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BEFORE THE
SUBCOMMITTEE ON WATER RESOURCES
AND THE ENVIRONMENT
COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
UNITED STATES HOUSE OF REPRESENTATIVES
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Good afternoon, Mr. Chairman and members of the subcommittee. I am Melissa Heist, Assistant Inspector General for Audit for the United States Environmental Protection Agency. Thank you for inviting me here today to discuss the results of our financial reviews of assistance agreement recipients.

On February 21, 2003, the committee requested the Office of Inspector General (OIG) report on the Environmental Protection Agency's (EPA) resolution of issues identified in reports on assistance agreements issued by the OIG in fiscal years 2001 and 2002.

We issued 369 audits of assistance agreements in fiscal years 2001 and 2002. Our office performed some of these audits, while others were performed by independent accountants under the Single Audit Act. Twenty-seven of these audits included material non-compliance issues, and questioned costs. For purposes of our discussion today, a material non-compliance is a financial management deficiency that is contrary to Federal regulation and could result in a material misstatement of costs, inhibit proper accounting for project funds, or impede the ability to conduct an audit.

Once the OIG issues an audit report, EPA reviews the report, decides whether or not it agrees with the OIG's recommendations, and issues its final decision. EPA issued final decisions for 19 of the 27 audit reports with material non-compliance issues. For one of the remaining eight reports where EPA has not made a decision, the audit resolution has been suspended at our request. Resolution has been in process for the other seven reports for periods ranging from 9 months to over 2 years.

Once EPA issues a final decision, the recipient can appeal the decision to either the Regional Administrator or Assistant Administrator, depending on circumstances. Recipients may file an appeal when they disagree with a decision, such as a decision that costs need to be repaid. Of the 19 reports where EPA issued final decisions, the recipients are appealing 9 of the decisions. For 9 of the 10 remaining reports, the recipients have either resolved the non-compliance issues or are implementing a corrective action plan.

Status of Questioned Costs

Description	Number of Reports	Amount	Percent of Total Questioned
Sustained	19	$5,381,033	18%
Not Sustained		$14,599,592	49%
Suspended	1	$1,301,365	5%
No Decision	7	$8,364,526	28%
Total Questioned	27	$29,646,516	100%

As shown in the table above, we questioned $29 million in the 27 audit reports with a material noncompliance. We questioned costs for various reasons, including inadequate accounting for payroll charges and lack of competition when procuring goods and services.

EPA issued decisions on 19 of the reports, sustaining about $5 million of costs the OIG questioned. EPA did not sustain about $14.5 million. Eighty-nine percent of unsustained costs ($13 million) was questioned in the report on Chicago Public Schools. The assistance to Chicago Public Schools was a loan, and after consulting with the U.S. Department of Justice, EPA concluded that there was no language in the loan document to permit immediate recovery of the unallowable costs. However, the unallowable costs will be recovered as the loan is repaid. Also, EPA did not sustain another six percent ($907,000) of the questioned costs when it determined that two engineering contracts, claimed under a grant to the Lake Wallenpaupack Watershed Management District, were reasonable in spite of conflicts of interest and competition issues. In its final determination, EPA did not specifically address the engineer's conflict of interest.

Of the 19 reports with final decisions, the recipients are appealing 9 of those decisions covering $2,199,695 of sustained costs (about 41 percent of sustained costs). To date, EPA has recovered through repayment or offsets $2,180,030 in sustained costs, and is due another $1,001,308.

EPA has various tools it can use if it determines, based on an audit report or its own evaluation, that a recipient does not have an adequate financial management system, or has not complied with the terms and conditions of the assistance agreement. For example, EPA can designate a recipient as high risk or include special conditions in future awards. As part of the high risk designation or special conditions, EPA can require that all payments be on a reimbursement basis or require the recipient to provide more detailed financial reporting. EPA provided new funds to 11 of the recipients after we issued audit reports with material noncompliances. EPA designated four recipients as high risk, which included requiring recipients to provide supporting documentation to EPA before they could be reimbursed. For one recipient, EPA suspended work and withheld future funds pending resolution of report findings.

EPA can also suspend or debar a recipient or employee of a recipient for more serious instances of fraud, waste and abuse. For one of the audits we reviewed, one employee was debarred for embezzling Federal funds from the recipient. The employee cannot participate in government contracts, subcontracts, loans, grants, or other assistance programs for five years.

Based on past audits, EPA, in December 2002, updated its policy on monitoring of assistance agreements. Under the revised policy, if baseline monitoring is properly carried out, it should identify deficiencies in financial status reports, progress reports, and cash draws. Other deficiencies, such as unsupported or ineligible costs, may not be detected unless EPA selects the recipient for advanced monitoring. EPA policy requires advanced monitoring on 10 percent of active recipients. Advanced monitoring includes, among other things, reviewing recipient's payroll procedures, procurement processes, and internal controls, areas where the OIG has found problems during financial reviews. We have suggested to EPA that it use a risk based approach in selecting recipients for advanced monitoring.

