U.S. ENVIRONMENTAL PROTECTION AGENCY
OFFICE OF INSPECTOR GENERAL

Catalyst for Improving the Environment

Attestation Report

Examination of Costs Claimed Under EPA Cooperative Agreement X83275501 Awarded to The Montana Physical Sciences Foundation

Report No. 11-4-0013

November 8, 2010

REDACTED VERSION FOR PUBLIC RELEASE

The full version of this report contained sensitive information. This is a redacted version of that report, which means the sensitive information has been removed. The redactions are clearly identified in the report.

Report Contributors: Jessica Knight
Lela Wong
Michael Owen

Abbreviations

CFR	Code of Federal Regulations
EPA	U.S. Environmental Protection Agency
FY	Fiscal Year
Grant	Cooperative Agreement Number X83275501
Grantee	The Montana Physical Sciences Foundation
OIG	Office of Inspector General

U.S. Environmental Protection Agency
Office of Inspector General

11-4-0013
November 8, 2010

At a Glance

Catalyst for Improving the Environment

Why We Did This Review

The U.S. Environmental Protection Agency (EPA) Office of Inspector General is examining assistance agreements to non-profit organizations. We selected The Montana Physical Sciences Foundation (grantee) for one of these examinations.

Background

EPA awarded Cooperative Agreement number X83275501 (grant) on September 23, 2005. The purpose of the grant was to provide federal assistance of $770,500 for research into producing biodegradable lubricants and solvents from waste. There was no match requirement for this grant. EPA's contribution to the project was 100 percent of approved costs not to exceed $770,500.

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

To view the full report, click on the following link: www.epa.gov/oig/reports/2011/20101108-11-4-0013.pdf

Examination of Costs Claimed Under EPA Cooperative Agreement X83275501 Awarded to The Montana Physical Sciences Foundation

What We Found

The grantee did not meet Title 40 Code of Federal Regulations (CFR) Part 30 requirements for procurement. In particular, the grantee:

- Has an apparent, if not real, conflict of interest with its subcontractor.
- Awarded a sole source subcontract without a documented justification and a cost or price analysis.
- Did not amend the sole source subcontract to cover a major change in project scope and extension of the project period.
- Did not include terms in the sole source subcontract that provide EPA rights to use work funded by the grant.

As a result, EPA will need to recover $707,320 in questioned contract costs. EPA should consider suspension and debarment proceedings against the grantee and its subcontractor.

What We Recommend

We recommend that the Assistant Administrator for Administration and Resources Management disallow and recover $707,320 in costs claimed for the grantee's subcontract. We also recommend that the Assistant Administrator consider suspension and debarment proceedings against the grantee and its subcontractor.

We recommend that the Assistant Administrator: (1) require the grantee to improve its procurement process to ensure compliance with Title 40 CFR Part 30; and (2) establish special conditions for future EPA awards to the grantee that require payment on a reimbursement basis, review and approval by the EPA project officer of reimbursement requests prior to payment, and review and approval by the EPA project officer of contracts prior to award.

The Agency generally agreed with the findings, but did not comment on the recommendations. The grantee generally disagreed with the findings and recommendations.

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

THE INSPECTOR GENERAL

November 8, 2010

MEMORANDUM

SUBJECT: Examination of Costs Claimed Under EPA Cooperative Agreement X83275501 Awarded to The Montana Physical Sciences Foundation
Report No. 11-4-0013

FROM: Arthur A. Elkins, Jr. *Mark Bialek for*
Inspector General

TO: Craig E. Hooks
Assistant Administrator
Office of Administration and Resources Management

David Gates
Chairman of the Board of Directors
The Montana Physical Sciences Foundation

This report contains a time-critical issue the Office of Inspector General (OIG) identified. This report represents the opinion of the OIG and does not necessarily represent the final position of the U.S. Environmental Protection Agency (EPA). EPA managers will make final determinations 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 $135,583.

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 you formally complete resolution with the recipient. Your proposed decision is due in 120 days, or on March 8, 2011. To expedite the resolution process, please e-mail an electronic version of your proposed management decision to adachi.robert@epa.gov. Your response will be posted on the OIG's public website, along with our memorandum commenting on your response. Your response should be provided as an Adobe PDF file that complies with the accessibility requirements of section 508 of the Rehabilitation Act of 1973, as amended. The final response

should not contain data that you do not want to be released to the public; if your response contains such data, you should identify the data for redaction or removal.

We have no objections to the further release of this report to the public. This report will be available at http://www.epa.gov/oig. If you or your staff has any questions regarding this report, please contact Robert Adachi, Director of Forensic Audits at (415) 947-4537 or at the above e-mail address; or Michael Owen, Project Manager, at (206) 553-2542 or owen.michael@epa.gov.

Note: We have redacted information on pages 15-19 of this report. Exemption (b)(6) of the Freedom of Information Act permits the government to withhold names of individuals when disclosure of such information "would constitute a clearly unwarranted invasion of personal privacy." [5 U.S.C. § 552 (b)(6)]

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Appendices

Introduction

Purpose

The purpose of the examination was to determine whether The Montana Physical Sciences Foundation (grantee) complied with assistance agreement requirements and applicable Federal laws and regulations. During our examination, we determined that the grantee did not comply with federal procurement requirements, including codes of conduct requirements. We believe these issues require immediate attention to ensure expeditious recovery of federal funds and implementation of additional controls to protect the government's interest.

