



U.S. ENVIRONMENTAL PROTECTION AGENCY
OFFICE OF INSPECTOR GENERAL

Catalyst for Improving the Environment

EPA Should Update Its Fees Rule to Recover More Motor Vehicle and Engine Compliance Program Costs

Report No. 11-P-0701

September 23, 2011



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Abbreviations

CAA	Clean Air Act
EPA	U.S. Environmental Protection Agency
FY	Fiscal year
GAO	U.S. Government Accountability Office
IFMS	Integrated Financial Management System
IOAA	Independent Offices Appropriation Act
MVECP	Motor Vehicle and Engine Compliance Program
OAR	Office of Air and Radiation
OCFO	Office of the Chief Financial Officer
OFS	Office of Financial Services
OIG	Office of Inspector General
OMB	Office of Management and Budget
OTAQ	Office of Transportation and Air Quality
U.S.C.	U.S. Code

Cover photo: A vehicle at the National Vehicle and Fuel Emissions Laboratory in Ann Arbor, Michigan, undergoing a dynamometer test to measure vehicle emissions.
(EPA photo)

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At a Glance

Catalyst for Improving the Environment

Why We Did This Review

We performed this review to evaluate the U.S. Environmental Protection Agency's (EPA's) assessment and collection of vehicle emissions testing fees for its Motor Vehicle and Engine Compliance Program (MVECP). Our objectives were to determine whether EPA is recovering its costs of administering the MVECP, and whether EPA has effective internal controls over the assessment and collection of the fees.

Background

EPA's MVECP ensures that vehicles and engines comply with emission standards. The Independent Offices Appropriation Act, with guidance from Office of Management and Budget Circular A-25, authorizes federal agencies to charge fees for the services they provide. The Clean Air Act authorizes EPA to establish fees to recover all reasonable costs associated with the MVECP. EPA's final rule of May 2004 provides specific requirements for assessing and collecting the fees.

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

The full report is at:
www.epa.gov/oig/reports/2011/20110923-11-P-0701.pdf

EPA Should Update Its Fees Rule to Recover More Motor Vehicle and Engine Compliance Program Costs

What We Found

EPA is not recovering all reasonable costs of administering the MVECP. Our analysis, using the Agency's cost estimate for fiscal year 2010, showed a \$6.5 million difference between estimated program costs of \$24.9 million and fee collections of \$18.4 million. EPA's final rule of May 2004 establishes fees under the authority of the Clean Air Act and the Independent Offices Appropriation Act. The rule limits the annual fee increases to inflation adjustments to EPA's labor costs. The rule does not allow fee increases to cover EPA's increasing costs of additional facilities, equipment, and personnel needed to address the growing MVECP activity. EPA has not conducted a formal cost study since 2004 to determine its actual MVECP costs, and has not updated the annual fee adjustment formula in the 2004 fees rule to recover more costs. By not recovering all reasonable costs, the federal government did not collect funds that otherwise could have been available to offset the federal budget deficit. EPA is considering an update of the fees rule, which would provide additional recurring annual revenue in future years.

EPA's internal controls over the assessment and collection of fees are generally effective, except for minor exceptions related to segregation of duties, fee refund approvals, untimely recording of collections, and correction of customer errors. EPA corrected the exceptions when we pointed them out.

What We Recommend

We recommend that the Assistant Administrator for Air and Radiation update the 2004 fees rule to increase the amount of MVECP costs it can recover, and conduct biennial reviews of the MVECP fee collections and the full cost of operating the program to determine whether EPA is recovering its costs. EPA agreed with these recommendations but did not provide planned completion dates. Therefore, we consider these recommendations unresolved with resolution efforts in progress.

We recommend that the Assistant Administrator for Air and Radiation and the Chief Financial Officer segregate certain fee collection functions to maintain a proper segregation of duties. We recommend that the Chief Financial Officer obtain approval of alternate payee names for fee refunds when alternate names are needed. EPA agreed with these recommendations and has completed the corrective actions.



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

THE INSPECTOR GENERAL

September 23, 2011

MEMORANDUM

SUBJECT: EPA Should Update Its Fees Rule to Recover More
Motor Vehicle and Engine Compliance Program Costs
Report No. 11-P-0701

FROM:

Arthur A. Elkins, Jr.
Inspector General

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

TO:

Gina McCarthy
Assistant Administrator for Air and Radiation

Barbara J. Bennett
Chief Financial Officer

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

The estimated direct labor and travel costs for this report are \$201,746.

Action Required

The Agency agreed with recommendations 1 and 2, but did not provide planned completion dates. We consider recommendations 1 and 2 unresolved with resolution efforts in progress. Therefore, in accordance with EPA Manual 2750 regarding unresolved recommendations, you are required to provide a written response to recommendations 1 and 2 within 90 calendar days. You should include a corrective action plan for agreed-upon actions, including milestone dates. Recommendations 3 through 6 are in a closed status for reporting purposes; therefore, you do not need to respond further regarding these recommendations.

Your response will be posted on the OIG's public website, along with our memorandum commenting on the response. The response should be provided as an Adobe PDF file that complies with the accessibility requirements of Section 508 of the Rehabilitation Act of 1973, as

amended. The final response should not contain data that you do not want to be released to the public; if your response contains such data, you should identify the data for redaction or removal. We have no objections to the further release of this report to the public. 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 Melissa Heist at (202) 566-0899 or heist.melissa@epa.gov, or Paul Curtis at (202) 566-2523 or curtis.paul@epa.gov.

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Chapter 1

Introduction

Purpose

We performed this review to evaluate the U.S. Environmental Protection Agency's (EPA's) assessment and collection of fees for its Motor Vehicle and Engine Compliance Program (MVECP). With the Administration's current focus on reducing the federal budget deficit, we wanted to determine whether EPA was charging sufficient fees to recover its costs. The objectives of our review were to determine whether EPA:

- Is recovering its cost of administering the MVECP
- Has effective internal controls over the assessment and collection of vehicle emissions testing fees

Background

EPA's MVECP ensures that vehicles and engines comply with emissions standards. EPA's Office of Transportation and Air Quality (OTAQ) conducts the vehicle emission testing and certification. Manufacturers and independent commercial importers pay EPA a fee for the testing and other compliance activities.

