



OFFICE OF INSPECTOR GENERAL

Catalyst for Improving the Environment

Attestation Report

Ozone Transport Commission Incurred Costs Under EPA Assistance Agreements XA98379901, OT83098301, XA97318101, and OT83264901

Report No. 2007-4-00068

July 31, 2007

Report Contributors:

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Abbreviations

CFR	Code of Federal Regulations
EPA	U.S. Environmental Protection Agency
FSR	Financial Status Report
OIG	Office of Inspector General
OMB	Office of Management and Budget
Recipient/OTC	Ozone Transport Commission



At a Glance

Catalyst for Improving the Environment

Why We Did This Review

We conducted this examination to determine whether (1) the incurred costs of \$9,042,706 fairly present the allowable costs under the U.S. Environmental Protection Agency (EPA) assistance agreements audited; (2) the amounts claimed by the recipient under EPA grants were reasonable, allocable, and allowable in accordance with the terms of the agreements and applicable regulations; and (3) the recipient achieved the intended results of the grants.

Background

EPA awarded four assistance agreements to the recipient for the following purposes: to coordinate Northeastern States' efforts to assess the degree of ozone transport, and strategies for mitigating interstate pollution; and to develop State implementation plans for reducing regional haze.

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/2007/20070731-2007-4-00068.pdf

Ozone Transport Commission Incurred Costs Under EPA Assistance Agreements XA98379901, OT83098301, XA97318101, and OT83264901

What We Found

In our opinion, with the exception of the questioned costs discussed below, 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. We questioned \$2,723,706 of the \$9,042,706 in reported outlays because the recipient claimed unallowable outlays for contractual services, indirect costs, and in-kind costs. Specifically, the recipient:

- Did not compete contracts, justify sole-source procurements, or perform cost analysis of contracts;
- Claimed indirect costs without approved indirect rates; and
- Did not maintain adequate documentation for in-kind costs used as recipient match.

We did not identify any concerns with the deliverables required by the grants.

What We Recommend

We recommend that EPA recover questioned outlays of \$2,723,706 unless the recipient provides sufficient documentation to support the related claimed costs in accordance with Federal regulations. We also recommend that EPA direct the recipient to implement procedures to address issues relating to procurement of contracts, indirect cost rates, and documentation of in-kind costs, and monitor the recipient's subrecipient and procurement activities until EPA is assured that the recipient is consistently meeting Federal requirements.



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

OFFICE OF
INSPECTOR GENERAL

July 31, 2007

MEMORANDUM

SUBJECT: Ozone Transport Commission Incurred Costs Under EPA Assistance Agreements
XA98379901, OT83098301, XA97318101, and OT83264901
Report No. 2007-4-00068

FROM: *John T. Walsh*
for Melissa M. Heist
Assistant Inspector General for Audit

TO: Richard Kuhlman
Director, Grants and Interagency Agreements Management Division

Donald S. Welsh
Regional Administrator
Region 3

This is our report on the subject audit conducted by the Office of Inspector General (OIG) of the U.S. Environmental Protection Agency (EPA). This report contains findings that describe the problems the OIG has identified and corrective actions the OIG recommends. This report represents the opinion of the OIG and does not necessarily represent the final EPA position. EPA managers in accordance with established audit resolution procedures will make final determination on matters in this report.

The estimated cost of this report – calculated by multiplying the project's staff days by the applicable daily full cost billing rates in effect at the time – is \$200,644.

Action Required

In accordance with EPA Manual 2750, Chapter 3, Section 6(f), you are required to provide us your proposed management decision for resolution of the findings contained in this report before any formal resolution can be completed with the recipient. Your proposed decision is due on November 28, 2007. To expedite the resolution process, please email an electronic version of your proposed management decision to kasper.janet@epa.gov.

We have no objections to the further release of this report to the public. For your convenience, this report will be available at <http://www.epa.gov/oig>. We want to express our appreciation for the cooperation and support from your staff during our review. If you have any questions, please contact Janet Kasper, Director, Assistance Agreement Audits, at (312) 886-3059.

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Background

We audited four assistance agreements awarded to the Ozone Transport Commission (recipient/OTC) totaling \$9,042,706. The recipient is a multi-state organization formed under Sections 176A and 184 of the Clean Air Act to advise EPA on transport issues and to develop and implement regional solutions to the ground level ozone problem in the Northeast and Mid-Atlantic regions. The recipient is an interstate government entity located in Washington, DC. OTC's members include the Northeastern States and the District of Columbia. The following table provides some basic information about the authorized project periods and funds awarded under each of the four agreements:

Assistance Agreement	Award Date	EPA Share	Recipient's Share	Total Costs	Project Period
XA98379901	03/12/2003	\$3,470,410	\$0	\$3,470,410	02/01/2003 – 01/31/2005
OT83098301	06/24/2003	1,297,763	1,086,333	2,384,096	06/13/2003 – 06/30/2005
XA97318101	12/29/2004	1,936,316	0	1,936,316	02/01/2005 – 06/30/2006
OT83264901	07/21/2005	633,592	618,292	1,251,884	06/01/2005 – 06/30/2006
Total		\$ 7,338,081	\$1,704,625	\$9,042,706	

Sources: The cost amounts shown were from the recipient's *Financial Status Reports/Federal Cash Transaction Reports*. The assistance agreements' information is from the recipient's grants documentation.

EPA awarded all four grants under the Clean Air Act.

Grants XA98379901 and XA97318101: These grants provide funds to OTC to assess and design strategies to reduce regional haze in the Northeastern United States. The recipient works with States and tribes to provide model State Implementation Plans for Regional Haze.