Background

The U.S. Environmental Protection Agency (EPA) awarded Cooperative Agreement number X83275501 (grant) on September 23, 2005. The purpose of the grant was to provide federal assistance of $770,500 for research into producing biodegradable lubricants and solvents from waste. There was no match requirement for this grant. EPA's contribution to the project was 100 percent of approved costs not to exceed $770,500. The grant's budget and project period was from October 1, 2005, to November 30, 2009.

Independent Attestation Report

As part of our continued oversight of the assistance agreements awarded to nonprofit organizations by EPA, we have examined the costs claimed by the grantee covering the period October 1, 2005, to November 30, 2009. By receiving the award, the grantee has accepted responsibility for preparing its cost claim to comply with the requirements of Title 2 Code of Federal Regulations (CFR) Part 230, Title 40 CFR Part 30, and the terms and conditions of the grant. Our responsibility is to express an opinion on the grantee's compliance and costs claimed based on our examination.

Our examination was conducted 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 examined evidence supporting the amount claimed under the grant and performed other procedures we considered necessary under the circumstances. We believe that our examination provides a reasonable basis for our opinion.

We conducted our fieldwork from February 2009 to July 2010. We performed the following steps during fieldwork:

- Reviewed EPA project and grant files
- Interviewed the EPA project officer and grant specialist to obtain an understanding of the project
- Reconciled and verified the deposits of EPA payments (drawdowns) to the grantee's bank statements for the period of February 2007 to December 2008.
- Reviewed the grantee's supporting documents for drawdowns under the grant including the grantee's electronic accounting records and the supporting invoices
- Conducted interviews of grantee and subcontractor personnel to obtain an understanding of the project as well as the grantee's process for procurement, drawdown, and invoice payment
- Reviewed the subcontractor procurement and the terms and conditions of the subcontract
- Performed fraud detection procedures including interviewing EPA and grantee personnel, reviewing transaction patterns, performing duplicate payment analysis, and reviewing Board of Director meeting minutes

As part of obtaining reasonable assurance that the grantee's costs claimed under the grant are free of material misstatement, we performed tests of its compliance with the requirements of Title 2 CFR Part 230, Title 40 CFR Part 30, and the terms and conditions of the grant. We also considered the grantee's internal controls over cost reporting to determine our audit procedures and to express our opinion on the costs claimed. Our consideration of internal control would not necessarily disclose all internal control matters that might be material weaknesses. A material weakness is a significant deficiency or combination of significant deficiencies, in internal control that provide a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe

than a material weakness, but important enough to warrant attention by those charged with governance.

Our examination disclosed the following material weaknesses concerning procurement requirements specified by Title 40 CFR Part 30:

- The grantee has an apparent, if not real, conflict of interest with its subcontractor.
- The grantee awarded a sole source subcontract without a documented justification and a cost or price analysis.
- The grantee did not amend the sole source subcontract to cover a major change in project scope and extension of the project period.
- The grantee did not include terms in the sole source subcontract that provide EPA rights to use work funded by the grant.

As a result, we questioned $707,320 of the $748,432 claimed under the grant.

In our opinion, because of the effect of the issues described above, the costs claimed do not meet, in all material respects, the requirements of Title 40 CFR Part 30 and the terms and conditions of the grant for the period ended November 30, 2009.

Robert K. Adachi
Director for Forensic Audits
July 22, 2010

Results of Examination

The grantee did not meet Title 40 CFR Part 30 requirements for procurement. In particular, the grantee:

- Has an apparent, if not real, conflict of interest with its subcontractor.
- Awarded a sole source subcontract without a documented justification and a cost or price analysis.
- Did not amend the sole source subcontract to cover a major change in project scope and extension of the project period.
- Did not include terms in the sole source subcontract that provide EPA rights to use work funded by the grant.

As a result, EPA will need to recover $707,320 in questioned contract costs. EPA should also consider suspension and debarment proceedings against the grantee and its subcontractor. The costs claimed and questioned are summarized in Table 1.

Table 1: Summary of costs claimed and questioned

Cost Category	Amount Claimed	Amount Questioned
Contract Costs[1]	$707,320	$707,320
Other Direct Costs	$41,112	$0
Totals	**$748,432**	**$707,320**

Sources: Amounts claimed were from supporting invoices provided by the grantee. Costs questioned were based on the OIG's analysis of the data.

[1] See discussion under *Apparent Conflict of Interest between Grantee and Subcontractor.*

Apparent Conflict of Interest Between Grantee and Subcontractor

The grantee has an apparent, if not real, conflict of interest with its subcontractor, Resodyn, in violation of Title 40 CFR Part 30.42 which states in part:

> "No employee, officer, or agent shall participate in the selection, award, or administration of a contract supported by Federal funds if a real or apparent conflict of interest would be involved. Such a conflict would arise when the employee, officer, or agent, any member of his or her immediate family, his or her partner, or an organization which employs or is about to employ any of the parties indicated herein, has a financial or other interest in the firm selected for an award."

We found that the president of the grantee's subcontractor not only established the nonprofit grantee, but the evidence indicates that he assisted with the preparation of an important

document associated with the procurement of the sole source subcontract and attended the grantee's Board of Directors meetings where operation and management decisions were made.

