



OFFICE OF INSPECTOR GENERAL

*Catalyst for Improving the Environment*

## **Attestation Report**

# **America's Clean Water Foundation Incurred Costs for EPA Assistance Agreements X82835301, X783142301, and X82672301**

**Report No. 2007-4-00045**

**February 20, 2007**

**Report Contributors:**

Keith Reichard  
Bill Spinazzola  
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Clem Cantil

**Abbreviations**

CFR	Code of Federal Regulations
EPA	U.S. Environmental Protection Agency
OIG	Office of Inspector General
OMB	Office of Management and Budget
FAR	Federal Acquisition Regulations



# At a Glance

*Catalyst for Improving the Environment*

## Why We Did This Review

We conducted this examination to determine whether the total costs incurred for three U.S. Environmental Protection Agency (EPA) assistance agreements were fairly presented, in all material respects, and the incurred costs were allowable in accordance with the terms and conditions of the agreements and applicable regulations.

## Background

EPA awarded three assistance agreements to the America's Clean Water Foundation (Foundation) to perform environmental risk assessments at agricultural facilities and to assist States, tribes, and territories in complying with the Clean Water Act.

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

To view the full report, click on the following link:  
[www.epa.gov/oig/reports/2007/20070220-2007-4-00045.pdf](http://www.epa.gov/oig/reports/2007/20070220-2007-4-00045.pdf)

## ***America's Clean Water Foundation Incurred Costs for EPA Assistance Agreements X82835301, X783142301, and X82672301***

### What We Found

The Foundation did not comply with the financial and program management standards and the procurement standards promulgated in Title 40 Code of Federal Regulations (CFR), Part 30. Specifically, the Foundation (1) could not provide support for any of its general journal entries; (2) included duplicate transactions in its accounting system; (3) recorded labor charged to EPA grants incorrectly; (4) could not support the recorded indirect costs; (5) claimed unallowable preaward costs; (6) recorded EPA cash draws inaccurately; (7) did not submit required indirect cost proposals to EPA; (8) did not complete the required single audits for fiscal years ended June 30, 2003, June 30, 2004, and June 30, 2005; and (9) did not submit a *Federal Cash Transactions Report* when required.

The Foundation's procurement practices and procedures did not comply with the grant regulations. The Foundation awarded sole source contracts without performing the cost/price analysis required by Title 40 CFR 30.45. It also awarded a contract to a member of its Board of Directors, contrary to the conflict of interest provisions at Title 40 CFR 30.42, and reimbursed a contractor for billings above contractual ceilings. Because the Foundation did not adequately document its costs and did not comply with the EPA regulations, we questioned the Federal share claimed of \$25,372,590.

### What We Recommend

We recommend that the Director for the Grants Administration Division: (1) disallow the Federal share claimed of \$25,372,590, and recover payments made of \$25,173,266, unless the Foundation reconstructs its accountings records to meet the financial management standards required by Title 40 CFR 30.21 through 30.28; (2) rescind provisional indirect rates for fiscal years ended June 30, 2005, and June 30, 2006; (3) require the Foundation to obtain single audits for fiscal years ended June 30, 2003, June 30, 2004, and June 30, 2005; (4) require the Foundation to prepare and submit overdue Standard Form 272 *Federal Cash Transactions Reports*; (5) disallow contract costs procured, claimed, and administered in violation of the requirements in Title 40 CFR Part 30; (6) disallow contract costs that were not authorized under the contract terms; (7) stop work on all active grants; and (8) not award any new grants until the Foundation meets minimum financial management requirements and repays all disallowed costs.



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

OFFICE OF  
INSPECTOR GENERAL

February 20, 2007

**MEMORANDUM**

**SUBJECT:** America's Clean Water Foundation Incurred Costs for  
EPA Assistance Agreements X82835301, X783142301, and X82672301  
Report No. 2007-4-00045

**TO:** Richard Kuhlman  
Director, Grants Administration Division

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

On September 29, 2006, we issued a draft report to the America's Clean Water Foundation's (Foundation's) attorney for comments. On December 7, 2006, we received a response from the Foundation's attorney which also included comments from Validus Services, LLC, the Foundation's contractor. The Foundation and Validus either disagreed with or did not respond to the report's findings. We did not receive the response, as requested, in an acceptable electronic format to include in the report. A copy is available on request. We have summarized the Foundation's pertinent comments after each finding in the report.

