



U.S. ENVIRONMENTAL PROTECTION AGENCY

OFFICE OF INSPECTOR GENERAL

Internal Controls Needed to Control Costs of Emergency and Rapid Response Services Contracts, as Exemplified in Region 6

Report No. 14-P-0109

February 4, 2014



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Abbreviations

CO	Contracting Officer
EPA	U.S. Environmental Protection Agency
ERRS	Emergency and Rapid Response Services
FAR	Federal Acquisition Regulation
G&A	General and Administrative
OAM	Office of Acquisition Management
ODC	Other Direct Cost
OIG	Office of Inspector General
PO	Project Officer
QAP	Quality Assurance Program

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At a Glance

Why We Did This Review

The purpose of this review was to determine whether the U.S. Environmental Protection Agency's (EPA's) Region 6 is managing task orders under the Emergency and Rapid Response Services (ERRS) contracts effectively and whether contractors are billing Region 6 in accordance with contract terms.

Region 6 awarded its two current ERRS contracts (EP-S6-07-01 and EP-S6-07-02) in May 2007. At the time of our preliminary review, EP-S6-07-01 had 124 issued task orders and EP-S6-07-02 had 50 issued task orders. The combined total expended amount on both contracts was \$77,579,001 as of October 2012.

This report addresses the following EPA theme:

- *Embracing EPA as a high performing organization.*

For further information, contact our public affairs office at (202) 566-2391.

The full report is at:
www.epa.gov/oig/reports/2014/20140204-14-P-0109.pdf

Internal Controls Needed to Control Costs of Emergency and Rapid Response Services Contracts, as Exemplified in Region 6

What We Found

Region 6 manages field activities under the ERRS contracts within the terms of the contract. However, our review of task order files and invoices submitted under those task orders showed us that infrequent internal control reviews and inadequate staffing levels hamper Region 6's ability to prevent and detect many contract management shortcomings, such as:

- Performing required annual invoice reviews.
- Monitoring contractor adjustment vouchers.
- Receiving prime contractor negotiated team subcontract agreements on time.
- Correctly coding task orders in the EPA Acquisition System.
- Performing adequate internal control reviews.

Improper application of general and administrative rates resulted in higher costs to the government.

Without adequate staffing levels, Region 6 is unable to conduct internal control reviews. Such reviews are a tool for ensuring that products comply with regulations and are consistently of high quality. Without internal control reviews, crucial aspects in the acquisition cycle cannot be assessed and management cannot determine and properly address weaknesses and vulnerabilities.

We identified two conditions that resulted in higher costs to the government. One prime contractor was applying a general and administrative indirect rate to its team subcontractors' other direct costs, which went against the prime contractor's proposal and indirect cost rate letter. Also, both prime contractors were receiving additional profit because the fixed labor rates negotiated between the EPA and the ERRS prime contractors were based solely on the prime's labor rates.

Recommendations and Planned Corrective Actions

We recommend that the Region 6 Regional Administrator require procurement personnel to conduct internal control reviews twice a year or declare contract management as a weakness in Region 6's next Federal Managers' Financial Integrity Act submission until Region 6 starts conducting internal control reviews. We also recommend that the Regional Administrator address issues related to subcontract other direct costs in the existing ERRS contracts, and require that proposals for future ERRS contracts include subcontractor rates as required.

Region 6 concurred with three out of five recommendations. Region 6 did not concur with recommendations 3 and 4, to require the contractor to adjust all billings to reflect application of the correct rate to team subcontract other direct costs, and to modify future billings. Region 6 believes the amounts involved are immaterial and do not justify the investment in time that would be needed to adjust all past invoices. These recommendations remain unresolved.



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

THE INSPECTOR GENERAL

February 4, 2014

MEMORANDUM

SUBJECT: Internal Controls Needed to Control Costs of Emergency and Rapid Response Services Contracts, as Exemplified in Region 6 Report No. 14-P-0109

FROM: Arthur A. Elkins Jr.

A handwritten signature in black ink, appearing to read "Arthur A. Elkins Jr.", is written over the printed name.

TO: Ronald Curry, Regional Administrator
Region 6

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 agreed with three recommendations and provided corrective actions with completion dates, and these recommendations are considered resolved. For the other two recommendations, the agency disagreed and these recommendations will be resolved through the audit resolution process. EPA managers, in accordance with established audit resolution procedures, will make final determinations on matters in this report.

The audit report identifies improvements that can be made to the Emergency and Rapid Response Services (ERRS) contracts in Region 6. Other regions also have similar contracts. The OIG encourages other regions to review the issues in this report and determine whether they may exist for their ERRS contracts. Addressing such issues will assist in controlling costs, which is imperative in the current budget environment. If you have any questions about the issues in the report, please contact the OIG staff listed below.

Action Required

In accordance with EPA Manual 2750, the resolution process begins immediately with the issuance of this report. We are requesting a meeting within 30 days between the Region 6 Regional Administrator and the OIG's Assistant Inspector General for Audit. If resolution is still not reached, the Region 6 Regional Administrator is required to complete and submit the dispute resolution request to the Chief Financial Officer to continue resolution.