The grantee's Articles of Incorporation identify that the president of Resodyn, the grantee's subcontractor, founded the nonprofit grantee in September 2004. In our interview of the president of Resodyn, the president stated that he established the nonprofit organization in order to obtain the grant funding for Resodyn. Congressional appropriation records showed that the conference report for the Fiscal Year (FY) 2004 Appropriation Act directed that EPA award $800,000 to Montec Research in Butte Montana for research of pilot scale enzyme catalyzed processes. In 2003, Montec Research officially changed its name to Resodyn. According to an EPA project officer and grant specialist who were responsible for the grant, the company was ineligible for the award because it was a "for profit" corporation rather than a nonprofit organization. Because EPA was not able to award the funding to the company, the funding was redirected to the nonprofit grantee through the conference report for the FY 2005 Appropriation Act.

Our review of EPA documentation associated with the grant award disclosed that in September 2005, EPA Office of General Counsel expressed concern about the award when an EPA pre-award compliance review found that the president of Resodyn was also a member of the grantee's Board of Directors. The Office of General Counsel was concerned about a potential conflict of interest because the grantee planned to subcontract most of the work under the grant to Resodyn through a sole source contract. To address EPA's concerns, the grantee provided EPA with a letter from the president of Resodyn, dated September 12, 2005, announcing his immediate resignation from the Board of Directors. The Office of General Counsel determined on September 20, 2005, that the conflict of interest was eliminated based on the resignation letter, and EPA proceeded to award the grant to the nonprofit.

Although the grantee informed EPA that Resodyn's president had resigned from the Board of Directors, our review of procurement documents the grantee submitted to EPA disclosed that Resodyn's president assisted with the preparation of an important document. Specifically, the electronic properties of a report summarizing the Board of Directors' review comments and approval of Resodyn's project proposal disclosed that Resodyn's president was the author of the document. According to the grantee, Resodyn's president did not author the content of the document. The grantee said that its Executive Director inquired and obtained from the subcontractor's president a template for evaluating project proposals. The grantee explained that the template was subsequently used by the Board of Directors to evaluate Resodyn's contract proposal.

In addition, a review of the minutes for the grantee's Board of Directors meetings held from October 2005 to May 2008 disclosed that the president of Resodyn attended the meetings even after his resignation from the Board. According to the minutes, the president of Resodyn was present at meetings where the Board made major decisions about the operation and management of the nonprofit as well as work under the EPA grant. Specifically, during these meetings, the Board elected the grantee's officers, made the employment selection for the grantee's Executive Director, established the roles and responsibilities for the Executive Director, and established the request for proposal process for Resodyn's sole source subcontract.

In total, the facts suggest a failure of an arm's length relationship between the grantee and Resodyn, and an apparent, if not actual, conflict of interest under Title 40 CFR Part 30.42, with regard to the award and administration of the sole source subcontract with Resodyn.

Subcontract Not Supported by Justification and Analysis

The grantee's sole source subcontract to Resodyn was awarded without a documented justification and a cost or price analysis as required by Title 40 CFR Part 30.45, Part 30.46, and the grant. Title 40 CFR Part 30.45 requires the grantee to complete a cost or price analysis and document the analysis in the procurement files for every procurement action. Title 40 CFR Part 30.46 specifies that procurement records and files for purchases that exceed the $100,000 small purchase threshold shall include a justification for lack of competition when competitive bids or offers are not obtained. The grant also required the nonprofit recipient, as a condition of the award, to submit for EPA's review the justification for the sole source award and the cost or price analysis for the subcontract. However, neither the grantee nor the EPA grant specialist or project manager responsible for managing the grant were able to provide copies of these documents. The grantee and EPA staff were also unable to confirm whether the justification and cost or price analysis were ever completed or submitted to EPA. Without a proper justification and cost or price analysis, the grantee was unable to show that the sole source subcontract was necessary and the costs claimed under the grant are fair and reasonable.

Subcontract Not Amended to Reflect Revised Project Scope

The grantee did not amend the sole source subcontract with Resodyn to cover a major change in project scope and extension of the project period as required by Title 40 CFR Part 30.48. Title 40 CFR Part 30.48 requires that recipients of federal awards include provisions that define a sound and complete contract. Title 40 CFR Part 30.48 also specifies that contracts exceeding the $100,000 small purchase threshold include provisions or conditions that allow and provide for administrative, contractual, or legal remedies in instances where a contractor violates or breaches the contract terms. Because the subcontract was not amended, the grantee was not in compliance with these federal contract requirements.

During 2007 and 2008, EPA amended the grant to revise the scope of work and extend the budget and project periods at the grantee's request. The grantee requested the scope change because there was an increase in market demand for the original project's source material. EPA amended the scope of work to change the source material, which was designated a major scope change in the grant amendment and extended the budget and project periods through November 2009. Despite the major change in the project scope and extension of the project period, the sole source subcontract was not revised.

