



U.S. ENVIRONMENTAL PROTECTION AGENCY

OFFICE OF INSPECTOR GENERAL

## *Financial Management*

# **EPA Should Collect Full Costs for Its Interagency Agreements and Report Full Costs for Great Lakes Legacy Act Project Agreements**

Report No. 15-P-0300

September 30, 2015



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## Abbreviations

|       |   |
|-------|---|
| CFC   | Cincinnati Finance Center                           |
| EPA   | U.S. Environmental Protection Agency                |
| FFMIA | Federal Financial Management Improvement Act        |
| FY    | Fiscal Year   |
| GLLA  | Great Lakes Legacy Act                              |
| GLNPO | Great Lakes National Program Office                 |
| IA    | Interagency Agreement                               |
| IGCE  | Independent Government Cost Estimate                |
| OARM  | Office of Administration and Resources Management   |
| OCFO  | Office of the Chief Financial Officer               |
| OIG   | Office of Inspector General                         |
| RMDS  | Resources Management Directives System              |
| SFFAS | Statement of Federal Financial Accounting Standards |

**Cover photo:** Kinnickinnic River Legacy Act Cleanup, Milwaukee Estuary Area of Concern.  
(EPA photo)

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# At a Glance

## Why We Did This Review

The U.S. Environmental Protection Agency (EPA), Office of Inspector General (OIG), performed this audit to determine whether the EPA collects the full cost of the services it provides through interagency agreements (IAs). The OIG also analyzed whether the EPA bills other agencies for its full costs (both direct and indirect).

An IA is a written agreement between federal, state or local agencies through which goods or services are provided. We also reviewed EPA Region 5's Great Lakes National Program Office (GLNPO) project agreements, which are similar to IAs. Those project agreements are binding cost-sharing agreements between GLNPO and nonfederal sponsors (i.e., state and local governments, industry, and other partners) to clean up contaminated sediment in the Great Lakes areas of concern. The EPA's Office of Administration and Resources Management administers IAs, and the GLNPO administers project agreements.

**This report addresses the following EPA goal or cross-agency strategy:**

- *Embracing EPA as a high-performing organization.*

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The full report is at: [www.epa.gov/oig/reports/2015/20150930-15-P-0300.pdf](http://www.epa.gov/oig/reports/2015/20150930-15-P-0300.pdf)

## ***EPA Should Collect Full Costs for Its Interagency Agreements and Report Full Costs for Great Lakes Legacy Act Project Agreements***

### What We Found

EPA project officers did not include indirect costs in agreed-upon cost estimates for IAs, or use the appropriate indirect cost rate for 15 IAs. When the agreed-upon cost estimate did not include indirect costs, the Cincinnati Finance Center reduced the direct costs and added indirect costs. Although this practice indicated the EPA recovered full costs, the EPA may not have provided all services needed by the other agencies.

**By reallocating direct costs to indirect costs, the EPA may not have provided all of the services needed by the other parties to the interagency agreement.**

Federal cost accounting standards direct the agency to report the full cost of products and services it generates. EPA guidance directs project officers to put indirect costs into funds-in IAs (in which the EPA is reimbursed for goods or services provided to another entity), but some project officers were not aware of the guidance. By not including indirect costs in agreed-upon cost estimates, the EPA had to reduce direct costs and may not have been able to provide all of the necessary services. We estimate that the EPA could have potentially recovered an additional \$6.4 million in 15 of the IAs we examined if the agency had included appropriate indirect costs in the agreed-upon cost estimate.

The EPA did not include direct labor and indirect costs in the Great Lakes Legacy Act project agreements. If the EPA had reported total project costs while including direct labor and indirect costs in the total costs, the EPA could have collected the nonfederal sponsors' share of the direct labor and indirect costs, which we estimated at \$2.7 million per year.

### Recommendations and Planned Agency Corrective Actions

We recommend that the Assistant Administrator for Administration and Resources Management work with the Chief Financial Officer to emphasize the funds-in IA guidance requirements to project officers, and train project officers to prepare cost estimates with indirect costs. We also recommend that the Regional Administrator, Region 5, working with the Chief Financial Officer, direct the GLNPO to track the Great Lakes Legacy Act project agreement direct labor costs. Based on discussions with the agency, we revised a recommendation to now have the Regional Administrator, Region 5, direct GLNPO to report full costs without charging direct labor and indirect costs to non-federal sponsors.

The agency concurred with and provided acceptable corrective actions and milestone completion dates for all recommendations except one. The recommendation for the Regional Administrator, Region 5, to direct GLNPO to report full costs is unresolved pending receipt of a planned corrective action and milestone date.



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

THE INSPECTOR GENERAL

September 30, 2015

**MEMORANDUM**

**SUBJECT:** EPA Should Collect Full Costs for Its Interagency Agreements and Report Full Costs for Great Lakes Legacy Act Project Agreements Report No. 15-P-0300

**FROM:** Arthur A. Elkins Jr.

A handwritten signature in black ink that reads "Arthur A. Elkins Jr." with a stylized flourish at the end.