We will post this report to our website at <http://www.epa.gov/oig>.

If you or your staff have any questions regarding this report, please contact Richard Eyermann, acting Assistant Inspector General for Audit, at (202) 566-0565 or eyermann.richard@epa.gov; or Janet Kasper, Product Line Director, at (312) 886-3059 or kasper.janet@epa.gov.

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Chapter 1

Introduction

Purpose

The U.S. Environmental Protection Agency (EPA) spends millions of dollars annually under Emergency and Rapid Response Services (ERRS) contracts to provide emergency, time-critical removal and quick remedial response cleanup services. With the large spending comes a higher risk of fraud, waste and abuse. As a result, the Office of Inspector General (OIG) conducted this audit to review the ERRS contracts awarded in Region 6 because of the high dollar value of contracts and volume of emergency response work performed. Our review sought to answer the following questions:

- Is Region 6 effectively managing task orders under ERRS contracts?
- Are contractors billing costs in accordance with contract terms?

Background

ERRS contracts are regionally-based contracts and provide cleanup personnel, equipment and materials to: contain, recover or dispose of hazardous substances; analyze samples; and conduct site restoration. The broad range of cleanup services needed and the rapid time frame within which the contractors must respond make it likely that the contractors will do substantial subcontracting—particularly in the area of transportation and disposal of hazardous wastes, which is a mandated subcontracting activity under the ERRS contracts.

As of October 2012, there were 23 ERRS contracts operating in the 10 regions with expenditures of \$721.7 million. The maximum potential value of all 23 contracts is \$2.4 billion. These contracts are predominantly indefinite-delivery contracts that issue task orders using various pricing arrangements. The predominant pricing arrangement on ERRS contracts are time-and-materials. A time-and-materials contract acquires services on the basis of direct labor hours at specified fixed hourly rates that include wages, overhead, general and administrative (G&A) expenses, and profit. These contracts also include materials at cost.

Scope and Methodology

We conducted this audit from November 2012 to August 2013 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives, which we believe we have done.

We identified internal controls regarding the management of task orders and the billing of invoices by reviewing EPA policies and procedures. We assessed the compliance with those internal controls in the sample of task orders and invoices analyzed. We also reviewed Region 6's Federal Financial Management Integrity Act review to determine whether it reported any internal control weaknesses related to contract management.

Region 6 has two ERRS contracts: EP-S6-07-01 and EP-S6-07-02. As of October 2012, Region 6 had issued 124 task orders under EP-S6-07-01 and 50 task orders under EP-S6-07-02. The combined total expended amount on both contracts, as of October 2012, was \$77,579,001.

To determine whether Region 6 effectively managed task orders under the ERRS contracts, we used a non-probability sample and selected a total of 10 task orders, five from each contract. We selected the sample based on higher obligation amounts and the type of work that was performed. For example, given the scope of our audit, we selected task orders that involved non-time critical removals and also task orders that involved emergency responses.

To determine whether contractors are billing costs in accordance with contract terms, we used a judgmental selection process. We selected recent invoices and invoices with a large dollar value. We reviewed eight invoices, four from each contract.

We interviewed the Region 6 staff managing contracts, including the contracting officer (CO), the contracting specialist, the procurement director, the project officer (PO), five on-scene coordinators, and two people in the management division who work on manpower strategy. We reviewed supporting documentation for each task order and invoice in our sample as well as compliance with applicable laws, regulations and guidance documents. During our audit, we found that Region 6 staff was not evaluating the qualifications of contractor personnel who were not considered key. Because this finding is being addressed in another OIG report, we did not pursue the matter in this report.

Prior Audit Coverage

In April 2013, the OIG found that Region 9 did not require its contracting personnel to verify that personnel for the contractor had the qualifications necessary to execute a time-and-materials contract.¹ To address this issue, the OIG recommended that the Assistant Administrator for Administration and Resources Management require task order contracting officer representatives to evaluate the qualifications of contractor key staff proposed by the contractor in the work plan. The task order contracting officer representatives should also review qualifications for samples of the non-key staff billed on invoices.

¹ EPA OIG Report No. 13-P-0209, *Opportunities for EPA-Wide Improvements Identified During Review of a Regional Time and Materials Contract*, April 4, 2013.

Chapter 2

Region 6 Needs More Frequent Internal Control Reviews

Region 6 manages field activities under the ERRS contracts within the terms of the contracts. However, our review of task order files and invoices submitted under those task orders showed that infrequent internal control reviews and inadequate staffing levels hampered Region 6's ability to prevent and detect many contract management shortcomings. The EPA's Acquisition Handbook and Contract Management Manual include policies and procedures that serve as internal controls in the contract management process. The contract management issues found during the course of this audit were attributable to insufficient internal control reviews and, according to procurement personnel, insufficient staff to handle the workload. When not conducting internal control reviews, critical aspects in the acquisition cycle cannot be assessed and, subsequently, strengths, weaknesses and vulnerabilities cannot be addressed properly by management.