The Independent Offices Appropriation Act (IOAA) of 1952 authorizes federal agencies to charge fees for the services they provide. The IOAA requires that each charge be fair and be based on the costs to the government, the value of the service to the recipient, the public policy or interest served, and other relevant facts. The IOAA states that each service provided by a federal agency should be self-sustaining to the extent possible.

Section 217 of the Clean Air Act (CAA) of 1970 (42 U.S. Code (U.S.C.) 7552), as amended, authorizes EPA to establish fees to recover all reasonable costs associated with:

- New vehicle or engine certification
- New vehicle or engine compliance monitoring and testing
- In-use vehicle or engine compliance monitoring and testing

Office of Management and Budget (OMB) Circular A-25, *User Charges*, dated July 8, 1993, implements the IOAA. It provides for charges for government goods and services that convey special benefits to recipients beyond those accruing to the general public. It also establishes that user charges should be set at a level sufficient to recover the full cost of providing the service, resource, or property. It

requires the Agency to review the user charges for Agency programs biennially, to include assurance that existing charges are adjusted to reflect unanticipated changes in costs or market values.

EPA's final rule of May 11, 2004, updated the 1992 MVECP fees regulation, under which the Agency collects fees for certain CAA compliance programs. The 2004 rule applies to light-duty vehicles, light-duty trucks, heavy-duty vehicles and engines, nonroad engines, and motorcycles. The 2004 rule provides specific requirements for assessing and collecting the fees, including a fee schedule by engine category and certificate type. A formula will automatically adjust the fees each calendar year by applying any change in the consumer price index to EPA's labor costs and by reflecting any changes in the number of certificates issued. However, the rule does not allow fee increases for other direct and indirect costs and overhead. EPA's final rule of October 8, 2008, added emission standards and compliance fees for new marine spark-ignition engines and small nonroad spark-ignition engines.

EPA deposits MVECP fees collected into a special fund in the United States Treasury, as authorized by the CAA, 42 U.S.C. 7552(b), *Motor Vehicle Compliance Program Fees*. The receipts in the special fund, known as the Environmental Services Special Fund, are to remain available for appropriation to carry out the Agency's activities for which the fees were collected. However, Congress has not appropriated the special fund receipts. Congress has been appropriating general funds, without specifying the Environmental Services Special Fund, to the Science and Technology funds to finance the MVECP. The special fund balance grew to \$275 million at the end of fiscal year (FY) 2010. Although Congress has not appropriated the special fund to finance the environmental programs that generated the receipts, the fund remains available for appropriation and offsets the federal budget deficit.

Noteworthy Achievements

When we notified OTAQ and the Office of the Chief Financial Officer (OCFO) about internal control weaknesses, they proactively took corrective actions. OTAQ and OCFO reassigned personnel to properly segregate duties relating to recording and reconciling fee collections. OCFO adjusted its fee refund procedures to ensure that it approved all payee names prior to the refund payments.

Scope and Methodology

We conducted this review in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the review to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our review objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions

based on our review objectives. We conducted our review from January through July 2011. Appendix A contains details on our scope and methodology.

Chapter 2

EPA's Motor Vehicle and Engine Compliance Program Is Not Recovering All Reasonable Costs

EPA is not recovering all reasonable costs of administering the MVECP. Our analysis, using the Agency's cost estimate for FY 2010, showed a \$6.5-million difference between estimated program costs of \$24.9 million and fee collections of \$18.4 million. The CAA (42 U.S.C. 7552) authorizes the EPA Administrator to establish fees to recover all reasonable costs associated with the program. EPA established its fee schedule for this program in a 2004 final rule. The rule limits the annual fee increases to inflation adjustments to EPA's labor costs. The rule does not allow fee increases to cover EPA's increasing costs of additional facilities, equipment, and personnel needed to address the growth in testing and compliance program activity. EPA has not conducted a formal cost study since 2004 to determine its actual MVECP costs, and has not updated the annual fee adjustment formula in the 2004 fees rule. By not recovering all reasonable costs, the federal government did not collect funds that otherwise could have been available to offset the federal budget deficit. EPA is considering an update of the fees rule, and accomplishing that initiative would provide additional recurring annual revenue in future years.

EPA's MVECP Fees Rule Does Not Account for Program Changes

Although EPA is recovering the MVECP costs as identified in the 2004 final rule, which EPA developed through a process of public notice and comment, it is not recovering all reasonable costs of administering the program. The 2004 rule's adopted methodology for calculating future fees recognized tradeoffs between cost recovery, stability for regulated industry, and uncertainty about future program activity and direction. Program changes that EPA could not have anticipated in 2004 have resulted in a shortfall between the FY 2010 MVECP costs and the amount that EPA can recover through fees.

The FY 2010 costs recoverable under the 2004 rule methodology were \$20.8 million. At our request, OTAQ developed an estimate of its actual costs based on actual FY 2010 spending and labor use, plus amortized costs for multiyear investments. OTAQ's estimate of its actual costs was \$24.9 million, indicating that actual MVECP costs exceeded recoverable costs under the 2004 rule by \$4.1 million. EPA's FY 2010 fee collections were \$18.4 million. Therefore, OTAQ did not recover \$6.5 million of the \$24.9 million estimated operating costs, nor did it recover the full \$20.8 million it should have recovered under the 2004 final rule, as illustrated in table 1.

Table 1: FY 2010 MVECP costs not recovered (\$ in millions)

	Total costs	Costs recoverable under the rule	Additional costs not recoverable under the rule
Program costs	\$24.9	\$20.8	\$4.1
Fee collections	18.4	18.4	0.0
Unrecovered program costs	6.5	2.4	4.1

Source: Office of Inspector General analysis of EPA data.

In FY 2010, EPA collected \$2.4 million less than costs recoverable under the 2004 rule. In any given year, EPA may collect more or less than its recoverable costs, based on the number of unique test groups/engine families that manufacturers certify. The fees formula adjusts for annual fluctuations in the number of certificates issued. The formula divides the recoverable costs by the average number of certificates issued 2 years and 3 years prior to the calendar year for the applicable fees. When the average number of certificates issued decreases, the formula increases the fee rates. Conversely, when the average number of certificates increases, the formula decreases the fee rates. Therefore, the formula adjusts the annual fee rates to help equalize the yearly differences between fee collections and recoverable costs.