Grants OT83098301 and OT83264901: These grants provide funds for OTC's ongoing operations. The recipient coordinates the efforts of member States to assess the degree of ozone transport throughout the region and to assess strategies for mitigating interstate pollution. OTC also makes recommendations to EPA on measures that the States need to include in their plans to meet health-based standards. The grants support OTC's effort to provide member States with air quality related expertise and support ranging from monitoring, developing implementation strategies and model rules, and education and outreach.

We reviewed deliverables under these grants and discussed the recipient's performance with EPA project officers. The project officers reported that all deliverables were completed and the recipient's work was acceptable.

We issued a draft report to OTC on May 11, 2007. OTC responded to our report on June 25, 2007. OTC's response is included as Appendix B.

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

Reported Outlays: Program expenses or disbursements reported by the recipient on the Federal *Financial Status Reports*.

Questioned Outlays: Outlays that are (1) contrary to a provision of a law, regulation, agreement, or other documents governing the expenditures of funds; or (2) not supported by adequate documentation.

Independent Auditor's Report

We have examined the total outlays reported by the Ozone Transport Commission (recipient/OTC) under the EPA assistance agreements, as shown below:

Assistance Agreement	<i>Financial Status Reports</i>			
	Date Submitted	Period Ending	Total Outlays Reported	Federal Share of Outlays Reported
XA98379901	09/09/2005	01/31/2005	\$3,470,410	\$3,470,410
OT83098301	03/15/2007	06/30/2005	2,384,096	1,297,763
XA97318101	12/29/2006	06/30/2006	1,936,316	1,936,316
OT83264901	03/28/200	06/30/2006	1,251,884*	633,592
Total			\$9,042,706	\$ 7,338,081

Source: The total amounts claimed and Federal share amounts were from the recipient's *Financial Status Reports/Federal Cash Transaction Reports*.

*This amount is net of \$16,551 of program income.

The recipient certified that the outlays reported on the *Financial Status Reports*, Standard Form 269, were correct and for the purposes set forth in the agreements. Preparing and certifying the claims were the responsibility of the recipient. Our responsibility is 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 under the circumstances. We believe that our examination provides a reasonable basis for our opinion.

We questioned \$2,723,706 of the \$9,042,706 in reported outlays because the recipient claimed unallowable outlays for contractual services, indirect costs, and in-kind costs. Specifically, the recipient:

- Did not compete contracts, justify sole-source procurements, or perform cost analysis of contracts;
- Claimed indirect costs without approved indirect rates; and,
- Did not maintain adequate documentation for in-kind costs used as recipient match.

In our opinion, with the exception of the questioned 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. Details of our examination are included in the *Schedule of Reported Outlays and Results of Examination* that follows.

Janet Kasper
Office of Inspector General
U.S. Environmental Protection Agency
March 22, 2007

Results of Examination

We questioned outlays of \$2,723,706 because the recipient claimed unallowable outlays for contractual services, indirect costs, and in-kind costs. The questioned outlays are summarized below and detailed in the supporting schedules.

Assistance Agreement	Total Reported Outlays	Questioned Outlays	Amount Due EPA	Schedule
XA98379901	\$3,470,410	\$192,572	\$192,572	1
OT83098301	2,384,096	1,583,158	817,200	2
XA97318101	1,936,316	145,854	145,854	3
OT83264901	1,251,884	802,122	363,735	4
Total	\$9,042,706	\$2,723,706	\$1,519,361	

Sources: The reported outlay amounts shown were from the recipient's *Financial Status Reports/Federal Cash Transaction Reports*. The amounts questioned were based upon OIG analysis.

The recipient's internal controls were not sufficient to ensure that reported outlays complied with Federal regulations, as required. These weaknesses and the resulting questioned costs are described in the following paragraphs; details on costs questioned for each agreement are included in Schedules 1 through 4.

Improper Procurements

OTC could not demonstrate that it had obtained fair and reasonable prices when obtaining contractual and consulting services. Consequently, we questioned contract outlays of \$150,263 as unallowable.

Under 40 CFR Part 31.36 (d)(1), small purchase procedures are those relatively simple and informal procurement methods for securing services, supplies, or other property that do not cost more than \$100,000. If small purchase procedures are used, price or rate quotations shall be obtained from an adequate number of qualified sources. In cases where sole source awards are made, a cost analysis is required for noncompetitive proposals in accordance with 40 CFR 31.36(d)(4).

According to 40 CFR 31.36 (b)(9), grantees will maintain records sufficient to detail the significant history of a procurement. These records will include, but are not necessarily limited to, the following: rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis for the contract price.

The OTC Procurement Policy Manual Section III.D states that OTC will obtain competitive bids to the extent it is practical and in accordance with good business practices. In procurements from \$1,000 to \$14,999, verbal quotes from two vendors are required. Written quotes from at least three vendors are required for procurements ranging from \$15,000 to \$49,999. Amounts in excess of \$50,000 require a formal closed solicitation, where bid documents are forwarded to potential bidders.

We reviewed five contracts valued at \$164,453. One, M.J. Bradley, was for consulting services. The remaining four were for various other technical services. All of these contracts were under the small purchase threshold of \$100,000. We questioned \$150,263 because the recipient did not adhere to Federal regulations or its own procurement procedures.

Contractor/Consultant	Total Amount Claimed	Amount Questioned
Bruce Carhart	\$ 9,220	\$ 9,220
EarthTech	74,885	74,885
Environ	36,456	36,456
ICF	29,702	29,702
M.J. Bradley	14,190	0
Total	\$164,453	\$150,263

Sources: The total amounts claimed were from the recipient's books and records. The amounts questioned were based upon the OIG analysis.

