



OIG

OFFICE OF INSPECTOR GENERAL

Catalyst for Improving the Environment

Special Report

Congressionally Requested Review of EPA Actions Taken in Response to Financial Assistance Agreement Reports

Report No. 2003-S-000006

July 23, 2003

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

JUL 23, 2003

THE INSPECTOR GENERAL

The Honorable Don Young
Chairman
Committee on Transportation and Infrastructure
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

On February 21, 2003, the House Committee on Transportation and Infrastructure sent a letter requesting 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 OIG in Fiscal Years 2001 and 2002. You asked that we also answer eight specific questions related to this subject. After reviewing the questions, and meeting with Committee staff, the original questions were modified and confirmed in a letter to the Committee on March 21, 2003.

When the EPA transfers funds for a public purpose, it uses a legal instrument called an assistance agreement, which may be in the form of a grant or cooperative agreement. Assistance agreements are the primary vehicle through which EPA delivers environmental and human health protection. In recent years, more than half of EPA's budgeted funds have been awarded to organizations outside the Agency through such agreements. EPA primarily awards assistance agreements to State, local, and tribal governments; universities; and nonprofit organizations.

The following paragraphs provide brief answers to your specific questions. Our answers are supplemented by additional information in Enclosures A through C. Enclosure D provides details on our scope and methodology.

1. What is the inventory of grants that were identified as having significant non-compliance issues concerning grant rules and/or questioned costs?

There were 369 audits of assistance agreements issued in fiscal 2001 and 2002. Of these audits, 27 included material non-compliance issues, and questioned costs. (Enclosure A identifies the 27 reports.) The 27 include both those reports prepared by our office and those prepared by independent accountants under the Single Audit Act. 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 accounting for project funds, or impede the ability to conduct an audit.

2. For each relevant case, what action did EPA take to ensure the recipient corrected the deficiencies?

EPA issued final decisions for 19 of the 27 audit reports with material non-compliance issues. EPA has not made decisions on eight reports. For one report, the audit resolution has been suspended at our request. For the other seven reports, EPA has not met the 6-month resolution period required by Office of Management and Budget (OMB) Circular A-50 and EPA Manual 2750, Change 2. Resolution has been in process for these seven reports for periods ranging from 9 months to over 2 years.

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. EPA did not require corrective action for 1 of the remaining 10 reports.

See Enclosure B for a summary table on actions taken and Enclosure C for details on actions taken as a result of each audit report.

3. For each case, did EPA recover the questioned costs? If not, why not?

We questioned a total of \$29,646,516 in the 27 audit reports. EPA issued decisions on 19 of the reports covering \$19,980,625 of questioned costs. As noted in question 2, EPA has not made decisions on eight reports. Resolution on one report is suspended, and EPA has exceeded the required 6-month resolution period on the other seven reports. The following table shows the status of the 27 reports and the results of EPA's decisions.

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%

EPA did not sustain \$14,599,592, of which \$13,026,526 (89 percent of unsustained costs) 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 recovery for unallowable costs.¹ Also, EPA did not sustain \$907,000 (6 percent of unsustained costs) in the Lake Wallenpaupack report when it determined that two engineering contracts were reasonable in spite of conflicts of interest and competition issues.

¹Since the assistance to Chicago Public Schools is a loan, all questioned costs will eventually be repaid to the Government. Chicago Public Schools is current in the repayment of this loan.

Of the 19 reports with final decisions, the recipients are appealing 9 of those decisions covering \$2,199,695 related to sustained costs (about 41 percent of sustained costs). To date, EPA has recovered through repayment or offsets² \$2,180,030 in sustained costs, and is due another \$1,001,308.

4. Did EPA provide new funds to any recipients that had a history of non-compliance concerning the other Federal grants? If so, what actions did EPA take to safeguard the new funds from future loss?

EPA provided new funds to 11 of the recipients since the issuance of audit reports included in this review. EPA designated four as high risk recipients. For another recipient, EPA required special conditions on the new funding; subsequently, EPA suspended all work under the agreement and withheld reimbursement of costs pending resolution of report findings.

5. Did EPA take any action to suspend or debar any recipients of the identified grants, or any employee of the recipient?

According to EPA officials, one employee of a recipient was debarred for embezzling grant funds from the recipient. The embezzlement was identified in the Advisory Report on Assistance Agreement Defalcation, National Asian Pacific Center on Aging. For the remaining grants, no recipients or employees of recipients were suspended or debarred as a result of issues identified in these reports.

6. What changes, if any, did EPA make in its own procedures as a result of the reports and what impact would the changes have on the control environment for grants management?

In response to this question, EPA officials provided no evidence of changes to written procedures resulting from the selected audit reports. However, on December 31, 2002, EPA issued Order 5700.6, *Policy on Compliance, Review, and Monitoring*, as part of its commitment to strengthen post-award management efforts. This revised policy resulted from a culmination of audit reports over the years.

According to Regions 8 and 10, some practices have been modified as a result of the assistance agreement audits issued in their regions. Region 8 has emphasized monitoring tribes and evaluating financial and programmatic reporting. Region 10 has incorporated “lessons learned” into yearly training, and has emphasized post award monitoring. Region 10 is also updating guidance for taking enforcement actions to provide a more pro-active approach to dealing with non-compliance issues.

²An offset is where EPA allows the recipient to apply the questioned costs against other allowable costs that have not been claimed.

7. Are EPA's current procedures adequate for EPA staff to identify the types of deficiencies found in these reports?

Current EPA procedures (issued December 31, 2002, after the issuance dates of the reports reviewed) appear to be adequate to identify deficiencies regarding financial status reports, progress reports, and cash draws. Other deficiencies, such as unsupported or ineligible costs, may not be detected by EPA unless the recipient is selected for advanced monitoring. However, careful adherence to pre-award procedures, which include reviewing proposed costs and assessing the recipients' ability to perform, should reduce the risk of misusing EPA assistance funds.³ Additionally, some recipients are required to have annual audits in accordance with OMB Circular A-133. These audits may identify control and compliance issues and questioned costs.