Another factor that reduces fee collections below the recoverable amount is the rule's policy to allow reduced fees for small-volume manufacturers. The fees formula does not compensate for reduced fees, causing collections to be less than the recoverable target.

EPA issued 32 percent more certificates of conformity in 2010 than it did in 2004 when it established the rule. The increasing MVECP activity suggests a corresponding increase in the amount of unrecovered costs. EPA expects the new workload created by the implementation of several recent regulatory actions to require a significant investment in testing and certification ability to ensure compliance with the new standards. The recent regulatory actions include:

- The Renewable Fuel Standards enacted under the Energy Independence and Security Act
- The Mobile Source Air Toxics Standard
- Light-Duty Greenhouse Gas Standards recently enacted under CAA authorities
- Nonroad Emission Standards (gasoline and diesel)
- Heavy-Duty Greenhouse Gas Standards currently being developed

The President's Budget Message for FY 2012 states that reducing the long-term federal deficit must be a priority. The federal government is looking for ways to save money and cut unnecessary costs. We believe that EPA could help the federal government in this endeavor by collecting more MVECP fees to recover

more of its costs. EPA needs a formal cost study and a fees rule update to accomplish the cost savings sought by the President.

EPA Needs a Formal Cost Study

OMB Circular A-25 requires the Agency to review the user charges for Agency programs biennially, to include assurance that existing charges are adjusted to reflect unanticipated changes in costs or market values. OTAQ has not conducted a formal cost study using a fees cost accounting method to determine its annual MVECP costs since 2004. OTAQ stated that it monitors program costs, tracks budget expenditures, and reviews compliance program resource use on an annual basis to align expenditures with resource availability and Agency priorities. However, these activities do not identify the universe of MVECP allocable costs.

According to OTAQ, the cost study that EPA conducted as part of the 2004 rulemaking effort was a major undertaking that involved significant staff time. EPA staff reviewed the entire OTAQ program to determine which activities were recoverable, and examined budget and payroll expenditures to determine the recoverable fraction of overall costs, including full Agency overhead applicable to direct and indirect program costs. The cost study assigned the recoverable costs to the specific industry sector receiving the benefit.

OTAQ stated that a cost study update would require a significant level of effort and allocation of resources. EPA lacks a cost accounting system with the ability to determine the recoverable program costs. EPA's budget categories do not distinguish between the recoverable and nonrecoverable activity costs. Therefore, EPA would have to conduct a manual cost study to determine the allocable program costs.

A systematic approach to reviewing the MVECP costs would help EPA conduct biennial cost studies. Without performing the biennial cost studies prescribed by OMB guidance, EPA does not have the cost data necessary to determine whether it should update the fees rule.

EPA Needs a Fees Rule Update

The CAA (42 U.S.C. 7552) authorizes EPA to establish fees to recover all reasonable costs associated with the MVECP. The 2004 fees rule provides a specific fee schedule and formula for annual fee increases. The rule does not provide for fee increases to cover the costs of additional facilities, equipment, and personnel needed to address the growth in testing and compliance program activity. Therefore, when program activity and costs increase, EPA needs to update the fees rule to recover all reasonable costs.

The 2004 fees rule limited the annual recoverable cost adjustments to inflation adjustments to EPA's labor costs. The rule does not allow fee increases for other

direct and indirect costs and overhead. Therefore, fee increases do not cover the costs of program expansion, information technology system costs, new laboratory modification, facility and equipment upgrades, contract cost inflation, and payroll increases.

EPA limited the cost adjustments in the 2004 fees rule instead of providing for more comprehensive cost increases because:

- The rule provides cost stability for the manufacturers in the regulated industries.
- To avoid uncertainty of indefinite future costs, EPA promulgated a straightforward and certain methodology to update the annual fee costs.
- The methodology enables EPA to calculate new fee rates in a timely manner and inform the industry of the updated rates through annual guidance well in advance of any certification request to which new fees would apply.

EPA has not updated the annual fee adjustment formula in the fees rule since 2004. OTAQ stated that it conducted several scoping exercises during the last 4 years to consider a new fees rulemaking and determined that the timing for a fees rule update was not optimal. However, OTAQ is currently considering an update of the fees rule.

Conclusion

EPA is not recovering all reasonable costs of administering the MVECP. Because the 2004 fees rule limits the amount of recoverable program costs, EPA should conduct a cost study and update the 2004 fees rule. By not recovering all reasonable costs, the federal government did not collect funds that otherwise could have been available to offset the federal budget deficit. A fees rule update would help EPA address the President's budget priority of reducing the federal government deficit. Additional fees would offset the amounts appropriated to EPA for the costs incurred. OTAQ is considering an update of the fees rule, and accomplishing that initiative would provide additional recurring annual revenue in future years. This update could result in potential additional revenue of up to \$6.5 million per year, based on FY 2010 estimated program costs.

Recommendations

We recommend that the Assistant Administrator for Air and Radiation:

1. Update the 2004 fees rule to increase the amount of MVECP costs it can recover.

2. Conduct biennial reviews of the MVECP fee collections and the full cost of operating the program to determine whether EPA is recovering its costs.

Agency Comments and OIG Evaluation

EPA agreed with our recommendations. The Office of Air and Radiation (OAR) provided Agency comments. We reviewed OAR's comments, met with OAR officials to discuss the comments, and made changes to the report where appropriate. Appendix B provides the full text of the Agency's comments.

Chapter 3

EPA Has Corrected Minor Internal Control Deficiencies in the Assessment and Collection of Fees

We found EPA's internal controls over the assessment and collection of fees to be generally effective. However, we identified some minor internal control issues related to a lack of segregation of duties, approval of payee names for fee refunds, untimely recording of collections, and the correction of customer errors. OMB and the U.S. Government Accountability Office (GAO) require federal agencies to establish and maintain internal controls. Internal controls are an integral component of an organization's management that provide reasonable assurance that the organization achieves effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. Although EPA's internal controls were generally effective, the minor internal control issues we found compromise EPA's ability to ensure that management's directives are followed and assets are safeguarded.

