



OIG

OFFICE OF INSPECTOR GENERAL

Catalyst for Improving the Environment

Audit Report

Costs Claimed by Central States Air Resource Agencies Association Under EPA Assistance Agreement Nos. X996940-01 and X986516-01

Report No. 2003-1-00087

March 31, 2003

This audit report contains findings that describe problems the Office of Inspector General (OIG) has identified and corrective actions the OIG recommends. The report represents the opinion of the OIG and findings contained in this report do not necessarily represent the final EPA position. Final determinations on matters in this report will be made by EPA managers in

Report Contributors:

Keith Reichard
Margaret Bastin
Juliet Ober

Abbreviations

| | |
|---------|--|
| CenSARA | Central States Air Resource Agencies Association |
| CFR | Code of Federal Regulations |
| EPA | Environmental Protection Agency |
| FSR | Financial Status Reports |
| OIG | Office of Inspector General |
| OMB | Office of Management and Budget |



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

OFFICE OF
INSPECTOR GENERAL

March 31, 2003

MEMORANDUM

SUBJECT: Report No. 2003-1-00087
Costs Claimed by Central States Air Resource Agencies Association
Under EPA Assistance Agreement Nos. X996940-01 and X986516-01

FROM: Michael A. Rickey
Director, Assistance Agreement Audits

TO: Lynda F. Carroll
Assistant Regional Administrator
for Management, Region 6

We have examined the costs claimed by the Central States Air Resource Agencies Association (CenSARA), Oklahoma City, Oklahoma, under EPA Assistance Agreement Nos. X996940-01 and X986516-01. Agreement No. X996940-01 provided funding to establish the Regional Multi-State Organization, consisting of the states of Arkansas, Iowa, Kansas, Louisiana, Minnesota, Missouri, Nebraska, Oklahoma, and Texas, as well as several local governments. No. X986516-01 provided funding for the establishment of the infrastructure for a Regional Planning Body for CenSARA.

We questioned the total Federal share claimed of \$1,644,618 as unsupported, because CenSARA did not comply with the Federal rules, regulations, and terms of the assistance agreements.

This audit report contains findings that describe problems the Office of Inspector General (OIG) has identified and corrective actions the OIG recommends. The report represents the opinion of the OIG, and findings contained in this report do not necessarily represent the final Environmental Protection Agency (EPA) position. The OIG has no objection to the release of this report to any member of the public upon request.

On July 30, 2002, we issued a draft report to CenSARA and Region 6 for comments. On September 16, 2002, Region 6 provided comments on the draft report, and included CenSARA's comments (without CenSARA's attachments). CenSARA did not agree with the report's findings. Region 6 took action on the draft report and issued a "show cause" letter and reclassified CenSARA as a "high-risk grantee." CenSARA's response is included in the report as Appendix A. We held a telephone exit conference on February 13, 2003, and informed CenSARA of the final results of our audit.

Action Required

In accordance with EPA Manual 2750, the action official is required to provide this office with a proposed management decision specifying the Agency's position on all findings and recommendations in this report. The draft management decision is due within 120 days of the date of this transmittal memorandum.

If you have questions concerning this report, please contact Keith Reichard, assignment manager, at (312) 886-3045.

Table of Contents

| | |
|--|----|
| Independent Accountant’s Report | 1 |
| Results of Audit | 3 |
| Claimed Outlays Do Not Agree with the General Ledger | 3 |
| Inadequate Labor Distribution System | 5 |
| Unsupported Direct Costs | 7 |
| Improper Procurement Practices | 8 |
| Recommendations | 11 |
| Agency Comments | 13 |
| Background | 15 |

Appendices

| | | |
|----------|---------------------------------|----|
| A | CenSARA’s Response | 17 |
| B | Distribution | 23 |

Independent Accountant's Report

We have examined the Federal share of costs claimed by the Central States Air Resource Agencies Association (CenSARA) under the Environmental Protection Agency (EPA) financial assistance agreements shown in the following table:

| Assistance Agreement No. | Financial Status Report | | | Federal Share |
|--------------------------|-------------------------|---------------|----------------------------------|---------------|
| | Date Submitted | Period Ending | Cumulative Total Outlays Claimed | |
| X996940-01 | 10/29/01 | 9/30/01 | \$1,508,618 | \$1,508,618 |
| X986516-01 | 10/29/01 | 9/30/01 | \$136,000 | \$136,000 |
| Total | | | \$1,644,618 | \$1,644,618 |

CenSARA certified that the outlays reported on each *Financial Status Report* (Standard Form 269A) were correct and for the purposes set forth in the agreements. The preparation and certification of each claim was the responsibility of CenSARA. Our responsibility is to express an opinion on these claims based on our examination.

