



OFFICE OF INSPECTOR GENERAL

Catalyst for Improving the Environment

Attestation Report

California Department of Toxic Substances Control Reported Outlays under Cooperative Agreement V99925204

Report No. 2005-4-00099

September 8, 2005

This 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 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 accordance with established audit resolution procedures.

Report Contributors:

Robert Adachi
Lela Wong
Clem Cantil
Keith Reichard

Abbreviations

CADD	Computer Aided Design and Drafting
CFR	Code of Federal Regulations
EPA	U.S. Environmental Protection Agency
GSA	General Services Administration
OIG	Office of Inspector General



At a Glance

Catalyst for Improving the Environment

Why We Did This Examination

We conducted this examination to determine whether:

- The reported outlays fairly present, in all material respects, the allowable costs incurred under EPA cooperative agreement V99925204 (agreement); and
- California Department of Toxic Substances Control (State) complied with applicable laws, regulations, and terms of the agreement.

Background

EPA Region 9 awarded the agreement to the State on June 24, 2002, for Superfund site assessments and Brownfields activities. The initial award was \$640,000. The agreement was amended to reflect total project costs of \$1,340,000. The agreement had a budget period from July 1, 2002, to June 30, 2004.

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

To view the full report, click on the following link:

www.epa.gov/oig/reports/2005/20050908-2005-4-00099.pdf

California Department of Toxic Substances Control Reported Outlays under Cooperative Agreement V99925204

What We Found

In our opinion, with the exception of contract outlays, the outlays reported by the State present fairly, in all material respects, allowable costs incurred under the agreement. EPA has determined that the State performed the activities in the agreement's work plan and has complied with the agreement's deliverable requirements.

The State's procurement process needs improvement to ensure that contractual outlays reported were allowable and that contracts were negotiated and administered in accordance with Federal regulations. Specifically, the State did not: (1) perform cost or price analysis, (2) negotiate profit as a separate line item in the contract, (3) ensure that the contractors monitor their subcontracts, and (4) include all the required clauses in the contracts. The State also did not inform or require its contractors to comply with the Federal Cost Principles. As a result, the State was unable to demonstrate that the reported outlays for contractual services were "fair and reasonable" and we questioned reported contract outlays of \$215,946.

What We Recommend

We recommend that the Regional Administrator, EPA Region 9:

1. Disallow contract outlays of \$215,946 reported under the agreement.
2. Revoke the State's procurement system self-certification until adequate policies and procedures are in place to ensure compliance with Federal regulations and cost principles.
3. Review and approve all State solicitations and contracts under EPA grants and cooperative agreements, other than small purchases.
4. Determine the adequacy of actions taken by the State to update its procurement handbook, develop additional procurement policies, develop procedures for negotiating prices, and provide adequate training on procurement and contract management.

The State disagreed with recommendation 1 and concurred with recommendations 2 through 4.



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

OFFICE OF
INSPECTOR GENERAL

September 8, 2005

MEMORANDUM

SUBJECT: Attestation Report:
California Department of Toxic Substances Control
Reported Outlays under Cooperative Agreement V99925204
Report No. 2005-4-00099

FROM: *Michael Rickey* /s/
Michael Rickey
Director, Assistance Agreement Audits

TO: Wayne Nastri
Regional Administrator
Region 9

As part of our effort to meet the requirements of Section 111 (k) of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, we have examined the outlays reported by the California Department of Toxic Substances Control (State) under cooperative agreement number V99925204. The purpose of this examination is to determine whether the reported outlays fairly present, in all material respect, the allowable costs incurred under the cooperative agreement and whether the State complied with applicable laws, regulations, and terms of the agreement. This examination also allowed us to follow-up on the internal control and compliance issues noted in our audit report number 2003-1-00143, "Costs Claimed on the Stringfellow Superfund Site by California Department of Toxic Substances Control," issued on September 30, 2003.

This attestation report contains findings that describe problems the Office of Inspector General (OIG) has identified and corrective actions the OIG recommends. This attestation report represents the opinion of the OIG and the findings contained in this report do not necessarily represent the final EPA position. Final determinations on matters in this attestation report will be made by EPA managers in accordance with established audit resolution procedures. Accordingly, the findings described in the report are not binding upon EPA in any enforcement proceedings brought by EPA or the Department of Justice.