**TO:** Karl Brooks, Acting Assistant Administrator  
Office of Administration and Resources Management

David Bloom, Deputy Chief Financial Officer  
Office of the Chief Financial Officer

Susan Hedman, Regional Administrator  
Region 5

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. Final determinations on matters in this report will be made by EPA managers in accordance with established audit resolution procedures.

The offices we identified with primary jurisdiction over the audit issues and the responsibility for taking corrective action on our recommendations are the Office of Administration and Resources Management; the Office of the Chief Financial Officer; and the Regional Administrator, Region 5, who is responsible for the Great Lakes National Program Office.

**Action Required**

The agency agreed with Recommendations 1 through 3 and provided acceptable high-level corrective action plans. The agency provided estimated completion dates for Recommendations 1 and 2 and completed corrective action for Recommendation 3. The agency did not initially agree with Recommendation 4, but subsequently agreed to a modified recommendation. Therefore, in accordance with EPA Manual 2750 regarding unresolved recommendations, you are required to provide a written response to Recommendation 4 within 60 calendar days. You should include planned corrective actions and a completion date. Recommendations 1 through 3 are in a closed status for reporting purposes; therefore you do not need to respond further regarding those recommendations.

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 along with corresponding justification.

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

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# Chapter 1

## Introduction

### Purpose

The U.S. Environmental Protection Agency (EPA), Office of Inspector General (OIG), performed this audit to evaluate the EPA's independent government cost estimates (IGCEs) and the indirect costs for EPA's interagency agreements (IAs). With the current focus on reducing the federal budget deficit, the OIG wanted to determine whether the EPA was recovering all appropriate indirect costs. The objectives of our audit were to determine whether the EPA:

- Develops IGCEs with appropriate indirect costs prior to entering into reimbursable IAs.
- Bills other agencies for full costs incurred (both direct and indirect costs).

### Background

An IA is a written agreement between federal, state or local agencies through which goods or services are provided on a funds-in or funds-out basis. Funds-in applies to an IA allowing the EPA to be reimbursed for goods or services provided to another federal agency, or to state or local governments. Under funds-in IAs, the EPA uses reimbursable authority provided by the Office of Management and Budget to perform IA activities. Funds-out refers to an IA where the EPA pays another agency for goods or services received.

We also reviewed project agreements, which are similar to IAs. A project agreement is a cost-sharing agreement between the Great Lakes National Program Office (GLNPO) and nonfederal sponsors (i.e., state and local governments, industry, and other partners) to clean up contaminated sediment in the Great Lakes areas of concern. Project agreements may differ from IAs by having nonfederal partners that are not a state or local government agency. Project agreements also differ from IAs, because project agreements may have nonfederal sponsors that are private parties. We included project agreements in our review because: (1) they have some characteristics similar to IAs; (2) EPA's Cincinnati Finance Center (CFC) records them in the accounting system with the same accounting treatment as IAs; and (3) we determined such agreements do not consider full costs as we define them (both direct and indirect) in cost-sharing.

An EPA OIG audit report issued in September 2012<sup>1</sup> disclosed that the EPA did not recover \$11 million in indirect costs on funds-in IAs. The EPA did not bill other federal agencies the full amount of indirect costs because:

- The EPA exempted itself from recovering indirect costs on funds-in IAs awarded under 19 statutory authorities.
- The EPA issued policies where indirect costs do not apply to funds-in IAs and amendments awarded before the policies were effective.
- The EPA issued policies stating that indirect rates in effect at the time the IA is negotiated will apply for the life of the IA.

In response to our audit, the EPA revised agency policy on October 18, 2012, to clarify that indirect costs should be assessed for IAs entered into under all authorities, unless the authority expressly prohibits the charging of full costs. Indirect costs must be charged on all monetary actions for new and existing funds-in IAs when conditions require an amendment. Amendments to existing agreements must include the current indirect cost rate, not the rate used when the agreement was originally negotiated. We conducted our current audit to determine whether the EPA included indirect costs in the cost estimates, which is an area not covered in the prior audit.

While project agreements are not IAs, EPA should consider following the same approach with its project agreements that it follows with its IAs. For the reasons discussed in Chapter 3 of this report, it would be a good practice to voluntarily apply the standards that the EPA is already applying to IAs and other financial instruments to project agreements as well.

### ***Statutory Authority***

IAs are not governed by a single authorizing statute or by governmentwide IA regulations. The EPA maintains a list of statutory authorities for IAs. These statutory authorities include:

- Governmentwide authorities such as the Economy Act.
- Cooperation authorities to carry out joint projects related to the needs and substantive interests of all involved agencies.
- Utilization authorities that expressly contemplate the EPA's use of another agency's personnel, services or other resources.