The estimated cost of this report – calculated by multiplying the project's staff days by the applicable daily full cost billing rates in effect at the time – is \$221,225.

**Action Required**

In accordance with EPA Manual 2750, Chapter 3, Section 6(f), you are required to provide us your proposed management decision for resolution of the findings contained in this report before any formal resolution can be completed with the Foundation. Your proposed decision is due on June 20, 2007. To expedite the resolution process, please email an electronic version of your proposed management decision to [reichard.keith@epa.gov](mailto:reichard.keith@epa.gov).

We have no objections to the further release of this report to the public. For your convenience, this report will be available at <http://www.epa.gov/oig>. We want to express our appreciation for the cooperation and support from your staff during our review. If you have any questions about this report, please contact Keith Reichard at (312) 886-3045.

Sincerely,

A handwritten signature in black ink, appearing to read "Bill A. Roderick", written over a horizontal line.

Bill A. Roderick  
Acting Inspector General

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## Background

The U.S. Environmental Protection Agency (EPA) awarded three assistance agreements<sup>1</sup> (grants) to the America's Clean Water Foundation (Foundation) totaling \$25,886,111. The Foundation, which is located in Washington, DC, was formed in 1989, and is a Section 501(c) (3) not-for-profit organization (specified in the Internal Revenue Code). The following table summarizes information about the authorized project periods and funds awarded under each of the three grants:

Grant	Award Date	EPA Share *	EPA Payments	Last Payment Date	Project Period
X82835301	08/31/2000	\$ 14,438,750	\$ 14,438,750	10/22/2003	07/01/2000 – 06/30/2004
X783142301	09/26/2003	9,938,000	9,225,155	02/17/2006	06/30/2003 – 06/30/2006
X82672301	07/23/1998	1,509,361	1,509,361	06/10/2004	06/01/1998 – 05/31/2004
Total		\$ 25,886,111	\$25,173,266		

Source: The source of the grant information was the OIG's summary of the grants/amendments. The EPA payments and payment dates came from EPA's Financial Data Warehouse.

\* EPA funded 100 percent of grants X82835301 and X783142301. EPA's share of grant X82672301 was \$1,509,361 and the Foundation's share was \$25,000.

All three grants were awarded under Section 104 (b)(3) of the Clean Water Act. The scopes of work are:

Grant X82835301: This grant was to conduct On-Farm Assessment and Environmental Review (OFAER) assessments at pork production facilities to identify actual or potential environmental risks, develop steps to mitigate those risks, and prevent them from becoming environmental problems. It also was intended to test the assessment process at beef, dairy, and poultry facilities.

Grant X783142301: This grant was for the continuation of the OFAER program described under Grant X82835301 above. It included assessments at beef, dairy, and poultry facilities as well as pork production facilities.

Grant X82672301: This grant was to enable the Foundation to continue liaison support by assisting States, Indian tribes, and territories in complying with the Clean Water Act, section 303(d) and Total Maximum Daily Load program requirements. The grant was also intended to enable the Foundation to provide Water Quality Standards Circuit Rider support.

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<sup>1</sup> EPA's assistance to the Foundation was either a grant or cooperative agreement. For reporting purposes, all assistance will be referred to as a grant.

While performing the single audit for the year ended June 30, 2004, RAFFA, the Foundation's accounting firm, discovered accounting irregularities and a potential embezzlement of funds. The Foundation's president and the managing partner of RAFFA met with EPA officials to report these irregularities. As a result of this meeting, EPA, on July 18, 2005, changed the Foundation's method of grant payments from "Advance" to "Reimbursement." EPA officials stated they took this action because the circumstances described indicated a breakdown in internal controls. They also stated that EPA would not process any new grant awards or amendments to existing grants until the Foundation demonstrated it had complied with EPA's standards for financial management systems in Title 40 CFR 30.21(b).