We issued a draft report to the State for comment on June 30, 2005. The State submitted its response on August 1, 2005. We have included the State's complete response as Appendix B of this report. An exit conference was held on August 18, 2005. Prior to the exit conference, the

State also provided documentation supporting its August 1 response. The State also provided its justification for the use of the time-and-materials type contracts. The justification appears to be reasonable. The State disagreed with recommendation 1 and concurred with recommendations 2 through 4.

Action Required

In accordance with EPA Manual 2750, you are required to provide a written response to this report by January 10, 2006. If you or your staff has any questions regarding this report, please contact me at (312) 886-3037 or Mr. Robert Adachi at (415) 947-4537.

Table of Contents

At a Glance

Background	1
Independent Auditor's Report	2
Schedule of Reported Outlays and Results of Examination	3
Status of Prior Audit Findings	4
Recommendations	4
Summary of State's Response	5
OIG Comments	6

Appendices

A Scope and Methodology	7
B State's Response to Draft Report.....	8
C Distribution	12

Background

Environmental Protection Agency (EPA) Region 9 awarded cooperative agreement V99925204 (agreement) to the California Department of Toxic Substances Control (State) on June 24, 2002, under section 104 of the Comprehensive Environmental Response, Compensation, and Liability Act. The agreement was for Superfund site assessments and Brownfields activities. The initial award was for \$640,000. The agreement was amended to reflect total project costs of \$1,340,000. The agreement had a budget period from July 1, 2002, to June 30, 2004, and did not require cost sharing from the State. As of September 7, 2004, the date of the final *Financial Status Report*, payments of \$1,316,276 had been made under the agreement.

Under the agreement's work plan, the State was required to perform 39 activities during the period from July 1, 2002, through June 30, 2004. These activities included completing and maintaining the preliminary assessment and site investigation tracking database, performing site inspections and site screenings, evaluating removal site status, attending National Site Assessment Conferences, establishing a geographic information system for well surveys, and preparing preliminary endangerment assessments for school sites. As required under the agreement, the State submitted performance reports to the EPA quarterly to summarize the status of each of the activities. EPA has determined the status of activities summarized in the final quarterly report as acceptable and in full compliance with the deliverable requirements under the agreement.

To help the reader understand the report, we define key terms below:

- Reported Outlays:** Program expenses or disbursements identified by the State on the *Financial Status Report* (Standard Form 269A).
- Unallowable Costs:** Outlays that are (1) contrary to a provision of a law, regulation, agreement, or other documents governing the expenditure of funds; (2) not supported by adequate documentation; or (3) not approved by a responsible Agency official.

Independent Auditor's Report

We have examined the total outlays reported by the California Department of Toxic Substances Control (State) under EPA cooperative agreement V99925204 (agreement). Total outlays of \$1,316,276 were reported in the final *Financial Status Report*, dated September 7, 2004, for the period July 1, 2002, through June 30, 2004.

The State certified that the Federal outlays reported on the *Financial Status Report*, Standard Form 269A, were correct and for the purposes set forth in the agreements. Our responsibility was to express an opinion on the reported outlays 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 the attestation standards established for the United States by the American Institute of Certified Public Accountants. We examined, on a test basis, evidence supporting the reported outlays, and performed such other procedures as we considered necessary in the circumstances (see Appendix A for details). We believe that our examination provides a reasonable basis for our opinion.

We questioned \$215,946 of the reported outlays for contracts awarded under the agreement because the State did not negotiate and administer the contracts in accordance with Federal regulations. Please refer to the *Schedule of Reported Outlays and Results of Examination* section of this report for details.

In our opinion, with the exception of the contract outlays discussed in the preceding paragraph, the outlays reported in the *Financial Status Reports* present fairly, in all material respects, the allowable outlays incurred in accordance with the terms and conditions of the agreements and applicable laws and regulations.