The Great Lakes Legacy Act (GLLA) of 2002, as amended in 2008, authorizes contaminated sediment remediation in the Great Lakes areas of concern. The GLLA authorizes the use of project agreements between the GLNPO and a

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<sup>1</sup> *EPA Could Recover More Indirect Costs Under Reimbursable Interagency Agreements*, EPA OIG Report No. [12-P-0835](#), issued September 19, 2012.

cooperating agency or entity. The GLLA requires a minimum of 35 percent nonfederal cost share for all projects.

The Federal Financial Management Improvement Act (FFMIA) of 1996 requires federal agencies to implement and maintain financial management systems that comply substantially with applicable federal accounting standards. FFMIA requires federal financial management systems to support full disclosure of federal financial data, including full costs of federal programs and activities, so that programs and activities can be considered based on their full costs and merits.

### ***Agency Internal Practices***

The agency conducts biennial user fee reviews of its programs. In eight of those reviews, completed in December 2013 and January 2014, the agency recommended the programs “apply the agency’s indirect rates to determine the full cost of operating the program.”

### ***Federal Policy, Standards and Guidance***

The Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, dated July 31, 1995, provides that full cost should be a primary basis for setting fees for government goods and services. The full cost of a government good or service is the total amount of costs used to produce the output, and includes direct and indirect costs that contribute to the output. The full cost of an output is the total amount of resources used to produce the output, including direct and indirect costs.

Direct costs are costs that can be specifically identified with an output. Indirect costs are costs that are jointly or commonly used to produce two or more types of outputs but are not specifically identifiable with any of the outputs. Typical examples of indirect costs include: general and administrative services; general research and technical support; security; rent; employee health and recreation facilities; and operating and maintenance costs for buildings, equipment and utilities.

The EPA’s *Interagency Agreement Policies, Procedures, and Guidance Manual*, dated 2008, states that EPA project officers are responsible for preparing an acceptable funding package with an independent government cost estimate/budget. For funds-in IAs using the Economy Act and cooperation authorities, indirect costs must be included in the budget.

The EPA’s Resources Management Directives System (RMDS) No. 2540-13-T1, *Cost Accounting Methods: Full Cost Funds-In Interagency Agreements*, dated October 18, 2012, states that EPA’s full costs (i.e., direct and indirect costs) shall be assessed to other agencies, both federal and nonfederal, for IAs entered into

under all authorities unless the authority expressly prohibits the charging of full costs. Indirect costs must be charged on all monetary actions for new and existing reimbursable funds-in IAs when conditions require an amendment. Amendments to existing agreements must use the current indirect cost rate, not the rate used when the agreement was originally negotiated.

The EPA's RMDS No. 2540-13-P1, *Cost Accounting Methods Agency Indirect Cost Allocation System for Funds-In Interagency Agreements*, issued January 26, 2009, with an administrative change dated April 17, 2014, states that project officers are responsible for assessing indirect costs on funds-in IAs. The EPA's policy is to recover the full cost of IAs, consistent with the authority for a particular IA, the circumstances involved, and the nature of the costs for which payment is made. The EPA's Office of Financial Management, within the Office of the Chief Financial Officer (OCFO), calculates appropriate indirect cost rates for regions and headquarters offices to apply to funds-in reimbursable agreements.

## Responsible Offices

The offices we identified with primary jurisdiction over the audit issues and the responsibility for taking corrective action on our recommendations are the Office of Administration and Resources Management (OARM); the OCFO; and the Regional Administrator, Region 5, who is responsible for the GLNPO.

## Scope and Methodology

We conducted this audit 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. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We conducted our audit from February 2014 through June 2015. Appendix A contains additional details concerning our scope and methodology.

## Prior Reports Reviewed

We researched prior EPA OIG and U.S. Government Accountability Office reports related to cost estimates and the recovery of indirect costs. As previously discussed, we noted one EPA OIG report—EPA OIG Report No. [12-P-0835](#), *EPA Could Recover More Indirect Costs Under Reimbursable Interagency Agreements*, issued September 19, 2012—with information relevant to our review.

## Chapter 2

### EPA Should Improve Its Assessment of Indirect Costs for Funds-In IAs

EPA project officers did not include indirect costs in the agreed-upon cost estimate provided to the agency with which the EPA entered into an agreement, or use the appropriate indirect cost rate for 15 IAs. In fiscal year (FY) 2013, the EPA improved its process by developing IGCEs, with the appropriate indirect costs, prior to entering into funds-in IAs and billing other agencies for its full costs (direct and indirect costs). However, when the agreed-upon cost estimate did not include indirect costs, CFC generally “imputed”<sup>2</sup> the indirect costs. CFC reallocated direct costs to the indirect costs, keeping the original agreed-upon amount as is to show that the EPA recovered full costs. Federal cost accounting standards direct the agency to report the full cost of the products and services it actually generates.

