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

OFFICE OF
INSPECTOR GENERAL

October 19, 2007

Randy Spencer OEPA
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MEMORANDUM

SUBJECT: Ineligible Costs under EPA Grant No. XP97579701
Awarded to the Village of Laurelville, Ohio
Assignment No. 2007-000950

FROM: Janet Kasper
Director of Assistance Agreement Audits

TO: Jason Hettinger
Mayor
Village of Laurelville, Ohio

Mary A. Gade
Regional Administrator
EPA Region 5

This is a discussion draft report that summarizes issues we identified in our review of the referenced grant to the Village of Laurelville, Ohio. The purpose of this discussion draft is to verify the accuracy of the information presented and to obtain comments from the grantee and the U.S. Environmental Protection Agency's (EPA's) Region 5 on the findings and recommendations. This discussion draft report is subject to revision by the EPA Office of Inspector General and, therefore, does not represent our final position on the subjects reported. It is provided to you solely for obtaining your review and comments. You are not authorized to distribute or disclose this draft or its contents, except that you may distribute it to other persons in your organization to obtain their review and comments on the subjects reported.

Action Required

We request that you review this discussion draft within 7 days of the report date. No written response to this discussion draft report is required. We would like to hold a meeting with you on October 26, 2007 to discuss the factual accuracy of this report. After that meeting, we will revise the report as needed and issue the final report.

If you or your staff has any questions regarding this report, please contact me at (312) 886-3059 or kasper.janet@epa.gov, or Randy Holthaus at (214) 665-6620 or holthaus.randy@epa.gov.

cc: Stephanie Crossland, EPA Region 5 Special Appropriation Act Projects Coordinator
Eric Levy, EPA Region 5 Audit Coordinator
Bill Roderick, Acting Inspector General
Melissa Heist, Assistant Inspector General for Audit
John Manibusan, EPA OIG Office of Congressional and Public Liaison

Purpose

During our review of Special Appropriation Act Projects (SAAP), the following condition came to our attention that we believe requires immediate attention. The Village of Laurelville, Ohio (grantee) did not maintain an acceptable financial management system, as required by Title 40, Code of Federal Regulations (CFR), sections 31.20(b)(2) and (b)(5), to support project costs of $513,268. As a result, we were unable to determine total project costs or the allocation of grant funds and the recipient's matching funds. Therefore, we are questioning the entire Federal share of $278,448 paid to the grantee.

Background

U.S. Environmental Protection Agency (EPA) Region 5 awarded Grant No. XP97579701 to the Village of Laurelville on May 24, 2002. The purpose of the grant was to provide Federal assistance of $376,000 to renovate the Laurelville wastewater treatment facility. The $376,000 represents EPA's contribution of up to 54.25 percent of the eligible project costs and is limited by the amount of the congressional appropriation. The grantee was responsible for matching, at a minimum, 45.75 percent of the eligible project costs. Total project costs under the grant were estimated to be $693,148, which represented construction costs and the purchase of equipment. In March 2005, EPA extended the budget and project period to December 30, 2006, to allow the grantee to complete unfinished tasks. However, the grantee did not make any progress after March 2005, and the project currently remains only 82 percent complete. Funds totaling $97,552 still remain on the grant and have not been drawn down by the grantee.

Scope and Methodology

We performed our audit in accordance with generally accepted government auditing standards, issued by the Comptroller General of the United States, with the exception of gaining a complete understanding of internal controls as required under Section 7.16 and gaining an understanding of information control systems as required under Section 7.23. We did not obtain a complete understanding of the internal control system because the limited nature of our review focused on the source documents that support costs claimed under the grant. We also did not test the recipient's grant drawdown process or process for entering information into its accounting system. Instead, we relied on the grantee's drawdown spreadsheets and supporting invoices. The grantee's consultant prepared the spreadsheets, and the spreadsheets were not part of the official accounting system. We did not obtain an understanding of information control systems because the review of general and application controls was not relevant to the assignment objectives.

We conducted our field work between August 27, 2007, and September 26, 2007. We made a site visit to the grantee and performed the following steps:

- Obtained and reviewed grantee support for drawdowns,
- Conducted interviews of current and former grantee personnel,

- Obtained printouts of grantee ledgers, and
- Obtained and analyzed loan information regarding grantee matching funds.

