet, in all material respects, the requirements of 40 CFR Part 31 for the period ended December 31, 2004.



Robert K. Adachi
Director for Forensic Audits
July 29, 2009

Results of Examination

The grantee did not meet the procurement requirements of 40 CFR Part 31.36. As a result, we questioned \$1,755,157 in unsupported A&E costs claimed. The grantee also did not have its own written procurement procedures, and did not maintain records sufficient to detail the procurement of the A&E contract. The grantee claimed total project costs of \$11,464,301, but only \$10,992,384 was approved under the EPA grant. The grantee provided the additional \$471,917 of project costs with excess matching funds. The excess funds can be used to offset the \$1,755,157 in questioned costs. As a result, the grantee is required to reimburse the EPA \$896,224. Below is a summary of the questioned costs.

Table 1: Summary of Questioned Costs

Cost Element	Questioned Costs
Total Eligible Project Costs	11,464,301
Less: Questioned Procurement Costs	(1,755,157)
Total Allowable Project Costs	9,709,144
Federal Share (69.86%)	6,782,808
Payments Made	7,679,032
Amount to be Repaid	(896,224)

Sources: Claimed costs are from the *Financial Status Report*.
Costs questioned are based on OIG's analyses of the supporting documentation provided by the grantee.

Weaknesses in Procurement Procedures

The grantee did not perform a cost analysis or negotiate a fair and reasonable profit as a separate element of the contract price for its A&E contract. Title 40 CFR 31.36(f) requires grantees to perform a cost analysis to determine price reasonableness for procuring A&E professional services. It also requires grantees to negotiate a fair and reasonable profit as a separate element of the contract price in all cases where cost analysis is performed. Without a cost analysis, we were unable to determine whether the A&E contract price was fair and reasonable. Therefore, we questioned as unsupported the A&E costs of \$1,755,157 claimed under the grant.

The grantee did not meet the requirements of 40 CFR 31.36(f) because its managers involved in the award process believed that the applicable standards to follow were the State of Mississippi Purchase Law (State Law), which allows the grantee to select an A&E firm based upon qualifications. Federal regulations also allow the selection of an A&E firm based upon qualifications. However, under federal regulations, the grantee is also required to perform a cost analysis as part of the price negotiation process. This requirement is not in the State Law; therefore, the grantee was unaware of the federal requirement to perform a cost analysis.

The grantee also did not have its own written procurement procedures. Title 40 CFR 31.36(b) requires grantees to:

- (1) Use their own procurement procedures that reflect applicable State and local laws and regulations, provided that the procurements conform to applicable federal laws and standards.
- (2) Maintain a contract administration system that ensures that contractors perform in accordance with the terms, conditions, and specifications of their contracts or purchase orders.
- (3) Maintain a written code of standards of conduct governing the performance of their employees engaged in the award and administration of contracts.

In the absence of written procurement procedures that include compliance with EPA regulations, the grantee did not ensure that its A&E contract met all compliance standards.

The grantee did not maintain all required procurement records required by 40 CFR 31.36(b)(9). The grantee could not find its score sheets used to rank the three firms that responded to the Request for Qualifications for the A&E contract under the subject SAAP grant. The grantee only provided copies of the board meeting minutes documenting the selection of the highest-ranked A&E firm. Title 40 CFR 31.36(b)(9) requires that grantees to maintain records sufficient to detail the significant history of a procurement. These records will include, but are not necessarily limited to, the following: rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis for the contract price.

As a result, we were unable to determine whether the grantee properly assessed each firm based upon prescribed ranking criteria to ensure that the ultimate selection of the A&E firm was justified.

Recommendations

We recommend that the EPA Region 4 Regional Administrator:

1. Require the grantee to provide the documentation demonstrating that it performed a cost analysis for the A&E contract at the time of negotiation. If the grantee is unable to do so, EPA should recover the federal share of questioned A&E costs of \$896,224.
2. Require the grantee to develop written procurement procedures in accordance with 40 CFR 31.36(b)(1).
3. Require the grantee to incorporate the procurement record keeping requirements in 40 CFR 31.36 (b)(9) into its written procurement procedures, and comply with those requirements.

Grantee Comments and OIG Analysis

We held an exit conference with representatives from Region 4 and the grantee on August 18, 2009, to obtain their comments regarding the factual accuracy of the discussion draft. The grantee provided a written response to the OIG on August 31, 2009, to verify its exit conference comments. Appendix A provides the full text of the grantee's comments.

The grantee agreed with the recommendations in the discussion draft and stated that it is currently taking steps to comply with the recommendations. These steps include developing written procurement and record keeping procedures and submitting them to Region 4 for comment and approval. The grantee needs to provide Region 4 with the specific steps it is taking to address the recommendations, along with milestone dates for each step.