Our review of progress reports on the research project and interviews of the Executive Director for the grantee and managers and staff from Resodyn disclosed that the company did not conduct the research specified by the subcontract. Rather, Resodyn conducted research on the new scope of work approved by the grant amendment. The progress reports and interviews also revealed that the research was ongoing as of February 2009 and had exceeded the March 20, 2007,

completion date specified by the subcontract. Although Resodyn's research work appeared to be consistent with the amended grant, the work was not within the scope of the subcontract and had not been completed within the period specified by the subcontract. Therefore, the grantee was not able to ensure through the contract provisions that Resodyn satisfactorily completed the research work specified and funded by the grant as required under Title 40 CFR Part 30.48.

Subcontract Terms Do Not Include EPA's Rights to Use Work

The grantee's subcontract with Resodyn did not include terms that provide EPA rights to use the work funded by the grant as required by Title 40 CFR Part 30. Title 40 CFR Part 30.36 states that EPA reserves a royalty-free, nonexclusive, and irrevocable right to reproduce, publish, or otherwise use for federal purposes work that was developed under an award. The appendix to Title 40 CFR Part 30 further specifies that contracts for the research work under an award shall include a provision that provides EPA with these rights. However, the grantee's subcontract with Resodyn did not include this provision and provided complete ownership of all work conducted under the subcontract to the company.

Conclusion

We question the $707,320 in contract costs claimed under the grant as unallowable, because the grantee did not meet Title 40 CFR Part 30 requirements for procurement. The apparent, if not real, conflict of interest between the grantee and its subcontractor is a material issue, and EPA should consider suspension and debarment of both entities from future federal awards under Title 2 CFR Part 180. Title 2 CFR Part 180 specifies that an Agency may pursue a suspension and debarment action for the willful violation of a statutory or regulatory provision or requirement applicable to a public agreement or transaction.

Based on the findings above, the grantee also does not meet the federal management standards for grants and may not have the capability to manage future EPA awards. Office of Management and Budget Circular A-110 establishes the federal standards for the administration of grant awards for nonprofit organizations. These standards include procurement codes of conduct, contract justification and analysis, and contract provision requirements that are equivalent to those specified by Title 40 CFR Part 30. EPA should impose special conditions on all future awards of EPA funds as outlined in Title 40 CFR Part 30. Title 40 CFR Part 30.14, S*pecial Award Conditions*, states:

> "If an applicant or recipient has a history of poor performance, is not financially stable; has a management system that does not meet the standards prescribed in Circular A–110; has not conformed to the terms and conditions of a previous award; or is not otherwise responsible, EPA may impose additional requirements as needed, provided that such applicant or recipient is notified in writing as to: the nature of the additional requirements, the reason why the additional requirements are being imposed, the nature of the corrective action needed, the time allowed for completing the corrective actions, and the method for requesting reconsideration of the additional requirements imposed."

The special conditions should include (1) payment on a reimbursement basis, (2) EPA review and approval of reimbursement requests prior to payment, and (3) EPA review and approval of contracts prior to award.

Recommendations

We recommend that Assistant Administrator for Administration and Resources Management:

1. Disallow and recover $707,320 in the costs claimed for the Resodyn subcontract.

2. Consider suspension and debarment of the grantee and Resodyn from future federal awards under Title 2 CFR Part 180.

3. Require the grantee to improve its procurement process to ensure compliance with Title 40 CFR Part 30, including codes of conduct and contract cost or price analysis requirements.

4. Require that the following special conditions be included for future EPA awards to the grantee until EPA determines that the grantee has met all applicable federal financial and procurement requirements:
    a. Payment on a reimbursement basis.
    b. Review and approval by the EPA project officer of reimbursement requests. including all supporting documentation for the claims prior to payment.
    c. Review and approval by the EPA project officer of contracts prior to award.

Agency and Grantee Comments

The OIG received comments on the draft report from the Office of Administration and Resources Management and the grantee on August 23, 2010. The grantee also provided supplemental documentation as support for its comments.

The Office of Administration and Resources Management generally agreed with the findings and offered clarifying information on the FY 2004 and 2005 appropriation acts with regard to the award to the grantee. The Office of Administration and Resources Management did not comment on the Recommendations. The Agency's complete written response is in Appendix A.

The grantee generally disagreed with the findings and recommendations and said that they were based on incomplete or misinterpreted factual information. The grantee's complete written response is in Appendix B. The supplemental documentation provided by the grantee is not included in the report. The supplemental documentation is available on request, except for documentation the grantee has determined to be confidential and requested that it be withheld from distribution outside of EPA.

OIG Response

We agreed with the clarifying information on the FY 2004 and 2005 appropriation acts provided by the Office of Administration and Resources Management and revised the report as appropriate. The Agency will need to provide a proposed management decision for resolution of the findings in response to this report.

The grantee's comments did not resolve the procurement issues; including the apparent, if not real, conflict of interest with its subcontractor. Therefore, our position on the findings and recommendations in the attestation report remains generally unchanged. However, we accepted the grantee's explanation about its use of letterhead templates and the quality assurance plan obtained from the sole source subcontractor. We also accepted the grantee's explanation about the attendance of the subcontractor’s president at Board of Directors meetings where project updates and progress reports were presented. We revised the report as appropriate based on these explanations. The full text of our response is embedded as text boxes in the grantee’s complete written response.