In a November 8, 2005, letter, EPA informed the Foundation that payment for grant costs incurred for contract ACWF-OFAER-01-05 awarded to Environmental Management Solutions, LLC (now Validus Services, LLC) would not be approved because the Foundation did not comply with EPA procurement requirements. In response, the Foundation provided information on the OFAER contract procurement and requested a deviation from the regulations. EPA deferred action on the Foundation's request for deviation to allow the Foundation additional time to provide the required cost review documentation. On July 11, 2006, EPA denied the Foundation's request for deviation because (1) the required documentation was not submitted and (2) the OIG indicated in a memorandum report<sup>2</sup> that costs incurred under the contract were not reasonable or allowable. EPA requested that the \$5.6 million it reimbursed the Foundation under the contract be returned.

In a July 14, 2006, letter, the Foundation's attorney notified EPA that the Foundation was formally dissolved. The letter stated that all members of the Board of Directors had resigned, the Foundation filed dissolution papers with the District of Columbia, and it no longer had any employees or an office location. The stated reason for the dissolution was the lack of program funding; the Foundation could no longer operate effectively or respond to Agency inquiries. The letter indicated that Foundation records and files had been moved to a storage facility in Standardsville, Virginia, that access to the records can be arranged, and that the Foundation retained its right to initiate and maintain claims.

## **Single Audit Activity**

Nonfederal entities that expend \$300,000 (\$500,000 for fiscal years ending after December 31, 2003) or more in a year in Federal awards are required by Title 40 CFR 30.26 to have a single audit conducted in accordance with applicable requirements of the OMB Circular A-133. The Foundation had single audits completed for the fiscal years ended June 30, 2000, June 30, 2001, and June 30, 2002. Applicable findings follow.

**Fiscal Year 2000** - During the year, the Foundation advanced \$100,000 in Federal funds to another not-for-profit organization. The advance was repaid in 90 days. However, the Foundation did not follow requirements that Federal funds be used only in strict adherence with terms of the grant agreement.

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<sup>2</sup> Memorandum no. 2006-M-0001, dated June 15, 2006, issued to Richard Kuhlman, Director, Grants Administration Division.



**Fiscal Year 2001** - Several *Federal Cash Transactions Reports* were not properly supported. There were discrepancies between cumulative grant expenditures and amounts in the general ledger. Adjustments to the grants were made after the reports were submitted. However, the Foundation did not retain support for amounts reported in the *Federal Cash Transaction Reports* or the adjustments to the general ledger.

The Foundation used accrued expenditures as the basis for the EPA cash draws instead of cash disbursements. As a result, an excess cash balance existed. In the case cited in the audit report, the Foundation reported excess cash on hand at December 31, 2000, of \$506,170. The funds were not disbursed until February 21, 2001, a period of about 6 weeks. In addition, the funds were not maintained in an interest-bearing account.

The Foundation did not submit its single audit report for fiscal year 2000 to the Federal Audit Clearing House timely. The report was due no later than March 31, 2001. It had not been submitted at the time of completion of fieldwork for the fiscal year 2001 audit (January 25, 2002).

**Fiscal Year 2002** - The Foundation received cash advances in excess of its current cash needs. As of June 30, 2002, the recipient had \$60,650 unspent from a \$100,000 advance on May 7. In addition, the funds were not maintained in an interest bearing account.

**Fiscal Years 2003 through 2005** - A single audit for fiscal year 2003 was completed but a report was not issued because of accounting irregularities discovered during the fiscal year 2004 single audit. In March 2005, the Foundation hired RAFFA to provide audit services, which included an audit of the fiscal year 2004 financial statements. However, RAFFA discontinued its work after identifying accounting irregularities that might extend back to prior years. Effective July 8, 2005, RAFFA took over daily accounting duties for the Foundation. The Foundation has either not issued or completed the single audits for the years ended June 30, 2003, June 30, 2004, and June 30, 2005.