We conducted our examination in accordance with the *Government Auditing Standards*, issued by the Comptroller General of the United States, and included the procedures we considered necessary under the circumstances. We used the following criteria to evaluate the costs claimed: Title 31 Code of Federal Regulations (CFR) Part 205; Title 40 CFR Part 30; Office of Management and Budget (OMB) Circular A-122; Resource Management Directives 2540, Chapter 5; Treasury Financial Manual, Chapter 6, Section 2075.30; and the terms and conditions of the assistance agreements. We believe that our examination provides a reasonable basis for our opinion.

In our opinion, the costs claimed for the two assistance agreements do not present fairly, in all material respects, the allowable costs incurred in the performance of the assistance agreements in accordance with the criteria set forth in the assistance agreements. Therefore, we do not consider the claims to be acceptable as a basis to determine reasonable and allowable costs. The following sections provide details of our examination and conclusions.

Keith Reichard /s/

Assignment Manager
Field Work End: May 3, 2002

Results of Audit

As a result of the deficiencies described below, we have questioned all \$1,644,618 in costs claimed under the two assistance agreements as unsupported.

Claimed Outlays Do Not Agree with the General Ledger

We were not able to reconcile the total program outlays claimed for each grant with CenSARA's general ledger. Consequently, we have questioned as unsupported, the claim costs of \$1,508,618 and \$136,000 for grant numbers X996940-01 and X986516-01, respectively. Title 40 CFR 30.21(b)(1) states that the recipient's financial management system shall provide for accurate, current, and complete disclosure of the financial results of each Federally-sponsored project or program in accordance with the reporting requirements set forth in 40 CFR 30.52. Because CenSARA's financial management system did not meet the requirements of 40 CFR 30.21(b)(1), we were unable to identify the specific costs reported by CenSARA.

CenSARA reported amounts drawn down as outlays, rather than actual expenditures. The outlays are the sum of actual cash disbursements for goods and services, the amount of indirect expenses charged, and the value of in-kind contributions applied. The following two tables outline the differences between costs claimed on the financial status reports (FSRs) and the expenditures in the General Ledger for the audited reporting periods:

| Assistance Agreement No. X996940-01 | | | | |
|--|-----------------------|------------------------------|--|-------------------|
| Period | Date Submitted | Costs Claimed on FSRs | Expenditures per General Ledger | Difference |
| 10/01/97 - 09/30/99 | 10/19/99 | \$239,262 | \$235,164 | \$4,098 |
| 10/01/99 - 09/30/00 | 12/22/00 | \$423,625 | \$487,503 | (\$63,878) |
| 10/01/00 - 09/30/01 | 10/29/01 | \$845,731 | \$916,864 | (\$71,133) |
| Cumulative Totals | | \$1,508,618 | \$1,639,531 | (\$130,913) |

| Assistance Agreement No. X986516-01 | | | | |
|--|-----------------------|------------------------------|--|-------------------|
| Period | Date Submitted | Costs Claimed on FSRs | Expenditures per General Ledger | Difference |
| 10/01/00 - 09/30/01 | 10/29/01 | \$136,000 | \$148,044 | (\$12,044) |

Because costs claimed on the FSRs do not represent actual costs incurred under EPA assistance agreements, and because CenSARA's financial management system did not meet the requirements of 40 CFR 30.21 (b)(1), we were unable to identify the specific costs claimed by CenSARA.

CenSARA's Comments

CenSARA agreed that it did not report actual outlays. Also, the audit team did not take into account program income that was applied back into the accounts. This difference accounts for a part of the discrepancies listed in the above tables. CenSARA also stated that it has reallocated its labor costs and its direct and indirect costs, so that all costs have been properly expensed. Consequently, all costs have been properly accounted for and supported in accordance with OMB Circular A-122. As part of reallocating the labor costs and indirect costs, CenSARA has adjusted the general ledgers and revised the FSRs.

Auditor's Response

We obtained copies of the revised draft FSRs. However, these FSRs were not dated or signed by CenSARA. Thus, our finding remains unchanged. However, before the issues identified in this report can be resolved, the action official will need to consider the following questions:

1. What indirect cost allocation method is CenSARA using?
2. What labor was reallocated to what projects?
3. What specific adjustments were made to the general ledger?
4. What costs were considered indirect costs?
5. What costs were considered direct costs?
6. What specific method did CenSARA use for allocating indirect costs and computing the indirect cost rates? Is this method in writing?
7. Does CenSARA have any written procedures defining direct and indirect costs?
8. What is the indirect cost allocation base?
9. Did CenSARA allocate indirect costs to the Baylor contract, the two state grants, the Texas-funded workshop, and the Louisiana contract?
10. Why were no indirect costs shown on the FSR for the period ended September 30, 1999?

11. Did CenSARA submit indirect costs rate proposals for approval?
12. Is CenSARA planning on revising its financial statements for the years that the general ledger has been revised?
13. Do the FSRs reconcile with the general ledger?