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	8	Disallow and recover $707,320 in the costs claimed for the Resodyn subcontract.	U	Assistant Administrator for Administration and Resources Management		$707.3	
2	8	Consider suspension and debarment of the grantee and Resodyn from future federal awards under Title 2 CFR Part 180	U	Assistant Administrator for Administration and Resources Management			
3	8	Require the grantee to improve its procurement process to ensure compliance with Title 40 CFR Part 30, including codes of conduct and contract cost or price analysis requirements.	U	Assistant Administrator for, Administration and Resources Management			
4	8	Require that the following special conditions be included for future EPA awards to the grantee until EPA determines that the grantee has met all applicable federal financial and procurement requirements: (a) Payment on a reimbursement basis. (b) Review and approval by the EPA project officer of reimbursement requests including all supporting documentation for the claims prior to payment. (c) Review and approval by the EPA project officer of contracts prior to award.	U	Assistant Administrator for Administration and Resources Management			

[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

Appendix A

Agency's Comments on the Draft Report

United States Environmental Protection Agency
Washington, DC 20460

Office of Administration and Resources Management

August 23, 2010

MEMORANDUM

SUBJECT: Draft Attestation Report
Examination of Costs Claimed Under EPA Cooperative Agreement X83275501
Awarded to The Montana Physical Sciences Foundation Project No. 2009-0840

FROM: Denise Sirmons, Director /s/
Grants and Interagency Agreement Management Division

TO: Robert K. Adachi
Director of Forensic Audits

Thank you for the opportunity to review and comment on the factual accuracy of the subject Office of Inspector General (OIG) Draft Attestation Report (Report), dated July 22, 2010. Based on our review of the Report and information available at this time, we generally agree with the Report findings, but offer the following two clarifications**:**

1. The "earmarks" that prompted EPA to award funding to The Montana Physical Sciences Foundation (Foundation) were not contained in EPA's Fiscal Year 2004 or Fiscal Year 2005 appropriation acts. Rather, the Agency honored the direction provided by EPA's appropriations committees in the conference reports to fund the Foundation. Although such directions in conference committee reports are not legally binding unless the text of the report is incorporated by reference into the appropriations act, Agency policy at the time was

to follow the direction. Executive Branch policy now prohibits EPA from honoring earmarks that are not included in statutory text.

2. The conference committee report for EPA's Fiscal Year 2004 Appropriation Act, Report 108-401 (November 25, 2003) directed that EPA award $800,000 to "Montec Research in Butte Montana." In 2003, Montec Research officially changed its name to Resodyn Corporation. The earmark is item 57 in the portion of the report on EPA's Science and Technology appropriation.

Our thanks again for the opportunity to comment on the Report. If you have any questions concerning this matter, please contact me at 202-564-6771. You may also contact Joe Lucia, the Office of Grants and Debarment Audit Follow-up Coordinator, at 202-564-5378.

cc: Michael Owen
Jessica Knight
Cynthia Johnson
Kysha Holliday
Joe Lucia

Appendix B

Grantee's Comments on the Draft Report and the OIG's Evaluation

The response from The Montana Physical Sciences Foundation is provided verbatim. OIG responses to those comments have been inserted in text boxes.

Montana Physical Science Foundation
Audit Comments
Agreement X83275501
between
The Montana Physical Sciences Foundation
and
the United States Environmental Protection Agency

The following is the Montana Physical Science Foundation (the "Foundation")'s response to the draft attestation report titled: Examination of Costs Claimed Under EPA Cooperative Agreement X83275501 Awarded to The Montana Physical Sciences Foundation, Project No. 2009-840, issued July 22, 2010 (the "Report").

Introduction

In several key respects, the Report's conclusion that the Foundation failed to comply with applicable procurement regulations is based on incomplete or misinterpreted factual information. In particular:

- Congress intended Resodyn to be the sole source subcontractor for Project No. 2009-840 (the "Project")
- The president of Resodyn promptly resigned from the Foundation's Board when his service was identified as a problem by EPA
- The president of Resodyn did not author any of the "important documents" identified in the Report
- The president of Resodyn did not participate in decisions made by the Board after his resignation, and was not present when the Board met in executive session
- Resodyn abided by the project's amended scope of work, even though the subcontract was not amended
- Resodyn is willing to transfer intellectual property rights to EPA as appropriate under law

Furthermore, the Foundation acted in good faith and in consultation with EPA throughout the Project. The Project work was completed by the subcontractor on time and within budget. Under these circumstances, there is no justification for seeking to recover any of the grant money, or imposing any other penalties on the Foundation.

Background

The background section of the Report omits several key facts related to the Project. As an initial matter, the Report fails to acknowledge that the Congressionally appropriated grant here at issue was originally made in response to a 2004 request by Montec Research Corporation—the predecessor to Resodyn Corporation—for an EPA appropriation. This request was for additional funding to continue work started under EPA Phase 1 SBIR Solicitations No. PR-NC-04-10308.[1] In 2005, Congress specifically designated $800,000 to Montec for this work.[2] This line item clearly evidences Congress' intent that Montec/Resodyn be the sole source subcontractor for the work performed in the Project. In addition, the sole source contract is justified by the follow-on nature of the Project's work, which is outlined in the SBIR Solicitation cited above.