Under two separate procurements (EarthTech and Environ), OTC awarded sole source contracts because the contractors were the only firms that responded to its requests for proposals. Forty CFR 31.36(d)(1) requires OTC to perform and document a cost analysis for each contract when competition is lacking. However, the recipient could not provide any such documentation. We, therefore, questioned claimed amounts for EarthTech and Environ.

OTC did not follow Federal procurement requirements or its own procurement procedures when awarding a sole source, small purchase time and materials contract to ICF. OTC did not perform a required cost analysis to determine if the contracted rates proposed by ICF were reasonable. Also, in accordance with OMB Circular A-87(c)(2), OTC is required to ensure that all costs charged under its grants are reasonable. However, the invoice provided by ICF was a one-line charge that did not break down the rates charged for its services. ICF did not submit sufficient detail or support for OTC to properly review the charges. Therefore, OTC could not determine if costs billed were reasonable and met the terms and conditions of the contract.

A fourth contractor, Bruce Carhart, was OTC's former Executive Director. OTC contracted with Carhart to perform consulting services. The current Executive Director stated that he performed a limited cost analysis of comparable consulting rates prior to negotiating a contract with Carhart. However, OTC was unable to provide the OIG with

any documentation to support this analysis. OTC did not comply with 40 CFR 31.36 (d) (1) which requires a cost analysis when competition is lacking. Because OTC could not provide documentation to support the required cost analysis, we questioned total costs for the contract of \$9,220.

Auditee Response

OTC disagreed with the conclusion that it has not consistently complied with the procurement requirements of 40 CFR Part 31 and OMB Circular A-87. It acknowledged difficulty in providing some of the information requested during our review, but said that it has full management systems in place that are consistent with, and more stringent than, Federal requirements.

OTC stated that it followed its internal procedures for procuring these contracts but good documentation of that was not readily evident in its files and OTC no longer employed the staff that managed the process. OTC's analysis showed the costs paid for the Environ, EarthTech, and ICF contracts were reasonable. The analyses consisted of comparing the proposed labor costs to the costs of two other firms who were capable of doing the work but who did not respond to the original contract proposal. OTC said the reasonableness of the Bruce Carhart contract was determined by comparing Carhart's proposed hourly rate to a rate listed in a GSA database for comparable work.

To resolve the reported findings, OTC said that it:

- reviewed and supplemented its procurement files to assure that they meet the requirements of 40 CFR Part 31 and OMB Circular A-87,
- prepared cost analyses for each of the contracts and included them as an attachment to its response,
- revised its procurement policies to add statements from 40 CFR Part 31 and OMB Circular A-87,
- will ensure that cost analyses are performed for all procurements,
- will provide new employees with contracts and grants management training, and will restructure its procurement filing system to provide more detail.

OIG Analysis

We have not revised our questioned costs or recommendations on procurement practices. OTC has not provided evidence that it performed the cost analyses required by 40 CFR 31.36(d)(4) for sole source contracts. This section defines a cost analysis as verifying the proposed cost data, the projections of the data, and the evaluation of the specific elements of costs and profit. OTC's comparisons of proposed labor rates to labor rates of other firms meet the requirements of a price analysis (comparing price quotes submitted), not a cost analysis. OTC compared prices, but did not verify the proposed data and evaluate the elements of cost and profit. Since the contracts were awarded without competition,

OTC could not perform a cost analysis, as required. OTC can improve its compliance with the procurement requirements of 40 CFR 31 and OMB Circular A-87 by following the procedures it listed in its response to our findings.

Unallowable Indirect Costs

We questioned unallowable indirect costs of \$868,818, as follows:

Assistance Agreement	Total Amount Claimed	Amount Questioned
XA98379901	\$ 155,120	\$ 155,120
OT83098301	402,754	402,754
XA97318101	145,854	145,854
OT83264901	214,440	165,090
Total	\$918,168	\$868,818

Sources: The total amounts claimed were from the recipient's *Financial Status Reports/Federal Cash Transaction Reports*. The amounts questioned were based upon the OIG analysis.

OMB Circular A-87, Attachment E, section D.1.d states that an indirect cost rate proposal must be developed and, when required, submitted within 6 months after the close of the governmental unit's fiscal year, unless the cognizant Federal agency approves an exception. In addition, OTC's grants included a condition requiring annual submission and approval of indirect cost rates.

OTC submitted an indirect rate proposal to EPA for the fiscal year ended March 31, 2003. EPA did not approve the proposal and OTC did not submit any additional proposals between 2003 and 2007. The recipient submitted a proposed indirect cost rate plan for FY 2007, and the Department of the Interior approved the provisional rate under an agreement with EPA.

Because of OTC's non-compliance with the indirect rate requirements of OMB Circular A-87 and its grant conditions for Fiscal Years 2003 through 2006, OTC improperly claimed \$868,818 in indirect costs.

Auditee Response

OTC stated that it submitted an indirect cost rate proposal for FY 2003 but EPA never responded to OTC's submission. OTC subsequently assumed the rate had been approved because it cited the rate and the pending rate proposal in all of its grant applications and EPA awarded those grants with the proposed rate. OTC also said it had an agreement with EPA to submit its indirect rate proposals for FY 2005 and FY 2006 whenever its financial audits for those years were completed. OTC completed these audits and OTC gave EPA proposals for FYs 2005 and 2006 in May 2007. In addition, the indirect cost rate for FY 2007 had been submitted and approved previously. To improve the timeliness of submission in the future, OTC said it has developed formats and worksheets

to assist with the computation of indirect rates and compliance with documentation requirements.