Contract Management Aspects Contained in EPA Guidance

Contract management at the EPA is guided primarily by two policies: the Contracts Management Manual and Acquisition Handbook. Both documents contain policy and procedures that serve as internal controls in the contract management process. The internal controls pertinent to this report are:

- Quality Assurance Program (QAP) – The Acquisition Handbook requires the primary contracting organization, such as a regional office, to establish, fully implement and sustain a QAP program. Under the QAP, each contracting office is to develop, implement and maintain its own unique plan to ensure its contracting processes and products are compliant with governing rules and are consistently of high quality. The QAP also serves as a tool to identify potential vulnerabilities and preempt the creation of serious or systemic problems.
- Invoice reviews – According to the Contract Management Manual, the CO has ultimate responsibility for invoice processing under individual contracts. POs review invoices monthly, and the CO conducts periodic monitoring. CO review is to ensure that the contractor and PO are fulfilling their roles properly. Periodic monitoring must be at the level of frequency necessary to ensure all invoice elements are charged properly. Periodic monitoring may include at least one detailed review of an invoice on each contract each year.

Effective Contract Management Lacking in Crucial Areas

Region 6 manages field activities under the ERRS contracts within the terms of the contract. However, our review of task order files and invoices submitted under those task orders showed that infrequent internal control reviews and inadequate staffing levels hampered Region 6's ability to prevent and detect many of the contract management shortcomings described in table 1.

Table 1: Contract management shortcomings

Issue area	Condition observed
Annual invoice reviews	Seven out of 10 required annual invoice reviews were not performed.
Adjustment vouchers	One adjustment voucher was not submitted within the required 60 days and another voucher was not submitted at all.
Subcontract agreements	Eight of 10 team subcontract agreements were not received in the required timeframe.
Definitized task orders	One of 10 task orders was not definitized within 5 days.
EPA's Acquisition System	Five out of 10 task orders were coded incorrectly in the EPA's Acquisition System.

Source: OIG analysis.

The awarding CO under Region 6's ERRS contracts did not perform seven out of 10 required annual invoice reviews. One contract only had two annual invoices reviewed and the other contract only had one annual invoice reviewed. Both contracts were entering the sixth year of performance and each contract should have had five CO annual invoices reviewed at the time we conducted the audit.

The CO and PO do not monitor the submission of adjustment vouchers for the prime contractors under both contracts. These adjustment vouchers reflect the negotiated indirect cost rate between the prime contractor and cognizant federal agency. Once the indirect cost rate is negotiated, prime contractors submit vouchers that reflect the difference between the billed indirect costs and the indirect costs resulting from the negotiated agreement. Out of the eight invoices we reviewed, we noted one instance where the adjustment voucher was not submitted within the required 60 days and one instance in which the adjustment voucher had not been submitted as of March 2013, making it more than 6 months late.

Team subcontractors are contractors that the prime contractor identifies in its proposal that will conduct work under the contract. The CO and PO for both contracts did not receive eight out of the 10 team subcontract agreements in the required timeframe. The contract requires that within 5 (calendar) days of the issuance of a notice to award, the contractor must provide the team subcontract agreement to the CO and PO. The team subcontractor agreements are contracts between the prime contractor and team subcontractor and serve to formalize that legal relationship.

One out of 10 task orders reviewed was not definitized within 5 days as required by the contract. Instead, contractors performed services based on a verbal authorization for 31 days before the task order was put into writing. A verbal authorization usually occurs when it is impossible to negotiate the terms due to time constraints and the criticality of the requirements. In this case, changing staff delayed the definitization of the task order. The period of time in which a task order is not definitized can pose significant risks to the government. For example, the government may pay increased costs during the undefinitized period because the contractor has little incentive to control costs.

We reviewed EPA's Acquisition System and found five out of 10 task orders were coded incorrectly. Those five task orders were coded as fixed-price when they were actually time-and-materials task orders.

Procurement personnel for Region 6 stated that the section's staffing levels were inadequate based on the workload-to-staff ratio. The director provided us with a matrix developed in November 2012 that detailed crucial acquisition activities that were not being performed at all or that were being performed sporadically at different staffing levels. The procurement activities that are not being performed at the current staffing level include the following:

- *Contract placement (oversight, quality assurance reviews and cost analysis):* Region must outsource major contract placements to other EPA locations.
- *Training and outreach:* No training or customer outreach can be done at this staffing level.

Meanwhile, the procurement activities being performed sporadically at the current staffing level include the following:

- Contract management (oversight, quality assurance reviews, cost analysis, filing and data entry).
- Simplified acquisitions (oversight and quality assurance reviews).
- Contract close-out.
- Commenting on and responding to new acquisition guidance and policy.
- Reading, digesting and implementing new acquisition guidance and policy.
- Responding to the Office of Acquisition Management's data calls.