Inadequate Labor Distribution System

CenSARA did not maintain an adequate labor distribution system to track labor efforts spent on each project or final cost objective. Therefore, CenSARA's time distribution system did not meet the minimum requirements of OMB Circular A-122, Attachment B, as required by 40 CFR 30.27. As a result, we were unable to determine whether the labor costs recorded in the general ledger were allowable and allocable to the EPA assistance agreements.

OMB Circular A-122 requires that CenSARA maintain reports reflecting the distribution of activity for each employee whose compensation is charged, in whole or in part, directly to a grant. These reports must account for an after-the-fact determination of the actual activity for each employee. Budget estimates and allocations of salary expense based on predetermined percentages do not qualify. The same records are needed for employees with portions of salaries being allocated indirectly to assistance agreements. Furthermore, agreement number X996940-01 was amended five times to add various state projects to the scope of work. The amendments indicated that multiple appropriations were used to fund the amendments, and that CenSARA was required to account for and bill each project and activity.

Labor claimed under the EPA assistance agreements was not based on actual hours worked. Employees prepared time sheets but did not specifically identify any grant projects or final cost objectives. Further, CenSARA did not use the time sheets to record salary costs in the general ledger. Instead, CenSARA charged all employee salaries, including vacation, holiday, and sick leave, to Assistance Agreement No. X996940-01. No labor was charged to Assistance Agreement No. X986516-01 or any non-EPA project. Without an adequate labor distribution system, we could not determine how much of these expenses should have been allocated to each final cost objective.

CenSARA Comments

CenSARA stated that it had only one grant (X996940-01) during the period May 5, 1998 through April 7, 2000, thus all costs were correctly attributed to grant X996940-01. The only period in question was during April 7, 2000 to September 30, 2001.

CenSARA has upgraded its personnel activity reports in accordance with OMB Circular A-122, to more effectively account for and allocate labor costs. This new system identifies the labor effort to be charged to any of CenSARA's funding sources, Federal and non-Federal; separates direct from indirect costs; and identifies different activities under each funding source. CenSARA also stated that it has reallocated its labor costs so that all costs have been properly expensed. As a result of reallocating the labor and indirect costs, CenSARA adjusted its general ledger and revised the FSRs.

Auditor's Response

We disagree with CenSARA's contention that it only had one project during the period May 5, 1998 through April 7, 2000. During this period, CenSARA had a contract with Baylor University which generated income of approximately \$679,067 plus interest of \$24,813. The funds for the contract came from the Texas Natural Resource Conservation Commission. The Commission stated that the interest earned on the funds would cover CenSARA's time since CenSARA was not taking an official percentage of the costs. However, CenSARA did not identify any labor activity and corresponding expense for the Baylor contract.

During the period October 1, 1997 through September 30, 1998, CenSARA received two state grants from Missouri and Oklahoma. CenSARA charged all salary costs to the two grants during this period even though it may have started work on the new EPA grant, X996940-01. Also, during the same period CenSARA was working on the Baylor University contract, CenSARA earned income of \$15,000 for a Texas-funded workshop. Again, no labor costs were charged to this workshop. Instead, beginning on October 1, 1998, all payroll costs were inappropriately charged entirely to EPA grant number X996940-01. Finally, CenSARA charged the labor costs to procure equipment and services for different states. These labor costs are not allowable charges to the EPA grants because procurement activity by itself does not meet the authorized use of the Clean Air Act, Section 103.

With respect to the new labor distribution system and the redistributed labor, we are unable to comment on the new system and the redistributed labor since the new procedures were not provided to us.

In summary, CenSARA did not provide us with any documentation to determine whether the labor costs recorded in the general ledger and charged to EPA grants were allowable and allocable costs under Federal regulations. Further, as discussed below, CenSARA claimed outlays did not reconcile with the general ledger; thus, we are still unable to determine what portion of the labor costs recorded in the general ledger were claimed under the EPA assistance agreements.

Unsupported Direct Costs

We were not able to evaluate the claimed direct costs because CenSARA improperly charged all indirect type costs – such as rent, office supplies, postage, telephone, and depreciation – to one EPA assistance agreement (X996940-01). No other projects or EPA assistance agreements were allocated or charged for any of these types of indirect costs.

Since these costs benefitted more than one cost objective, the costs are not allowable direct costs. CenSARA did not: (1) have written accounting procedures regarding allocation of joint costs, (2) develop an indirect cost rate to allocate costs benefitting multiple projects or assistance agreements, and (3) submit indirect cost proposals that would distinguish indirect from direct costs. Normally, indirect type costs are allocated to projects through an indirect cost rate or rates. Title 40 CFR 30.21(b)(6) requires CenSARA's financial management system to include written procedures for determining allocability of costs. Without written procedures or an indirect cost plan, we cannot properly evaluate direct costs charged to the assistance agreements.