To assist the reader in obtaining an understanding of the report, key terms are defined below:

<b>Reported Outlays:</b>	Actual cash disbursements identified by the Foundation on the <i>Financial Status Report</i> (Standard Form 269A) or the <i>Federal Cash Transaction Report</i> (Standard Form 272).
<b>Questioned Costs:</b>	Costs that are (1) contrary to a provision of a law, regulation, agreement, or other documents governing the expenditures of funds; or (2) not supported by adequate documentation.

## Independent Auditor's Report

We have examined the total outlays and disbursements reported by the Foundation under the EPA grants shown below:

Grant	Financial Status Report/ Federal Cash Transactions Report			
	Date Submitted	Period Ending	Reported Outlays/ Disbursements	Federal Share Of Outlays Reported
X82835301	09/28/2004	06/30/2004	\$14,438,750	\$14,438,750*
X783142301	09/22/2005	06/30/2005	9,424,479	9,424,479**
X82672301	09/28/2004	05/31/2004	1,534,361	1,509,361*
Total			\$25,397,590	\$25,372,590

Source: The sources of the reported outlays were the recipient's *Financial Status Reports/Federal Cash Transactions Report*.

\* Outlays reported on the Final Financial Status Reports

\*\* Disbursements reported on the Federal Cash Transactions Report

The Foundation certified that the outlays and disbursements reported on the *Financial Status Reports*, Standard Form 269A, and the *Federal Cash Transactions Reports*, Standard Form 272, were correct and for the purposes set forth in the agreements. Preparing these reports was the Foundation's responsibility. Our responsibility is to determine the allowable costs incurred in accordance with the terms and conditions of the grants and applicable EPA regulations.

We conducted our examination in accordance with the *Government Auditing Standards* issued by the Comptroller General of the United States, and the attestation standards established for the United States by the American Institute of Certified Public Accountants. We also followed the guidelines and procedures established in the *Office of Inspector General Project Management Handbook*, dated January 14, 2005. We examined, on a test basis, evidence supporting the reported outlays/expenditures, and performed such other procedures as we considered necessary in the circumstances (see Appendix A for details). We believe that our examination provides a reasonable basis for our opinion.

We questioned the Federal share of \$25,372,590 that the Foundation claimed because it did not comply with the financial and program management standards and the procurement standards promulgated in Title 40 Code of Federal Regulations (CFR), Subchapter B, Part 30.

In our opinion, because of the effects of the deficiencies discussed in the *Results of Examination*, the reported Federal outlays and disbursements on the *Financial Status Reports and Federal Cash Transactions Report* do not present fairly, in all material respects, the allowable costs incurred in accordance with the terms and conditions of the grants and applicable EPA regulations.

/s/ *Keith Reichard*

Keith Reichard

Office of Inspector General

U.S. Environmental Protection Agency

February 20, 2007

## Results of Examination

### Financial and Program Management Systems Did Not Comply with Standards

The Foundation did not comply with the financial and program management standards promulgated in Title 40 CFR, Subchapter B, Part 30. Because the Foundation did not meet its fiduciary responsibilities under the regulations, outlays and expenditures reported on the *Financial Status Reports* and *Federal Cash Transactions Reports* are not allowable.

When applying for grant assistance, the Foundation certified that it had the institutional, managerial, and financial capability to ensure proper planning, management, and completion of the project described in the grant application, and that it would comply with applicable requirements of Federal laws, executive orders, regulations, and policies governing the grant. EPA's administrative grant regulations for nonprofit organizations are codified in Title 40 CFR, Subchapter B, Part 30. Under the provisions of Title 40 CFR Part 30, the Foundation was required to follow the financial and program management standards codified in Title 40 CFR 30.21 through 30.28. As part of our audit procedures, we asked the Foundation to (1) summarize the outlays reported to EPA and (2) reconcile the reported outlays to the Foundation's book and records. In response, the Foundation provided EPA with schedules that presented costs by assistance agreement by cost element by fiscal year. However, these schedules did not reconcile to the outlays reported on the *Financial Status Reports* and disbursements on the *Federal Cash Transactions Report*. The Foundation reported outlays to EPA that were greater than amounts it recorded in its books and records by a total of \$611,289. See Schedule 1 for details on reported outlays and disbursements by grant and differences when compared to the Foundation's books and records.