EPA guidance directs project officers to include indirect costs in funds-in IAs. Some project officers were not aware of the guidance and did not fully understand their responsibilities for including indirect costs in IAs. By not including indirect costs in the agreed-upon cost estimate, the EPA had to reduce the direct costs and may not have been able to provide all the services needed by other agencies. The EPA was also at greater risk of providing additional services beyond the agreed-upon cost to complete a project without recovering the cost of those services. We estimate that the EPA could have potentially recovered an additional \$6.4 million in 15 of the IAs that we examined if the EPA had included appropriate indirect costs in agreed-upon cost estimates.

#### EPA Project Officers Did Not Include Indirect Costs in Agreed-Upon Cost Estimates

Federal policy and EPA guidance documents support the use of full costs in IAs:

- SFFAS No. 4, *Management Cost Accounting Concepts and Standards*, states that federal entities should measure and report the full costs of outputs in general purpose financial reports.
- The EPA’s RMDS No. 2540-13-T1, *Cost Accounting Methods Full Cost Funds-In Interagency Agreements*, states: “The EPA’s full (i.e., direct and indirect) costs shall be assessed to other agencies, both federal and non-federal, for IAs entered into under all authorities unless the authority expressly prohibits the charging of full costs.”
- The EPA’s RMDS No. 2540-13-P1, *Cost Accounting Methods Agency Indirect Cost Allocation System for Funds-In Interagency Agreements*,

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<sup>2</sup> Imputed indirect cost is the portion of the agreed-upon cost estimate attributable to indirect cost, based on the indirect cost rate.

states that project officers are responsible for assessing indirect costs on funds-in IAs.

Prior to the EPA's policy interpretation on October 18, 2012, we found that the EPA did not consistently apply indirect costs to IAs or recover full costs. In FY 2013, following the EPA's policy interpretation, the EPA improved its process by developing IGCEs (with the appropriate indirect costs) prior to entering into funds-in IAs and billing other agencies for its full costs. However, EPA project officers can improve at including indirect costs in the agreed-upon cost estimate and using the appropriate indirect cost rate for funds-in IAs. When the cost estimate did not include indirect costs, the CFC imputed indirect costs. The CFC kept the agreed-upon amount the same and reallocated a portion of the direct costs as indirect costs to show that the EPA recovered full costs. By imputing indirect costs, the EPA did not follow its guidance requiring project officers to include indirect costs in the cost estimate.

We reviewed a statistical sample of 40 IAs and amendments from a universe of 463 to determine exceptions to EPA's guidance. From our sample of 40 IAs and amendments, 15 occurred after October 18, 2012, and 25 occurred before that date. We found the following types of exceptions in four of 15 agreements occurring after October 18, 2012:

- Three imputed indirect costs.
- One amendment containing an incorrect indirect cost rate.

We also found the following types of exceptions in 11 of 25 agreements occurring before October 18, 2012:

- Eight containing no indirect costs.
- Three imputed indirect costs.

The types of exceptions noted above demonstrate that after the October 18, 2012, policy interpretation, the EPA improved its performance related to including indirect costs. However, EPA project officers need further improvement to prevent the need to impute indirect costs.

We determined the cause of the exceptions by examining the IAs and interviewing project officers and personnel in the IA shared service centers and the OCFO. EPA project officers did not always include indirect costs in the agreed-upon cost estimate or use the appropriate indirect cost rate for funds-in IAs because:

- EPA project officers for four of the 15 agreements occurring after October 18, 2012, were not aware of current guidance requirements and did not fully understand their responsibilities for including indirect costs in IAs. The project officers relied on the CFC to impute indirect costs.

- EPA project officers for 13 of the 40 agreements said they had not been trained to prepare IGCEs with indirect costs. Neither the OCFO nor the IA shared service centers have provided specific training on preparing IGCEs with indirect costs.

By not including indirect costs in agreed-upon cost estimates, the EPA had to reduce direct costs and may not have been able to provide all of the services needed by the other parties to the IA. The EPA was also at greater risk of providing additional unreimbursed services beyond the agreed-upon cost to complete a project without recovering the cost of those services. We estimate that the EPA could have potentially recovered an additional \$6.4 million in 15 of the IAs that we examined if the agency had included the appropriate indirect costs in the agreed-upon cost estimate.

As part of the audit resolution for our audit report issued September 2012, we agreed with the EPA that it was not practical or cost effective to amend all agreements awarded prior to the October 18, 2012, effective date of the new policy to include the ability to recover indirect costs. Therefore, we are not asking the EPA to amend existing funds-in IAs to recover additional indirect costs.