In developing written procedures, CenSARA needs to address the requirements of OMB Circular A-122. Specifically, CenSARA needs to address: (1) the allocability of costs (Attachment A, paragraph A.4); (2) the three allocation methods authorized for indirect costs (Attachment A, paragraph D); (3) definition of direct and indirect costs (Attachment A, paragraphs B and C); and (4) the negotiation and approval of indirect cost rates (Attachment A, paragraph E).

CenSARA Comments

CenSARA reiterated its position that it had only one grant for the majority of the project period, and it would be correct to assume that all costs should be allocated to this source. CenSARA agreed that for the small portion of the audit period where it had two assistance agreements, the costs were not correctly charged.

With respect to written accounting principles, CenSARA disagreed with the draft report but stated that it was in the process of upgrading its financial management manual, and a preliminary draft of the procedures was provided to Region 6.

CenSARA indicated it did not understand what was required to distinguish indirect costs from direct costs. However, CenSARA plans to work with Region 6 to establish an indirect rate and will submit an indirect cost rate package to Region 6 as soon as possible. Meanwhile, CenSARA will assume an indirect cost rate based on "our experience mode."

Auditor's Response

Again, we disagree with CenSARA that it had only one grant or project during the majority of the audit period. From October 1, 1998 through September 30, 2001, CenSARA improperly charged all of its indirect type costs – such as rent, office supplies, postage, telephone, and depreciation – direct to EPA grant X996940-01. During this same period, CenSARA also had one other EPA grant (X986516-01), contracts with Baylor University and the State of Louisiana, and earned income from workshops. However, no indirect type costs were allocated to any of these other projects.

Also, during the period October 1, 1997 through September 30, 1998, CenSARA charged all of its depreciation expenses¹ to EPA grant X996940-01, but all its salaries and payroll costs were charged entirely to the two state grants awarded by Missouri and Oklahoma. We do not understand the rationale for charging all depreciation expenses to one grant when all the labor costs are charged to other projects. This practice seems inconsistent with accounting requirements in OMB Circular A-122. According to OMB Circular A-122, indirect costs are those that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective. Normally, indirect type costs are allocated to projects through an indirect cost rate or rates. Thus, when a grantee has multiple projects it is necessary to properly allocate indirect type expenses to all benefitting projects to ensure an equitable allocation of costs. This was not done.

With respect to the written accounting procedures, we are unable to comment on those procedures because we were not furnished a copy of the procedures.

In summary, CenSARA did not provide us with any documentation to determine whether the direct costs recorded in the general ledger were allowable and allocable to the EPA assistance agreements. Further, as discussed below, CenSARA's claimed outlays did not reconcile with the general ledger; thus, we are still unable to determine what portion of the direct costs recorded in the general ledger were claimed under the EPA assistance agreements.

Improper Procurement Practices

Under Assistance Agreement No. X996940-01, CenSARA: (1) did not competitively procure equipment and services, and (2) did not perform cost or price analysis for the purchases of equipment and services.

¹Since CenSARA relies on Federal funds for most of its income, it is unclear what depreciable assets it might own that would be an allowable direct charge to EPA grants.

The provisions of 40 CFR 30.43 provide that all procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition. Further, 40 CFR 30.45 requires some form of cost or price analysis to be made and documented in the procurement files in connection with every procurement action. Price analysis may be accomplished in various ways, including the comparison of price quotations submitted, market prices, and similar indicia, together with discounts. Costs analysis is the review and evaluation of each element of cost to determine reasonableness, allocability, and allowability.

For the contract procurements, the state agencies selected the contractors, prepared the contract documents, and CenSARA signed the contracts. The state agencies managed the contracts, reviewed and approved invoices, and forwarded the invoices to CenSARA for payment. CenSARA did not solicit any bids, and did not perform cost or price analyses for the sole source contracts awarded. As of September 30, 2001, CenSARA incurred \$403,726 in contract expense under nine sole source contracts.

Similarly, for the equipment purchases, the state agencies prepared and forwarded to CenSARA the purchase requests. The purchase requests identified the vendor, quantities, total purchase price, and the justification for the purchase. CenSARA purchased the equipment and instructed the vendor to ship the equipment directly to the requesting state agency. Once the equipment was received, CenSARA transferred the title to the equipment to the state agencies. CenSARA did not solicit any bids, and did not perform cost or price analyses for any of the equipment purchases. As of September 30, 2001, CenSARA incurred \$172,017 for equipment purchases.