EPA's monitoring procedures identify two types of monitoring that should take place for assistance awards: baseline monitoring and advanced monitoring. Baseline monitoring is the minimum monitoring that should take place on every award issued by the grant management and program offices on an ongoing basis throughout the life of the award. It includes: (a) ensuring financial status reports, progress reports, and any quality assurance materials are received and accepted; (b) reviewing financial status by comparing available funds to project progress and the time remaining on the project; and (c) monitoring payments to identify concerns with cash draws.

Advanced monitoring is required for a minimum of 10 percent of the active grants. Advanced monitoring includes desk reviews and on-site evaluations, which involve reviewing the recipient's accounting system, personnel, payroll, travel, matching or cost sharing, indirect costs, procurement, property management, and internal controls.

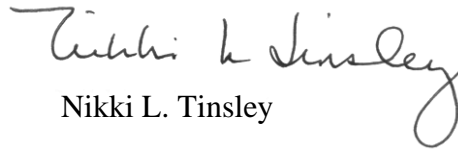
8. What, if any, personnel actions did EPA take concerning EPA employees who had failed to carry out Agency procedures involved with the identified grants?

According to EPA officials, they did not take any adverse personnel actions related to assistance agreement responsibilities against any EPA employees associated with the assistance agreements included in Enclosure A.

³In a recent report (Report No. 2003-P-00007, *EPA Must Emphasize Importance of Pre-Award Reviews for Assistance Agreements*, dated March 31, 2003), we concluded that EPA was not always following required pre-award procedures.

If you or your staff have additional questions, please contact me at (202) 566-0847, or Eileen McMahon, Assistant Inspector General for Congressional and Public Liaison, at (202) 566-2546.

Sincerely,

A handwritten signature in black ink, reading "Nikki L. Tinsley". The signature is written in a cursive, flowing style. The first name "Nikki" is written with a large, stylized "N" and "i". The last name "Tinsley" is written with a large, stylized "T" and "i". The signature is positioned above the printed name "Nikki L. Tinsley".

Nikki L. Tinsley

Enclosures

Selected Assistance Agreement Reports

Descriptive Title	Report No.	Questioned Costs	Action Official
1. 3 Rivers Wet Weather, Inc.	2002-3-00016	\$150,201	Region 3
2. Alaska Energy Authority	2002-3-00075	\$171,600	Region 10
3. Center for Chesapeake Communities	2001-1-00101	\$120,093	Region 3
4. Chicago Public Schools	2001-1-00120	\$14,390,438	Headquarters
5. Confederated Tribes of Chehalis Reservation - 1998	2001-3-00094	\$152,209	Region 10
6. Confederated Tribes of Chehalis Reservation - 1999	2001-3-00181	\$24,895	Region 10
7. Coordinating Committee for Automotive Repair	2003-S-00001	\$2,026,837	Headquarters
8. Crow Tribe	2002-1-00098	\$237,683	Region 8
9. Department of Public Works, Virgin Islands	2001-1-00128	\$1,268,874	Region 2
10. Iliamna Village Council - 1999	2002-3-00009	\$71,055	Region 10
11. Iliamna Village Council - 2000	2002-3-00042	\$111,813	Region 10
12. Lake Wallenpaupack	2002-M-00007	\$978,000	Region 3
13. Lower Brule Sioux Tribe	2002-1-00099	\$632,615	Region 8
14. MBI International	2002-2-00008	\$1,301,365	Headquarters
15. Michigan Department of Environmental Quality - 1997	2001-3-00076	\$353,308	Region 5
16. Michigan Department of Environmental Quality - 1999	2001-3-00209	\$431,090	Region 5
17. Missouri Clean Water State Revolving Fund	2001-1-00143	\$36,305	Region 7
18. Napoleon City Schools	2001-1-00073	\$4,017,412	Headquarters
19. National Asian Pacific Center on Aging - Defalcation	2001-S-00006	**\$1,000,653	Headquarters
20. National Asian Pacific Center on Aging - Cash Management	2001-S-00012	\$160,360	Headquarters
21. National Association of Minority Contractors	2001-1-00203	\$636,069	Headquarters
22. North Ohio Valley Air Authority	2001-3-00138	\$57,653	Region 5
23. Northern Cheyenne Tribe	2002-1-00089	\$25,789	Region 8
24. Red Lake Chippewa	2002-1-00119	\$264,640	Region 5
25. Rosebud Sioux Tribe	2002-1-00096	\$387,621	Region 8
26. Sault Ste. Marie Chippewa	2002-1-00056	\$34,043	Region 5
27. SF Cooperative Agreement - Washington, D.C.	2002-1-00184	\$603,895	Region 3
Total Questioned Costs		\$29,646,516	

** The report disclosed an embezzlement of \$1,802,546 of Federal grant funds from Department of Labor and EPA programs. The embezzled funds could not be readily reconstructed to identify the specific amount of embezzled funds pertaining to each agency. However, based on information received from an independent accountant, EPA's share was estimated to be \$937,072.40 with applicable indirect costs of \$63,580.35 for a total of \$1,000,653.

Summary of Results

Descriptive Title	Did Agency ensure correction of deficiencies?	Did Agency recover questioned costs?	Did Agency provide new funds since issuance of audit report?	Did Agency suspend or debar any recipient or their employee(s)?	Did Agency modify internal procedures?	Did Agency take any formal action against any EPA employee?
3 Rivers Wet Weather, Inc.	Yes	Yes	No	No	No	No
Alaska Energy Authority	Yes	Yes	No	No	Yes	No
Center for Chesapeake Communities	In Appeal	In Appeal	No	No	No	No
Chicago Public Schools	No	Yes	No	No	No	No
Confederated Tribes of Chehalis Reservation - '98	In Appeal	In Appeal	Yes	No	Yes	No
Confederated Tribes of Chehalis Reservation - '99	In Appeal	In Appeal		No	Yes	No
Coordinating Committee for Automotive Repair	No Decision	No Decision	Yes	No	No	No
Crow Tribe	In Appeal	In Appeal	Yes	No	Yes	No
Department of Public Works, Virgin Islands	No Decision	No Decision	No	No	No	No
Iliamna Village Council - '99	No Decision	No Decision	No	No	No	No
Iliamna Village Council - '00	No Decision	No Decision		No	No	No
Lake Wallenpaupack	In Appeal	In Appeal	No	No	No	No
Lower Brule Sioux Tribe	In Appeal	In Appeal	Yes	No	Yes	No
MBI International	Suspended	Suspended	No	No	No	No
Michigan Department of Environmental Quality - '97	Yes	Yes	Yes	No	No	No
Michigan Department of Environmental Quality - '99	Yes	Yes		No	No	No
Missouri Clean Water State Revolving Fund	Yes In Process	Yes	Yes	No	No	No
Napoleon City Schools	No Decision	No Decision	No	No	No	No
National Asian Pacific Center on Aging - Defalcation	Yes	Pending	Yes	Yes	No	No
National Asian Pacific Center on Aging - Cash Management	Yes	Pending			No	No
National Association of Minority Contractors	In Appeal	In Appeal	No	No	No	No
North Ohio Valley Air Authority	In Appeal	In Appeal	No	No	No	No