OIG RESPONSE 1 The project funded under the cooperative agreement is not related to nor a continuation of work conducted under EPA SBIR Phase 1 solicitation #PR-NC-04-10308. The cooperative agreement, which provided the funding for this project, was not awarded under the SBIR program. Rather, the cooperative agreement specifies that the award was made under the statutory authorities of the Clean Air, Clean Water, Solid Waste Disposal, and Toxic Substances Control Acts. In addition, the scope of work included in the grantee's application for the cooperative agreement made no reference to the SBIR program. The Congressional conference report for EPA's Fiscal Year (FY) 2004 appropriation designated the $800,000 in funding for Montec's pilot scale enzyme catalyzed processes research project. However, the conference report for the FY 2005 Congressional appropriation, which redirected the funding to The Montana Physical Sciences Foundation, did not require the grantee to award an uncompetitive, sole source subcontract to Resodyn. As a recipient of the EPA cooperative agreement award, The Montana Physical Sciences Foundation was required to comply with Title 40 Code of Federal Regulation (CFR) Part 30. Title 40 CFR Part 30.46 specifies that procurement records and files for purchases that exceed the small purchase threshold shall include a justification for lack of competition when competitive bids or offers are not obtained. The grantee was not able to provide the required justification during our examination, and its comments above do not justify the sole source contract award to Resodyn.

Once the appropriation was made Resodyn was informed that the EPA would not award the funds to a for-profit company. To resolve this problem and fulfill the intent of Congress, Resodyn, working jointly

[1] See Resodyn Corp., Proposal to the Foundation for Biodegradable Lubricant and Solvent Production from Waste Greases (Dec. 15, 2005) at 5 (attached as Ex. A)

[2] H.R. Rep. 108-401, at 1118, Line item 57 (2003) ($800,000 for Montec Research); H.R. Rep. 108-792, at 1555 (2004) (transferring funding from Montec to Resodyn). The relevant excerpts of both reports are attached as Ex. B.

and cooperatively with the EPA, set up The Montana Physical Sciences Foundation. The Foundation applied for and received its tax exempt 501(c)3 status and a Board of Directors was established. The Foundation then subcontracted with Resodyn to perform the Project work.

OIG RESPONSE 2 We acknowledge that Resodyn established The Montana Physical Sciences Foundation because EPA determined that the for-profit company was not eligible for the funding provided by the Fiscal Year 2004 appropriation. Our review of EPA's grant and correspondence files and interviews with EPA grant and project officer personnel involved with awarding and managing the cooperative agreement did not disclose or suggest that EPA participated in creating The Montana Physical Sciences Foundation. The Articles of Incorporation for The Montana Physical Sciences Foundation show that the president of Resodyn created the non-profit organization in 2004 as discussed in the attestation report.

When EPA raised concerns about the Foundation's capability to fulfill its role as contract administrator, the Foundation completed an Administrative Capability Questionnaire.[3] After reviewing this documentation, EPA informed the Foundation that [redacted], as a principal of Resodyn, could not be on the Board of the Foundation. As the Report acknowledges, [redacted] immediately resigned from the Foundation's Board. The EPA ultimately issued a Cooperative Agreement for the project. Again, the Foundation took these steps in consultation with EPA, and made every effort to ensure that it was in compliance with all rules and regulation regarding the award and administration of the Project funding.

Ultimately, the Project work for which EPA contracted was completed on time and within budget. The final Project report was accepted by the Agency.[4]

OIG RESPONSE 3 We acknowledge that the final project report was accepted by EPA. However, EPA's acceptance of the final project report does not resolve the procurement issues and questioned costs discussed in the attestation report.

Apparent Conflict of Interest between Grantee and Subcontractor

As discussed above, the basis for the award of the Project work as a sole source contract to Resodyn was a Congressional appropriation. The Foundation was created to satisfy EPA's rules and regulations, which dictated that the Congressional funding must be managed by a non-profit entity. The Foundation accordingly was set up with the full knowledge and consent of the EPA.[5]

[3] See Administrative Capability Questionnaire (attached as Ex. C).
[4] See Federal Financial Report (attached as Ex. D); Email from [redacted], EPA to [redacted] (Sept. 24, 2009) (attached as Ex. E).
[5] See Email from [redacted] (EPA) to [redacted] (Sept. 19, 2005) (attached as Ex. F).

OIG RESPONSE 4 As discussed in OIG RESPONSE 1, the conference report for the Fiscal Year 2005 Congressional appropriation, which designated the funding to the grantee, did not require the sole source subcontract to Resodyn. Our review of EPA's grant and correspondence files and interviews with EPA grant and project officer personnel involved with awarding and managing the cooperative agreement did not disclose or suggest that EPA participated in creating The Montana Physical Sciences Foundation as discussed in OIG RESPONSE 2. We also note that the email cited in the comment above discusses EPA's concerns with a conflict of interest between the grantee and the president of Resodyn rather than providing the Agency's consent on the creation of the non-profit organization.

The Draft Report accurately states the facts regarding the president of Resodyn's participation in the creation of the Foundation and his initial position on the Foundation's Board of Directors. It also accurately reflects that the president resigned immediately after the EPA General Counsel determined there could be an actual or apparent conflict of interest. EPA and the Foundation concluded that the actual or apparent conflict was eliminated when the president's resignation from the Foundation occurred. The Report does not seem to challenge that conclusion. Instead, the Report identifies two circumstances that allegedly "suggest a failure of an arm's length relationship between the grantee and Resodyn, and an apparent, if not actual conflict of interest . . . ." The Report's conclusion, however, is based on a misinterpretation of the facts.