OIG Analysis

We continue to question indirect costs of \$868,818. OTC claimed indirect costs using unapproved rates and had not submitted the rates annually as required by OMB Circular A-87 and the conditions of its grants. OTC prepared indirect cost rate proposals for FY 2006 and FY 2005 and submitted them to EPA. However, the rates remain unapproved. EPA has not approved OTC's FY 2003 rate. OTC did not address the lack of a submitted or approved rate for FY 2004. Once all indirect cost rates are submitted to and approved by EPA, the related indirect costs would be allowable.

OTC did not submit, as part of its response, the indirect cost rate formats and worksheets that it used to improve its timeliness of future indirect cost rate submissions. Therefore, we cannot say with certainty that OTC's corrective action will ensure future timeliness.

Unallowable and Unsupported In-Kind Costs

OTC claimed in-kind costs without determining the allowability of the costs. Therefore, EPA had no assurance that OTC met the matching requirements of its grants. Consequently, we questioned in-kind outlays of \$1,704,625 as unallowable, as follows:

Assistance Agreement	Total In-Kind Costs Claimed	Questioned In-Kind Costs
OT83098301	\$1,086,333	\$1,086,333
OT83264901	618,292	618,292
Total	\$1,704,625	\$1,704,625

Sources: The total amounts claimed were from the recipient's *Financial Status Reports/Federal Cash Transaction Reports*. The amounts questioned were based upon the OIG analysis.

Under 40 CFR 31.24, in-kind contributions include allowable costs incurred by a grantee, subgrantee, or cost-type contractor. This includes the value of third party in-kind contributions applicable to the grant period. Costs and third party contributions must be verifiable to grantee records. The records must show how the value placed on third party in-kind contributions was derived. Third party in-kind contributions count towards a cost sharing or matching requirement only where, if the party receiving the contributions were to pay for them, the payments would be allowable.

OMB Circular A-87 Attachment A.1 and Attachment B.8 and B.12 state that costs can only be used for the matching requirement in one Federal award, in either the current or prior period. The Circular also states that the value of donated services may be used to meet cost sharing or matching requirements and that donated services will be supported

by the same methods used by the governmental unit to support the allocability of regular personnel services.

OTC was unable to determine if in-kind contributions were supported by allowable costs and complied with the above requirements. Member States submitted the following types of in-kind contributions: salaries, fringe benefits, travel, supplies, and other costs. Documentation that each State submitted to OTC differed. Data packages were incomplete, and detail-supporting documents were not summarized or did not agree to amounts included on summary sheets. One State did not submit supporting data to OTC in time for recording in the general ledger. Some States only submitted a one-page letter summarizing their costs by category. Others submitted combinations of summary reports and backup documentation (such as employee timesheets and travel vouchers). The backup documentation either was incomplete or did not trace to cost summaries. None of the states included statements and signatures that attested to the accuracy and allowability of the costs.

We also found that OTC does not formally document its review and approval of in-kind contributions. When States submit their reports of in-kind contributions, OTC summarizes the costs and records them in its accounting records. OTC informed us that it reviews the recorded costs but the process is not formally documented, such as with an approval stamp or with the initials and dates of the reviewer. Lack of a formal documented review process increases the risk of errors. For example, in four cases we found that OTC's quarterly summaries did not agree to the States' quarterly reports, once for Vermont and three times for Massachusetts. OTC should revise its review process for State contributions to include formal documentation of the review and a clear statement of the review steps performed.

Because (1) support for in-kind contributions did not meet the requirement of OMB Circular A-87 and 40 CFR 31.24, and (2) OTC lacks a formal review process for in-kind contributions, we questioned total in-kind contribution claimed of \$1,704,625.

Auditee Response

OTC said that it has been following its procedures for State matching documentation since 1993. The procedures allowed for various types of documentation from member States to support their matching contributions. OTC acknowledged that some States do not use separate project numbers or identifiers to accumulate hours and costs incurred for OTC work but said that it discussed the contributions with member States and understood that the States only included time spent on OTC related work in their matching contributions. In addition, OTC said that the sections of 40 CFR Part 31 and OMB Circular A-87 cited in our report were not sufficiently detailed and did not provide sufficient guidance on what constitutes adequate documentation.

OTC included written procedures that it follows when collecting and reviewing State matching contributions, an outline of how States meet their matching contributions, and a list of the work and projects that the States have completed.

To resolve the reported findings OTC said it is:

- reviewing State matching records to supplement and verify that the matching amounts are allowable in accordance with 40 CFR 31.24 and OMB Circular A-87,
- working with the States to establish time sheet codes for OTC work,
- developing alternative documentation procedures when States are unable to adopt time sheet coding for OTC work,
- reviewing documents States submitted to support their matching contribution, indicating approval with the initials of the reviewer and date, and returning unapproved submissions for additional documentation, and
- updating the OTC Financial Management Policies Manual to include a section on collecting, documenting, reviewing, and approving State matching contributions.

OIG Analysis

OTC did not provide any additional documents that demonstrate the allowability of matching costs. Without any further documentation, we have no basis to conclude that the costs are allowable.