Descriptive Title	Did Agency ensure correction of deficiencies?	Did Agency recover questioned costs?	Did Agency provide new funds since issuance of audit report?	Did Agency suspend or debar any recipient or their employee(s)?	Did Agency modify internal procedures?	Did Agency take any formal action against any EPA employee?
Northern Cheyenne Tribe	Yes	No	Yes	No	Yes	No
Red Lake Chippewa	No Decision	No Decision	Yes	No	No	No
Rosebud Sioux Tribe	In Appeal	In Appeal	Yes	No	Yes	No
Sault Ste. Marie Chippewa	Yes	Yes	Yes	No	No	No
SF Cooperative Agreement - Washington, D.C.	No Decision	No Decision	No	No	No	No

Analysis of Audit Reports

***Single Audit Report on 3 Rivers Wet Weather, Inc. Pittsburgh Pennsylvania;
Report No. 2002-3-00016, issued October 23, 2001;
Audit Period: July 1, 1999 to June 30, 2000***

This report disclosed two reportable conditions that affected EPA assistance agreements. The audit questioned funds drawn down under the wrong grants. EPA concurred with the finding. The recipient repaid \$110,092 in overdrawn funds, which was confirmed in the next year's single audit report.

***Single Audit Report for Alaska Energy Authority Anchorage, Alaska;
Report No. 2002-3-00075, issued March 27, 2002;
Audit period: July 1, 1999 to June 30, 2000***

This report contained two findings related to EPA funds: (1) \$171,600 of questioned payroll and related administrative costs, and (2) lack of procedures to ensure performance of single audits. The recipient provided evidence and EPA allowed some additional questioned costs. On November 4, 2002, EPA issued its final decision and required the recipient to repay \$131,724. The amount has been repaid.

Region 10 is preparing enforcement action guidance to provide a more pro-active approach for non-compliance issues. The Region is also incorporating "lessons learned" from audit reports into yearly grants management training.

***Final Financial Audit Report of Assistance Agreements Awarded to the
Center for Chesapeake Communities;
Report No. 2001-1-00101, issued February 13, 2001***

The audit questioned \$120,093 of the \$920,338 incurred for three assistance agreements. Some of the costs were unsupported, such as personnel and related fringe benefit costs, because the recipient did not maintain payrolls supported by time sheets. Other costs were ineligible, such as equipment, computer software costs, and other/in-kind expenditures.

On August 22, 2001, EPA issued the final decision requiring the recipient repay EPA \$120,093. The recipient appealed the final decision to the Regional Administrator on September 28, 2001. The recipient believed that the final decision was incorrect because it did not consider previously submitted documentation and failed to take into consideration prior comments. On November 19, 2002, the Regional Administrator reversed, in part, the original decision, and

reduced the repayment to \$67,732. The recipient subsequently appealed the Regional Administrator's decision to Headquarters. No decision has been made on the latest appeal.

***Audit of Assistance Agreement J858353-010 Awarded April 16, 1993
for Asbestos Abatement Chicago Public Schools, Chicago, IL;
Report No. 2001-1-00120, issued March 26, 2001***

The audit report questioned \$14,390,438 of \$14,618,298 claimed because Chicago Public Schools either did not spend the money as authorized or did not maintain sufficient documentation to determine authorized use of the money. Specifically, the report questioned:

- < \$1,781,687 for unauthorized activities outside the statutory limits of the Asbestos School Hazard Abatement Re-authorization Act of 1990, the approved scope of work, or the approved project period.
- < \$1,363,912 because the recipient received funds in excess of the final claimed costs.
- < \$11,244,839 because the lump-sum contracts included both authorized abatement work and unauthorized work.

The recipient returned the \$1,363,912 in excess funds to EPA. The award to Chicago Public Schools was a loan rather than a grant. According to the Department of Justice, EPA could not recover the other questioned costs because the loan instrument did not allow for recovery unless the recipient defaults on repayment. No other recovery provisions were incorporated into the loan agreement. Per EPA's Financial Management Division, Chicago Public Schools was current on its loan repayment schedule.

On March 20, 2003, EPA notified the recipient that EPA was closing the audit without requiring further action other than to require the school district to continue making loan payments in accordance with the repayment schedule.

***Single Audit Report on the Confederated Tribes of Chehalis Reservation,
Oakville, Washington;
Report No. 2001-3-00094, issued February 20, 2001;
Audit Period: January 1, 1998 to December 30, 1998***

This report contained 10 findings that pertain to all Federal programs. The following findings directly affected EPA assistance agreements:

- < The audit questioned \$152,209 of EPA funds the recipient received in excess of assistance agreement expenditures. Significant amounts of Federal funds were spent for non-Federal purposes.
- < Fixed asset records did not support amounts reported on the financial statements.
- < Reports prepared from the financial information system were likely to be inaccurate and misleading.
- < Costs were allocated to programs based on budgeted amounts.

- < The recipient needs to monitor grants and contracts, and file required financial reports timely.

EPA issued its final decision on October 12, 2001. Based on EPA's independent analysis of supporting documentation, EPA required the recipient to repay \$294,835, which was more than the disallowed cost identified in the single audit. EPA designated the recipient as "high risk." Under the designation, EPA will monitor results of single audits, closely track submission of financial reports, include additional conditions in all assistance agreements, and place the recipient on a reimbursable payment method. If the recipient fails to implement corrective actions, EPA will terminate the assistance agreements and take enforcement actions.