Infrequent Internal Control Reviews Hinder Effective Contract Management

Infrequent internal control reviews allowed the contract management issues to occur. These internal control reviews are not being conducted as often as required per Region 6's QAP. The QAP requires that internal control reviews, which the document refers to as peer reviews, occur semiannually. The purpose of the

review is to ensure that COs are properly exercising their authority and to ensure that individuals and the organization comply with applicable rules and regulations. Procurement personnel indicated to us that they do not have the adequate amount of staff to perform the reviews. These reviews are a key element in Region 6's quality control program. Without them, crucial aspects in the acquisition cycle cannot be assessed and, subsequently, strengths, weaknesses and vulnerabilities cannot be exposed properly by management.

Recommendations

We recommend that the Regional Administrator, Region 6:

1. Require procurement personnel to conduct internal control reviews twice a year; or
2. Identify contract management as a weakness in Region 6's next Federal Managers' Financial Integrity Act annual assurance letter unless Region 6 starts conducting internal control reviews twice a year.

Agency Response and OIG Evaluation

Recommendations 1 and 2 represented an either/or option as they were linked together. EPA Region 6 agreed with our findings and opted for recommendation 1, namely, that it pledged to conduct internal control reviews twice a year. The OIG believes that doing so will help Region 6 effectively monitor its contract vulnerabilities and be proactive about reducing contract risk. Therefore, we consider recommendations 1 and 2 adequately addressed because Region 6's proposed corrective action, when implemented, will address the problems identified.

Chapter 3

Contractor Applying G&A Rate Inconsistent With Rate Letter

One of Region 6's prime ERRS contractors is incorrectly applying a general and administrative rate to its team subcontractors' other direct costs (ODCs). Based on the contractor's negotiated indirect cost rate letter, team subcontractors should have received the lower subcontract administration rate and not the higher G&A rate. The prime contractor's proposal and indirect cost rate letter do not clearly distinguish between team and non-team subcontractor costs. This has resulted in the prime contractor overbilling subcontractor indirect costs.

The indirect cost rate agreement describes how contractors apply indirect costs. The rate agreement identifies the type of expense pool, the basis of application, the applicable rate, the contracts affected and the period to which the rate will apply. The expense pool represents a grouping of indirect costs such as fringe benefits, overhead and G&A expenses. The basis for application identifies whether the indirect cost rate is applied to direct labor costs, subcontract costs or some other combination of costs. The basis for application will vary by contractor and is based on the contractor's accounting system. The indirect cost rate agreement is considered part of each contract.

One of Region 6's prime ERRS contractors did not follow its own proposal and indirect cost rate letter when it applied G&A to its team subcontractors' ODCs. When we reviewed one prime contractor's proposal, we determined that the contractor has several pools for allocating indirect costs. Of importance to this audit were the contractor's G&A and subcontract administration pools. The basis for application, per the contractor's negotiated rate agreement, is as follows:

- **G&A:** Total costs incurred excluding G&A and subcontract costs.
- **Subcontract Administration:** Direct subcontract costs.

During our review of task order files and invoices under this contract, we determined that the prime contractor was applying the higher G&A rate to its team subcontractors' ODCs.² Based on this contractor's proposal and indirect rate letter, team subcontractors should have received the subcontract administration rate and not the higher G&A rate. The contractor's negotiated indirect cost rate letter states that the G&A pool's basis for application does not include subcontract costs. The subcontract administration rate is substantially lower than the G&A rate.

² The rates are not being disclosed in this report because they are confidential business information.

The proposal does not clearly differentiate between team and non-team subcontractors. The proposal also contradicts itself in describing how the indirect costs associated with team subcontractors should be applied. Under the contractor's "General Information" section of its proposal, it states that, "Non-team subcontractor costs will be billed at cost plus a mark-up for Subcontract Administration costs." This would indicate that team subcontractors are to receive the G&A rate as opposed to the subcontract administration rate. However, the prime contractor's proposal states that its accounting practice is to apply subcontract administration rates on all subcontractor costs.

The prime contractor has been overbilling team subcontractors' ODCs by applying the G&A rate instead of the subcontract administration rate. In three of the five invoices analyzed, the contractor overbilled by a total of \$3,435. This practice results in the government paying a higher rate for subcontract indirect costs.

Recommendations

We recommend that the Regional Administrator, Region 6:

3. Direct COs to require that the contractor adjust all its billings to reflect the application of the correct rate to team subcontract ODCs.
4. Direct COs to work with the contractors to modify future billings.

Agency Response and OIG Evaluation

EPA Region 6 did not agree with recommendations 3 and 4. Region 6 reviewed a Defense Contract Audit Agency audit, Financial Administrative Contracting Officer review, contractor's statement, and Removal Cost Management System data and concluded that the contractor is applying the correct G&A rate to the team subcontract ODCs. We reviewed the EPA and Defense Contract Audit Agency reports, and neither specifically addressed the application of the G&A rate to team subcontract ODCs. In addition, the reports are more than 5 years old and may not reflect current practices.