OMB Circular A-87 and 40 CFR Part 31 provides requirements for allowability of State matching contributions. A general requirement at 40 CFR 31.24(b)(7)(i) states that third party in-kind contributions count towards satisfying a cost sharing or matching requirement only where, if the party receiving the contributions were to pay for them, the payments would be allowable costs. The allowability and documentation requirements for other cost elements are also provided. Requirements for salary costs, for example, are listed in 40 CFR 31.24(c) (2). It states that when an employer other than a grantee, subgrantee, or cost-type contractor furnishes free of charge the services of an employee in the employee's normal line of work, the services will be valued at the employee's regular rate of pay exclusive of the employee's fringe benefits and overhead costs. Additional requirements for salary costs are presented in OMB Circular A-87 Attachment B (8) (h) (1) and (5).

If OTC follows the procedures it listed in its response, it will improve compliance with the requirements of 40 CFR Part 31 and OMB Circular A-87.

Recommendations

We recommend that EPA's Director, Grants and Interagency Agreements Management Division:

1. Require the recipient to provide adequate support for the questioned contractual costs, indirect costs, and in-kind costs, totaling \$2,385,280 under assistance agreement nos. OT83098301 and OT83264901, and disallow and recover the Federal share of any outlays which are not supported.

We recommend that EPA's Region 3 Regional Administrator:

2. Require the recipient to provide adequate support for the questioned contractual and indirect costs, totaling \$338,426 under assistance agreement nos. XA98379901 and XA97318101, and disallow and recover the Federal share of any outlays which are not supported.

We recommend that EPA's Director, Grants and Interagency Agreements Management Division:

3. Require the recipient to implement the proposed procedures that were identified in the recipient's response to the draft report to ensure that:
 - a. Procurements are conducted in accordance with Title 40 CFR Part 31.36.
 - b. Indirect cost proposals are submitted to, and approved by EPA, in accordance with OMB Circular A-87 and applicable EPA grant requirements.
 - c. Documentation for in-kind contributions includes evidence that the donated services were properly valued in accordance with Title 40 CFR 31.24 and OMB Circular A-87.
4. Periodically monitor the recipient's procedures for reviewing and claiming subrecipient costs and for awarding and documenting procurements, until EPA is satisfied that the recipient is complying with Federal requirements.

Schedules of Reported Outlays and Results of Examination

Schedule 1 Reported Outlays and Results of Examination for Assistance Agreement XA98379901

Description	Amount	Questioned Outlays	Note
Personnel	\$ 174,072	\$ 0	
Fringe Benefits	49,492	0	
Travel	48,471	0	
Supplies	161	0	
Contractual	60,898	37,452	1
Subrecipients	2,945,355	0	
Other	36,842	0	
Indirect Costs	155,120	155,120	2
In-Kind Costs	0	0	
Less: Program Income	0	0	
Subtotal	3,470,411	\$192,572	
Reported Outlays	3,470,411		
Less: Questioned Costs	(192,572)		
Adjusted Total Outlays	3,277,839		
Less: Recipient Share	0		
Federal Share	3,277,839		
EPA Payments	3,470,411		
Due EPA	\$ 192,572		

Sources: The total reported outlays and amounts claimed were from the recipient's *Financial Status Reports/Federal Cash Transaction Reports*. The amounts questioned were based upon the OIG analysis

Note 1: See discussion of improper procurement in the **Results of Examination**.

Note 2: See discussion of unallowable indirect costs in the **Results of Examination**.

Schedule 2
Reported Outlays and Results of Examination for
Assistance Agreement OT83098301

Description	Amount	Questioned Outlays	Note
Personnel	\$ 356,103	\$ 0	
Fringe Benefits	104,923	0	
Travel	89,042	0	
Supplies	22,970	0	
Contractual	200,010	94,071	1
Subrecipients	0	0	
Other	121,961	0	
Indirect Costs	402,754	402,754	2
In-Kind Costs	1,086,333	1,086,333	3
Less: Program Income	0	0	
Subtotal	\$2,384,096	\$1,583,158	
Reported Outlays	\$2,384,096		
Less: Questioned Costs	(1,583,158)		
Adjusted Total Outlays	\$800,938		
Less: Recipient Share- 40%	(320,375)		4
Federal Share	480,563		
EPA Payments	\$1,297,763		
Due EPA	\$ 817,200		

Sources: The total reported outlays and amounts claimed were from the recipient's *Financial Status Reports/Federal Cash Transaction Reports*. The amounts questioned were based upon the OIG analysis

- Note 1: See discussion of improper procurement in the **Results of Examination**. Costs questioned were for the following contractors: EarthTech - \$18,693; Environ -\$36,456; ICF Consultants - \$29,702; and Bruce Carhart - \$9,220.
- Note 2: See discussion of unallowable indirect costs in the **Results of Examination**.
- Note 3: See discussion of unallowable and unsupported in-kind costs in the **Results of Examination**.
- Note 4: The allowable recipient share was calculated by applying the recipient's 40 percent cost share matching requirement to total allowable outlays.

Schedule 3
Reported Outlays and Results of Examination for
Assistance Agreement XA97318101

Description	Amount	Questioned Outlays	Note
Personnel	\$170,220	\$ 0	
Fringe Benefits	47,773	0	
Travel	30,868	0	
Supplies	628	0	
Contractual	14,340	0	
Subrecipients	1,487,824	0	
Other	38,809	0	
Indirect Costs	145,854	145,854	1
In-Kind Costs	0	0	
Less: Program Income	0	0	
Subtotal	\$1,936,316	\$145,854	
Reported Outlays	\$1,936,316		
Less: Questioned Costs	(145,854)		
Adjusted Total Outlays	1,790,462		
Less: Recipient Share	0		
Federal Share	1,790,462		
EPA Payments	1,936,316		
Due EPA	\$145,854		

Sources: The total reported outlays and amounts claimed were from the recipient's *Financial Status Reports/Federal Cash Transaction Reports*. The amounts questioned were based upon the OIG analysis

Note 1: See discussion of unallowable indirect costs in the **Results of Examination**.