Duties for Fee Collections Were Not Segregated

We found a lack of segregation of duties for fee collections in OTAQ and in OCFO's Office of Financial Services (OFS). GAO's *Standards for Internal Control in the Federal Government*, dated November 1, 1999, states:

Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud. This should include separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets.

OMB Circular A-123, *Management's Responsibility for Internal Control*, dated December 21, 2004, describes a proper segregation of duties as separating personnel with authority to authorize, process, and review the transaction. An improper segregation of duties may increase the risk of error or fraud by providing an individual the opportunity to commit an irregularity and conceal it.

OTAQ Segregation of Duties

OTAQ did not have a proper segregation of duties for fees collections in two separate situations. In one situation, during a short transitional period, an employee recorded fees collections and also reconciled them to the accounting system. In the second situation, an OTAQ certification representative uploaded fees collection files to an information systems database and also worked closely

with manufacturers who paid fees. GAO and OMB require a division of key duties among different people to reduce the risk of error or fraud. Without a proper segregation of duties, OTAQ increased the risk of error or fraud.

In the first situation, an employee who gathered the fees collection data and entered it into a fees database also reconciled the database collection amounts to EPA's accounting system. For a proper segregation of duties, a separate person who does not gather and record fees collections should perform the reconciliation. Prior to January 2011, a contractor gathered and entered collection data into the fees database, and EPA reconciled the data. When the contract expired on December 31, 2010, EPA brought the entire fees process in-house in January 2011. With only a few people on the fees team, OTAQ did not properly segregate the fees duties and allowed an employee to gather, record, and reconcile the fees data. The improper segregation of duties occurred within a short time frame, and OTAQ management corrected the situation when we brought it to its attention on January 14, 2011.

In a second situation, an OTAQ certification representative uploaded the fees collection amounts to the Information Management System database. Since the certification representatives have a close working relationship with the manufacturers who pay the fees, they should not be put in a position in which they could alter the collection amounts. Although the certification representative who uploaded the fees worked with manufacturers in an industry sector other than the sectors managed in the Information Management System database, we believe a person independent of any certification representative duties should perform the upload. OTAQ allowed a certification representative to upload the fees collection data because he reviewed the data prior to uploading and was familiar with the database. OTAQ management corrected the situation when we brought it to its attention on January 14, 2011.

OFS Segregation of Duties

OFS did not properly segregate the duties of recording and reconciling fees collections. We found a situation where an employee had responsibility for recording fees collections in the Integrated Financial Management System (IFMS), EPA's accounting system, as well as reconciling the daily and monthly collections to IFMS. GAO and OMB require a division of key duties among different people to reduce the risk of error or fraud. OFS did not properly segregate the duties because it had a limited number of people working in collections, and it relied on EPA's SF-224 fund balance with Treasury reconciliation to detect any errors in recorded collections. Without a proper segregation of duties, OFS increases the risk that errors or irregularities may not be detected and corrected in a timely manner.

Allowing one person to be responsible for recording data and reconciling his/her own work creates a conflict where errors could be overlooked or not found and

corrected. For a proper segregation of duties, a separate person who does not record the fees collections should perform the reconciliation. We notified OFS on March 29, 2011, of the improper segregation of duties. OFS quickly took corrective action and reassigned personnel to correct the segregation of duties.

Nonapproved Payee Names Were Used for Fee Refunds

OFS did not consistently use approved payee names for making fee refunds. OFS sometimes used other payee names instead of those approved by OTAQ and OFS. According to internal control guidance, an organization should ensure that controls are in place to protect against the misappropriation of assets by disbursements of false refunds. OFS did not require its staff to make refund payments to the approved payee names. The lack of approved payee names on fee refunds increases the risk of errors or irregularities.

Managing the Business Risk of Fraud: A Practical Guide, a publication sponsored by the Institute of Internal Auditors, American Institute of Certified Public Accountants, and the Association of Certified Fraud Examiners, states that an organization's assets can be misappropriated by employees, customers, or vendors. Common schemes include misappropriation by employees through the creation of, and payments to, fictitious vendors. One type of fraud that an organization might encounter is the misappropriation of assets by disbursements of false refunds. The organization should ensure that controls are in place to protect such assets.

OFS did not consistently use the payee names approved by OTAQ or OFS for making fee refunds. OTAQ submitted to OFS an approved refund request form with the manufacturer's name. OFS checked the manufacturer's application, prepared a refund payment request form with the payee name designated by the manufacturer, and approved the request form for payment. OFS did not always use the name on the approved OFS refund payment request form and sometimes made refund payments to a name other than the approved name on the OFS or the OTAQ form. In the 42 refund samples tested, we found 6 refunds with a different payee name than the name on the approved OFS refund payment request form, and 10 refunds with a different payee name than the name on the approved OTAQ refund request form. When OFS needed to use an alternate name on a fee refund, it did not require the personnel processing the refund to obtain approval for the alternate name. OFS did not update the approved refund request form to approve the alternate payee name. Therefore, OFS did not have an effective internal control to ensure it paid fee refunds to the appropriate parties.

OFS did not use the approved refund request forms as a control to ensure that it paid fee refunds to approved payee names. OFS provided several reasons why it sometimes used alternate names instead of the approved payee names on fee refunds:

- OFS records credit card collections under the account holder name and refunds the collections via Pay.gov to the original card holder account. OFS cannot refund credit card transactions that are over 1 year old via Pay.gov. Therefore, OFS pays these refunds by hard-copy check payable to the name on the refund request form, which may differ from the account holder name.
- In some cases, OFS records the original payment under the name of the remitter who submitted the payment on behalf of the manufacturer. In those cases, OFS processes the refund to the manufacturer in care of the remitter.
- OFS records wire payments with the wire remitter name that best represents the manufacturer name and processes the related refunds to the payee name on the manufacturer's program request form.

Although OFS provided reasons for using alternate names, it did not have a process to ensure the alternate names were valid and approved. The lack of approved payee names on fee refunds increases the risk of errors or irregularities.