After receiving the response, the OIG discussed the disagreement at the exit conference, exchanged additional information, and had several followup discussions in order to try and reach agreement on the finding. Region 6 obtained assistance from Office of Acquisition Management (OAM) to further analyze the issue. OAM determined that the contractor should have been applying a composite rate to team subcontractor ODCs. The composite rate consisted of a handling charge plus the contractor's subcontractor administration rate.³ The

³ The subcontractor agreements state that the subcontractor can charge a handling charge if consistent with the subcontractor's accounting system. There is no evidence that the EPA or the contractor has verified that the handling charge was consistent with the subcontractor's system.

composite rate was not mentioned in the contractor's proposal or contract. However, the agency believes it is a valid cost since the handling fee was included in the contractor's agreements with the team subcontractors. According to OAM, the contractor should have been using a composite rate. Instead, the contractor was using its G&A rate in the billings. According to Region 6, the G&A rate was applied because the Removal Cost Management System that is used to create the invoices only allows one indirect cost rate.

OAM did recommend that if the supporting explanation and documentation proved acceptable to the OIG, the contracting officer could take corrective action to address the issue in the future. However, OAM believes that based on the review of a couple of invoices, the difference is immaterial. Further, OAM believes the immaterial nature of the finding does not justify the investment of time that would be needed to review all past invoices.

OAM's analysis identified that the contractor should have been applying a composite rate rather than the G&A rate. We agree that the contracting officer needs to work with the contractor to correct invoices in the future. We disagree regarding whether the past invoices need to be reviewed and adjusted. We calculated the composite rate using approved billing rates for 2008 to 2012 and compared it to the G&A rate that was billed. The rate billed was higher than what the contractor was entitled to for each of the years.

Table 2: Difference between composite and G&A rate

Year	Difference
2008	2.77%
2009	3.26%
2010	3.41%
2011	1.03%
2012	1.05%

Source: OIG analysis of contractor information.

For the one invoice reviewed as part of reaching agreement on this finding, the difference was \$85. However, the difference on each invoice will vary depending on the amount of team subcontractor ODCs included on the invoice and the year the costs were incurred. There are over 125 task orders under the contract, each with multiple invoices. Therefore, the OIG continues to recommend that Region 6 work with the contractor to adjust past invoices to correct the application of indirect costs.

We revised the draft report recommendations to reflect the additional analysis that was conducted after the draft report was issued. The audit resolution process will be used to resolve the recommendations.

Chapter 4

By Not Separating Subcontracted Labor Rates, Prime Contractors Receiving Additional Profit

Prime contractors are billing subcontracted labor at the prime contract's labor rates even though they negotiated lower rates with their subcontractors. Under Federal Acquisition Circular 2005-15, the Federal Acquisition Regulation (FAR) was amended to require offerors to establish, for each category of labor, fixed hourly rates using one of three options: separate rates for prime and subcontracted labor, blended rates, or a combination of separate and blended rates. Because this rule became effective shortly before the ERRS contracts were awarded, the prime contractors were not required to comply with the new rule when they submitted their proposals for these noncommercial services. As a result, the prime contractors on Region 6's ERRS contracts were receiving extra profit.

At the time the EPA analyzed the cost proposals for the ERRS contracts, Federal Acquisition Circular 2005-15 was not in effect. The fixed rates negotiated between the EPA and the ERRS prime contractors were based solely on the prime's rates. These negotiated rates were then applied to the prime contractors and their team subcontractors. Because the rule was not in effect during the solicitation phase of the contract, it allowed the prime contractors to negotiate lower rates with its team subcontractors. The lower rates allowed the prime contractors to receive additional profit that was not disclosed to the EPA during contract negotiations.

Our analysis determined that one of the two ERRS prime contractors negotiated agreements with its team subcontractors that were approximately 9.1 percent lower for all labor categories (excluding laborer). This spread in costs equated to the prime contractor receiving roughly 9.1 percent extra profit on those labor categories based on the difference between the rates. Our review found that for two task orders the prime contractor received approximately \$3,600 and \$12,800 in extra profit.

For the other ERRS contract, the prime contractor generally negotiated rates with its subcontractors that were lower than the established rates in the prime contract. For one subcontractor, the labor rates were approximately 8 percent less than the prime's rates with Region 6. For another subcontractor, the labor rates in the agreement were 14 to 16 percent less than the prime's rates with Region 6. The third subcontractor had only a few labor rates in the agreement and some labor rates were higher and some were lower than the prime's rates. Overall, a majority of the labor rates in the subcontract agreements were significantly lower than the rates in the prime's contract with Region 6.

When the EPA negotiated labor rates for the ERRS contract, it only had information on the rates of the prime contractors employees and not the subcontracted labor. The prime contractor charged its own labor and team subcontract labor to the EPA at the negotiated rate. As a result, the prime contractors were receiving additional profit based on the difference between the rates in the prime contract and the rates in the subcontract agreements.

Recommendation

We recommend that the Regional Administrator, Region 6:

5. Require that proposals for future ERRS contracts include subcontractor rates as required by the amended FAR.

Agency Response and OIG Evaluation

EPA Region 6 concurred with recommendation 5, noting that the award of any future ERRS contracts would be subject to FAR and EPA Acquisition Regulation requirements. The OIG believes that separate or blended rates for prime contractors and team subcontractors make good business sense for the government. Each category of labor should have fixed hourly rates using separate rates, blended rates, or a combination of separate and blended rates to reduce the risk of prime contractors receiving additional profit. Consequently, we consider this recommendation closed.