Schedule 4
Reported Outlays and Results of Examination for
Assistance Agreement OT83264901

Description	Amount	Questioned Outlays	Note
Personnel	\$221,369	\$ 0	
Fringe Benefits	51,551	0	
Travel	28,563	0	
Supplies	521	0	
Contractual	27,556	18,740	1
Subrecipients	0	0	
Other	106,142	0	
Indirect Costs	214,441	165,090	2
In-Kind Costs	618,292	618,292	3
Less: Program Income	(16,551)	0	
Subtotal	\$1,251,884	802,122	
Reported Outlays	\$1,251,884		
Less: Questioned Costs	(802,122)		
Adjusted Total Outlays	449,762		
Less: Recipient Share- 40%	(179,905)		4
Federal Share	269,857		
EPA Payments	633,592		
Due EPA	\$363,735		

Sources: The total reported outlays and amounts claimed were from the recipient's *Financial Status Reports/Federal Cash Transaction Reports*. The amounts questioned were based upon the OIG analysis

- Note 1: See discussion of improper procurements in the **Results of Examination**. Costs questioned were for the EarthTech contract.
- Note 2: See discussion of ineligible indirect costs in the **Results of Examination**.
- Note 3: See discussion of unallowable and unsupported in-kind costs in the **Results of Examination**.
- Note 4: The allowable recipient share was calculated by applying the recipient's 40 percent cost share matching requirement to total allowable outlays.

Status of Recommendations and Potential Monetary Benefits

RECOMMENDATIONS						POTENTIAL MONETARY BENEFITS (in \$000s)	
Rec. No.	Page No.	Subject	Status ¹	Action Official	Planned Completion Date	Claimed Amount	Agreed To Amount
1	12	Require the recipient to provide adequate support for the questioned contractual costs, indirect costs, and in-kind costs, totaling \$2,385,280 under assistance agreement nos. OT83098301 and OT83264901, and disallow and recover the Federal share of any outlays which are not supported.	U	Director, Grants and Interagency Agreements Management Division	TBD	\$2,385	
2	12	Require the recipient to provide adequate support for the questioned contractual and indirect costs, totaling \$338,426 under assistance agreement nos. XA98379901 and XA97318101, and disallow and recover the Federal share of any outlays which are not supported.	U	Region 3 Regional Administrator	TBD	\$338	
3	12	Require the recipient to implement the proposed procedures that were identified in the recipient's response to the draft report to ensure that: (a) procurements are conducted in accordance with Title 40 CFR Part 31.36; (b) indirect cost proposals are submitted to, and approved by EPA, in accordance with OMB Circular A-87 and applicable EPA grant requirements; and, (c) documentation for in-kind contributions includes evidence that the donated services were properly valued in accordance with Title 40 CFR 31.24 and OMB Circular A-87.	U	Director, Grants and Interagency Agreements Management Division	TBD		
4	12	Periodically monitor the recipient's procedures for reviewing and claiming subrecipient costs and for awarding and documenting procurements, until EPA is satisfied that the recipient is complying with Federal requirements.	U	Director, Grants and Interagency Agreements Management Division	TBD		

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

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 recipient complied with all applicable laws and regulations, as well as with any special requirements under the agreement. We conducted our fieldwork from November 27, 2006, through March 22, 2007.

In conducting our examination, we performed procedures as detailed below:

- We interviewed EPA personnel, reviewed grants, and project files to obtain background information on the recipient and the agreements.
- We interviewed recipient personnel to understand the accounting system and the applicable internal controls as they relate to the reported outlays.
- We reviewed a 2006 EPA contractor's report on OTC's Financial Management System, and the Fiscal Years 2003, 2004, 2005, and 2006 single audit reports, to identify issues that may impact our examination.
- We reviewed the recipient'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 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.

We verified that the recipient performed all tasks and provided all deliverables required under the agreement.

The Office of Inspector General has not audited OTC before. Followup of prior findings was, therefore, not necessary.

Recipient Response

June 25, 2007



Ms. Leah Nikaidoh
 US EPA Office of Inspector General
 US EPA Facilities
 26 West Martin Luther King Drive
 Mail Code: NWD
 Cincinnati, OH 45268

RE: OTC Response to EPA Office of Inspector General Draft Attestation Report Findings

Dear Ms. Nikaidoh:

On May 11, 2007, the EPA Office of Inspector General (OIG) transmitted its draft Attestation Audit Report of the Ozone Transport Commission (OTC) for our review and response. The OTC appreciates this opportunity to respond to the draft report.

Introduction

The draft report identified three key findings that the OIG, in its opinion, cites as the reasons for its questioning \$2,723,706 of the \$9,042,706 in reported outlays for the period covered by the audit for EPA Assistance Agreements XA98379901, OT83098301, XA97318101, and OT83264901. Specifically, the OIG states that OTC claimed unallowable outlays for contractual services, indirect costs, and in-kind costs because we:

- Did not compete contracts, justify sole source procurements, or perform cost analysis of contracts; and
- Claimed indirect costs without approved indirect rates; and
- Did not maintain complete, detailed documentation for in-kind costs used as recipient match.

In its draft report the OIG further recommends that EPA (1) recover the questioned outlays of \$2,723,706 unless OTC provides sufficient documentation to support the related claimed costs in accordance with Federal regulations; (2) direct OTC to establish procedures to address issues relating to procurement of contracts, indirect cost rates, and documentation of in-kind costs; and, (3) monitor OTC's subrecipient and procurement activities until EPA is assured that we are consistently meeting Federal requirements.