Important Documents

Relying on "electronic properties," the Report identifies Resodyn's president, [redacted], as the creator of "four important documents." The Report reasons that [redacted] must have either "created or participated in the preparation of" those document. In fact, there is another explanation for the "electronic properties" of these documents.

Because [redacted] was originally a part of the Foundation's Board, he created several electronic letterhead templates that the Foundation's Executive Director and Chairman used when they authored certain correspondence.[6] But [redacted] did ***not*** author or otherwise have any hand in creating the three letters mentioned in the Report.[7] The fact that the Foundation continued to use a letterhead template for correspondence originally created by [redacted] does not suggest the failure of an arm's length relationship, much less a conflict of interest, between the Foundation and Resodyn.

The Quality Assurance Plan mentioned in the Report has a similarly innocent explanation.[8] When the need arose, the Foundation's Executive Director inquired of [redacted] whether Resodyn had a template that The Foundation could use in evaluating proposals it would be receiving.[9] [redacted] sent such a

[6] Affidavit of [redacted] ("[redacted] Aff.") ¶ 5 (attached as Ex. G).
[7] [redacted] Aff. ¶ 6.
[8] The Quality Assurance Plan was part of the contract work to be performed by Resodyn and was appropriately done by them.
[9] [redacted] Aff. ¶ 7.

template, and the Foundation's Executive Director deemed it sufficient for The Foundation's purposes.[10] There is no evidence to supports the claim in the Report that Resodyn had any influence in the ***content*** of the report summarizing the Board's comments on Resodyn's proposal. In fact, as explained in the Executive Director's declaration, the evaluation of Resodyn's proposal was completed by the Board members alone, without any input whatsoever from Resodyn.[11] Again, the fact that the Board decided to use a template from Resodyn's president does not suggest any apparent or actual conflict of interest.

OIG RESPONSE 5 We accept the grantees explanation about the letterhead templates and quality assurance plan and have revised the report as appropriate. However, the grantee's explanation about the template for evaluating proposals provides additional support for our position on the conflict of interest. The Executive Director's inquiry to Resodyn for a template to evaluate contract proposals and the Board's subsequent use of the contractor's template to evaluate the sole source contract proposal suggest a failure of an arm's length relationship between the two entities.

Board Meetings

The Report also points to Resodyn's attendance at Foundation Board meetings as evidence of a less than an arm's length relationship between the parties. While it is true that Resodyn employees regularly attended Foundation Board meetings, their attendance was at the request of the Board, for the purpose of providing the Board with contractually-required project updates and progress reports.[12] When Resodyn's employees were present at Board meetings, they did ***not*** participate in votes by the Board, or in the discussions leading up to those votes.[13] When the President of the Foundation's Board called for an executive session of the Board, all Resodyn employees were excluded from the session.[14]

The Report infers based on the mere presence of Resodyn employees that Resodyn participated in the Board's decision making processes. That is simply not the case. The Foundation's Board was merely fulfilling its responsibilities under the agreement with EPA by ensuring that Resodyn was properly carrying out work on the Project. No conflict of interest, actual or apparent, existed.

[10] [redacted] Aff. ¶ 7.
[11] [redacted] Aff. ¶ 8.
[12] Affidavit [redacted] Aff.") ¶ 7 (attached as Ex. H); Affidavit of [redacted] Aff.") ¶ 4 (attached as Ex. I).
[13] [redacted] Aff. ¶ 8; [redacted] Aff. ¶¶ 4, 5.
[14] [redacted] Aff. ¶ 8; [redacted] Aff. ¶ 5.

OIG RESPONSE 6 We accept the grantees explanation for the presence of Resodyn's president and employees at Board of Directors meetings where project updates and progress reports were presented and revised the report as appropriate. However, our review of the Board meeting minutes disclosed that the president of Resodyn attended Board meetings when Resodyn was not providing project updates and progress reports. According to the minutes, the president of Resodyn attended Board meetings where Resodyn did not present their work and major decisions were made about the operation and management of the nonprofit. For example, the meeting minutes for the November 3, 2005 meeting disclosed that the President of Resodyn was present at the meeting when the Board discussed revising the non-profit organization's by-laws, roles and responsibilities of the executive director, and the request for proposal process for the sole source contract. The presence of the president of Resodyn at this and the other Board meetings where the contractor did not present work results and major decisions were made about the operation and management of the nonprofit suggests an apparent, if not actual, conflict of interest under Title 40 CFR Part 30.42 as discussed in the attestation report.

Subcontract Not Supported by Justification and Analysis

As discussed above, the Project was originally conceived as a Congressional appropriation to Montec/Resodyn, and was follow-on work to a prior SBIR Solicitation. These facts alone warranted the sole sourcing of the subcontract to Resodyn. Moreover, appropriate cost justification and analysis was completed for this project. The rates that Resodyn charged the Foundation for the project were audited by the Defense Contract Audit Agency (DCAA) which established Resodyn's rates for ***all*** government projects. The Board reviewed Resodyn's Proposal[15] for the work and found it acceptable. The Board found that Resodyn was uniquely qualified to carry out the work proposed and determined that the scope of work and schedule were consistent with the level of effort (budget) proposed by Resodyn. This information was provided to the EPA and no further analysis or justification was requested by the Agency. Further indication of the acceptability of the analysis to the EPA is evidenced by the Agency's issuance of the contract to the Foundation for the work.[16] At all times, the Foundation acted in good faith and consistent with Congressional intent.