Keith Reichard /s/
Keith Reichard
Office of Inspector General
Environmental Protection Agency
April 29, 2005

Schedule of Reported Outlays and Results of Examination

Cost Element	Reported Federal Outlays	Questioned Outlays	Note
Personnel	\$ 528,514	\$0	
Travel	4,856	0	
Contractual	215,946	\$215,946	1
Supplies/Other	163	0	
Indirect Costs	566,797	0	
Total	\$1,316,276	\$215,946	

Note 1: We questioned reported outlays of \$215,946 because the State did not procure its architectural/engineering (A/E) contractual services in accordance with Title 40 Code of Federal Regulations (CFR), Part 35, Subpart O, and did not require its contractors to comply with the applicable Federal regulations. The State awarded three time-and-materials contracts to the following contractors:

Contractor	Total Outlay	Competitively Bid
URS	\$84,313	No
Tetra Tech	62,647	No
Accord Engineering	68,986	Yes
Total	\$215,946	

During the award of the three contracts, the State did not: (1) perform a cost or price analysis as required by Title 40 CFR 35.6585(a) (1); (2) negotiate profit as a separate line item as required by Title 40 CFR 35.6585(b); (3) ensure that contracts awarded by its contractors complied with Title 40 CFR 35.6610, and (4) include all the contract clauses required by Federal statutes as required by Title 40 CFR 31.36(a). The State also did not inform or require its contractors to comply with the Contract Cost Principles and Procedures of Title 48 CFR Part 31 as required by Title 40 CFR 35.6550 (b)(4), 35.6270(a)(2), and 31.22(b). Consequently, the State was unable to demonstrate that the reported outlays for contractual services were “fair and reasonable” as required by Title 40 CFR 35.6565(c) (5).

The conditions explained above were due to:

- The lack of sufficient guidance for contract price negotiation and compliance with Federal regulations in California's State-wide procurement policies. Therefore, State personnel were not aware of the Federal procurement regulations.
- The State did not have procedures to ensure that contract outlays reported are allowable under Title 40 CFR 31.22 and in compliance with 48 CFR Part 31.
- The State's procurement handbook did not include procedures to ensure compliance with Federal procurement regulations.
- The State did not provide training to staff regarding the nature of the various acceptable contract types and their procurement requirements.

Status of Prior Audit Findings

In a prior audit¹ of the Stringfellow Superfund site located in Riverside County, California, we identified two reportable conditions and one noncompliance area. Specifically, the State: (1) needed to improve the accuracy of their *Financial Status Report* and ensure that only eligible costs were claimed, (2) ensure that the costs claimed took into account any special cooperative agreement conditions, and (3) identify the contract reimbursement mechanism to ensure that prohibitive contracts were not used. Based on our examination, these prior findings have been corrected.

Recommendations

We recommend that the Regional Administrator, EPA Region 9:

1. Disallow unsupported contractual outlays of \$215,946 reported under the agreement.
2. Revoke the State's procurement system self-certification until adequate policies and procedures are in place to ensure compliance with Federal procurement regulations and cost principles.
3. Review and approve all State solicitations and contracts under EPA grants and cooperative agreements, other than small purchases, until the State's procurement system self-certification can be reinstated.

¹ Report No. 2003-1-00143, *Costs Claimed on the Stringfellow Superfund Site by California Department of Toxic Substances Control*, issued on September 30, 2003.

4. Determine the adequacy of the State's actions to:
 - a. Update its procurement handbook to ensure compliance with all Federal regulations and cost principles.
 - b. Develop procurement policies to supplement the California State-wide policies.
 - c. Develop procedures for the negotiation of fair and reasonable contract prices.
 - d. Provide adequate training to staff involved in procurement and contract management on Federal procurement regulations and cost principles.

Summary of State's Response

The State concurred with recommendations 2 through 4. The State explained that its procurement system has been substantially revised since the process was reviewed by the auditor. The State has put policies and procedures in place that comply with all Federal procurement regulations and cost principles. The State has also updated its procurement manuals and is scheduling statewide contract and purchasing training in the fall. The State said it looks forward to EPA's expeditious review of its procurement system so that self-certification can be reinstated soon. Until such time that self-certification is approved, the State welcomes and invites EPA to review its EPA grant solicitations and contracts.