We also discussed issues related to this grantee with Region 5 grants management staff and the project officer.

Finding

The Village of Laurelville was unable to support drawdown requests submitted to the EPA for $278,448 in grant funds. According to 40 CFR 31.20(b)(2) and (b)(5), the financial management systems of grantees must meet the following standards:

> *Accounting records – Grantees and subgrantees must maintain records which adequately identify the source and application of funds provided for financially-assisted activities. These records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income.*
>
> *Allowable cost – Applicable OMB [Office of Management and Budget] cost principles, agency program regulations, and the terms of grant and subgrant agreements will be followed in determining the reasonableness, allowability, and allocability of costs.*

We found that the grantee did not maintain an acceptable financial management system in accordance with 40 CFR 31.20(b)(2) and (b)(5) to support drawdown requests submitted to EPA. In support of its drawdowns, the grantee provided spreadsheets that its consultant prepared, along with numerous invoices to support those spreadsheets. However, the invoices provided either did not reconcile to the drawdown spreadsheets, or included costs that were not allowable under cost principles, Agency guidance, and the grant agreement. As a result, we were unable to determine total project costs or the allocation of expenditures between the Federal grant and matching funds. Therefore, we are questioning the entire $278,448 that the grantee has drawn down.

When grantees do not have a system of meeting financial management standards, EPA can identify them as "high risk." According to 40 CFR 31.12, a grantee may be considered "high risk" if an awarding agency determines that the grantee:

- Has a history of unsatisfactory performance,
- Is not financially stable,
- Has a management system that does not meet management standards,
- Has not conformed to terms and conditions of previous awards, or
- Is otherwise not responsible.

We found that the grantee was not in compliance with 40 CFR 31.12(a)(2) and (a)(4). The grantee is not financially stable. According to current and former Village officials,

the Village is currently $35,000 in debt, and had run out of matching funds for the grant in late 2004. The grantee also has not conformed to the terms and conditions of its award. It did not maintain adequate accounting records to support drawdowns or submit required quarterly progress reports and Financial Status Reports during the grant period. Therefore, EPA should classify the Village of Laurelville as a high risk grantee.

In addition to being unable to support its drawdowns, some of the costs the grantee claimed were not allowable under Federal regulations and grant conditions, as shown in Table 1. Details on each instance are provided in the paragraphs that follow the table.

Table 1: Schedule of Costs

Description	Total Cost	Federal Share (54.25%)	Matching Funds (45.75%)
Pre-award costs claimed from 2000-2002	$260,015	$141,058	$118,957
Loan for grantee matching funds repaid with EPA grant funds	75,000	40,687	34,313
Loan interest claimed for matching funds	13,446	7,294	6,152
Garage extension	11,190	6,071	5,119
Purchase of computer, monitor, and printer	3,190	1,731	1,459
Purchase of a tractor/mower	14,400	7,812	6,588
Purchase of a tiller	1,054	572	482
Consultant costs	4,150	2,251	1,899
Total	**$382,445**	**$207,476**	**$174,969**

Source: OIG analysis of Village of Laurelville data

Pre-Award Costs

The grantee claimed pre-award costs that were not approved by EPA and thus were ineligible for Federal reimbursement. EPA awarded grant XP97579701 to the Village of Laurelville on May 24, 2002. In making the award, Region 5 retroactively approved the project and budget periods to December 1, 2000. However, the memorandum, "Award of Grants and Cooperative Agreements for the Special Projects and Programs Authorized by the Agency's FY 2002 Appropriations Act," dated April 15, 2002, and issued by Michael Cook, Director, Office of Wastewater Management, states:

> *Since 1995, EPA Headquarters (in accordance with established OMB and Agency procedures) have approved pre-award costs for more than 50 special Appropriations Act projects in the following two situations:*
>
> > *The pre-award costs were incurred after the start of the fiscal year for which the funds were appropriated but before grant award; and/or,*
> >
> > *The pre-award costs were for facilities planning or design work associated with the construction portion of the project for which the grant was awarded.*

Accordingly, effective April 1, 2000, the Regions have the authority to approve pre-award costs for the two situations described above.