Upon appeal, the Regional Administrator required repayment of \$281,375. On January 14, 2003, the recipient appealed the Regional Administrator's decision to Headquarters.

Currently, EPA Region 10 has taken enforcement action against the recipient by not awarding any additional grants. EPA did not award a General Assistance Program grant for 2003, and is taking individual enforcement actions to close expired grants. The Region is unable to close other grants because the recipient has not provided required reports and documentation. The recipient requested EPA remove the "high risk" designation. EPA has refused because the recipient has never complied with the original decision.

Region 10 is preparing enforcement action guidance to provide a more pro-active approach for non-compliance issues. The Region is also incorporating "lessons learned" from audit reports into yearly grants management training.

***Single Audit Report on the Confederated Tribes of Chehalis Reservation,
Oakville, Washington;***

Report No. 2001-3-00181, issued July 11, 2001;

Audit Period: January 1, 1999 to December 31, 1999

This report contained 10 findings that pertained to all Federal programs. The following findings directly affected EPA assistance agreements:

- < Fixed asset records did not support the amounts reported on the financial statements (repeat finding).
- < The general fund spent significant Federal funds for general fund purposes. Specific Federal funds expended or the dollar amount for unallowable costs could not be identified (repeat finding).
- < Reports prepared from the financial information system during the year were likely inaccurate and may be misleading (repeat finding).
- < Tests of internal controls identified many instances where original source documentation did not support expenditures.
- < The auditors questioned \$24,895 of EPA funds based on limited transaction testing.

EPA issued its final decision on July 2, 2002. Based on EPA's independent analysis of the supporting documentation, EPA required the recipient to repay \$225,325, which was more than the disallowed cost identified in the single audit. The recipient remains designated as "high risk." The Regional Administrator upheld the decision upon appeal. The recipient has appealed the Regional Administrator's decision to Headquarters.

Currently, Region 10 has taken enforcement action against the recipient by not awarding any additional grants. The Region did not award a General Assistance Program grant for 2003, and is taking individual enforcement actions to close expired grants. The Region is unable to close other grants because the recipient has not provided required reports and documentation. The recipient requested EPA remove the "high risk" designation. EPA has refused because the recipient has never complied with the original decision.

Region 10 is preparing enforcement action guidance to provide a more pro-active approach for non-compliance issues. The Region is also incorporating "lessons learned" from audit reports into yearly grants management training.

EPA Cooperative Agreements Awarded to the Coordinating Committee for Automotive Repair;
Report No. 2003-S-00001, issued May 29, 2002

The audit questioned all costs claimed under the three cooperative agreements because the recipient did not account for funds in accordance with Federal rules, regulations, and terms of the cooperative agreements. The \$2,026,837 of questioned costs consisted of unsupported and ineligible payroll costs and unsupported travel, equipment, printing/postage, rent, telephone, outreach, recipient administration, web/computer, and supply costs.

The audit recommended that EPA:

- < Require the recipient to modify its financial management system to meet the requirements of 40 Code of Federal Regulations (CFR) §30.21.
- < Require the recipient to develop a time distribution system meeting the requirements of OMB Circular A-122.
- < Not provide any new funds until EPA confirms the recipient has financial management capabilities to manage funds in accordance with regulations.
- < Require the recipient to reconstruct accounting records necessary to support the expenditure of funds in accordance with OMB Circular A-122.
- < Require the recipient to submit indirect cost proposals for the fiscal periods 1995 to present, in accordance with OMB Circular A-122.
- < Recover all ineligible costs that do not meet the requirements of OMB Circular A-122.
- < Recover all funds that cannot be supported by the recipient in accordance with OMB Circular A-122.

The audit report is still in the resolution process and EPA has not issued a final decision. On October 24, 2002, the Grants Administration Division issued a memo to the OIG concurring with all recommendations except the recommendation not to provide new funds until the recipient can manage the Federal funds in accordance with regulations. EPA had provided additional funds of \$93,945 to the recipient on July 23, 2002. Subsequently, on July 30, 2002, EPA imposed special conditions and restrictions, including (1) placing the recipient on a reimbursement payment method, and (2) requiring the recipient's employees take a grant management course. On December 13, 2002, EPA suspended work and temporarily withheld funds until the recipient resolved the findings outlined in the OIG report (45-day stop-work order/suspension). The recipient has appealed the stop-work order.

EPA Grants Awarded to the Crow Tribe;
Report No. 2002-1-00098, issued March 27, 2002

The audit questioned \$237,683, or 72 percent of the costs claimed under three grants. All payroll, payroll-related, and indirect costs were questioned because the recipient's payroll system did not meet OMB Circular A-87 requirements. The auditors also reported two material weaknesses in the recipient's internal controls that raised serious concerns about the Tribes' ability to adequately manage environmental grants. Tribal leadership, management, and staff did not emphasize the importance of good internal controls and did not adequately communicate program or financial information.

The audit recommended that EPA:

- < Recover \$237,683 of questioned costs.
- < Designate the recipient as high risk until it can assure that its financial management system meets all regulatory requirements, and project tasks can be completed.
- < Suspend all current and new grants if, after 6 months, the recipient has not met requirements.
- < Discuss the importance of strong internal controls, including meaningful, timely program performance reporting with the recipient.
- < Work with the recipient to help it develop and implement policies and procedures to protect EPA grant funds and strengthen environmental program performance.

On September 25, 2002, EPA issued a final decision sustaining the OIG findings and designating the Tribe as a "high risk" recipient. The decision required the Tribe to repay \$237,683. On October 23, 2002, the Tribe requested that the Regional Administrator review the final decision, which is still pending. EPA has required weekly progress reports from the Tribe and makes monthly on-site visits.

EPA Region 8 awarded additional funds to the Tribe. Awards were made with special conditions related to the "high risk" designation. Under the designation, grant reimbursements are not made until supporting financial and programmatic documentation is submitted and reviewed.

As a result of several tribal audits, Region 8 has become more proactive with the tribes and works with the Tribal Office. Grants are given additional scrutiny and Region 8 is responding earlier to non-compliance with grant requirements. For example, Region 8 determined insufficient progress was being made under an air grant and is terminating the grant. The Tribe repaid funds that were misspent.