The State did not concur with recommendation 1. While the State agreed that the Federal procurement regulations were not met at the time of contract award, it believes that the \$215,946 contractual outlay should be allowed because the contracts were awarded in compliance with the State's regulations and the intent of the applicable Federal regulations. Also, the State believes that the documentation provided in response to the draft have demonstrated that the contract prices are fair and reasonable.

In its response, the State provided comparisons of rates used in the URS and Tetra Tech contracts to the contractors' Federal contract rates published in the existing General Services Administration (GSA) Supply Schedules. The State believes these rate comparisons have demonstrated that the prices of the contracts funded by the cooperative agreement are fair and reasonable. The State believes that it has satisfied the cost analysis requirement. State officials said they believed this because the details on the labor buildup used in the State's contracts have been audited by the contractor's internal auditor and the higher rates reflected in the GSA Supply Schedules have been audited by Federal auditors.

The State explained that the Accord Engineering contract was competitively bid using the State's Small Business process, which met the EPA's Disadvantaged Business requirements under Title 40 CFR 35.6610(c). The State believes that since there was adequate price competition to arrive at a fair and reasonable price as defined in Title 40 CFR 35.6585(a) (1), cost and profit analysis was not needed.

OIG Comments

The State's concurrence with recommendations 2 through 4 is noted. Based on the State's response, we have reworded recommendation 4 to emphasize the need for EPA Region 9 to determine the adequacy of the State's actions

The OIG maintains its position that the contractual outlay of \$215,946 should be disallowed. The State has not adequately demonstrated that the contract prices are fair and reasonable.

In connection with the URS and Tetra Tech contracts, the State has not demonstrated the validity of the rate comparisons. The GSA rates and contract rates the State used in the comparison were not always from the same labor classifications. For example, the State compared the contract rate for Senior Risk Manager to the GSA rate for Subject Matter Expert. However, the State has not provided documentation to show that these two labor classification are substantially the same in qualifications and responsibilities. In another comparison, the State used the GSA rate for either Senior Technician or Senior Engineer to show that it was higher than the contract rate for Computer Aided Design and Drafting (CADD) Technician. However, there was a Staff CADD rate and a Senior CADD rate in the same GSA schedule, both of which were lower than the contract rate for CADD Technician. We are unable to determine whether the correct rates were used in the comparisons without additional details. The State has also not shown whether the GSA rates and contract rates were for the same geographical areas since both of these contractors have regional-specific rates.

In connection with the Accord Engineering contract, we believe that the State is required to prepare a cost analysis. Under Title 40 CFR 35.6585(a),

...a cost analysis is not required when adequate price competition exists and the recipient can establish price reasonableness. The recipient must base its determination of price reasonableness on a catalog or market price of a commercial product sold in substantial quantities to the general public, or on prices set by law or regulation.

The State may have demonstrated adequate price competition; however it has not shown price reasonableness by catalog price, market price, or price established by law or regulations as required under Title 40 CFR 35.6585(a).

During the exit conference, the State mentioned that all subcontracts awarded by its contractors were under \$25,000. As a result, the State believed that the requirements of Title 40 CFR 35.6610 did not apply. The State has, however, included the subcontract requirements of Title 40 CFR 35.6610 in all Federally funded agreements awarded since May 2005.

OIG believes that the State must comply with the requirements of Title 40 CFR 35.6610 in monitoring subcontracts awarded by its contractors. The \$25,000 threshold applies to the cost and price analysis required under Title 40 CFR 35.6610(g) and 35.6585. The remaining requirements under Title 40 CFR 35.6610 apply to all subcontracts, regardless of value.

Scope and Methodology

We performed our examination in accordance with the *Government Auditing Standards*, issued by the Comptroller General of the United States, and the attestation standards established by the American Institute of Certified Public Accountants. We also followed the guidelines and procedures established in the “Office of Inspector General Project Management Handbook,” dated January 14, 2005.

We conducted this examination to express an opinion on the reported outlays, and determine whether the State complied with all applicable laws and regulations, as well as any special requirements under the agreement. We conducted our field work from November 29, 2004, through April 29, 2005.