Based on the criteria cited, the Region could have approved pre-award costs as of the beginning of Fiscal Year 2002. However, the Region did not grant such approval, and the grant did not contain any terms or conditions that allowed the grantee to claim pre-award costs. Further, much of the costs pre-dated Fiscal Year 2002 and thus were not eligible even with approval. We found that for all costs submitted in its first drawdown, those costs had actually been incurred prior to the award of the grant. Therefore, the $260,015 is ineligible for reimbursement, and EPA should recover the Federal share of $141,058.

Loan Repayment and Loan Interest

The grantee did not obtain EPA approval to use grant funds to repay a bank loan and interest incurred on that loan. The grantee used grant funds to repay $75,000 on a $100,000 loan it borrowed from a local bank, as well as $13,446 of interest incurred on this loan. Both of these actions are unallowable according to the Special Appropriation Act Project guidance and OMB Circular A-87. The memorandum, "Award of Grants and Cooperative Agreements for the Special Projects and Programs Authorized by the Agency's FY 2002 Appropriations Act," states:

> *Funds appropriated for the special projects should not be used solely to pay down loans received from a State Revolving Fund or other indebtedness unless there are explicit instructions to do so in the Appropriations Act or accompanying Reports, or the facts of the case are such that this is the only way to award the funds that were appropriated for the project. Any request to use special Appropriations Act grant funds to pay down a loan must be approved, in writing, by EPA Headquarters.*

OMB Circular A-87, Section 23.a, also indicates the interest costs are unallowable:

> *Costs incurred for interest on borrowed capital or the use of a governmental unit's own funds, however represented, are unallowable except as specifically provided in subsection b. or authorized by Federal legislation.*

Because the grantee did not obtain approval from EPA to use grant funds to repay its loan, the $75,000 loan repayment and $13,446 interest repayment are ineligible for reimbursement under the grant. Therefore, EPA should recover the Federal shares of $40,687 and $7,294, respectively.

Garage Extension

The grantee used grant funds to construct a garage extension that EPA did not approve under the grant. According to OMB Circular A-87, Section 15.b(2):

Capital expenditures for improvements to land, buildings, or equipment which materially increase their value or useful life are unallowable as a direct cost except with the prior approval of the awarding agency.

The garage extension was used to store equipment, and was not necessary for the function of the treatment plant. The garage extension was not included in the budget for the grant and EPA did not approve the costs as a direct charge to the grant. Therefore, the $11,190 cost of the garage extension is ineligible for reimbursement under the grant, and EPA should recover the Federal share of $6,071.

Computer and Maintenance Equipment

The grantee used grant funds to purchase the following computer and maintenance equipment, totaling $18,644, which EPA did not approve under the grant:

- Computer, monitor, and printer - $3,190
- Tractor/mower - $14,400
- Tiller - $1,054

The grantee used the computer, monitor, and printer for administrative purposes, such as issuing bills for monthly sewer charges. The grantee used the tractor/mower for landscaping purposes, such as mowing the lawn at the treatment plant. We did not determine how the grantee was using the tiller, but it also was not approved under the grant. A consultant had advised the grantee to purchase equipment to keep the plant orderly and safe for the next 10 years. However, these costs were not included in the grant budget and do not appear necessary for the renovation of the wastewater treatment facility. Therefore, EPA should recover the Federal share of $9,898 for the equipment.

Consultant Costs

The grantee did not comply with Federal regulations in procuring consultant services that cost $4,150. Specifically, the grantee did not: (1) compete procuring the consultant's services, (2) maintain records regarding the procurement, and (3) ensure the consultant's rates were within Federal limits.

The consultant was responsible for preparing the grantee's electronic drawdown requests, and performing site visits to the treatment plant to inspect grant-related work. The consultant billed the grantee for costs related to compiling and reviewing invoices, and preparing supporting spreadsheets for drawdown requests.

The grantee did not use competition when procuring the consultants services, as required by Federal regulations. Title 40 CFR 31.36(c) requires all procurement transactions to be conducted in a manner providing full and open competition. Grantee officials said they hired the consultant because he was the former superintendent for the wastewater treatment plant and thus knowledgeable about the work performed under the grant. They

also needed the consultant to submit their electronic drawdown requests to EPA because they did not have the capability or expertise to do so. Therefore, the Village hired the consultant via sole source procurement, without competition.