[15] See Letter from [redacted] to [redacted] (Dec. 20, 2005) (attached as Ex. J).
[16] See U.S. Environmental Protection Agency Cooperative Agreement (Sept. 25, 2005) (attached as Ex. K).

OIG RESPONSE 7 As discussed in OIG RESPONSE 1, the conference report for the Fiscal Year 2005 Congressional appropriation, which designated the funding to the grantee, did not require an uncompetitive, sole source subcontract to Resodyn. As also discussed in OIG RESPONSE 1, the project funded under this cooperative agreement is not related to nor a continuation of work conducted under EPA SBIR Phase 1 solicitation #PR-NC-04-10308. Regardless of the grant's history, the grantee was required by Title 40 CFR Part 30.45, Part 30.46, and the grant award to complete a cost or price analysis and document a sole source justification. With regard to Resodyn's rates charged to the project, the grantee has not provided documentation showing the rates were audited by and established by DCAA. However, a review of Resodyn's rates by DCAA does not satisfactorily meet the analysis and justification requirements of Title 40 CFR Part 30. Title 40 CFR Part 30 and the grant award required that the grantee conduct a cost or price analysis and justification to determine and support cost reasonableness, allocability, and allowability before awarding the sole source subcontract.

Subcontract Not Amended to Reflect Revised Project Scope

As the Report acknowledges, the Foundation sought and received EPA approval for the change in scope and extension of time to complete the Project work. The Foundation discussed this change in scope with Resodyn and obtained their verbal acceptance. But the Foundation acknowledges that it did not formally amend the subcontract with Resodyn. The Foundation, as indicated by Board minutes, project reviews, and ultimately final acceptance by the EPA of the work, still administered the contract with Resodyn in accordance with the approved project scope change.[17] Under these circumstances, the failure to amend the subcontract should be considered a minor failure.

OIG RESPONSE 8 Our position remains unchanged. Title 40 CFR Part 30.48 requires that recipients of federal awards include provisions that define a sound and complete contract. Title 40 CFR Part 30.48 also specifies that contracts exceeding the $100,000 small purchase threshold include provisions or conditions that allow and provide for administrative, contractual, or legal remedies in instances where a contractor violates or breaches the contract terms. Because the subcontract was not amended, the grantee was not in compliance with these federal contract requirements.

[17] See Email from [redacted] to [redacted] (EPA) (May 28, 2007) (attached as Ex. L); Email from [redacted] (EPA) to [redacted] (July 20, 2007) (attached as Ex. M).

Subcontract Terms Do Not Include EPA's Rights to Use Work

It was the Foundation's belief that the work conducted under this agreement was follow-on Phase II or Phase III work originating from the EPA Phase 1 SBIR Solicitations No. PR-NC-04-10308.[18] Under the Bayh-Dole Act, intellectual property (IP) created through this process belongs to the contractor not the EPA. Thus the contract was written with the IP belonging to the contractor. That being said, the Foundation also recognizes that, outside of the SBIR process, IP generally belongs to the EPA, but as per the provisions of the Bayh Dole act, subcontractors to the government can elect title to their inventions. The Foundation is willing to negotiate with Resodyn to make this change if it is determined that the IP has been generated under this contract. Practically speaking, there was no IP of value created under this project.

OIG RESPONSE 9 As discussed in OIG RESPONSE 1, the project funded under this cooperative agreement is not related to nor is a continuation of work conducted under EPA SBIR Phase 1 solicitation #PR-NC-04-10308. However, we acknowledge that the grantee is also subject to Title 37 CFR Part 401, which implements the Bayh-Dole Act. Title 37 CFR Part 401.14, as well as Title 40 CFR Part 30.36, specify that the Federal government reserves a royalty-free, nonexclusive and irrevocable right to use for federal purposes work that was developed under an award. Therefore, the grantee is obligated under both Title 40 CFR Part 30 and Title 37 CFR Part 401 to provide EPA with the right to use the research work funded by the cooperative agreement through an appropriate contract revision or other corrective action.

Conclusion

A full understanding of the facts demonstrates that there was no actual or apparent conflict of interest between the Foundation and Resodyn. Accordingly, any effort to recover the $707,320 paid to Resodyn for work it successfully completed is inappropriate.

The sole sourcing of the contract to Resodyn was consistent with Congressional intent and the prior SBIR processes. The Foundation also performed thorough and unchallenged cost justification for the Project.

The other issues raised in the Report are either minor issues, such as the failure to formally amend the subcontract, or can be resolved through negotiation, such as the ownership of any IP created during the Project.

The Foundation is pleased to answer any questions that OIG has about this response, and looks forward to the opportunity to discuss these matters in more detail as appropriate.

[18] Ex. A at 5.

OIG RESPONSE 10 The grantee's comments have not resolved the procurement issues; including the apparent, if not real, conflict of interest with its subcontractor. Therefore, our position on the findings and recommendations in the attestation report remains generally unchanged. However, we have accepted the grantee's explanation about the letterhead templates and quality assurance plan and revised the report as appropriate.

Appendix C

Distribution

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