In conducting our examination, we performed the following procedures:

- We interviewed EPA personnel and reviewed grant and project files to obtain background information on the State and the agreement.
- We interviewed State personnel to obtain an understanding of the accounting system and the applicable internal controls as they relate to the reported outlays.
- We reviewed and followed up on prior audit findings and recommendations.
- We reviewed the most recent single audit report to identify issues which may impact our examination.
- We reviewed the State’s internal controls specifically related to our objectives.
- We performed tests of the internal controls to determine whether they were in place and operating effectively.
- We examined the State’s compliance with Office of Management and Budget Circular A-87, Title 40 CFR Part 31 and Part 35 Subpart O, and the terms and conditions of the agreements.
- We examined the reported outlays on a test basis to determine whether the outlays were adequately supported and eligible for reimbursement under the terms and conditions of the agreements and Federal regulations and cost principles. All of contractual outlays were tested. Statistical samples were performed on the remaining outlays based on a tolerable error rate of 10 percent.
- We verified that the State performed all tasks and provided all deliverables required under the agreement.

State's Response to Draft Report



Department of Toxic Substances Control



Alan C. Lloyd, Ph.D.
Agency Secretary
Cal/EPA

1001 "I" Street
P.O. Box 806
Sacramento, California 95812-0806



Arnold Schwarzenegger
Governor

Mr. Michael Rickey, Director
Assistance Agreement Audits
United States Environmental Protection Agency
1200 Pennsylvania Avenue, N.W.
Washington, D. C. 20460-0001

COOPERATIVE AGREEMENT V99925204 – DEPARTMENT OF TOXIC SUBSTANCES CONTROL RESPONSE TO DRAFT REPORT ON THE AUDIT

Dear Mr. Rickey:

Thank you for the opportunity to respond to the draft report conducted by the U.S. Environmental Protection Agency (EPA), Office of the Inspector General on the audit of the costs claimed on Cooperative Agreement V99925204. We believe the completion of the audit and these recommendations have been invaluable in assisting our staff in understanding and applying the Federal Contracting requirements associated with contracts funded by EPA grants.

We have prepared our responses to the specific recommendations identified in the report. We believe that the actual costs incurred in the contracts funded by the Cooperative Agreement met the intent of the applicable Federal regulations and cost principles as demonstrated when the contract rates were subsequently broken down following Federal requirements and compared to existing Federal Contracts with the same Contractors and California's Certified Small Business competitive bid process.

RESPONSES TO RECOMMENDATIONS

Recommendation 1

"Disallow unsupported contractual outlays of \$215,946 reported under the agreement."

Response: We believe that the \$215,946 contractual outlay should be allowed because the contracts in question were awarded in compliance with Department of Toxic Substances Control (DTSC) and State of California Architectural and Engineering contracting regulations and competitively bid contracting regulations and the intent of

Mr. Michael Rickey

Page 2

applicable Federal regulations and cost pricing. When DTSC's contract rates/costs for the services rendered were compared to Federal contract rates published in existing URS Corporation and Tetra Tech GSA Schedules, DTSC's contract rates were lower. It is our position that while the required Federal process/documentation was not in place when the contracts were let, DTSC has demonstrated that the contractual outlays were appropriately expended to provide the agreed upon work product funded by the grant. Upon becoming aware of the Federal procurement regulations, DTSC prepared price comparisons, justified the award of time and material contracts, shown profit as a separate line item, ensured that contracts awarded by its contractors complied with requirements, and demonstrated that the contract clauses required by Federal statutes were adhered to such that the contractual outlays were fair and reasonable.

The third contract with Accord Engineering was competitively bid under California's Certified Small Business Contracting authority and awarded to the lowest responsible bidder. It is our position that this competitive bid complies with the intent of 40 CFA 35.6585. When the competitively bid rates were subsequently presented in a format following the Federal regulations and cost pricing requirements and compared to comparable existing Federal GSA rates, the competitively bid rates were lower.

The documentation supporting our position that the \$215,946 contractual outlay should be allowed is available for your review. We would appreciate the opportunity to go over the material with you at your earliest convenience.