## **Conclusion**

EPA project officers can improve at including indirect costs in the agreed-upon cost estimate and using the appropriate indirect cost rate for funds-in IAs. The EPA should include indirect costs in the agreed-upon cost estimate, instead of imputing indirect costs after the EPA and the agency with which the EPA entered an agreement have agreed on the project cost. By including indirect costs, the EPA could better meet the needs of other agencies and reduce the risk of not recovering all its costs. Project officers need to be made aware of EPA policy and trained to implement the policy. The EPA can make the needed improvements by emphasizing the guidance requirements to project officers and providing training.

## **Recommendations**

We recommend that the Assistant Administrator for Administration and Resources Management work with the Chief Financial Officer to:

1. Emphasize funds-in IA guidance requirements to project officers, and ensure the officers fully understand their responsibilities for including indirect costs in IAs.
2. Train project officers to prepare IGCEs with indirect costs.

## **Agency Comments and OIG Evaluation**

The agency agreed with our findings and recommendations and provided acceptable corrective actions and estimated completion dates.

# Chapter 3

## EPA Should Report Full Costs for GLLA Project Agreements

The GLNPO did not include full costs (direct labor and indirect costs) in the GLLA project agreements. The GLLA project agreements require the EPA to include the total project costs in project agreements. The GLLA project agreements do not define total project costs or specifically include or exclude direct costs or indirect costs. The agency includes indirect costs in its other billings for cost recovery, Superfund oversight, funds-in IAs, and fees for services where applicable.

The agency's FY 2013 biennial user fee review reports recommended that fee programs apply indirect cost rates to determine the full cost of the programs. SFFAS No. 4 directs federal agencies to report the full cost of products and services generated without specifying direct labor costs or indirect costs. When the EPA began funding GLLA project agreements in 2004, the agency did not include direct labor and indirect costs in its project agreements. Had the EPA reported both direct and indirect costs in arriving at total project costs for the GLLA projects, the agency could have collected the nonfederal sponsors' share of those costs, which we estimate to be \$2.7 million per year.

### GLNPO Did Not Include Full Costs in GLLA Project Agreements

The GLLA requires a nonfederal sponsor to provide at least 35 percent of total project costs when no responsible parties are clearly identified, and the EPA provides up to 65 percent. In cases where a nonfederal sponsor may have some clear responsibility, the GLNPO will require a substantially higher contribution (a minimum of 40–50 percent). The nonfederal contribution may include cash funds or in-kind services. Project agreements generally define “total project costs” as all costs incurred by the nonfederal sponsor and the GLNPO, and are directly related to the work on the project. Total project costs include:

- The value of the nonfederal sponsor's in-kind contributions.<sup>3</sup>
- The GLNPO's engineering and design costs during the project.
- Investigation costs to identify the existence and extent of hazardous substances.
- Actual project costs.
- The GLNPO's costs related to contract dispute settlements or awards.
- Audit costs.

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<sup>3</sup> GLLA project agreements define “in-kind contributions” as the value established by the GLNPO for project-related goods and services provided by the nonfederal sponsors that the GLNPO determines are integral to the project.

Under federal costing standards, including the approach used for IAs (probably the most analogous vehicle to GLNPO project agreements), the portion of total project costs identified as “actual project costs” would include the GLNPO’s indirect costs. According to SFFAS No. 4, the entity providing the goods or services has the responsibility to provide the receiving entity with the full cost of such goods or services, including indirect costs. When GLLA nonfederal sponsors meet their cost-share requirements through in-kind contributions, they include their indirect costs. The GLLA project agreements require nonfederal sponsors to document their in-kind costs and to categorize these costs as direct or indirect costs. To achieve full costs, the GLNPO should include its indirect costs into project agreements in a manner consistent with its nonfederal sponsors.

FFMIA requires federal agencies to implement and maintain financial management systems that comply substantially with applicable federal accounting standards, which include the SFFAS No. 4 requirement for full costing. To comply with FFMIA and implement SFFAS No. 4, the agency has provided guidance for implementing full costing in several financial instruments and systems, including funds-in IAs, cost recovery billings, Superfund oversight cost billings, and user fees where applicable. The agency has not provided guidance for implementing full costing in GLLA project agreements.

The GLNPO did not include direct labor and indirect costs in GLLA project agreements. The project agreements required the GLNPO to include total project costs, but the definition of total project costs did not specify direct labor or indirect costs. Therefore, the GLNPO charged nonfederal sponsors only for costs expressly named in the project agreements. The GLNPO did not employ the approach specified for situations subject to FFMIA or SFFAS No. 4 (to include direct labor and indirect costs). GLNPO personnel estimated that annual labor costs for project agreements would be \$891,000, and the nonfederal sponsors’ share would be \$311,850.

We estimated the annual indirect costs that the GLNPO could recover from GLLA project agreements. An EPA analysis of all project agreements estimated project costs of \$553 million for FYs 2004 through 2013. We calculated the average annual nonfederal sponsors’ share of project costs to be \$22.1 million, based on 10 years of costs and our calculated average cost share of 40 percent. Accordingly, the average annual nonfederal sponsors’ share of indirect costs would be \$2.4 million, based on Region 5’s FY 2014 indirect cost rate of 10.9 percent. Thus, our total estimate of direct labor and indirect costs that the EPA did not collect from nonfederal sponsors was approximately \$2.7 million per year (\$300,000 for direct labor and \$2.4 million indirect costs).