The grantee did not concur with the questioned A&E costs. The grantee stated that it performed the equivalent of a required cost analysis along with the engineering firm selected to perform work under the EPA grant. This analysis consisted of an EPA Form 5700-41,¹ the experience of its Director of Public Works, and ensuring that the fees the City paid to its engineering firm did not exceed fees recommended by the State Revolving Fund (SRF) Curve established by the State of Mississippi.

The grantee also stated that the selection process for its engineering firm took place more than 15 years ago, and it hoped the OIG would take this into account since the grantee could not locate its ranking score sheets. However, the grantee provided its official board meeting minutes that documented the selection of the most qualified engineering firm to the OIG.

We disagree with the grantee's assertion that its EPA Form 5700-41, along with the SRF Curve and the experience of the Director of Public Works, who is not an engineer, provided the equivalent of the cost analysis required by 40 CFR 31.36(f). The City of Flowood did not meet the cost analysis requirements of 40 CFR 31.36(f), and did not support how it determined that the costs listed on its Form 5700-41 forms were fair and reasonable.

Title 40 CFR 31.36(f)(3) requires that the costs included in negotiated prices to be consistent with the federal cost principles outlined in 40 CFR 31.22. However, 40 CFR 31.36(f) does not clearly describe what constitutes an adequate cost analysis. To assist the grantee, we identified criteria in the Federal Acquisition Regulations (FAR) that provides specific criteria that contractors and subcontractors should use to perform a cost analysis. According to FAR 15.404-1(c), a cost analysis is the review and evaluation of the separate cost elements and profit in the offeror's proposal (including cost or pricing data). FAR 15.404-1(c)(2)(iii) provides cost analysis techniques and procedures to ensure a fair and reasonable price. These techniques and procedures include the comparison of costs proposed by the offeror for individual cost elements with:

- Actual costs previously incurred by the same offeror,
- Previous cost estimates from the offeror or from other offerors for the same or similar items,
- Other cost estimates received in response to the government's request,
- Independent government cost estimates by technical personnel, and/or,
- Forecasts of planned expenditures.

¹ EPA Form 5700-41 (2-76): Cost or Price Summary Format for Subagreements Under U.S. EPA Grants, EPA Handbook of Procedures, Construction Grants Program for Municipal Wastewater Treatment Works February 1976.

EPA Form 5700-41 was used during the construction grants program and was the basis for a cost and price review by EPA or the State agency delegated to monitor the construction grants program. The information contained in the grantee's form was prepared and certified by the contractor or subcontractor. Although the form provided the costs and price details, the grantee did not provide adequate documentation to satisfy the federal cost analysis requirements. In particular, the grantee did not determine whether the information contained in the EPA Form 5700-41 was current, accurate and complete. As a result, the grantee could not certify that the proposed cost and price was reasonable.

The grantee also mentioned that the SRF Curve developed by the State of Mississippi was used to determine cost reasonableness. The SRF curve is identical to the practice outlined in 40 CFR Part 35 Subpart I, Appendix B. Appendix B to the CFR applied to construction grants awarded after October 1, 1984, under Section 201 (g)(1) of the Federal Water Pollution Control Act. Appendix B was used to determine the allowance EPA would provide for facilities planning and design services. Appendix B was not intended to reimburse grantees for costs incurred and was not meant to be used to answer questions of equity. Since Appendix B is identical to the SRF Curve established by the State of Mississippi, the grantee should not imply its use is a substitute for or an enhancement of a cost and price analysis.

Our position that the A&E costs of \$1,755,157 are unsupported remains unchanged.

While the OIG understands that the engineering firm selection process took place years ago, the grantee did not comply with the record keeping requirements of 40 CFR 31.36(b)(9). The grantee's board meeting minutes only contained the total scores the three engineering firms received. Without the individual score sheets, the OIG could not determine the scores each of the five members of the Selection Committee gave each firm, how these scores were computed, or if the most qualified firm was selected. The grantee needs to ensure that the written procurement procedures it is developing contain the record keeping requirements of 40 CFR 31.36(b)(9).

Status of Recommendations and Potential Monetary Benefits

RECOMMENDATIONS						POTENTIAL MONETARY BENEFITS (in \$000s)	
Rec. No.	Page No.	Subject	Status ¹	Action Official	Planned Completion Date	Claimed Amount	Agreed To Amount
1	5	Require the grantee to provide the documentation demonstrating that it performed a cost analysis for the A&E contract at the time of negotiation. If the grantee is unable to do so, EPA should recover the federal share of questioned A&E costs of \$896,224.	U	Regional Administrator, Region 4		\$896.2	
2	5	Require the grantee to develop written procurement procedures in accordance with 40 CFR 31.36(b)(1).	O	Regional Administrator, Region 4			
3	5	Require the grantee to incorporate the procurement record keeping requirements in 40 CFR 31.36 (b)(9) into its written procurement procedures, and comply with those requirements.	O	Regional Administrator, Region 4			