On May 9, 2006, we discussed these differences with the Foundation's President and requested revisions to grant claims or supporting accounting records. We made similar requests on May 23, 2006, and May 30, 2006. The Foundation did not respond. Title 40 CFR 30.21(b)(1) requires accurate, current, and complete disclosure of the financial results of federally funded programs or projects. The Foundation did not comply with this requirement. Because the Foundation did not adequately document its costs and did not comply with the grant regulations, we questioned the Federal share of \$25,372,590 claimed by the Foundation. However, in order to provide EPA with pertinent information related to the Foundation's incurred costs (presented in Schedule 1) we conducted additional tests to determine if the costs were supported and allowable in accordance with the terms and conditions of the grants and applicable EPA regulations.

Our review disclosed that the Foundation:

- Did not provide support for any of its general journal entries.
- Included duplicate transactions in its accounting system.
- Recorded labor charged to the EPA grants incorrectly.

- Could not support the recorded indirect costs.
- Claimed unallowable preaward costs.
- Recorded EPA cash draws inaccurately.
- Did not submit required indirect cost rate proposals to EPA.
- Did not complete the required single audits for the fiscal years ended June 30, 2003, June 30, 2004, and June 30, 2005.
- Did not submit a *Federal Cash Transactions Report* when required.

Title 40 CFR 30.62 provides that if a recipient materially fails to comply with the terms and conditions of an award, whether stated in a Federal statute, regulation, assurance, application, or notice of award, EPA may disallow all or part of the cost of the activity or action not in compliance. Because the Foundation did not adequately document its costs and did not comply with the grant regulations, we questioned the Federal share claimed of \$25,372,590. Details of our findings follow.

### **Unsupported General Journal Entries**

The Foundation did not provide the required documentation to support and sufficiently explain the general journal entries recorded for any of its three grants. Title 40 CFR 30.21(b)(7) states that recipient's financial management systems shall have accounting records supported by source documentation. The Foundation used general journal entries to (1) record accruals such as payroll costs, (2) reverse posting entries, (3) allocate indirect costs, (4) correct errors, (5) record revenue, and (6) post transactions that were not recorded in the general ledger by other means. However, the Foundation could not provide supporting documentation to explain and support any general journal entries.

For the three grants under review, the Foundation recorded a net value of \$2,703,076 with general journal entries. Among other items, this amount included \$59,857 in salaries and \$1,391,614 in indirect costs. We requested the Foundation to provide support for all general journal entries on three occasions during our review. We have not received a response to these requests or any support for the entries. The Foundation has not complied with the requirement of Title 40 CFR 30.21(b)(7) that accounting records be supported by source documentation.

#### ***Foundation's Response***

The Foundation did not address this finding.

### **Duplicate Recorded Costs**

The Foundation recorded duplicate transactions in its accounting system totaling at least \$63,388. During the fiscal year ended June 30, 2005, the Foundation used two different databases to record grant expenditures in its general ledger. One database covered the period July 1, 1999, to November 30, 2004, and the second covered the period July 1, 2004, to June 30, 2005. There is an overlapping period from July 1, 2004, to November 30, 2004. We reviewed transactions in both databases for the overlapping period and

noted duplicated amounts of at least \$48,008 in salaries and \$15,380 in associated fringe benefits. Title 40 CFR 30.21 requires the Foundation to maintain a financial management system that is accurate, current and complete, and provides for the effective control over and accountability for all funds. Because recorded costs were duplicated, the Foundation's financial management system was not accurate, and the incurred costs were incorrect and overstated.