CenSARA indicated that various state agencies requested that CenSARA procure contracts and equipment for specific projects. According to CenSARA, the state agencies would solicit bids, perform cost or price analysis, and select the contractors and vendors. CenSARA said that the states maintained the cost or pricing data but could not provide any support that the cost or price analysis had been performed by the states. There is no assurance that costs of \$575,743, to obtain equipment and services under these EPA grants, are reasonable. Therefore these costs are not allowable under Federal rules.

CenSARA's Comments

CenSARA agreed that it did not have documentation readily available in its files for the audit team. To correct this oversight, CenSARA has requested the justifications from the requesting states and will in the future ensure that the justifications or price cost analysis is in the file with the award.

Auditor's Response

CenSARA did not provide any contemporaneous bidding information or cost or pricing data to support the procurement under the nine sole source contracts totaling \$403,726 or the purchases of goods and services totaling \$172,017, a total of \$575,743.

Accordingly, these costs are unsupported and should be recovered to the extent that these costs have been claimed. However, as previously discussed, CenSARA's claimed outlays did not reconcile with the general ledger; thus, we are still unable to determine what portion of the contract and procurement costs recorded in the general ledger were claimed under the EPA assistance agreements. For future purposes, we recommend that the cost or pricing analysis be retained in the files.

Recommendations

We recommend that EPA Region 6:

1. Recover all assistance agreement funds that cannot be supported in accordance with 40 CFR Part 31 and OMB Circular A-122 within 180 days of the date of this report.
2. Suspend work under the current agreements and make no new awards until CenSARA can demonstrate that its accounting practices are consistent with Federal requirements (see recommendation number 4).
3. Recover the costs of \$575,743 for equipment and services unless CenSARA can show that the requirements of 40 CFR 30.40 through 30.47 were met, including justification for sole-source procurement under 40 CFR 30.46
4. Require CenSARA to modify its financial management system to meet the requirements of 40 CFR 30.21. At a minimum, CenSARA's system must:
 - a. Ensure that financial results are current, accurate, and complete.
 - b. Include records that adequately identify source and application of funds for Federally-sponsored programs.
 - c. Include written procedures to determine reasonableness, allocability, and allowability of costs in accordance with OMB Circular A-122.
 - d. Include accounting records that are supported by adequate source documentation.
 - e. Require CenSARA to establish an adequate time distribution system that meets the requirements of OMB Circular A-122, Attachment B, paragraph 7. The system should account for total hours worked and leave taken, and identify the specific activities the employees performed during the pay period. It should also serve as the basis for charging labor costs to Federal grants and cooperative agreements.
 - f. Require CenSARA to allocate indirect costs in accordance with OMB Circular A-122.
 - g. Require CenSARA to follow all procurement standards under 40 CFR 30.40 through 30.48.

Agency Comments

As previously discussed, Region 6 provided comments on the draft report. Although we considered these comments, we consider them to be pre-decisional because the final report is subject to the process outlined in EPA Manual 2750. Therefore, Region 6's preliminary comments are not included in this report.

Background

On May 5, 1998, and April 7, 2000, EPA awarded Assistance Agreement Nos. X996940-01 and X986516-01, respectively, to CenSARA, headquartered in Oklahoma City, Oklahoma. CenSARA is an association of air quality agencies in nine states located in EPA Regions 5, 6, and 7, and several local governments in those regions. The States are: Arkansas, Iowa, Kansas, Louisiana, Minnesota, Missouri, Nebraska, Oklahoma, and Texas.

The following table provides some basic information about the authorized project periods and the amounts awarded under the assistance agreements covered by this audit.

| Assistance Agreement No. | EPA Share | Grantee Share | Total Costs | Project Period |
|--------------------------|-------------|---------------|-------------|---------------------|
| X996940-01 | \$2,226,243 | \$0 | \$2,226,243 | 05/05/98 - 09/30/02 |
| X986516-01 | \$1,000,000 | \$0 | \$1,000,000 | 04/10/00 - 03/31/03 |

Assistance Agreement No. X996940-01: This provided funding to establish CenSARA, a Regional Multi-State Organization. The mission of CenSARA is to promote the exchange of information between its states and other interested parties related to the control of air pollution. Activities under the assistance agreement included training courses and other projects, such as ozone mapping. The Federal share was 100 percent of total costs.

Assistance Agreement No. X986516-01: This provided funding to establish the infrastructure for a Regional Planning Body to enable the states to work together to reduce and prevent air pollution. The Regional Planning Body is to develop proposals to be reviewed and considered by the various member states and tribes, when developing State Implementation Plans, to address regional haze issues. The Federal share was 100 percent of total costs.

To assist the reader in obtaining an understanding of the report, key terms are defined below:

Claimed Costs: Program outlays identified by CenSARA on the *Financial Status Report* (Standard Form 269 or 269A).

Unsupported Questioned Costs: Adjustments made by the Office of Inspector General because the claimed costs are not supported by adequate documentation and/or have not been approved by a responsible agency official.