During our review, OCFO updated its fee refund procedures to require the documentation and approval of alternate names for fee refunds. Payee name changes must be approved in the form of an e-mail or memorandum from the division director of the originating program office or his delegate. OCFO's procedure update addressed our concerns and corrected the internal control weakness.

Other Internal Control Matters

We found that OFS could improve its financial management by recording fees collections more timely, and that reviewing manufacturers' reduced fee refund requests in more detail would help OTAQ provide better customer service by identifying and correcting customer errors. We did not make any recommendations for these minor internal control matters.

Untimely Recording of Collections

OFS did not consistently record engine certification fees collections timely. OFS recorded 36 collections affecting 46 of 226 collection samples in our review (20 percent) more than 3 work days after receiving notice that Treasury received the collection. OFS recorded the collections, totaling \$4.5 million, 4–20 days after receiving notice of the collection.

EPA's Resources Management Directive System 2540-03, *Cash Management Collections and Deposits*, requires the Agency to record collections in the

financial system within 3 work days of receipt. GAO's *Standards for Internal Controls in the Federal Government* states:

Transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from the initiation and authorization through its final classification in summary records.

OFS stated that it experienced a significant increase in collections volume during FY 2010 from the newly implemented Lead-Safe Certification Program. During FYs 2008 and 2009, OFS processed an annual average of 2,845 lead fees collections. However, in FY 2010, OFS processed over 56,000 lead fees collections. Due to the increased volume of fees in FY 2010, OFS did not record the engine certification fees within the required time frame. Recording fees collections untimely increases the risk of inaccurate information in the Agency's accounting system and impacts the quality of data available to manage EPA's resources.

Since OFS has procedures to record collections timely, we are not making a recommendation. We believe OFS could improve timeliness by assigning more resources during periods of high collections volume.

Correction of Customer Errors

OTAQ did not help a manufacturer correct the errors in its reduced fees refund requests. Table 2 provides details of the errors in the three reduced fee refund requests. For one refund, the manufacturer's supporting documents did not agree with the sales amount that the manufacturer recorded on the MVECP Fee Refund Request Form. The error understated the refund by \$300. In another reduced fee request, the manufacturer incorrectly used \$750 (the minimum initial payment required by the final rule) as the fee required instead of 1 percent of the aggregate retail sales price of the vehicle engines sold. The error understated the refund by \$276. In a third reduced fee request, the manufacturer had no sales and was therefore entitled to a full refund. However, the manufacturer requested the full refund amount less \$750 (the minimum initial payment required by the final rule). The error understated the refund by \$750.

Table 2: Reduced fees refund request errors

IFMS transaction number	Amount refunded	Correct refund	Refund under-payment	Explanation of error
9910DVC1011 Line 001	\$16,159.62	\$16,459.62	\$300.00	Sales amount per refund request form did not agree with supporting documents.
9910DVC1011 Line 003	30,935.00	31,211.41	276.41	Manufacturer overlooked a refund provision based on 1 percent of the retail sales price.
9910DVC1011 Line 005	30,935.00	31,685.00	750.00	Manufacturer with no sales was entitled to a full refund but incorrectly requested a full refund less the \$750 minimum initial payment.

Source: Office of Inspector General analysis of EPA data.

EPA’s 2004 final rule, updating 40 Code of Federal Regulations Parts 85 and 86, states, “A manufacturer may request a refund if the final fee is less than the initial payment.” The rule further states, “The Agency will also fully refund any fees if the manufacturer overpaid based on their own projections.”¹ The rule allows manufacturers to pay a reduced fee based on 1 percent of the aggregate retail sales price of all vehicles or engines covered by a certificate. A manufacturer must pay a fully refundable initial payment of \$750 or 1 percent of the aggregate retail price of the vehicles or engines, whichever is greater, with the request for a reduced fee.

OTAQ stated that when it finds an error, its policy is to contact the manufacturer to discuss a correction. However, it did not notice these errors. OTAQ did not believe it was reasonable to dedicate the resources that would be necessary to scrutinize every refund request to the level of detail needed to identify the types of errors disclosed in table 2.

Because OTAQ did not identify the errors and help the manufacturer correct them, it refunded amounts that were slightly less than what the final rule of 2004 provided. We believe that OTAQ’s annual refund volume is low; we found 50 refunds for FY 2010. OTAQ could reasonably perform a more detailed review of reduced fee refund requests to identify errors. OTAQ would improve its customer service by helping manufacturers receive a refund equal to what the final rule provides.

Conclusion

EPA has generally effective internal controls over the assessment and collection of fees. When we found minor exceptions and recommended improvements, EPA

¹ See Motor Vehicle and Engine Compliance Program Fees for: Light-Duty Vehicles; Light-Duty Trucks; Heavy-Duty Vehicles and Engines; Nonroad Engines; and Motorcycles; Final Rule, 69 Fed. Reg. 26226 and 26228, May 11, 2004.

demonstrated a commitment to maintaining effective internal controls by implementing corrective actions. We identified other internal control matters regarding untimely recording of collections and correction of customer refund errors. We make no recommendations for these other matters and report them only for EPA's consideration.

Recommendations

We recommend that the Assistant Administrator for Air and Radiation:

3. Segregate the OTAQ functions of recording fee collections and reconciling them to the accounting system.
4. Segregate the OTAQ functions of serving as a certification representative to the manufacturers and uploading fee collection data to an information system database.

We recommend that the Chief Financial Officer:

5. Segregate the OFS functions of recording and reconciling fee collections.
6. Implement a procedure to obtain and document the approval of alternate payee names for fee refunds when it is necessary to use an alternate payee name instead of the originally approved payee name.

Preliminary Agency Actions

During our audit field work, OTAQ reassigned personnel to properly segregate the functions of (1) recording fee collections and reconciling them to the accounting system, and (2) serving as a certification representative to the manufacturers and uploading fee collection data to an information system database. OFS reassigned personnel to properly segregate the functions of recording and reconciling fee collections. OFS also adjusted its fee refund procedures to ensure that it approved all payee names prior to the refund payments. EPA's corrective actions have satisfied recommendations 3 through 6.

Agency Comments and OIG Evaluation

EPA agreed with our recommendations and completed corrective actions. Appendix B provides the full text of the Agency's comments.