The GLNPO did not apply to project agreements the SFFAS No. 4 cost accounting standard for collecting full cost, and did not include direct labor and indirect costs in project agreements. The GLNPO did not track its direct labor for project agreements; therefore, it did not have labor data available. According to

Region 5 and OCFO, within 1 or 2 years of the passage of the GLLA, the GLNPO and OCFO had a discussion about whether GLNPO labor costs for work on the GLLA should be charged to the GLLA appropriation or to the GLNPO general appropriation. A decision was made to charge the GLNPO general appropriation, and to preserve as much funding as possible for use in project agreements. However, the GLNPO could not provide documentation to support or justify its earlier decisions.

By not using a labor-tracking system, the GLNPO does not have the cost information needed to make effective management decisions to improve operating economy and efficiency. Not including direct labor and indirect costs in the total project costs prevented the EPA from passing the amount on to the nonfederal sponsors via their share of those costs, which we estimated to be \$2.7 million per year. Additional direct labor and indirect costs recovered could be used to pay for other environmental activities.

## **Conclusion**

The GLNPO did not include direct labor and indirect costs in the GLLA project agreements in accordance with the internal practices that the EPA follows with other contracting instruments to include indirect costs and federal cost accounting standards. The GLNPO should track its direct labor costs and include both labor and indirect costs in project agreements and in the related cost-share billings to nonfederal sponsors. Since the GLLA requires the EPA to collect a minimum of 35 percent of total project costs, the EPA should follow internal guidance used to determine total costs in other programs by applying indirect cost rates to the program costs to determine the full costs. By applying the indirect costs rates, the agency would be consistent with federal cost accounting standards to include direct labor and indirect costs in the total project costs.

By implementing full costing, the GLNPO can be consistent with billing practices in other EPA programs; comply with GLLA requirements, the terms of project agreements, and federal costing standards; and collect additional funds that can be put to environmental use. With the current focus on reducing the federal budget deficit, it is important for the EPA to collect full costs.

The GLLA and related project agreements do not define total project costs or specifically include or exclude direct costs or indirect costs. The GLNPO determined that it was not legally required to include direct labor and indirect costs, and therefore elected not to collect full costs from its nonfederal sponsors. However, to be consistent with the federal cost accounting standard for reporting full costs, GLNPO agreed to disclose in the GLLA project agreements that direct labor and indirect costs are not being included.

## Recommendations

We recommend that the Regional Administrator, Region 5, work with the Chief Financial Officer to:

3. Direct the GLNPO to track GLLA project agreement direct labor costs to provide information for potentially improved management decisions.
4. Direct the GLNPO to disclose in the GLLA project agreements that EPA's direct labor and indirect costs are not being included, with management's reason for not including these costs. Document the final project costs, including direct and indirect charges, in the closeout memo for each project agreement.

## Preliminary Agency Actions

Region 5 said it was generally in agreement with Recommendation 3 to track GLLA project agreement direct labor costs. OCFO assisted Region 5 in developing a full cost recognition methodology that aligns with SFFAS No. 4 to capture direct labor costs. On October 1, 2014, Region 5 began tracking GLNPO labor costs of GLLA project agreements. Region 5 said that it did not agree to pass the direct labor and indirect costs on to the nonfederal sponsors of GLLA project agreements.

## Agency Comments and OIG Evaluation

The agency agreed with Recommendation 3 to track direct labor costs. The agency completed an acceptable corrective action by implementing a labor tracking methodology by October 1, 2014.

The agency agreed with the goal of being able to capture and report on the full direct and indirect costs associated with EPA's implementation of the GLLA, but it disagreed with passing those costs on to the nonfederal sponsors of GLLA projects. After discussion with the agency, we revised Recommendation 4 to have the Regional Administration, Region 5, direct GLNPO to disclose full costs without charging direct labor and indirect costs to the nonfederal sponsors. Recommendation 4 is unresolved pending receipt of a planned corrective action and milestone date.