CenSARA's Response

Attachment 2

CenSARA
Central States Air Resource Agencies Association
10005 S. Pennsylvania, Suite C, Oklahoma City, OK 73159
(405) 378-7377 Fax (405) 378-7379
Larry D. Byrum, Executive Director
E-mail: lbyrum@cen Sara.org



September 4, 2002

Lynda F. Carroll
U.S. Environmental Protection Agency
6MD
1445 Ross Avenue, Suite #1200
Dallas, TX 75202-2733

Re: Audit Response regarding Grant Nos. X-996940-01 and X-986516-01

Dear Ms. Carroll:

CenSARA is in receipt of the draft audit report dated July 30, 2002 and your Show Cause letter of August 27, 2002. We have attached a detailed response to all the issues raised in that report.

Our response points out many errors and misstatements in the audit document and strongly disagrees with the findings. While this report represents the opinions of the Office of Inspector General (OIG), they bear little resemblance to the true facts. In the attachment, we have addressed each issue raised in the report and comment on each of the recommendations.

Let me assure you that we share your concern that our financial procedures are of the highest quality. CenSARA has contracted for outside audits of its financial system every year we have been in existence. These audits have never found any problems that would have indicated to us that our system needed changes. These audits were routinely provided to all three of the EPA regional offices CenSARA supports. We have never been asked to address any issues resulting from the review of these reports.

At the same time, CenSARA also believes that there is always room for improvement in management systems. In response to this audit, we have brought in outside assistance to totally review our financial management system. The results of that review are detailed in the attachments. We are also attaching revised copies of the five manuals that make up our policies and procedures. We are continuing to revise our financial management document and will continue to make changes for the next few weeks. When the changes are finalized, we will forward the manual to EPA Region 6 for your review and

Re: Audit Response regarding Grant Nos. X-996940-01 and X-986516-01
Page 2
September 4, 2002

comment: We look forward to working with Region 6 to develop any further changes necessary to strengthen our financial management system.

Finally we must take issue with the statement by Mr. Rickey, the OIG auditor, in his memorandum to Mr. Gregg A. Cooke, Regional Administrator of Region 6. It states "CenSARA served as a front for various state agencies." This language is obviously inflammatory in nature and infers that CenSARA has somehow performed illegal activities. The truth of the situation is that CenSARA was and is performing those activities that we were formed by the states to accomplish. The charter of CenSARA expressly requires that the organization provide services to the member states that allow them to accomplish their mission under the Clean Air Act in an expeditious and professional manner. CenSARA contracting performed for the states meets the criteria of being mission-critical, time-critical or a combination of the two. The contracting we have accomplished is a very small portion of the contracting accomplished by the states and is done with the full knowledge of the management of the state agencies as well as the regional office. Since we are a very small service organization, existing for our members' benefit, we believe that the efforts by the members to support the procurement activities as well as the technical activities of the organization are well founded.

We have taken the audit very seriously, and have acted as quickly as possible to have a complete set of answers to the audit. It is our opinion that we have answered each of the findings of the audit and that the efforts we have expended since the receipt of the report show our resolve to be good stewards of the funding we receive. I appreciate the opportunity to respond to the draft audit and meet with Region 6 staff to correct any real deficiencies in our financial management system.

Sincerely,



Larry Byrum

cc: Region 5, 6 and 7 Air Directors
CenSARA Member State Air Directors

ATTACHMENT

CenSARA is in receipt of the DRAFT audit report dated July 30, 2002. The attached is our response to the issues listed in that report. CenSARA finds that there are many errors and misstatements in this document and strongly disagrees with the findings. While this report represents the opinions of the Office of Inspector General (OIG) they bear little resemblance to the true facts. We will address each issue raised in the report and comment on each of the recommendations.

The statement listed in the second paragraph of the memorandum to the audit report is a complete misstatement of fact. We take great exception to "We questioned the total Federal share claimed of \$1,644,618 as unsupported, because CenSARA did not comply with the terms or conditions of the assistance agreements". In no instance did the auditors cite where CenSARA did not comply with the terms and conditions of the assistance agreements; that is, identify costs that were not reasonable, ordinary and necessary for the performance of CenSARA or the awards; or identify any costs charged to the assistance agreements that were unallowable costs per OMB Circular A-122. Additionally, all costs were supported by source documentation, e.g. time sheets were prepared for all employees and invoices supported all payments. In further support of the facts, CenSARA has contracted for outside audits for the entire period in question and beyond. The audit reports were shared with the regional office and the audit team; there were no findings that required corrective action on the part of CenSARA. We recognize that improvements in the methods used to make allocations to direct and indirect labor costs and to allocate indirect costs among the funding sources can be made. Corrective action has already been taken and is in place, including reallocating costs during the period, 10/1/99- 9/30/01, which were in question.