I would like to share the results of three recently issued reports. They show that financial accountability continues to be problematic with some recipients of EPA funds. They also show the importance of EPA performing on-site reviews of assistance recipients. In two of our examples, EPA requested that we conduct audits after on-site reviews identified weaknesses in the recipients' accounting systems.

- At EPA's request, we evaluated the costs a recipient claimed for providing education and training to Federally recognized tribes regarding solid waste and emergency response. We questioned the $2.3 million the recipient claimed primarily for several reasons. First, the recipient did not have an adequate financial management system, and could not (a) reconcile the costs claimed to its own accounting records, or (b) show that salaries and wages claimed were for activities supporting the assistance agreement. Second, the recipient claimed $500,000 for a research contract that was awarded without competition or an evaluation of the proposed cost. According to the recipient, board members investigated potential vendors. One vendor made a verbal proposal and was awarded the contract. Our review disclosed that the board member who was instrumental in obtaining the contractor subsequently resigned from the board and was hired by the contractor before the contract was awarded. Under the circumstances, there are no assurances that the contractor was the best qualified organization to conduct the research or that the $500,000 paid was reasonable and the best price.

  Finally, the recipient made payments of almost $122,000 to contractors on behalf of an Indian tribe without any written agreement to support the purpose and circumstances for the payments. It is our understanding that the Indian tribe also received funds from EPA for work at the same site. Without a written agreement outlining the scope of work being paid, EPA has no assurance that these costs do not duplicate the costs being claimed under another EPA grant.

- At the Agency's request, we evaluated the costs a recipient claimed for public outreach and information dissemination about geothermal heat pump technology. We questioned the $1.1 million the recipient claimed for several reasons. First, the recipient did not separately identify costs associated with all lobbying activities in its accounting records. Costs associated with lobbying are not allowable under Federal regulations, and we could not verify that EPA funds were not used to pay for lobbying activities.

  Second, the recipient did not competitively obtain contractual services. The recipient awarded contracts based on past experience with the firms. For example, in response to a solicitation for services the recipient received seven proposals, but awarded the contract to the current vendor, even though the vendor had not submitted a proposal.

  Finally, the recipient did not recognize dues received from its membership as program income generated by EPA supported activities. The membership represented every facet of the GeoExchange industry including utilities, energy service companies, manufacturers, contractors and many others. According to Federal Regulations, program income must be used as directed by the funding agency or deducted from allowable grant costs.

  Membership benefits included publication of the "Earth Comfort Update" newsletter, design and maintenance of the web site, dissemination of publications from the GeoExchange information center, trade show attendance, use of the design assistance and strategic outreach programs, and a sales lead referral service. All of these activities were also identified as tasks completed and funded under either one or both of the EPA agreements.

  In this instance, it seems that EPA awarded two agreements which essentially funded the costs to operate this membership organization. During the agreement periods, the recipient received membership payments in excess of $1.9 million, which is more than the agreement awards. The questioned raised is whether the Federal funds were necessary for the purpose awarded or whether the funds could have been awarded for a better purpose. In one of the agreements, EPA included a requirement to document energy performance in 10 to 30 of their buildings and report energy reductions. According to the recipient, the work was not done because of a lack of funds.

- Based on a Single Audit report, we questioned $1.7 million, which represented all costs a recipient claimed during one year for several assistance agreements. The recipient's accounting system did not identify the costs associated with each assistance agreement as required by Federal regulations. The auditors were not able to verify that the costs claimed under the assistance agreements were for activities that supported the agreements.

These recent financial reports indicate that procurement of contractual services continues to be a problem for some recipients. In March 2002, the OIG issued a report that specifically looked at EPA's oversight of recipient procurement practices. The report found that recipients did not have sufficient knowledge of procurement regulations, and often procured services as a result of familiarity and long-term relationships with contractors. Competition in procuring services is important to ensure that the government is getting the best product, at the best price from the most qualified firms. Competition also promotes innovation and new ideas in solving environmental problems. EPA needs to ensure project officers are adequately monitoring recipients' procurements.

As the Inspector General stated in her testimony before this committee in June, if EPA is to improve its management of assistance agreements, it needs to ensure that adequate resources are devoted to the function. Senior leaders need to set expectations for managers and staff. They must hold management and staff accountable for adhering to Agency policies that promote good management of assistance agreements. In issuing its grants management plan earlier this year, EPA stated its vision was to ensure that its grants programs meet the highest management and fiduciary standards and further the Agency's mission of protecting human health and the environment. The OIG will monitor Agency progress in implementing the grants management plan, and we will evaluate whether the actions are effective in improving the financial accountability of recipients.

We are proud of the efforts the OIG staff have made in bringing these issues to light, and I thank you, Mr. Chairman and members of the Committee, for the opportunity to participate in a discussion of such an important topic. We are committed to working with Congress and EPA to ensure that the money awarded every year through assistance agreements is producing the intended environmental and public health benefits.

This concludes my prepared remarks, and I will be happy to respond to questions.