***Environmental Protection Agency Grants Virgin Islands, Department of Public Works;
Report No. 2001-1-00128, issued April 11, 2001***

The Department of Public Works did not effectively manage the grants awarded by EPA. For example, Public Works did not:

- < Use grant funds effectively.
- < Maintain required documentation.
- < Validate cash draws for grants administered by the U.S. Army Corps of Engineers.
- < File financial reports in a timely manner.
- < Establish procedures to use electronic funds transfers.
- < Maintain property control records.
- < Provide sufficient oversight of costs incurred by the Corps.

The report questioned \$1,268,874 for projects administered by the Corps. The report also concluded that the Corps may have incurred excess costs of \$715,914 under two of the grant projects. Public Works requested additional funds of \$130,000 to correct deficiencies in Corps-administered work. The report included 12 recommendations to the Governor of the Virgin Islands to improve grant administration.

EPA has not issued a final decision. EPA sent a letter to the recipient requesting the status of corrective actions. To date, 4 of the 12 findings have been closed. EPA expects to close an additional four findings by September 30, 2003, and is currently researching the remaining four findings.

***Single Audit Reports on the Iliamna Village Council (Village) Iliamna, Alaska;
issued September 30, 2002***

Report No. 2002-3-00009 - Audit Period: October 1, 1998 to September 30, 1999

Report No. 2002-3-00042 - Audit Period: October 1, 1999 to September 30, 2000

The reports questioned \$182,868 (\$71,055 in fiscal year 1999 and \$111,813 in fiscal year 2000) charged to EPA assistance awards due to a lack of supporting documentation (repeat finding). Additional findings included:

- < Deficient cash management and budgetary controls (repeat finding).
- < Duplicate payments for travel.
- < Late submission of required Federal financial reports and quarterly reports (repeat finding).

- < Inconsistent preparation of time sheets and personnel activity reports.

The OIG recommended that EPA: (1) obtain supporting documentation or recover the questioned costs, and (2) determine the adequacy of the recipient's response to the independent audit reports.

EPA has not issued its final decision. EPA is currently reviewing the recipient's accounting records and working to match documents provided to expenditures identified in accounting records.

***Assistance Agreement X993795-01 Awarded by EPA to the
Lake Wallenpaupack Watershed Management District;
Report No. 2002-M-00007, issued January 18, 2002***

The report concluded that the Lake Wallenpaupack Watershed Management District did not follow Federal procurement procedures regarding conflicts of interest and competition when awarding \$907,000 for two engineering contracts. The issues included:

- < There was a conflict of interest associated with the award of the engineering contracts, as the chosen contractor played a significant role in the District's affairs leading up to the contract awards. For example, the successful contractor proposed the projects to the Board of Directors, solicited grant funds on behalf of the District, recommended the procurement method to be used, wrote the request for qualifications, and drafted both contracts. The above activities represent a conflict of interest according to 40 CFR §31.36 (b)(3).
- < The District awarded engineering contracts without engaging in adequate competition, in violation of the regulations.
- < There was no documentation to indicate that the District performed cost analysis as required by Federal regulations.

In addition, the contracts included \$140,000 for non-engineering services, including preparing mailing lists, developing brochures, and hosting golf and other activities. The District paid the contractor \$71,000 for services outside the scope of the contract.

EPA determined that the contracts were reasonably priced. On May 6, 2002, EPA issued its final decision and required the recipient to repay the \$71,000 for engineering services that were outside the scope of the contract. EPA also recommended that the District follow procurement regulations for future acquisitions and place the District's procurement procedures in a stand-alone document. EPA did not specifically address the conflict of interest issue in the final decision letter. EPA explained that it used the price reasonableness determination as its method to address all of the shortcomings with the contracting process.

The recipient appealed the decision to repay the \$71,000 on September 30, 2002. The appeal is on hold pending a decision on the grantee's ability to pay the \$71,000.

***EPA Grants Awarded to the Lower Brule Sioux Tribe;
Report No. 2002-1-00099, issued March 29, 2002***

The audit questioned \$632,615, or 97 percent of the costs claimed under three grants. All costs for two grants were questioned because the recipient could not provide a reasonably complete and accurate list of expenses. The Tribe's financial management system was inadequate and internal controls did not support good grant management. Specifically, the Tribe: (1) could not adequately identify the source and application of funds for two of the three grants audited, (2) could not provide supporting documentation for some costs claimed, (3) did not compare actual expenditures to budgeted amounts in its progress reports, (4) did not comply with applicable OMB cost principles, and (5) did not provide accurate, current, and complete disclosure of financial results. Additionally, internal control weaknesses raised serious concerns about the Tribes's ability to adequately manage environmental grants. Tribal leadership, management, and staff did not emphasize the importance of good internal controls and did not adequately communicate program or financial information.

The audit recommended that EPA:

- < Recover \$632,615 of questioned costs
- < Maintain the recipient's "high risk" designation until it can assure that its financial management system meets regulatory requirements, and the payroll system meets OMB Circular A-87 requirements.
- < Suspend all current and new grants if, after 6 months, the recipient has not met the above requirements.
- < Discuss the importance of strong internal controls with the recipient.

On September 25, 2002, EPA issued the final decision and required the Tribe to repay \$632,615. On October 25, 2002, the Tribe requested that the Regional Administrator review the original decision, which is still pending.

EPA Region 8 has awarded additional funds to the Tribe since the audit report, but not after making the decision. Prior to the OIG report, EPA had already designated the Tribe as a "high risk" recipient. Under the designation, EPA stated that it reviewed financial and program information for each payment request. From the reviews, the Region believes the Tribe has demonstrated sufficient progress, and may soon start reviewing payments on a "spot check" basis.

***Procurement Practices Under Grant No. X825532-01 Awarded to MBI International;
Report No. 2002-2-00008, issued January 29, 2002***

The audit found that MBI, a non-profit organization, did not have adequate justification to support awards of sole source contracts to related for-profit companies. Justifications submitted were not dated and did not justify any sole source procurement. Also, MBI's procurement practices did not meet Federal requirements. For example, six contracts were signed after work

began. Further, there were conflicts of interest between MBI and related companies. Board members were involved in awarding sole source contracts to each other's companies. As a result, \$1,301,365 of the \$1,320,940 incurred was not eligible for Federal reimbursement. The OIG recommended that EPA disallow the ineligible costs incurred. At this time, audit resolution has been suspended at OIG's request.