Inadequate Labor Distribution System

In this section of the report, the audit team represents that CenSARA did not have a time accounting system. They also give the impression that the entire term from 5/5/98 to 9/30/01 is in question. The actual truth of the situation is that CenSARA had only one grant from 5/5/98 to 4/7/00. For this period all costs were correctly attributable to grant number (X996940-01). The only period of time in question then becomes the period from 4/7/00 to 9/30/01. During this time the staff were working with EPA Region 6 to set an indirect cost rate. We met with the regional office staff as well as staff from headquarters on the issue. We were advised that we did not have sufficient data upon which to build a request for an indirect cost rate. We were advised to utilize the percentage system we are now being criticized for, in order to obtain the necessary data.

In this section the auditors also address the fact that the grant was amended five times to add various state projects to the scope of work. While we agree with that statement we cannot agree with the inference that we did not account for each project. CenSARA is an organization formed for the purpose of aiding each of our members in the implementation of their Clean Air Act activities. Each of the amendments was for specific projects that the states were required to perform. These projects were considered to be a part of the mission for CenSARA and the minimal labor costs on these activities were charged to the administrative grant (X996940-01).

CenSARA has developed a revised time tracking system, which is described in the attached documents. We will work with EPA Region 6 to establish an indirect cost rate as quickly as

possible. Until that time, we will assume an indirect cost rate based on our experience mode. We will be asking for approval of this method until a formal indirect cost rate can be obtained.

Unsupported Direct Costs

Once again the audit report misstates the facts. The facts reflect that CenSARA had only one grant for the majority of the audit period. It therefore would be correct to assume that all costs should be allocated to this source. It is however also true that a small portion of the audit period reflects two grants. For that time period, CenSARA did not correctly charge the costs. CenSARA was actively trying to establish an indirect cost rate. CenSARA staff met with EPA staff to discuss this issue and was following the advice we were given. In response to item (2), CenSARA has now adopted an interim indirect cost rate, which will be utilized until EPA and CenSARA agree upon a permanent rate.

Item (1) states that CenSARA did not have written accounting principals. We disagree with this statement, however CenSARA is in the process of upgrading our financial management manual and a preliminary draft is attached. It is our belief that the policy and procedure manuals we have are living documents and revisions will be made to these manuals as needed.

Item (3), states that CenSARA needs to "submit indirect cost proposals that would distinguish indirect costs from direct costs." This statement is vague and we do not fully understand what is required here. However, CenSARA plans to submit an indirect cost rate package to Region 6 as soon as possible. If we have not met the requirements of this item with that work, we will work with Region 6 to fully meet their needs.

No Cost or Price Analysis

The audit report states, "CenSARA did not perform cost or price analysis for sole source contracts awarded under Grant No. X996940-01". This statement on its face is true. However CenSARA is comprised of its members and those members provided the justification for the sole source procurements. CenSARA did not have that documentation readily available in its files for the audit team. To correct this oversight, CenSARA has requested the justifications from the requesting states and will in the future ensure that the justifications or price cost analysis is in the file with the award.

The audit report refers to existing CenSARA procurement procedures and states that we did not follow our written policies for purchasing. This statement is misleading and leads one to believe that there were single purchases above the \$15,000 limit that did not have the necessary documentation. The truth is that with the exception of the sole source items discussed above CenSARA did not have any single purchases that exceeded the \$15,000 limit.

In the Memorandum to Mr. Gregg A. Cooke Regional Administrator of Region 6, Mr. Rickey states, "CenSARA served as a front for various state agencies." This language is obviously inflammatory in nature and infers that CenSARA has somehow performed illegal activities. The truth of the situation is that CenSARA was and is performing those activities that we were formed by the states to accomplish. The charter of CenSARA expressly requires that the organization

provide services to the member states that allow them to accomplish their mission under the Clean Air Act in an expeditious and professional manner. The contracting that CenSARA has performed for its members meets these requirements. The contracting services we have provided have met one or more of the following criteria and have often meant the difference between a project being completed or not. CenSARA contracting performed for the states meet the criteria of being mission critical, time critical or a combination of the two. The contracting we have accomplished is a very small portion of the contracting accomplished by the states and is done with the full knowledge of the management of the state agencies as well as the regional office. Since we are a very small service organization, existing for our members' benefit, we believe that the efforts by the members to support the procurement activities as well as the technical activities of the organization are well founded. Mr. Rickey also states that " We do not see any tangible benefit to use Clean Air, section 103 grant funds in this manner, and it is unclear why this process was supported by Region 6". We would refer EPA to the membership, which have been able to utilize the limited contracting to accomplish timelines, and functions that would have been impossible under the standard practices.