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	6	Require procurement personnel to conduct internal control reviews twice a year; or	O	Regional Administrator, Region 6	6/30/14		
2	6	Identify contract management as a weakness in Region 6's next Federal Managers' Financial Integrity Act annual assurance letter unless Region 6 starts conducting internal control reviews twice a year.	C	Regional Administrator, Region 6	9/23/13		
3	8	Direct COs to require that the contractor adjust all its billings to reflect the application of the correct rate to team subcontract ODCs.	U	Regional Administrator, Region 6			
4	8	Direct COs to work with the contractors to modify future billings.	U	Regional Administrator, Region 6			
5	11	Require that proposals for future ERRS contracts include subcontractor rates as required by the amended FAR.	C	Regional Administrator, Region 6	9/23/13		

¹ O = Recommendation is open with agreed-to corrective actions pending.
 C = Recommendation is closed with all agreed-to actions completed.
 U = Recommendation is unresolved with resolution efforts in progress.

Agency Response to Draft Report and OIG Evaluation



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
REGION 6
1445 ROSS AVENUE, SUITE 1200
DALLAS, TEXAS 75202 – 2733

Office of the Regional Administrator

September 23, 2013

MEMORANDUM

SUBJECT: Response to Office of Inspector General Draft Report No. OA-FY13-0046
“Internal Control Reviews Would Improve Region 6’s Management of
Emergency
and Rapid Response Services Contracts,” dated August 20, 2013

FROM: Ron Curry
Regional Administrator

TO: Richard Eyermann
Acting Assistant Inspector General

Thank you for the opportunity to respond to the findings and recommendations presented in the Office of Inspector General (OIG) Draft Report, “Internal Control Reviews Would Improve Region 6’s Management of Emergency and Rapid Response Services Contracts”. We appreciate the OIG’s audit of our ERRS contracts and your recommendations on internal control and contract management.

Region 6 has reviewed the findings and has determined that the recommendations in Chapter 2 and Chapter 4 have merit for improving Region 6’s management of current and future Emergency and Rapid Response Services (ERRS) contracts. With respect to the findings and recommendations in Chapter 3, we do not concur with the OIG’s assertion that one contractor is incorrectly applying a general and administrative (G&A) rate to its team subcontractors’ other direct costs. For your consideration, we have included our position and corrective actions or proposed alternatives to the recommendations and a Technical Comments Attachment.

Agency’s Response to Report Recommendations

Recommendation Nos. 1 and 2: The OIG identified findings related to the accuracy, timeliness or completion of annual invoice reviews, adjustment vouchers, subcontract agreements, definitized

task orders and the EPA Acquisition System. We understand that those findings are attributed to Region 6's non-compliance with the semi-annual Internal Control Reviews as required by the Quality Assurance Plan (QAP). Therefore, Region 6 concurs with the conclusion and agrees to implement a corrective action to ensure that we are complying with applicable rules and regulations. The OIG's recommendation was to require procurement personnel to conduct internal control reviews twice a year or identify contract management as a weakness in Region 6's next Federal Managers' Financial Integrity Act annual assurance letter, unless Region 6 starts conducting internal control reviews twice a year. Due to the OIG's either-or option in Recommendation Nos. 1 and 2, we have decided to combine the recommendations with the understanding that our final decision will negate the need for the other corrective action. Subsequently, we decided to implement Recommendation No. 1, and our corrective action is to conduct internal control reviews in the 1st Quarter of FY 2014 and 3rd Quarter of FY 2014 and in accordance with the Peer Review Process in the QAP.

Recommendation Nos. 3 and 4: The OIG reviewed the ERRS prime contractors' proposal and indirect cost rate letters and concluded that the documents do not clearly distinguish between team and non-team subcontractor other direct costs (ODCs) with regards to the application of G&A or subcontract administration G&A. Due to this ambiguity, the OIG asserts that one contractor is incorrectly applying a G&A to its team subcontractors' other direct costs and this practice may result in the government paying a higher rate for subcontract indirect costs. As corrective actions, the OIG recommended that we direct the COs to require that the contractor adjust all its billings to reflect the application of the subcontract administration rate to team subcontract ODCs and direct the COs to modify the contract to explicitly explain that team subcontract ODCs receive subcontract administration rate.

We understand the OIG's concerns and we have made many efforts to determine the contractor's intent at pre-award and its accounting practice after contract award. We reviewed a Defense Contract Audit Agency (DCAA) audit, Financial Administrative Contracting Officer (FACO) review, contractor's statement, and Removal Cost Management System (RCMS) data and concluded that the contractor is applying the correct G&A rate to team subcontract ODCs. Therefore, Region 6 does not concur with Recommendation Nos. 3 and 4. Our corrective action is to remove the ambiguity in the contract via a modification to explicitly explain that team subcontract Other Direct Costs (ODCs) will receive the general and administrative (G&A) rate. We have combined Recommendation Nos. 3 and 4 in our response because they are integrally related to each other. Additionally, OAM reviewed the Region's response to Recommendation No. 3 and concurs with this position. For your consideration, we are providing the following results of our review.