# Status of Recommendations and Potential Monetary Benefits

| RECOMMENDATIONS |          |  |                     |   |                         | POTENTIAL MONETARY BENEFITS (in \$000s) |                  |
|-----------------|----------|--|---------------------|---|-------------------------|---|------------------|
| Rec. No.        | Page No. | Subject  | Status <sup>1</sup> | Action Official   | Planned Completion Date | Claimed Amount                          | Agreed-To Amount |
| 1               | 7        | Emphasize funds-in IA guidance requirements to project officers, and ensure the officers fully understand their responsibilities for including indirect costs in IAs.  | O                   | Assistant Administrator for Administration and Resources Management and Chief Financial Officer | 09/30/15                |   |                  |
| 2               | 7        | Train project officers to prepare IGCEs with indirect costs.   | O                   | Assistant Administrator for Administration and Resources Management and Chief Financial Officer | 06/30/16                |   |                  |
| 3               | 11       | Direct the GLNPO to track GLLA project agreement direct labor costs to provide information for potentially improved management decisions.  | C                   | Regional Administrator, Region 5, and Chief Financial Officer                                   | 10/01/14                |   |                  |
| 4               | 11       | Direct the GLNPO to disclose in the GLLA project agreements that EPA's direct labor and indirect costs are not being included, with management's reason for not including these costs. Document the final project costs, including direct and indirect charges, in the closeout memo for each project agreement. | U                   | Regional Administrator, Region 5, and Chief Financial Officer                                   |                         | \$5,400 <sup>4</sup>                    |                  |

<sup>1</sup> 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.

<sup>4</sup> EPA OIG policy is to base efficiencies from recurring events on the projected monetary benefit for the current and following year. The potential monetary benefit represents the recurring costs recovered from collecting the GLNPO's direct labor and indirect costs associated with GLLA project agreements, based on estimated costs for the current and following year.

## ***Details on Scope and Methodology***

To gain an understanding of the EPA's processes for developing IGCEs, and assessing indirect costs on funds-in IAs and GLLA project agreements, we:

- Reviewed applicable laws, regulations, federal and EPA policies, standards, guidance, and relevant prior audit reports.
- Reviewed the EPA's procedures for assessing indirect costs on IAs.
- Interviewed OARM's IA project officers and personnel in the Interagency Agreement Shared Service Centers; OCFO personnel responsible for IA policy and indirect cost rates; CFC personnel responsible for billing IAs; and GLNPO and EPA Region 5 personnel involved with Great Lakes project agreements.
- Reviewed the EPA's FY 2013 management integrity assurance letters from the regions, program offices, and finance centers for reported internal-control weaknesses related to indirect costs.

We tested IA billings and awards to determine whether the EPA properly included indirect costs in the IGCE/budget. We used the monetary unit method of statistical sampling to test 40 IA and six GLLA project agreements. We tested 28 IA billings totaling \$24,430,185 from a universe of 2,784 FYs 2012 and 2013 billings totaling \$218,393,222. We tested an additional 12 IAs and amendments totaling \$12,061,754 from a universe of 463 IAs totaling \$103,835,155, with award dates in FYs 2012 and 2013. Of our 40 IA samples, 15 occurred after the EPA's new policy effective date of October 18, 2012, and 25 occurred before then. From the IA billings universe, we tested six GLLA project agreement billings totaling \$33,646,349 to determine whether they included direct labor and indirect costs.

We did not assess the reliability of data in any of the information systems, because using the data did not materially affect our findings, conclusions or recommendations. We accessed billing information in Compass Financials, the agency's accounting system. We did not review the internal controls over Compass Financials from which we obtained financial data, but relied on the review conducted during the audit of the EPA's FY 2013 financial statements.

## ***Agency Response to Draft Report***

July 15, 2015

### **MEMORANDUM**

**SUBJECT:** Response to OIG Draft Audit Report OA-FY14-0130, “EPA Should Collect Full Costs for Its Interagency and Great Lakes Project Agreements” dated June 15, 2015

**FROM:** David A. Bloom /s/ **Original Signed By:**  
Deputy Chief Financial Officer

**TO:** Kevin Christensen  
Assistant Inspector General, Office of Audits

Thank you for the opportunity to respond to the issues and recommendations in the subject draft audit report. Following is a summary of the agency’s overall position, along with its position on each of the report recommendations. For those report recommendations with which the agency agrees, we have provided either high-level intended corrective actions and estimated completion dates to the extent we can or reasons why we are unable to provide high-level intended corrective actions and estimated completion dates at this time. For those report recommendations with which the agency does not agree, we have explained our position and provided proposed alternatives to recommendations.

### **AGENCY’S OVERALL POSITION**

The agency concurs with three of the recommendations and non-concurs with one recommendation.

### **AGENCY’S RESPONSE TO DRAFT AUDIT RECOMMENDATIONS**

#### **Agreements**

| <b>No.</b> | <b>Recommendation</b>   | <b>High-Level Intended Corrective Action(s)</b>   | <b>Estimated Completion by Quarter and FY</b> |
|------------|---|---|---|
| 1          | Emphasize funds-in IA guidance requirements to project officers, and ensure the officers fully understand their responsibilities for including indirect costs in IAs. | OARM will notify our internal partners of any changes or updates to EPA policy on reimbursable agreements. Notification may include emails to our Grants Management Officers, Grants Customer Relations Council and IA Shared Service Center Customer | 9/30/2015                                     |

|   |   |   |                     |
|---|---|---|---------------------|
|   |   | Liaisons, and appropriate intranet postings and links.  |                     |
| 2 | Train project officers to prepare IGCEs with indirect costs.  | OARM will update current IA Project Officer training to ensure it reflects current Agency policy.   | 6/30/2016           |
| 3 | Direct the GLNPO to track GLLA project agreement direct labor costs to provide information for potentially improved management decisions. | Region 5 began tracking labor costs of the Great Lakes National Program Office employees working on GLLA project agreements on October 1, 2014. OCFO assisted Region 5 in developing a project code schema in order to capture costs. | Completed 10/1/2014 |