Claimed Outlays Do Not Agree With the General Ledger

CenSARA disagrees with the statement that its financial system did not meet the requirements of 40 CFR30.21 (b)(1). CenSARA has undergone outside audits of its financial system every year as required by federal guidance. These audits have never found any areas that indicate to us that our system needed to be addressed. Furthermore these audits have been routinely provided to all three of the regional offices CenSARA supports. We have never been asked to address any issues resulting from the review of these reports. CenSARA however believes that there is room for improvement in its systems and is in the process of doing a total revision to its financial management system. A draft of that plan is attached and we look forward to working with Region 6 to formulate the final plan.

The audit report states " CenSARA reported amounts drawn down as outlays, rather than actual expenditures." This statement is true, however when this was noted in the audit visit, our CPA offered to correct the issue on site; she was told that the FSR could not be changed. Our accountant simply read the guidance and interpreted it differently than the audit staff; we have made the corrections to the FSR in the same manner, as we would have done previously.

It should also be noted that the audit team did not take into account program income that was applied back into the accounts. This difference accounts for a part of the discrepancies listed in the table on page four. We have also shown these corrections in our response.

Recommendations

The following are our comments regarding the actions CenSARA has and will be taking to address and resolve the audit recommendations. Based upon our actions, as discussed below, we strongly believe that satisfactory corrective action has been taken and that each of the recommendations should be closed.

1. CenSARA has reallocated its labor costs and its direct and indirect costs, so that

all costs have been properly expensed among CenSARA's federal and non-federal awards. Consequently, all funds have been properly accounted for and supported in accordance with OMB Circular A-122.

2. CenSARA has changed its accounting practices and has revised its financial management manual to more closely mirror the standards set forth in OMB Circular A-110, Subpart C, .21(b)(1)-(7) and 40CFR 30.21 (b)(1)-(7). Furthermore the CenSARA staff has taken a one-day workshop on "An Overview to Managing Federal Grants." This workshop covered OMB Circulars A-110, 40 CFR Part 30, A-122, and A-133, plus other relevant topics.
3. As part of the reallocating the labor costs and indirect costs, we adjusted our general ledger and revised the FSRs.
4. In our effort to upgrade and modify our financial management systems, we have developed a financial management manual to meet the standards set forth in the OMB Circular A-110, Sub part C, .21(b)(1)-(7) and 40CFR30.21(b)(1)-(7) and OMB Circular A-122. As a part of this effort, we have upgraded our personnel activity reports in accordance with OMB Circular A-122, Attachment B.7.m. to insure we properly account for and allocate labor costs. We have also identified all costs as either direct or indirect. Finally, our chart of accounts is being restructured to more clearly identify funding sources and enhance the allocation costs to the appropriate funding source, Federal and Non Federal.
5. CenSARA has upgraded its personnel activity reports in accordance with OMB Circular A-122, Attachment B.7.m. to more effectively account for and allocate labor costs. This new system identifies the labor effort to be charged to any of our funding sources, Federal and non-federal, separates direct from indirect costs, and identifies different activities under each funding source.
6. By virtue of refining our chart of accounts and instituting a revised personnel activity report, we are now able to allocate indirect costs in accordance with OMB Circular A-122.
7. We have greatly expanded our existing procurement policies that action has resulted in a more comprehensive Procurement Policy Manual. As described in the manual, a separate file will be established for each new procurement action, and the required Price and cost analysis will be kept in the folder. Previously, CenSARA members in behalf of CenSARA performed many of the analyses, and these analyses were kept by the members and not always forwarded to us for our files. As part of our new operating policies and procedures, CenSARA members have been advised that procurement actions will not be taken until a copy of the price cost analyses has been forwarded to our offices. CenSARA has also taken action to request the cost price analyses for prior purchases be forwarded to our offices so we may be able to establish more complete files.

We have taken the audit very seriously, and have acted as quickly as possible to have a complete set of answers to the audit. We realize that in some few instances we will still be working on final versions of manuals after the date the answers are required. We will however continue to refine our policies and procedures as necessary to ensure we meet the federal guidance. It is our opinion that we have answered each of the findings of the audit and that the efforts we have expended since the receipt of the report show our resolve to be good stewards of the funding we receive. We have attached the revised copies of the five manuals that make up our policies and procedures. We are asking that EPA region 6 review the manuals that have been provided and supply comments and or approve these for use by CenSARA.

Distribution

Region 6

Assistant Regional Administrator for Management (Action Official)
(Responsible for report distribution to recipient.)
Director, Multimedia Planning and Permitting Division (6PD)
Audit Coordinator (6MD RC)

Headquarters

Director, Grants Administration Division (3903R)
Agency Audit Followup Coordinator (2724A)
Associate Administrator for Congressional and Intergovernmental Relations (1301A)
Associate Administrator for Communications, Education, and Media Relations (1101A)

Office of Inspector General

Inspector General (2410)