***Single Audit Report for the State of Michigan Department of Environmental Quality;
Report No. 2001-3-00076, issued January 22, 2001;
Audit Period: October 1, 1995 to September 30, 1997***

This report contained 15 findings related to EPA funds involving a variety of assistance agreements. Findings included:

- < Various internal control weaknesses.
- < Improper allocation of payroll costs to Federal grants.
- < Ineligible costs of \$76,980 for terminal leave payments.
- < Ineligible costs of \$163,000 because the recipient erroneously applied a higher indirect cost rate to its Federal programs.
- < Ineligible costs of \$58,943 because the recipient incorrectly charged the Clean Water State Revolving Fund for activities to establish the Drinking Water State Revolving Fund.
- < Ineligible costs of \$54,385 because supporting documentation did not agree with the amounts claimed.
- < Financial status reports to EPA were not timely.

The OIG report recommended that EPA review the adequacy of documentation, the recipient's response, and the corrective action plan. The recipient provided documentation of corrective action and proposed to offset the questioned costs of \$353,308. EPA determined the grantee's response was adequate and informed the recipient that no further action was necessary.

***Single Audit Report for the State of Michigan Department of Environmental Quality,
Lansing, Michigan;
Report No. 2001-3-00209, issued August 22, 2001;
Audit Period: October 1, 1997 to September 30, 1999***

This report contained four findings pertaining to EPA funds, including:

- < All State Revolving Fund loan recipients did not provide required single audit reports. Some loan recipients did not identify State Revolving Fund loans as Federal funds in their single audits. (Similar finding in prior year report.)
- < The State agency had not established a system to properly allocate \$538,863 (\$431,090 Federal share) in payroll expenditures to all Federal grant programs. (Similar finding in prior report.)

EPA issued its final decision on March 21, 2002, which determined the recipient provided an acceptable response to the first finding above, but did not provide sufficient documentation to support the allocation of administrative costs to Federal programs. The decision required the recipient to repay \$431,090, the Federal share of the amount disallowed.

On April 3, 2002, the recipient appealed the final decision to the Regional Administrator. After review of additional documentation, the Region reduced the disallowed Federal share to \$181,774. The disallowed costs have been repaid.

***Auditor's Report for the State of Missouri Department of Natural Resources
Clean Water State Revolving Fund for the Year Ended June 30, 2000;
Report No. 2001-1-00143, issued May 29, 2001***

The report identified material weaknesses within the internal control system and operations, and concluded that Missouri did not maintain an adequate accounting system for State Revolving Fund activities in accordance with the Clean Water Act. Specifically:

- < The control environment established by management needed to be corrected to provide the accountability and safeguards inherent in proper accounting systems.
- < The accounting system only accounted for the cash balance of the State Revolving Fund, and did not account for loans receivable, construction loan funds, revenue bonds, bond reserves, EPA capitalization grants, or many other accounts.
- < The subsidiary systems Missouri used were not reconciled to the trustee records, and were not self-balancing groups of accounts.
- < The State Revolving Fund financial statements did not include all program expenses.
- < The State of Missouri, since 1999, transferred \$722,328 of State Revolving Funds and \$36,305 of administrative funds to the State's general fund in violation of the Clean Water Act because of Article X of the Missouri State Constitution.

EPA issued the final decision on September 24, 2001, requiring Missouri to prepare a Corrective Action Plan to address each recommendation in the audit report. Missouri repaid the \$36,605 transferred to the general fund on May 29, 2001.⁴ According to Region 7, all recommendations have been satisfactorily addressed, except for developing a formal accounting system. Missouri has issued a contract to develop that system with a target completion date of August 2003. EPA notified Missouri that unless the Accounting System is complete and functioning as intended in accordance with the Corrective Action Plan, EPA in all likelihood would not award the next capitalization grants for both the Clean Water and the Drinking Water Revolving Funds.

⁴The State repaid the \$722,328 to the fund before the final report was issued.

***Audit of Costs Claimed by Napoleon City Schools, OH
Under EPA Assistance Agreement No. J858565-010;
Report No. 2001-1-00073, issued January 11, 2001***

The agreement covered three projects. Two projects were funded with a combination of a loan and a grant for \$1,905,519 and \$1,905,515, respectively. The third project was funded by a loan for \$467,622. The OIG questioned \$4,017,412 of the \$4,278,656 claimed because the recipient did not spend funds in accordance with the Asbestos School Hazard Abatement Re-authorization Act of 1990, regulations, and the terms of the agreement. Specifically, the recipient claimed:

- < Costs for damages and delays caused by a contractor's deficient work and default.
- < Costs for renovations and other items not necessary to complete the authorized abatement project.
- < Costs for unauthorized asbestos abatement.
- < Costs for lump-sum contracts that included both authorized asbestos abatement and general renovation work.
- < Costs for contracts and other agreements that were not procured in accordance with Federal regulations and terms of the assistance agreement.
- < Duplicate, unallowable, and unsupported costs.

EPA has not issued a final decision for this report. EPA's Office of Grants and Debarment has worked closely with the school district, the Office of General Counsel, and the OIG on this complex audit resolution. The resolution is complicated by the combination loan/grant funding. The method for resolving the questioned costs related to the loan has been determined by the precedent set by the resolution of the Chicago Public Schools audit (see prior discussion).

***Advisory Report on Assistance Agreement Defalcation, National Asian Pacific Center on Aging, Seattle, Washington;
Report No. 2001-S-00006, issued March 29, 2001***

The report disclosed the embezzlement of \$1,802,546 of Federal grant funds from Department of Labor and EPA programs.⁵ The embezzled funds could not be readily reconstructed to identify the specific amount of embezzled funds that pertained to each grantor agency or agreement. Therefore, the report requested EPA officials to coordinate with Department of Labor representatives and jointly demand repayment by the recipient of the embezzled funds.