Defense Contract Audit Agency: The DCAA examined the contractor's Indirect Cost Pools and Allocation Bases to determine if the accounting system provided for, in part, the following procedures:

- Direct and indirect costs are appropriately identified, accumulated, and reported; and
- Indirect costs are allocated equitably and consistently to contracts and other cost objectives.

Based on DCAA Audit Report No. 1621-2006B17740009 dated October 24, 2006, the contractor's accounting system is adequate for accumulating and billing costs under government contracts.

Although the aforementioned audit was conducted seven (7) months prior to the award, the current contract is a follow-on requirement to the previous ERRS contract, in which the general and administrative (G&A) rate was applied in the same manner (i.e. G&A rate applied to team subcontract ODCs).

Financial Administrative Contracting Officer: The FACO reviewed the contractor's accounting and financial records under the contract. The FACO released Financial Monitoring Report No. 8DFM010 dated July 29, 2008 in which a finding was identified that related to the contractor's Value Added Total Cost Input G&A base. The report stated that the contractor incorrectly excluded subcontract administration labor, fringe benefits applicable to subcontract administration labor and warehouse labor from its value added G&A base calculation; however, the report did not identify any findings related to an incorrect application of the G&A rate to team subcontract Other Direct Costs.

Contractor's Statement: "This practice has been a standard and consistent practice on our ERRS contracts, it is fully compliant with our contracts, and it is in compliance with our accounting system and practices. There is no documentation related to this practice from previous audits because no auditors have questioned or disputed this practice."

Removal Cost Management System: Region 6 reviewed and verified data through RCMS related to the application of the G&A rate to team subcontract ODCs under the ERRS contracts in Region 5, 9 and 10. Our internal review indicated that the contractor applied a standard and consistent business practice for team subcontract ODCs under the contractor's ERRS contracts.

Recommendation No. 5: The OIG reviewed the ERRS labor rates in the proposals and contract files and concluded that Region 6 did not require separate or blended rates for the prime contractor and team subcontractors. Under the Federal Acquisition Circular 2005-15 and the subsequent FAR amendment, contractors are required to establish, for each category of labor, fixed hourly rates using separate rates, blended rates, or a combination of separate and blended rates. When the FAC 2005-15 came into effect, Region 6 was in the process of awarding the contracts. The OIG recognized the timing issue with the current ERRS contracts and recommended that we require proposals for future ERRS contracts to include subcontractor rates as required by FAR 52.216-29.

Region 6 concurs with the recommendation for future ERRS contracts and we agree to comply with FAR and EPAAR requirements in effect. Our intent is to recommend negotiated blended labor rates to the ERRS Placement Contracting Officers.

Furthermore, the Office of Acquisition Management (OAM) stance on FAR 52.216-29 is to follow the FAR as written. Additionally, Chapter 1 in the Acquisition Handbook does not contain a class deviation for ERRS solicitations. Should the ERRS Program request a class deviation, a Determination & Findings (D&F) must be processed and submitted through the Policy, Training and Oversight Division (PTOD) to the Senior Procurement Executive (SPE) for review and approval.

Response to Recommendations Table

Findings Region 6 is in agreement

No.	Recommendation	High-Level Intended Corrective Action(s)	Estimated Completion by Quarter and FY
1	Require procurement personnel to conduct internal control reviews twice a year.	Region 6 concurs with Recommendation No. 1 and agrees to conduct internal control reviews in accordance with the Peer Review Process in the Quality Assessment Plan (QAP).	1 st Quarter FY 2014 and 3 rd Quarter FY 2014
2	Identify contract management as a weakness in Region 6's next Federal Managers' Financial Integrity Act annual assurance letter unless Region 6 starts conducting internal control reviews twice a year.	Region 6 agreed to the corrective action in Recommendation No. 1; therefore, a corrective action for Recommendation No. 2 is not required.	Not Applicable
5	Require that proposals for future ERRS contracts include subcontractor rates as required by the amended FAR.	Region 6 concurs with Recommendation No. 5 and agrees to require proposals for future ERRS contracts to include subcontractor rates as required by the amended Federal Acquisition Regulations (FAR) and to recommend negotiated blended rates to the Placement Contracting Officers.	FY 2015

Findings Region 6 is in disagreement

No.	Recommendation	Agency Explanation/Response	Proposed Alternative
3	Direct COs to require that the contractor adjust all its billings to reflect the application of the subcontract administration rate to team subcontract ODCs.	Region 6 does not concur with Recommendation No. 3. Based on the DCAA audit, FMR, contractor's statement, and an internal data review, Region 6 determined that the contractor's billings shall remain unchanged.	The contractor's billings shall remain unchanged.
4	Direct COs to modify the contract to explicitly explain that team subcontract ODCs receive subcontract administration rate.	Region 6 does not concur with Recommendation No. 4. Refer to Region 6's explanation on Pages 2 and 3 of this response.	The COs shall modify the contract to explicitly explain that team subcontract ODCs receive the G&A rate.