¹ O = recommendation is open with agreed-to corrective actions pending
C = recommendation is closed with all agreed-to actions completed
U = recommendation is undecided with resolution efforts in progress

Appendix A***Grantee Response***

August 31, 2009

VIA ELECTRONIC TRANSMISSION and FIRST CLASS MAIL

Mr. Robert K. Adachi
Director of Forensic Audits
Office of the Inspector General
United State Environmental Protection Agency
Washington, D.C. 20460

**Re: Response to Draft Attestation Report – Costs Claimed Under EPA Grant
XP9468195 Awarded to the City of Flowood, Mississippi; Project No. 2009-843
dated July 29, 2009**

Dear Mr. Adachi:

This letter is in response the draft report referenced above and in furtherance of our telephone conference which took place on August 18, 2009 with representatives of your office and those of Region 4-EPA in Atlanta, Georgia.

First, let me thank the participants in this audit for their questions and comments during this audit process. As you might imagine, responding to this audit was a challenge to the City of Flowood (“Flowood”) because the first grant which was the subject of this audit was awarded in February 10, 1995, more that fourteen years ago, and the last grant was more than five year ago. Although the Mayor Rhoads and Public Works Director Garry Miller were in place in 1995, the long- time City Clerk, Ms. Dew, is no longer with Flowood. Locating documents dating back to 1995 was in some cases simply not possible.

We agree with the recommendations contained in the draft report and are currently taking steps to comply with those recommendations in the future. However, we feel compelled to respond to the factual basis for these recommendations.

With regard to the first recommendation regarding documentation of the performance of a cost analysis for the A&E Contract, an analysis was performed by Flowood in cooperation with the engineering firm selected by Flowood using an outdated Form 5700-41 for the original contract. We would argue that this analysis was the functional equivalent to the mandates of 40 CFR 31.36(f). I have enclosed a copy of the contract forms for your review and consideration. This analysis coupled with Mr. Miller’s considerable experience should adequately serve to satisfy the requirement of 40 CFR 31.36(f).

As you know, there were three substantive amendments to the contract. I have enclosed copies of each amendment for your convenience. Each contract provided that the fee to be

charged for engineering services would be in accordance with the SRF Curve which was attached to each as an exhibit. In fact, some of the fees were significantly lower than that recommended by the curve. As I am sure that you know, the SRF Curve was developed by the State of Mississippi as a guideline for circumstances such as the one at hand. We would submit to you that the SRF Curve coupled with Mr. Miller's experience was the functionally equivalent to the analysis required by 40 CFR 31.36(f). Furthermore, the contract we submitted to Region 4 with the SRF Curve attached as an exhibit and no objection was ever made to this method of verifying the reasonableness of the engineers' fees.

I hope the foregoing explanation persuades you to conclude that while Flowood may not have complied with the letter of the law, it did verify that the costs charged by the engineers were reasonable under the circumstances.

As for the lack of score sheets used to rank the three firms that responded to the request for qualifications, I would hope that you would consider the fact that this selection process took place more than fifteen years ago and it is impossible to keep up with every scrap of paper generated by the city. As noted in the draft, Flowood did have in its official board minutes copies of the documents which evidence the selection of the most qualified engineering firm. I am enclosing a copy of those minutes for your reference.

In closing, I hope that we have provided you sufficient information regarding the reasonableness of the engineering fees and the documentation of the procurement process. As I indicated earlier, Flowood is in the process of developing written procurement and record keeping procedures and will be submitting them to Region 4 for comment and approval.

If you have any further questions, please don't hesitate to contact me.

Very truly yours,

WATSON & JONES, P. A.

J. Kevin Watson

JKW:ew

Enclosures

ec/enc: A. Stanley Meilburg, Acting Regional Administrator

Leah Nikaidoh, Audit Manager, Northern Audit Division

Ed Springer, Region 4 Special Appropriation Act Projects Coordinator

Carol Williams, Region 4 Audit Coordinator

Bill Roderick, Acting Inspector General

Melissa Heist, Assistant Inspector General for Audit

John Manibusan, OIG Office of Congressional, Public Affairs and Management

Mayor Gary Rhoads, City of Flowood

Julia Williams, City Clerk, City of Flowood

Appendix B

Distribution

Acting Regional Administrator, Region 4
Director, Office of Wastewater Management, Office of Water
Director, Office of Wastewater Management - Municipal Support Division, Office of Water
Director, Office of Grants and Debarment
Director, Grants and Interagency Agreements Management Division
Agency Follow-up Official (the CFO)
Agency Follow-up Coordinator
Associate Administrator for Congressional and Intergovernmental Relations
Associate Administrator for Public Affairs
Region 4 Audit Follow-up Coordinator
Region 4 Public Affairs Office
Region 4 Special Appropriation Act Project Coordinator
Mayor, City of Flowood, Mississippi
Acting Inspector General