Connecticut

Delaware

District of Columbia

Maine

Maryland

Massachusetts

New Hampshire

New Jersey

New York

Pennsylvania

Rhode Island

Vermont

Virginia

Christopher Recchia
 Executive Director

444 N. Capitol St. NW
 Suite 638
 Washington, DC 20001
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We respectfully disagree with the OIG's assertion that OTC is not consistently meeting Federal requirements in its subrecipient and procurement activities, and that we lack adequate procedures to address issues related to procurement of contracts, indirect cost rates, and documentation of in-kind costs. While we acknowledge difficulty in providing some of the information requested during the Audit, OTC has full management systems in place consistent with, and more stringent than, the 40 CFR Part 31 Requirements and OMB Circular A-87.

The period covered by the Audit represented a transition from previous management to current management, during which improvements in our internal controls were implemented upon recognizing that systems had been lacking. Since 2004, OTC has been engaged in a process to improve its internal policy and guidance practices, strengthen its financial management systems, and enhance and update its documentation of these controls and systems. Our systems are sound, appropriate for an organization of our size, and generate complete and accurate information. Indeed, we believe it was evident to the OIG as it conducted the Audit that the later records from the audit period provided better documentation and comported with Federal requirements.

We will discuss each of the OIG's findings individually to explain the actions we have taken since the completion of the auditors' visit and will continue to work on during EPA's 120-day period to respond once they have received the OIG's final report. It is our goal to provide sufficient documentation, per the recommendations in the draft report, to support the costs in question to EPA's satisfaction. As you know, OTC is 100 percent funded by Federal EPA funds; as such we have no other funding available for recovery of these costs.

Regardless of these difficulties, we are confident that we can resolve these issues by continuing to work in coordination with our EPA Project Officer, Grants Administration Division, and EPA/OAR management to assure them that OTC is consistently meeting Federal requirements. We have viewed this Audit constructively and continue to improve staff and system capabilities to enhance our internal controls and performance. We would welcome the opportunity for EPA to return in the near future to revisit these issues, and hope you will be receptive to this offer and request.

The following sections address the specific areas of concern identified in the OIG draft report and the actions we are taking.

I. Competition of Contracts

OTC did follow its internal procedures regarding procurements made using its grant funds; however, good documentation of those procedures was not readily evident in the records for the procurements the OIG reviewed during its audit. The procurements for Earth Tech and Environ were done competitively, in accordance with OTC's policy at that time, but only one response was received for each of these solicitations. The staff managing the procurement process at that time did engage a group of OTC member state

staff as a review panel for each of the procurements. Complete documentation of that review process was not available in the procurement records, however, and the staff that initiated the procurement actions were no longer with OTC. Therefore, we could not provide them to the OIG.

Regarding the ICF contract, OTC engaged their services for the purpose of running the Integrated Planning Model (IPM), to compare alternative OTC policy scenarios to EPA's own CAIR program, using the same cap and trade framework as provided in the CAIR program. The goal was to compare the cost of the OTC policy scenarios (using some different emission reduction and fuel cost parameters and other variables from those in the EPA's model run) with that of the EPA CAIR program. Since we needed to have a result that would be comparable to EPA-developed information, it was important to use the same modeling platform used by EPA, which is IPM. IPM is a proprietary product of ICF, Inc., and therefore cannot be run by a competing firm. To our knowledge, there are no other models in the public domain that exactly replicate IPM. Therefore, we contracted with ICF on a sole-source basis. No cost analysis for the IPM runs quoted in the statement of work from ICF were performed because (1) we were familiar that ICF charged costs to other entities for IPM runs that were in the range of \$8,000 – 12,000, and (2) we assumed that since ICF designed IPM in collaboration with EPA that these costs were "reasonable," since only ICF can set the price for a model run.

In the case of the procurement with Bruce Carhart and Associates, LLC, it was also made on a sole source basis. Bruce Carhart was Executive Director of OTC during the period December 16, 1991 to March 15, 2003. In the transition to the new Executive Director, there were a number of issues that required significant historical knowledge of OTC records and procedures that no other staff at OTC possessed. During the development of the contractual agreement with Mr. Carhart's firm, Chris Recchia, the new Executive Director, had an e-mail dialogue with Mr. Carhart about the proposed agreement in which he negotiated both the work and the consultant's hourly rate, based on comparisons with information in the GSA database on comparable firms. These negotiations provide the basis for a cost analysis and are included in this report as an attachment.

To correct this finding in accordance with the OIG's recommendation, we have reviewed the procurements cited in the OIG report to supplement and verify that the procurement documentation includes information that validates their conformance with 40 CFR Part 31 and OMB Circular A-87 requirements. Cost analyses for each of the procurements are provided as Attachments 1a-d. In addition, we are also taking the following actions:

- Revising the OTC procurement policy to include more specific citations from 40 CFR Part 31 and OMB Circular A-87 that describe procedures for small purchases, maintaining details of the procurement history, performing and documenting a cost analysis for each contract when competition is lacking, performing a cost analysis to determine if rates are reasonable, and other applicable procedures; and
- Ensuring that cost analyses are performed for all procurements, including any which solicit a response only from a single bidder; and

- Providing new employees with contracts and grants management training; and
- Revamping OTC's filing system for procurements, to provide more detail on specific documentation categories which will assist OTC staff in maintaining a proper procurement history for each contract or grant.