### **Disagreements**

| <b>No.</b> | <b>Recommendation</b>  | <b>Agency Explanation/Response</b>  | <b>Proposed Alternative</b> |
|------------|--|---|-----------------------------|
| 4          | Direct the GLNPO to include applicable direct labor costs and indirect costs in GLLA project agreements. | While we agree with the goal of being able to capture and report on the full direct and indirect costs associated with EPA's implementation of the Great Lakes Legacy Act, we disagree with passing those costs to the non-federal sponsors of GLLA projects. We request OIG remove Recommendation #4 from the final report. (See attached technical comments.) |                             |

### **CONTACT INFORMATION**

If you have any questions regarding this response, please contact Stefan Silzer at 202-564-4905.

Attachment

cc: Susan Hedman  
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Eric Levy  
Brandon McDowell  
Lorna Washington

**Technical Comments Related to OIG's Draft Audit Report OA-FY14-0130, "EPA Should Collect Full Costs for Its Interagency and Great Lakes Project Agreements," dated June 15, 2015**

**OIG Finding/Issue – "GLNPO Did Not Include Full Costs in GLLA Project Agreements"**

**Agency Position:** While EPA agrees with tracking labor costs of the Great Lakes National Program Office employees working on Great Lakes Legacy Act Project Agreements and agrees with the goal of being able to capture and report on the full direct and indirect costs associated with EPA's implementation of GLLA, we disagree with passing the indirect costs to the non-federal sponsors of GLLA projects.

The GLLA PAs are not Interagency Agreements. EPA's Interagency Agreement Policies, Procedures, and Guidance Manual, dated December 15, 2008, specifically defines and describes IAs in Section 1.3A. PAs do not meet this definition as they are not limited to State and municipal partners and often involve a private entity. There is no transfer of federal funds in any of these cost sharing agreements. As a result, a number of PAs do not fulfill the basic definition under Section 1.3A, much less the six factors which appear below that. In addition, neither EPA nor the non-federal sponsors are providing services to each other. They are each carrying out their roles and work as specified under the GLLA. More specifically, EPA is not performing any services for the non-federal partner and the non-federal partner is not performing any services for EPA for which the non-federal partner would seek reimbursement from EPA.

As OIG previously acknowledged in an earlier findings outline, GLNPO does not have a legal requirement to include full costs in PAs. While Federal Financial Accounting Standards (No. 4) states that, "each reporting entity should accumulate and report the costs of its activities on a regular basis for management information purposes," it does not require recovery of those costs. GLNPO can recognize all costs while not passing them on to the non-federal sponsors.

EPA's Great Lakes Restoration Initiative provides adequate funding to implement the GLLA, including administering the PAs. Some EPA programs do seek to recover cleanup costs from the parties directly responsible for the pollution. The GLLA is best implemented with non-federal partners who voluntarily share costs in the cleanup of polluted sediments in Great Lakes Areas of Concern regardless of the contamination source. The agency exercises its flexibility to minimize non-Federal cost share by only including direct costs to optimize voluntary participation in cleanup efforts. This is consistent with congressional intent expressed in the budget conference reports for Fiscal Years 2010, 2011, and 2012, for the appropriation which funded the GLLA work. The report, "directs the agency and the other federal agencies to exercise maximum flexibility to minimize non-federal match requirements in recognition of the exceptional economic circumstances of the region and the significant ongoing investments made by non-federal partners."

The draft audit report assumes, without any rationale, that by passing additional costs along to the non-federal sponsors, the program will have the same amount of participation. Additional

costs, including the indirect costs, are likely to dissuade voluntary participation in these important cleanup efforts. Although cost is a factor, the primary purpose of GLLA projects is to speed up the pace of cleaning up contaminated sediments in AOCs across the Great Lakes.

For these reasons, the agency requests the OIG remove Recommendation #4 from the final report.

## ***Distribution***

Office of the Administrator  
Deputy Chief Financial Officer  
Assistant Administrator for Administration and Resources Management  
Regional Administrator, Region 5  
Agency Follow-Up Coordinator  
General Counsel  
Associate Administrator for Congressional and Intergovernmental Relations  
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Assistant Deputy Chief Financial Officer  
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Director, Office of Grants and Debarment, Office of Administration and Resources Management  
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Office Director, Great Lakes National Program Office