### ***Foundation's Response***

The Foundation did not address this finding.

## **Incorrect Labor Costs**

The Foundation's recorded labor costs were inaccurate. The Foundation reported labor costs for the three grants totaling \$1,413,973. We found differences between labor hours reported on employee timesheets and labor hours recorded in the Foundation's accounting system. For example, we reviewed the April 2001 pay period for the Foundation's Chief Operations Officer. The Foundation's accounting system reported that 242 labor hours were used to distribute this employee's gross pay to projects. However, labor activity reports only reported 178 hours. We discussed this issue with Foundation personnel on April 27, 2006. The Foundation's accountant agreed with the finding, said he had also found errors, and stated he would provide us with a spreadsheet that documents reconstructed labor dollars based on actual employee timesheets and payroll. We have not received the reconstruction. Title 40 CFR 30.21 requires the Foundation to maintain a financial management system that is accurate, current and complete, and provides for the effective control over and accountability for all funds. The Foundation did not comply with this requirement because its recorded labor is inaccurate.

### ***Foundation's Response***

The Foundation did not address this finding.

## **Unsupported and Inaccurate Indirect Cost**

The Foundation's indirect costs are unsupported and inaccurate. The Foundation reported a total of \$1,439,947 in indirect costs. Of the total, \$1,391,614 was recorded in the accounting system using general journal entries. As discussed above under Unsupported General Journal Entries, the Foundation did not provide any documentation to support its general journal entries. Without any documentation, we were unable to determine if the Foundation applied appropriate indirect cost rates or if the base to which the rates were applied was correct.

Also, under Incorrect Labor Costs and Duplicated Recorded Costs discussed above, we reported that the Foundation's recorded labor costs were incorrect, and that duplicate labor transactions were recorded in the accounting system. Labor and fringe benefits are

elements of an indirect cost pool and an indirect cost rate allocation base. Inaccuracies in these costs would render indirect cost rates and resulting indirect costs inaccurate.

Title 40 CFR 30.21(b)(7) states that a recipient's financial management system shall provide for accounting records including cost accounting records that are supported by source documentation. In addition, Title 40 CFR 30.21 requires the Foundation to maintain an accurate, current, and complete financial management system. The Foundation did not comply with either of these requirements.

### ***Foundation's Response***

The Foundation did not address this finding.

### **Unallowable Preaward Costs**

The Foundation reported \$19,038 under grant X82835301 for costs incurred by The Grizzle Company. The costs were billed to the Foundation prior to award of the grant. However, the Foundation did not obtain the prior approval for preaward costs required by Title 40 CFR 30.25. Without prior approval, the costs are unallowable for reimbursement.

Title 40 CFR 30.25(f) states that recipients are authorized without prior approval or waiver to incur pre-award costs 90 calendar days prior to award. Preaward costs incurred more than 90 calendar days prior to award require the prior approval of the EPA Award Official. The applicant must include all pre-award costs in its application.

The Grizzle Company billed the \$19,038 to the Foundation between September 1, 1999, and February 1, 2000. Grant X82835301 was awarded on August 31, 2000, 5 months later. The Grizzle Company billed the Foundation between 212 and 365 calendar days prior to award of grant X82835301. The costs, therefore, needed the prior approval of EPA and they should have been included in the grant application. A review of the grant files for grant X82835301 did not disclose any evidence of prior approval by EPA. Neither The Grizzle Company contract (by name) nor costs incurred of \$19,038 were included in the grant application.

### ***Foundation's Response***

The Foundation's response indicated that the OIG referenced the wrong grant (X82835301) and the wrong period of performance. They stated that the work was authorized and performed under grant X82728401.

### ***OIG's Comments***

The Foundation claimed the \$19,038 under grant X82835301. However, the contract was authorized and performed under the previous grant, X82728401. The costs are, therefore,

not allowable for reimbursement under grant X82835301. The Foundation claimed the costs under an incorrect grant. The costs remain questioned.