EPA issued a final decision for this report. On September 25, 2001, EPA entered into a memorandum of understanding with the Department of Labor to coordinate on the embezzlement recovery. The Department of Labor has the lead on resolution of this report. On October 15, 2001, EPA issued a preliminary decision disallowing the total amount of the embezzlement. The

⁵As noted in attachment A, an independent accountant estimated EPA's share was \$937,072.40 with applicable indirect costs of \$63,580.35 for a total of \$1,000,653. However, EPA and Department of Labor both requested the recipient repay \$1,802,546 of disallowed costs and did not assign a specific share to each Agency. EPA instructed the recipient to remit the disallowed costs to the United States Treasury.

Department of Labor issued a similar decision on October 16, 2001. In November 2001, the recipient disputed both decisions. The Department of Labor and EPA held a dispute resolution meeting with the recipient in December 2002. On June 25, and July 8, 2003, EPA and the Department of Labor each issued final decisions disallowing all \$1.8 million of embezzled funds and the related indirect costs. Prior to this decision, EPA and the Department of Labor had discussions with the recipient about recovery of the funds. The recipient raised financial hardship regarding the repayment. We have been informed that the Department of Labor and EPA, in consultation with the Department of Justice, have determined the recipient is able to repay only \$300,000 of the disallowed costs and will request the recipient remit that amount. However, no formal decision has been made regarding the collection.

EPA has awarded additional funds to the recipient since the audit report. Also, EPA debarred the recipient's former employee convicted of the embezzlement.

Advisory Report on Continued Cash Management Issues - National Asian Pacific Center on Aging, Seattle, Washington;
Report No. 2001-S-00012, issued September 26, 2001

The audit questioned \$160,360 because the recipient drew down more cash than expended. The audit also found that the recipient was in non-compliance with the Single Audit Act, had not submitted all financial reports timely, and did not provide adequate documentation for reconciliation of the Senior Environmental Employment program timesheets.

The EPA Office of Grants and Debarment has worked closely with the OIG and the Office of General Counsel on resolution of this audit. EPA performed a site review in November 2002 and notified the recipient of the current issues still needing to be addressed. The recipient responded in April 2003. On July 9, 2003, EPA sent a memorandum to the OIG detailing its final decisions on the questioned costs and the recipient's corrective actions. EPA concluded that all system weaknesses and non-compliances have been adequately addressed. EPA plans to conduct a followup review of the recipient's system changes next fiscal year.

Regarding the questioned costs, EPA analyzed a subsequent period and also found that the cash draws exceeded the supported expenditures. The recipient asserted that the unsupported difference was, in fact, part of the embezzlement which was discussed in the preceding report summary. EPA has accepted the recipient's assertion and considers the questioned costs to be included in the amount disallowed for the embezzlement.

EPA has awarded additional funds to the recipient since the audit report.

Grant No. X-824519-01 Awarded to the National Association of Minority Contractors;
Report No. 2001-1-00203, issued September 27, 2001

The audit questioned \$636,069 of either ineligible or unsupported costs. Ineligible costs included:

- < Personnel costs that were not reasonable or allocable in accordance with regulations.
- < Contractual costs where studies were not completed, conferences were not conducted, and consultant costs were ineligible.
- < Telephone costs that were not reasonable and allocable in accordance with regulations.
- < Travel costs where there was no indication how the travel benefitted the grant.
- < Other costs where procurement practices were inappropriate and advertisement did not benefit the grant.

On March 13, 2002, EPA issued the final decision and required the recipient to repay \$515,926. Most of the questioned costs EPA reinstated were personnel costs of \$116,305. EPA concluded that the documentation supporting these costs was sufficient. The recipient did not agree with the final decision and filed an appeal with the EPA Administrator on April 12, 2002.

North Ohio Valley Air Authority (NOVAA), Ohio;
Report No. 2001-3-00138, issued May 16, 2001;
Audit Period: October 1, 1995 to September 30, 1996

This single audit report noted the North Ohio Valley Air Authority received Federal funds (a sub-agreement) under a cooperative agreement awarded to the Ohio Environmental Protection Agency. The audit report on the sub-agreement questioned Federal costs of \$57,653 because of a lack of supporting documentation. The report also concluded that the financial reports were inaccurate and unreliable and requests for budget transfers and/or program revisions were made later than 30 days after the beginning of the quarter.

The recipient ceased operations on September 30, 1999. On July 19, 2001, EPA issued its final decision to the Ohio EPA. The decision requested repayment of \$57,653. The Ohio EPA requested that the Regional Administrator review the decision. The Regional Administrator has not issued a decision on the appeal.

EPA Grants Awarded to the Northern Cheyenne Tribe;
Report No. 2002-1-00089, issued March 5, 2002

The audit questioned \$25,789 for a contract because the Tribe did not follow competitive contracting requirements when awarding the contract. Region 8 had directed the recipient to award this contract to a specific organization without competition.

On September 25, 2002, EPA issued the final decision. EPA did not require the recipient to repay \$25,789 in questioned contract costs because the Region directed the Tribe to award the sole source contract without justification. The decision instructed the Tribe to follow applicable EPA procurement regulations or, in certain instances, follow its own procurement regulations, for future procurement.

EPA Region 8 has awarded additional funds to the Tribe since the audit report.

As a result of several Region 8 tribal audits, Region 8 officials have become more proactive with the tribes and work with the tribal Office. Grants are given additional scrutiny, and Region 8 is responding earlier to non-compliance with grant requirements.

Costs Claimed by the Red Lake Band of Chippewa Indians Under EPA Assistance Agreement Nos. GA995767-03, CD985239-01, and I985959-01; Report No. 2002-1-00119, issued May 24, 2002

The audit questioned costs of \$264,640 because the recipient did not account for funds in accordance with Federal rules, regulations, and the terms of the agreements. The report included the following findings:

- < The recipient did not have a time distribution system that met the requirements of OMB Circular A-87.
- < The recipient did not properly account for fringe benefit costs.
- < The recipient did not maintain records to support its cost sharing for two of the grants.
- < The recipient did not properly allocate indirect costs to all benefitting activities.
- < The recipient did not submit financial reports timely, as required by the grant and Federal regulations.
- < The recipient's performance reports for two of the three grants did not meet minimum Federal requirements because the reports were incomplete.

EPA had not yet issued the final decision at the time of our review. Region 5 submitted its proposed final decision for OIG review on September 25, 2002, and OIG did not agree with some proposed actions. Region 5 submitted a revised proposed final determination on March 28, 2003, which was incomplete.