Recommendation 2

"Revoke the State's procurement system self-certification until adequate policies and procedures are in place to ensure compliance with Federal procurement regulations and cost principles."

Response: DTSC's procurement system has been substantially revised since the process was reviewed by the auditors earlier this year. The Contracts and Business Management Branch (CBMB) has put policies and procedures in place that comply with all Federal procurement regulations and cost principles and would be pleased to have the process we have put in place reviewed for compliance.

Recommendation 3

"Review and approve all State solicitations and contracts under EPA grants and cooperative agreements, other than small purchases, until the State's procurement system self-certification can be reinstated."

Mr. Michael Rickey

Page 3

Response: DTSC looks forward to EPA's expeditious review of our procurement system so that self-certification can be reinstated soon. Until such time that self-certification is approved, DTSC welcomes and invites EPA to review its EPA grant solicitations and contracts. A Federal Grant team composed of program, Contracting, Accounting and Management staff was formed to examine DTSC's grant process and procedures and to take corrective action to assure that all grant related activities are in compliance with all applicable regulations, policies and procedures. The result of this workgroup has been the development of procedures that include all potentially affected disciplines in the grant process beginning at the point of grant application. This assures that should there be contracted services and/or purchases of goods or commodities included in the grant application, the appropriate staff are involved from the beginning and can advise program staff on what must be done to comply with Federal procurement regulations and cost principles. This will provide the program grant administrators and program contract managers with the information needed to appropriately set its timeline to allow for time to conduct a federally based solicitation.

Recommendation 4

"Require the State to:

- Upgrade its procurement handbook to ensure compliance with all Federal regulations and cost principles.
- Develop procurement policies to supplement the California State-wide policies.
- Develop procedures for the negotiation of fair and reasonable contract prices.
- Provide adequate training to staff involved in procurement and contract management on Federal procurement regulations and cost principles.

Response: Since May 2005, CBMB has had policies and procedures in place that require all solicitation endeavors that could possibly be funded by EPA grants be advertised in a manner that clearly indicates that the Federal procurement regulations and cost principles will apply in addition to the State contracting requirements. We have changed procedures and improved our coordination efforts among program sections. As a part of this process, our procurement desk manuals and training materials have been updated to include all the Federal requirements. CBMB has refined its contract negotiation policies and procedures to provide for more structure and more direct involvement of CBMB staff in the negotiation. This procedural change gives CBMB control of the amount and timing of contact between program staff and contractor staff and will assure that program negotiators are knowledgeable about and comply with acceptable practices. This approach assures that there is adequate separation of duties between program staff and contractor staff.

Mr. Michael Rickey

Page 4

Statewide contract and purchasing training is scheduled to begin in the fall after the vacation season has ended. The training manual and related materials have been developed to provide detailed training on when and how to apply both the State and Federal procurement regulations and cost principles. As a part of the training, hands on contracting scenarios are being developed to afford the trainee with opportunities to apply the training principles and better understand when and how to apply appropriate contracting policies and procedures.

I look forward to having your staff review our current policies and procedures and documentation which demonstrates that the \$215,946 contractual outlays should be allowed.

If you have any questions concerning our response, please feel free to contact me at (916) 445-7076.

Sincerely,

Harriet Kiyon, Chief
Financial Operations
Department of Toxic Substances Control

cc: Wayne Nastri
Regional Administrator
EPA Region IX
75 Hawthorne Street, 18th floor
San Francisco, California 94105

Robert Adachi
Assignment Coordinator
EPA-OIG
75 Hawthorne Street, 7th Floor
San Francisco, California 94105-3901

Richard J. Hennecke
Audit Coordinator
75 Hawthorne Street, PMD - 4
San Francisco, California 94105

Timothy J. Swickard
Director
Department of Toxic Substances Control

Distribution

Region 9

Regional Administrator
Audit Coordinator

Headquarters Office

Director, Grants Administration Division
Director, Office of Grants and Debarment
Agency Followup Official (the CFO)
Agency Audit Followup Coordinator
Audit Followup Coordinator (GAD)

Office of Inspector General

Inspector General