Status of Recommendations and Potential Monetary Benefits

RECOMMENDATIONS						POTENTIAL MONETARY BENEFITS (in \$000s)	
Rec. No.	Page No.	Subject	Status ¹	Action Official	Planned Completion Date	Claimed Amount	Agreed To Amount
1	7	Update the 2004 fees rule to increase the amount of MVECP costs it can recover.	U	Assistant Administrator for Air and Radiation		\$13,000 ²	³
2	8	Conduct biennial reviews of the MVECP fee collections and the full cost of operating the program to determine whether EPA is recovering its costs.	U	Assistant Administrator for Air and Radiation			
3	15	Segregate the OTAQ functions of recording fee collections and reconciling them to the accounting system.	C	Assistant Administrator for Air and Radiation	02/16/11		
4	15	Segregate the OTAQ functions of serving as a certification representative to the manufacturers and uploading fee collection data to an information system database.	C	Assistant Administrator for Air and Radiation	02/16/11		
5	15	Segregate the OFS functions of recording and reconciling fee collections.	C	Chief Financial Officer	05/05/11		
6	15	Implement a procedure to obtain and document the approval of alternate payee names for fee refunds when it is necessary to use an alternate payee name instead of the originally approved payee name.	C	Chief Financial Officer	06/06/11		

- 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

2 The potential monetary benefit represents the recurring annual cost savings of \$6.5 million, based on FY 2010 unrecovered program costs, calculated for 2 years.

3 The Agency did not agree with the potential monetary benefits amount because it was an estimate. The actual monetary benefits amount will not be determined until the Agency updates the fees rule.

Details on Scope and Methodology

We reviewed EPA's processes for the assessment and collection of vehicle emission testing fees. To gain an understanding of the processes, we:

- Reviewed the applicable laws, regulations, fees rules, and program information
- Observed the laboratory facilities in Ann Arbor, Michigan, and reviewed operating procedures
- Interviewed OTAQ personnel in Ann Arbor and Washington, DC, and OCFO personnel in Washington, DC
- Examined the applicable fees databases

We tested fee transactions to determine whether EPA assessed the proper fee amount, collected the fee before issuing a certificate of conformity, and recorded the collection timely. We determined whether EPA approved and paid the proper refund amounts. We selected collection fee transactions from the period October 1, 2009, to January 11, 2011, and refund transactions from the period October 1, 2009, to December 31, 2010. We used the monetary unit method of statistical sampling to test 226 fee collections totaling \$6,351,820, and 22 refund transactions representing 42 individual engine refunds totaling \$311,944. The fee collections universe included 5,296 transactions totaling \$23,057,492, and the refunds universe included 27 refund transactions totaling \$517,068. We used random sampling to test 45 certificates out of 5,038 certificates issued in the 15-month period from October 1, 2009, to December 31, 2010, to search for certificates issued with no corresponding fee collection.

We obtained fee collections and program operating costs for FY 2010 and determined whether the collections were sufficient to recover all the reasonable program operating costs.

We assessed the internal controls related to assessing, collecting, and refunding fees. We gained an understanding of the internal controls through interviews with OTAQ and OCFO personnel, and examination of fees database information and the related supporting documents. We reviewed EPA's OAR FY 2010 management integrity assurance letter for reported internal control weaknesses.

We did not assess the reliability of data in OTAQ's information systems because their use did not materially affect our findings, conclusions, or recommendations. We verified fee collection, refund, and certificate of conformity data by examining supporting documentation and accessing financial information in IFMS. We did not review the internal controls over IFMS from which we obtained financial data, but relied on the review conducted during the audit of EPA's FY 2010 financial statements.

We found no prior Office of Inspector General or GAO reports with findings or recommendations related to EPA's vehicle emission testing fees.

Agency Response to Draft Report

(Received September 15, 2011)

MEMORANDUM

SUBJECT: EPA Response to OIG Draft Report *EPA Should Update Its Fees Rule to Recover More Motor Vehicle and Engine Compliance Program Costs* Project No. OA-FY11-0040

FROM: Gina McCarthy
Assistant Administrator

TO: Melissa M. Heist
Assistant Inspector General for Audit
Office of Inspector General

Thank you for the opportunity to comment on the Office of Inspector General (OIG) draft report, *EPA Should Update Its Fees Rule to Recover More Motor Vehicle and Engine Compliance Program Costs* Project No. OA-FY11-0040, dated August 10, 2011. The report focuses on EPA's administration of Motor Vehicle and Engine Compliance Program (MVECP) user fees, which the Agency collects under the Independent Offices Appropriations Act and the Clean Air Act, as amended. The recommendations in the draft report offer useful guidance for EPA's Office of Air and Radiation (OAR) and Office of the Chief Financial Officer (OCFO) as we work to continuously improve management of the fees program. The comments we offer in this response have been coordinated and reflect the input of both OAR and OCFO.

We are pleased that the OIG review confirmed OAR's effective fiduciary oversight of the fees program. The OIG audit team's intense scrutiny of more than 200 transactions totaling \$6.7 million identified only \$1,326 that might be questioned, and that amount resulted from manufacturer rather than Agency error. We also appreciate OIG's interest in ensuring that the Agency's MVECP fee collections are sufficient to recover the program's operating costs. OIG's finding that EPA is not recovering all its costs is consistent with OAR's expectation based on a rough cost analysis of current operations.

A summary of our response to OIG's findings and recommendations is provided below. The attachment provides a more detailed response that addresses factual accuracy of statements in the draft report and suggests alternative language to improve clarity or provide context.

1. Finding: EPA is not recovering all reasonable costs of administering the MVECP.

EPA Response: EPA agrees that the current fees program is not recovering all costs associated with administering the MVECP. Some shortfall is expected given that the fee rate structure promulgated under the 2004 fees rule does not fully account for cost increases due to inflation; does not consider costs associated with operating fuels compliance programs or new engine and vehicle compliance programs initiated since 2004; and allows reduced fees for small volume manufacturers. However, EPA cautions against attaching a specific dollar number to the shortfall without conducting a comprehensive cost analysis and notice-and-comment rulemaking. The \$6.5 million shortfall cited in OIG's finding conveys a false sense of precision and is unlikely to be correct. Suggested alternative language is provided in the attachment.