The grantee did not maintain the documentation Federal regulations require when procuring services. Title 40 CFR 31.36(b)9 states:

> *Grantees and subgrantees 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 grantee did not have a formal written agreement with the consultant. Grantee representatives said their agreement to pay the consultant an hourly rate of $75 was recorded in the Village Council's monthly minutes, but the grantee was unable to produce those meeting minutes.

The grantee requested reimbursement for consultant fees that exceed those allowed under Federal regulations. Title 40 CFR 31.36(j) states: "EPA will limit its participation in the salary rate (excluding overhead) paid to individual consultants retained by grantees or by a grantee's contractors or subcontractors to the maximum daily rate for a GS-18" (Level IV of the Executive Schedule). For the years 2002 through 2004, when the consultant was working for the grantee, the allowable hourly rates for a consultant ranged from $62.29 to $65.60 per hour, excluding overhead. The grantee and its consultant said that the consultant charged $75 per hour, which exceeded the maximum rates specified by the Federal guidance. The consultant's invoices did not show hours worked, and we were unable to determine the amount of hours worked based on the dollar amounts provided.

Because the grantee did not compete the procuring of consultant services, maintain records documenting the consultant's procurement, and adhere to consultant salary requirements, the entire $4,150 paid for consultant costs is ineligible. Therefore, EPA should recover the Federal share of $2,251.

Other Issues

Ultraviolet Disinfection System

The grant work plan included costs for the purchase of a $9,250 ultraviolet disinfection system to be installed in spring 2003. However, when we visited the site in August 2007, we found that although the grantee used grant funds to purchase the equipment, the equipment had not been installed. A grantee official told us the system was never installed because the grantee exhausted its matching funds for the grant. During our site visit, a former Village official and the plant operator said the plant was functioning properly and meeting its permits, and the effluent was of drinking water quality without the ultraviolet system.

One of the determining factors when considering the allowability of costs is reasonableness. When Region 5 closes the grant, the Region needs to determine whether the equipment needs to be installed and, if not, whether it is reasonable to pay for the cost of the equipment. If it is not reasonable to pay for the costs, EPA should recover the Federal share of $5,018 from the grantee.

The unused ultraviolet disinfection system (EPA OIG photo)

Matching Costs

The issues in the report not only affect the Federal funds associated with the project but matching costs as well. Just as we were not able to reconcile Federal drawdowns, we were not able to determine the project costs that comprised the grantee's match or the source of the matching funds. According to current and former grantee officials, the grantee was to use the $100,000 loan for matching costs. However, the grantee repaid with grant funds $75,000 of the loan and $13,446 in loan interest, as previously noted. Further, the grantee needs to provide documentation of matching costs incurred to support Federal funds drawn.

Recommendations

We recommend that the Regional Administrator, EPA Region 5

1. Require the Village of Laurelville to:

    a. Repay the $207,476 in ineligible Federal funds drawn.
    b. Develop an adequate accounting system to support the remaining $70,972 of Federal funds drawn. If this cannot be accomplished, the Region should recover the funds.
    c. Install the ultraviolet disinfection system or repay the $5,018 of Federal costs claimed for the system.

2. Provide documentation to support matching costs. If the grantee cannot provide the sufficient documentation, costs claimed will need to be revised.

3. Classify the Village of Laurelville as a high risk grantee in accordance with 40 CFR 31.12, and apply special conditions on all future awards.

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	7	Require the Village of Laurelville to: a. Repay the $207,476 in ineligible Federal funds drawn. b. Develop an adequate accounting system to support the remaining $70,972 of Federal funds drawn. If this cannot be accomplished, the Region should recover the funds. c. Install the ultraviolet disinfection system or repay the $5,018 of Federal costs claimed for the system.		Regional Administrator, Region 5		$278	
2	7	Provide documentation to support matching costs. If the grantee cannot provide the sufficient documentation, costs claimed will need to be revised.		Regional Administrator, Region 5			
3	7	Classify the Village of Laurelville as a high risk grantee in accordance with 40 CFR 31.12, and apply special conditions on all future awards.		Regional Administrator, Region 5			

[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