**Inaccurate Recording of EPA Cash Draws**

Contrary to Title 40 CFR 30.21, the Foundation could not always show the receipt of EPA cash draws in the Foundation’s accounting records. Title 40 CFR 30.21(b)(2) states that a recipient's financial management system should provide records that adequately identify the source and application of funds for federally sponsored activities. In addition, Title 40 CFR 30.21(b)(1) requires the Foundation to maintain a financial management system that is accurate, current, and complete. The Foundation has not complied with these requirements because it recorded EPA cash draws inaccurately and was unable to accurately identify the source of funds for the three EPA grants. The following table provides a comparison of actual EPA grant payments with the revenues recorded in the Foundation’s accounting system.

EPA Grants	EPA Grant Payments	Foundation Recorded Revenues	Difference
X82835301	\$14,438,750	\$17,661,062	(\$3,222,312)
X82672301	\$1,509,361	\$1,296,216	\$213,145
X783142301	\$9,225,155	\$6,184,483	\$3,040,672

Source: The source for the EPA grant payments was EPA's Financial Data Warehouse. The Foundation's recorded revenues came from the Foundation's accounting system.

***Foundation’s Response***

The Foundation did not address this finding.

**Indirect Cost Rates Were Not Submitted**

In addition to the unsupported indirect costs discussed above, the Foundation has not submitted all of the indirect cost rate proposals required by OMB Circular A-122, Attachment A, Subparagraph E.2. The Circular requires a recipient to submit an initial indirect cost rate proposal no later than 3 months (or 90 days) after the effective date of an award. Organizations that have previously established indirect cost rates must submit a new indirect cost rate proposal within 6 months after the close of each fiscal year.

The Foundation provided us with indirect cost rate negotiation agreements for fiscal years 2005 and 2006. The rates were negotiated by the Department of Interior, National Business Center under agreement with EPA. In addition, the Foundation provided us with indirect cost rate proposals and transmittal letters for submission to EPA for fiscal years 1999 and 2004. We did not find evidence of preparation or submission of proposals for fiscal years 2000 through 2003. The Foundation has not demonstrated that it complied with the requirements of OMB Circular A-122 regarding submission of indirect cost rate proposals for fiscal years 2000 to 2003.



### ***Foundation's Response***

The Foundation did not address this finding.

### **Single Audits Not Completed**

The Foundation has not completed required single audits for the fiscal years ended June 30, 2003, June 30, 2004, or June 30, 2005. Title 40 CFR 30.26 states that nonprofit organizations are subject to the audit requirements of OMB Circular A-133. OMB Circular A-133, Subpart B requires a non-Federal entity that expends \$300,000 (\$500,000 for fiscal years ending after December 31, 2003) or more in a year in Federal awards to have a single audit conducted for that year in accordance with the requirements of the Circular. The Circular also requires that the audit be completed and a reporting package be submitted no later than 9 months after the end of the audit period.

The Foundation's President stated that a single audit had been completed for fiscal year 2003 but the discovery of accounting irregularities indicated issuance of the report may not have been appropriate. The report was, therefore, withheld. In addition, the accounting firm contracted to perform the single audit for fiscal year 2004 discontinued work after discovery of the irregularities. The Foundation stated it does not have plans for an audit of fiscal years 2004 and 2005 at this time.

### ***Foundation's Response***

The Foundation did not address this finding.

### **Noncompliance with Federal Financial Reporting Requirements**

We noted that the Foundation's *Federal Cash Transactions Report* for the 6-month period ended December 31, 2005 was overdue. Title 40 CFR 30.52(a)(2) states that EPA shall require each recipient to submit a *Federal Cash Transactions Report* and that it should use this report to monitor cash advanced and to obtain disbursement information for each agreement with the recipient. As of June 2005, EPA's policy is to require a recipient to submit a Federal Cash Transactions Report within 15 working days following the semiannual periods ending June 30 and December 31. As of May 23, 2006, the Foundation had not submitted its *Federal Cash Transactions Report* for the semiannual period ended December 31, 2005. The Foundation did not comply with EPA reporting requirements.