2. Finding: EPA's internal controls over the assessment and collection of fees are generally effective, except for minor exceptions.

EPA Response: EPA agrees with OIG's conclusion that effective internal controls are in place and questions the draft report's lengthy discussion of "minor exceptions" that OIG correctly states have been resolved. EPA is concerned that the prominence conferred by this treatment of minor internal control issues that have already been resolved disproportionately elevates their significance relative to the overall integrity of the program. Suggested alternative language is provided in the attachment.

3. Recommendation: EPA should update the 2004 fees rule to increase the amount of MVECP costs it can recover.

EPA Response: EPA concurs with this recommendation but is unable at this time to commit to a timeframe for updating the rule. The statutory authority for the MVECP allows the Administrator to exercise discretion in promulgating regulations for fees recovery. Thus, timing for reopening the fees rule will depend on the Administrator's discretion to consider various factors, including how best to deploy extremely constrained program staff resources in light of many pressing Agency priorities.

4. Recommendation: EPA should conduct biennial reviews of the MVECP fee collections and full cost of operating the program.

EPA Response: EPA concurs with this recommendation. EPA intends to conduct streamlined MVECP cost assessments as an extension of ongoing cost monitoring activity.

5. Recommendation: OAR and OCFO should maintain segregation of duties and OCFO should obtain approval of alternate payee names for fee refunds when alternate names are needed.

EPA Response: The draft report notes that the conditions of concern have been corrected; EPA concurs. EPA also notes that the OAR activity of concern to OIG occurred in a transition period during which some functions normally performed by contractors were temporarily being conducted in house due to delays in award of the new

contract. The transition period lasted for less than a month. EPA believes the draft report overemphasizes the significance and context of the situation OIG observed.

Please see the attachment for a more thorough discussion of the above points. Please contact me if you have any questions or your staff may contact Janet Cohen at 734-214-4511.

Attachment

Attachment

EPA Response to OIG Draft Report OA-FY11-0040, “EPA Should Update Its Fees Rule to Recover More Motor Vehicle and Engine Compliance Program Costs”

EPA offers the following comments for OIG’s consideration in preparing a final report on the MVECP fees program.

Corrections

Page/Paragraph	Correction	Explanation
1/1	Change first sentence, “collection of vehicle emissions testing fees” to “... collection of fees ..”	MVECP fees recover costs associated with a broad range of compliance activities beyond vehicle testing.
1/2	Change second sentence, “EPA’s National Vehicle and Fuel Emissions Laboratory in Ann Arbor, Michigan ..” to “EPA’s Office of Transportation and Air Quality ..”	MVECP compliance activity for which fees are assessed is performed in Washington as well as Ann Arbor.
1/2	Change language to indicate that fees recover costs of testing and other compliance activities	See above
4/1	Change sentence in middle of introduction paragraph to say, “EPA has not conducted a formal cost study....and has not updated the 2004 fees rule” to “ ...has not update the annual fee adjustment formula in the 2004 fees rule. ”	EPA updated the fees regulations as part of the 2008 Nonroad Spark-Ignition Engines and Equipment Rule.

General Comments

At a Glance

Please see comments on chapter text, below. The ‘At a Glance’ section is a summary of what follows in the draft report; thus our comments on the report are also relevant to the summary.

Chapter 1: Introduction

Noteworthy Achievements, page 2

We believe OIG’s failure to find any significant problems in EPA’s overall management of a program that has recovered some \$260 million to date in fees charged to regulated industry, without complaint from industry fee payers, merits mention as a noteworthy achievement.

In its initial communication with EPA, OIG stated that a primary purpose of the investigation was to determine whether EPA ensures that the proper fee is collected before issuing a certificate of conformity. We consider it highly noteworthy that OIG found no evidence of certificates being issued improperly or fees being improperly assessed.

We suggest that language noting the exemplary overall management of the MVECP fees program be added to the noteworthy achievements section.

Chapter 2: EPA’s Motor Vehicle and Engine Compliance Program Is Not Recovering All Reasonable Costs

Introduction, page 4

OIG’s primary finding that EPA is not recovering all reasonable costs of administering the MVECP is based on a comparison of actual fees revenues for 2010 and a rough estimate of 2010 costs. We agree that a more comprehensive cost study would likely confirm some shortfall between recoverable revenues under the current fees regulations and the costs EPA incurs to operate the MVECP. However, it is likely that the size of the gap will be different from the \$6.5 million stated in the draft report. This is because in providing the rough estimate, we did not have time to thoroughly reassess all cost inputs. For example, we did not update the methods or assumptions used in 2004 to distinguish between fees-recoverable and non-recoverable expenses, and we did not re-examine overhead ratios that may have changed since 2004. EPA furthermore did not consider costs associated with administering its fuels compliance programs, which are not included in the 2004 rule.

EPA suggests the following substitute language:

“EPA is not recovering all reasonable costs of administering the MVECP. For example, a rough analysis for FY2010, EPA did not recover showed a \$6.5 million of its costs, based on its difference between estimated program costs of \$24.9 million and fee collections of \$18.4 million ..”

EPA’s MVECP Fees Rule Does Not Account for Program Changes, page 4-5

We cannot overstate concerns about assessing fees-recoverable costs with any degree of confidence without conducting a comprehensive cost study and notice-and-comment rulemaking. We therefore reiterate that the \$24.9 million FY2010 MVECP cost estimate represents an estimate that could change. We strongly caution against attaching too much significance to this dollar figure.

We also caution against comparing the cost estimate to the actual fees collections for a given year. The draft report correctly states that EPA collected \$18.4 million in fees for FY2010, compared to a \$20.8 million target for FY2010 in the fees rule. However, it is misleading to imply that this represents an under-collection of fees. The fees rule methodology anticipates and accounts for annual fluctuations in actual collections. In any given year, we may collect more or less than the fees rule target for that year, based on the number of unique test groups/engine

families manufacturers certify. For example, in 2007 EPA collected \$20.3M in fees compared with a \$20.0M recovery target, and in 2008 EPA recovered \$20.5M compared to a \$20.2M target. In 2010 fees revenues happened to be less than the recovery target. The 2004 fees rule formula EPA uses to set fees each year is designed to adjust for annual fluctuations in the number of certified test groups/engine families in a given sector. Although EPA collected less than EPA's 2010 costs as projected by the fees rule, the rule methodology increases the fee rate per test group the following year such that the collected amount should return to the 2011 recovery goal.