EPA Region 5 has awarded additional funds to the Tribe since the audit report.

EPA Grants Awarded to the Rosebud Sioux Tribe; Report No. 2002-1-00096, issued March 19, 2002

The audit questioned \$387,621, or 86 percent of the costs claimed under four grants. The questioned costs consisted primarily of unsupported payroll costs and related indirect costs. Auditors also observed two material weaknesses in the recipient's internal controls that raised serious concerns about the recipient's ability to adequately manage environmental grants. Tribal leadership, management, and staff did not emphasize the importance of good internal controls and did not adequately communicate program or financial information.

The audit report recommended that EPA:

- < Recover \$387,621 of questioned costs.

- < Designate the recipient as “high risk” until it can assure that its financial management system meets all regulatory requirements.
- < Suspend all current and new grants if, after 6 months, the recipient has not made substantial progress toward meeting the requirements above.
- < Discuss the importance of strong internal controls, including meaningful, timely program performance reporting with recipient.

On September 25, 2002, EPA issued a final decision sustaining the OIG findings and designating the Tribe as a “high risk” recipient. The decision required the Tribe to repay \$387,621.

On October 1, 2002, the Tribe requested that the Regional Administrator review the original decision, which is still pending.

EPA Region 8 has awarded additional funds to the Tribe since the audit report, but not after making the final decision. New awards will be made with special conditions related to the “high risk” designation. Under the designation, grant reimbursements are not made until supporting financial and programmatic documentation is submitted and reviewed.

As a result of several Tribal audits, Region 8 has become more proactive with the Tribes and works with the Tribal Office. Grants are given additional scrutiny, and Region 8 is responding earlier to non-compliance with grant requirements.

Audit of Final Costs Claimed by Sault St. Marie Tribe of Chippewa Indians Under Assistance Agreement Nos. CP985954-01, I985367-01, and GA995191-04; Report No. 2002-1-00056, issued December 18, 2001

The audit questioned \$34,034 and identified four internal control weaknesses:

- < The recipient’s time distribution system did not meet Federal requirements.
- < The recipient’s accounting practices needed improvement to ensure the proper segregation and accounting of costs as required by Federal regulations.
- < The recipient did not timely submit financial reports as required by the grant and Federal regulations.
- < The recipient did not have an adequate process to request payment of grant funds in accordance with the grant agreement and Federal regulations.

On April 8, 2003, the Regional Administrator ruled on an appeal and sustained \$3,570 of questioned direct labor and related costs. Some of the questioned costs were allowed because the recipient provided additional supporting documentation. EPA had already determined that the recipient had corrected the internal control weaknesses. After applying an offset of \$2,915, the recipient was required to repay \$655 plus interest.

EPA Region 5 has awarded additional funds to the recipient. Officials did not believe any additional special grant conditions were necessary in the new award. The recipient’s response to

Region 5's preliminary determination included documentation or assurance the recipient took the corrective action recommended in the audit report.

***Costs Claimed by the Washington, D.C., Department of Health
Under EPA Superfund Cooperative Agreement No. VC983169;
Report No. 2002-1-00184, issued September 26, 2002***

The audit examined costs claimed under the assistance agreement and found the recipient did not:

- < Maintain a financial management system adequate to account for source and application of Federally-sponsored activity funds as required by 40 CFR §31.20.
- < Maintain a time distribution system to meet requirements as required by OMB Circular A-87.
- < Meet matching or cost sharing requirements specified in the Agreement.
- < Submit timely indirect cost proposals to its cognizant Federal agency.
- < Meet financial reporting requirements in 40 CFR §31.41; financial reports either were not submitted or were not timely or accurate.
- < Request and allocate Federal funds appropriately.
- < Submit complete and timely quarterly performance reports.
- < Obtain timely single audits, as required by 40 CFR §31.26 and OMB A-133.
- < Provide supporting documentation for selected transactions.
- < Record equipment consistently in its official property management records.

The OIG recommended that EPA: (1) suspend all activity under the assistance agreement, and designate the recipient as “high risk” until its financial management system meets Federal requirements; (2) recover all costs that cannot be supported in accordance with Federal rules and regulations; (3) require the recipient to prepare indirect cost proposals; (4) require the recipient to obtain timely single audits; (5) require the recipient to prepare accurate and timely financial and performance reports; and (6) terminate the agreement in accordance with 40 CFR §31.44 if the recipient does not complete all corrective actions within 180 days of the report.

As of April 1, 2003, EPA had not issued its final decision. Due to the complexity of the crosscutting issues, the resolution has taken longer than anticipated. EPA officials believe it will be some time before issuance of the decision, due to difficulties in getting an adequate corrective action plan from the recipient.

Scope and Methodology

The purpose of our work was to obtain, review, and summarize the information necessary to answer the questions contained in the Chairman's February 21, 2003, letter, as modified by discussion with the Committee and confirmed by our letter dated March 21, 2003. This work was not an audit in accordance with generally accepted government auditing standards. We did not complete this work with the intent of providing an independent assessment of the performance of a government organization or activity, as required by generally accepted government auditing standards. We performed our fieldwork from February 12, 2003, through July 9, 2003.

To complete our work, we obtained assistance agreement information from EPA's Grants Administration Division, Office of Human Resources and Organizational Services, and audit followup coordinators in some regional offices. We relied on data provided by EPA officials and data from the *Integrated Financial Management System* and the *Grants Information Control System*. We obtained information from EPA officials, but did not independently verify the accuracy of the data.

We used the Inspector General's Operations Reporting (IGOR) system and pertinent Semiannual Reports to the Congress to identify the universe of 369 assistance agreement reports issued in fiscal years 2001 and 2002. From the universe of 369 reports, we selected 27 reports that met our self-defined criteria of a material non-compliance. For purposes of the review, a material non-compliance is defined as a financial management deficiency that is contrary to Federal regulations and may result in a material misstatement of costs, inhibit accounting for project funds, or impede the ability to conduct an audit.

We also reviewed EPA Order 5700.6, *Policy on Compliance, Review and Monitoring*, issued December 31, 2002. Although this policy was not in effect at the time the selected reports were issued, we wanted to review the latest policy to determine whether the new procedures could prevent or identify the types of problems noted in our fiscal 2001 and 2002 reports.