Contact Information

If you have any questions about this letter, please call me at (214) 665-2100, or your staff may contact Susan Jenkins, Audit Follow-up Coordinator, at (214) 665-6578, or by email at jenkins.susan@epa.gov.

Attachment

- cc: Kevin Christensen, OIG
 Janet Kasper, OIG
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*Response to Office of Inspector General Draft Report No. OA-FY13-0046
“Internal Control Reviews Would Improve Region 6’s Management of Emergency
and Rapid Response Services Contracts,” dated August 20, 2013*

Technical Comments on the Draft Report

While we agree with most of the findings and recommendations, we have included Technical Comments on the contract management shortcomings identified in Chapter 2 to further explain the procurement and program office activities related to the findings and to clarify or improve the accuracy of specific details in the report.

Page 4, Chapter 2 – Table 1: Contract Management Shortcomings:

Annual Invoice Reviews – Although the Administrative Contracting Officers could not locate seven (7) out of ten (10) annual invoice reviews for the prior periods, the three (3) reviews that were in the files were for the most recent required review periods (i.e. one for 2011 and two for 2012).

It should be noted that the Administrative Contracting Officers identified the contract management shortcomings of the Awarding Contracting Officers and implemented a corrective action by conducting the required annual invoice reviews that were due at the time.

Adjustment Vouchers – The adjustment vouchers are required for negotiated interim and final Indirect Cost Rates (ICR), and the vouchers must be submitted within sixty (60) days. Although the voucher submissions were not timely, all monies due to the Government or to the contractors for prior year indirect cost rates must be settled after contract completion and final DCAA ICR audits and before contract closeout.

It should be noted that a corrective action has been implemented that requires the Project Officer to monitor the submission of ICR adjustment vouchers and requires the Contracting Officer to verify the receipt of periodic ICR adjustment vouchers during the annual invoice review process.

Subcontract Agreements – The Team Subcontract Agreements were not submitted to the Awarding Contracting Officers and Project Officer within five (5) calendar days of the issuance of a notice of award; however, the delayed submission of formal team subcontract agreements did not have a financial or technical impact on the contracts.

As a corrective action, it should be noted that the Administrative Contracting Officers will recommend to the Placement Contracting Officers for the future ERRS contracts to review the requirement and make a determination regarding the reasonableness of the contractor’s timeframe to fully execute and submit formal team subcontract agreements to the Government.

Definitized Task Orders – One out of ten task orders was not definitized by the Awarding Contracting Officer within five (5) days due to an administrative oversight related to internal staffing changes (i.e. the transfer of the Contract Specialist to another EPA Section and Division, and the changing of Administrative Contracting Officers).

It should be noted that the administrative oversight only occurred once under the contracts. If the subject task order was excluded from the sample because of the unusual circumstances or replaced with another similar type of task order, it is our opinion that Region 6 success rating would be 100%, which is effective and efficient contract management.

Furthermore, from an administrative and technical standpoint, the delayed definization did not pose any significant financial or technical risks to the Government because a Contracting Officer Technical Representative (COTR)/On-Scene Coordinator (OSC) was assigned to the project when the verbal authorization for services was given to the contractor. The COTR/OSC safeguarded the Government and controlled costs by being on-site during performance, providing daily technical direction to the contractor, reviewing and signing daily 1900-55s of all costs incurred, and developing a cost estimate and Statement of Work within five (5) days. As a result, there were no changes in field performance/activities or an increase in government costs.

EPA's Acquisition System (EAS) – The system default for the Award Type/pricing arrangement on all EPA orders is “Firm-Fixed Price” regardless of the contract pricing arrangement, which poses a national EAS data quality issue.

The Administrative Contracting Officers (COs) identified the system default issue prior to this audit and was working with the national EAS Focus Workgroup on a resolution to change the award type/pricing arrangement from “Firm-Fixed Price” to “Time-and-Materials”. Also, the COs presented the issue to OAM's Information Technology Service Center (ITSC) and recommended two options, one was the removal of the default feature (i.e. automatic population of the field), which would allow for user selection, and the other was to retain the default feature but with the automatic population of the contract pricing arrangement as the award type. The COs recommendation was not implemented by ITSC, and the EAS default remains unchanged. Nonetheless, the paper file is the official contract file, and all task orders under the ERRS contracts fall under the “Time-and-Materials” pricing arrangement, unless otherwise negotiated as “Firm-Fixed Price” and stated on the task order in the official contract file.

It should be noted that the Administrative Contracting Officers understand that data quality is important and necessary so they have implemented a corrective action to verify and validate that the information in the EAS award type field is consistent with the official contract file. Additionally, the COs have taken corrective action by changing the award type on incorrectly coded task orders in EAS when a modification is required.

Distribution

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