II. Indirect Costs

During an April 26, 2006 follow-up meeting with EPA's Grants Administration Division (GAD) concerning the limited scope review they conducted in 2005 on OTC's administrative and financial management systems of EPA grant funds, we discussed how to proceed with our indirect cost proposals for FY 2005 and FY 2006, which had not previously been submitted. This oversight was due to a difference in perspective between OTC and EPA with regard to its 2003 indirect cost proposal, which was never responded to by EPA. From OTC's perspective, the indirect cost rate was presumed approved as we cited the rate and the pending indirect cost rate application in all our grant applications to EPA and grants awarded by EPA to OTC utilized and approved that rate.

We came to the agreement that OTC would submit its indirect cost proposals for FY 2005 and FY 2006 as soon as we completed our financial audits for those years. Those financial audits are now completed, and we have submitted our proposals for indirect cost rates for FY 2005 and FY 2006 to EPA. They are currently in review by the U.S. Department of Interior's National Business Center. We previously submitted and received approval of our indirect cost rate for FY 2007, and are working to submit our proposal for FY 2008 as soon as possible. As part of this work, our new accountant has developed appropriate formats and worksheets to assist with the computation of the rate and compliance with other documentation requirements for indirect cost proposals so that we can be timely with our submissions in the future. Copies of the correspondence submitting our FY 2005 and FY 2006 indirect cost proposals to EPA are provided as Attachments 2a and 2b to this document.

III. State Match Documentation

OTC has been following the state match documentation procedures that have been in place since the first grant match was required in 1993. These procedures allowed for various types of documentation from the OTC member states in support of to their individual state match contributions.

At the end of each quarter of OTC's fiscal year, which begins in April, we send to our state member administrative contacts (see Attachment 3a, Administrative Contacts for State Match) detailed listings of the conference calls and a listing of meetings that occurred during that quarter (see Attachment 3b, State Match Instructions). The level of detail on the conference call reports has varied depending on the provider OTC was using, but generally at least the individual callers' telephone numbers were included as part of the record for each call, along with the duration of the call and its subject matter/group. The states use these records to help track and verify their participation on

OTC Committees, workgroups, and other work projects (see Attachment 3c, Sample Submission Packages, from April 2003 and January 2001).

It is our understanding from discussions with our members regarding their contributions that only time spent on OTC-related work is included in their state match documentation (see Attachment 3d, Qualifying Expenditures for State Match, dated May 15, 2003). This is true even though a number of OTC member states did not have a timesheet code corresponding to time spent on OTC work in their timekeeping systems (which the OIG indicated as their preferred form of documentation for in-kind contributions for regular state personnel services). Thus they were not reporting time spent doing work paid for by Section 105 grants or other federal funds. Both Rhode Island and the District of Columbia do not report state match for OTC because their air staff positions are fully funded from Section 105 grants.

From our conversations with the OIG and with EPA Grants Administration personnel and our EPA Grants Project Officers, we understand that there are no written EPA procedures or guidance for what constitutes acceptable documentation for state match purposes. The references we were cited for this purpose are the sections of the 40 CFR and OMB Circular A-87 that pertain to the subject of state match requirements, which are not particularly detailed. We were under the assumption that we were following a well-tested set of procedures that had been established and agreed to with EPA from the inception of the OTC. As we now understand that these procedures may not satisfy the OIG's requirements for documentation of state match, we are taking the following actions:

- Reviewing state match records for EPA Assistance Agreements OT8398301 and OT83264901 to supplement and verify that the match amounts are allowable in accordance with 40 CFR 31.24 and OMB Circular A-87; and
- Establishing with states, where possible, timesheet coding corresponding to OTC work and projects (note that this will not be possible for all OTC states to do); and
- Developing alternative documentation protocols for in-kind state personnel services for states unable to adopt timesheet codes, and for other types of in-kind contributions in collaboration with our state members, subject to the acceptance of EPA GAD and our EPA Grant Project Officer; and
- Reviewing state match contribution submissions and updates when they are submitted, acknowledging approval with the initials of the reviewer and date, and returning unapproved submissions to states for additional documentation; and
- Updating our OTC Financial Management Policies Manual to include a section on procedures for collecting information for, documenting and reviewing and approving state match contributions.

We are also providing a written estimate outlining, in general, how the OTC states meet their match contribution for the EPA grant that supports OTC's basic operations. In addition, we are including a specific list of the work and projects that OTC produced from 2003 through 2006 that member states were engaged in substantively, devoting

numerous hours of their time performing analyses, developing inputs to models and performing model runs, composing documents and presentations, preparing reports, reviewing reports and other documents, co-managing contractual work, and providing policy perspectives, among other efforts (see Attachment 3e, Estimate for OTC State Match Contributions). More specific reports on state member contributions are provided in the quarterly reports that the state administrative contacts provide to OTC during the course of the grant year. It should be noted that OTC has always managed to meet or exceed its state match goals because of the significant work hours that member states spend to ensure that OTC accomplish its mission.

We hope that the information we have provided in this response to the draft OIG Attestation Report will assure you that we are proactively taking the proper actions to resolve the findings you outlined, and to ensure that the OTC continues to manage its federal EPA grant funds responsibly. We will also request a meeting between our OTC officers and appropriate representatives of EPA's Office of Air and Radiation and Grants and Debarment to discuss our comments and other OTC issues.

Please contact me if you have any questions or need further information.

Sincerely,

Anna Garcia

Enclosures

cc: Bill Spinazzola
Rich Howard
Pat Childers
Marcia Spink

Distribution

EPA Headquarters

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Director, Office of Grants and Debarment
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