EPA Needs a Fees Rule Update, page 6-7

The draft report states that EPA has not updated the fees rule since 2004. This is inaccurate. The Agency updated the fees program as part of the 2008 Control of Emissions from Nonroad Spark-Ignition Engines and Equipment Final Rule. The 2008 rulemaking changed the 2004 fees regulations to include fees for equipment and fuel system components associated with nonroad and stationary spark-ignition engines. EPA also took the opportunity offered by this rulemaking to streamline certain administrative requirements and to improve fees collection and processing procedures. EPA has collected a total of about \$90,000 in new fees revenues since fee requirements for sectors covered by the 2008 rulemaking took effect.

Conclusion, page 7

Please see previous comments regarding false precision in the estimate of potential additional revenue that might be recovered under an updated fees rule.

Chapter 3: EPA Has Corrected Minor Internal Control Deficiencies in the Assessment and Collection of Fees

Introduction, page 9

The draft report states, "We found EPA's internal controls over the assessment and collection of fees to be generally effective." Given the insignificant nature of the problems OIG identified, we believe it would be more accurate to state that the internal controls are highly effective.

Similarly, the introductory paragraph concludes, "Although EPA's internal controls were generally effective, the minor internal control issues we found compromise EPA's ability to ensure that management's directives are followed and assets are safeguarded." EPA does not believe the facts support this conclusion and we disagree. None of the internal control issues OIG identified compromise the integrity of EPA's fiscal oversight. The OIG audit did not identify a single instance of mismanagement in its scrutiny of 45 certificates, 226 transactions, and almost \$6.4 million in net receipts. The draft report also neglects to acknowledge the findings of two internal audits of the fees program that EPA shared with OIG. The results of these reviews, which examined thousands of certificates and fees transactions, were similar to the OIG's findings, confirming the program's integrity and providing reassurance that existing management and fiduciary controls are effective.

EPA suggests the following substitute language for the end of the introductory paragraph:

“~~Although Overall, OIG found~~ EPA’s internal controls ~~were generally~~ to be highly effective, ~~t~~. The minor internal control issues we found did not compromise EPA’s ability to ensure that management’s directives are followed and assets are safeguarded.”

Duties for Fee Collections Were Not Segregated

OTAQ Segregation of Duties, page 9-10

The draft report cites two instances of improper segregation of duties. EPA does not believe that these situations would have compromised assurance in fiscal oversight, even if they were not temporary. In the first instance, the draft report accurately explains that this was a temporary situation that lasted for two weeks during a contract transition period. Ironically, if OTAQ had not designed extra verification steps into the fees application and data entry processes, this issue wouldn’t have met the threshold of raising the segregation issue in the first place.

In the second situation, the draft report states that a certification representative with “close working relationship with manufacturers who pay the fees” was involved in uploading fees collection amounts to a certification database. We disagree with OIG’s interpretation of the situation. First, the data upload function is essentially a file transfer that involves copying a data file from the fees database into a certification database so OTAQ can confirm that the proper fee has been paid before a certificate can be issued. The baseline fees information continues to reside in the fees database such that an alteration of copied information would be noticed. Second, as the draft report states, the employee did not work with the industry sector for which data were being transferred. Third, the employee’s role is administrative in nature. The employee normally has no contact with fee-paying manufacturers, and certainly does not have a close working relationship with them. We believe that the OIG’s characterization of this situation in the draft report misrepresents actual conditions and recommend that it not be cited as a segregation of duties concern in the final report.

Other Internal Control Matters

Correction of Customer Errors, page 13-14

The draft report cites three cases OIG identified in its sample in which manufacturers requested smaller refunds than they could have claimed under the 2004 fees rule. In all three cases OTAQ processed refunds for the amount the manufacturer requested. OIG states that OTAQ could improve customer service by performing a more detailed review of reduced fee refund requests to identify and help manufacturers correct such errors.

We do not believe that increased OTAQ scrutiny of manufacturer reduced fee refund requests is sensible or realistic, given constrained resources and other priorities. First, it is not always the case that a refund request for less than the allowable maximum necessarily represents an error. Manufacturers sometimes intentionally request a smaller refund than they are entitled to under the law because they intend to apply the overpayment to a future fee obligation. Second, OTAQ

strongly believes that the staff resources that would be necessary to thoroughly evaluate every refund request are better deployed tracking other aspects of the fees program. In recent years OTAQ has processed an average 60 refund requests annually. These represent about 1% of quantifiable fees related actions. In calendar year 2010 for example, 66 of the 7,190 quantifiable fees actions EPA processed were refunds. EPA has instituted controls to ensure that these actions are accurately reviewed and recorded but intense scrutiny of every individual action is simply not possible, given OTAQ's resources. It is worth noting that the potential \$1,326 under-refund in the three cases cited by OIG would reflect an error rate of 0.02% relative to the \$6.7 million in transactions that OIG audited.

Conclusion, Recommendations, Preliminary Agency Actions, page 15

The 'Conclusion' and 'Preliminary Agency Actions' sections indicate that OTAQ took action to segregate certain staff functions because of OIG's investigation. In actuality the conditions OIG observed were unavoidable and known by OTAQ to be temporary, occurring during a contract transition period in January, 2011 that lasted less than a month. We suggest the following substitute language for these sections to more accurately reflect the condition that existed during the OIG audit:

EPA has generally effective internal controls over the assessment and collection of fees. The minor exceptions we observed were temporary in nature, occurring during a contract transition period that happened to coincide with the OIG site visit. The situation was caused by delays beyond OAR's control in award of a new contract, and lasted for only a few weeks. EPA demonstrated a commitment to maintaining effective internal controls by implementing corrective actions.

The recommendations for the Assistant Administrator for Air and Radiation and the Chief Financial Officer appear to be moot, given that these actions have already been taken.

Distribution

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