### ***Foundation's Response***

The Foundation did not address this finding.

## **Procurement System Did Not Comply with Standards**

The Foundation's procurement system did not comply with EPA's procurement standards. When applying for grant assistance, the Foundation certified that it would comply with applicable requirements of Federal laws, executive orders, regulations, and policies governing each grant. The procurement standards are codified in Title 40 CFR 30.41 through 30.48. We found that the Foundation:

- Awarded contracts without performing the cost or price analysis required by Title 40 CFR 30.45.
- Awarded a contract to a member of its Board of Directors, contrary to the conflict of interest provisions in Title 40 CFR 30.42.
- Continued to reimburse Validus for billings even though the billings exceeded ceilings specified in the contract.

### **Cost or Price Analysis not Performed**

The Foundation did not comply with EPA regulations when procuring contracts and obtaining prior approval for contract costs. The Foundation claimed outlays of \$21,107,498 (\$12,308,145 under grant X82835301 and \$8,799,353 under grant X783142301) for contracts awarded to conduct on-farm assessments. The first contract was originally awarded in fiscal year 1999 to the National Pork Producer's Council (Council). Subsequent contracts were awarded to Environmental Management Solutions, LLC, a 100 percent owned subsidiary of the Council. Environmental Management Solutions, LLC later changed its name to Validus Services, LLC (collectively referred to as Validus). The contract was extended several times through fiscal year 2005.

All of these contracts were awarded without competition and without a cost or price analysis. In correspondence with the Director, EPA's Grants Administration Division on July 27, 2005 and September 21, 2005, the Foundation's Executive Director said that it did not perform a cost or price analysis because there were no sources of comparable data for it to use. Title 40 CFR 30.45 states that some form of cost or price analysis is required in connection with every procurement action. Price analysis may be accomplished in various ways, such as comparison of price quotations submitted, market prices and similar indicia. A cost analysis is the review and evaluation of each element of cost to determine reasonableness, allocability, and allowability. Since the contracts were awarded without competition, a price analysis could not be performed because there were no prices available to compare. Accordingly, the Foundation's only alternative was to conduct a cost analysis. However, the Foundation did not conduct a cost analysis on any of the awarded contracts, and thus was unable to demonstrate that the contract costs were reasonable, allowable, and allocable.

In addition, Title 40 CFR 30.44(e)(2) requires recipients to make pre-award review (i.e., costs analysis) and procurement documents available whenever a contract is awarded without competition and exceeds the small purchase limit of \$100,000. The Foundation did not comply with either requirement. Without the required cost or price analysis, we

have no assurance that a reasonable and fair price was obtained for the contracted services.

We performed an on-site review of the \$21,107,498 that the Foundations claimed for Validus' services, and found that claimed outlays exceeded recorded costs by \$6,195,057 (\$3,466,808 for grant X82835301 and \$2,728,249 for grant X783142301). This significant difference between claimed outlays and recorded costs further indicates that the Foundation did not obtain fair and reasonable contract prices. A comparison of claimed outlays to recorded costs by cost category is presented in Schedule 2 (page 19).

We also noted that claimed outlays for Validus' services included \$4,278,615 in unallowable costs (\$2,223,940 under grant X82835301 and \$2,054,675 under grant X783142301). Additional details on unallowable costs are presented in Schedule 3 (page 21).

### ***Foundation's Response***

The Foundation did not specifically address this finding other than to say that previous grant dispute submissions (see the Foundation's filing to Disputes Decision Official dated May 8, 2006) of the Foundation have argued that the Agency has used a number of techniques to recognize the value of such work, regardless of purported defects in the contract award, and that EPA must provide funding for Validus work.

### ***OIG's Comments***

The Foundation did not demonstrate that it complied with the provisions of Title 40 CFR 30.45. Accordingly, we did not revise our findings and recommendations.

### **Conflict of Interest**

Another contract was awarded to The Grizzle Company on April 5, 1999, on a noncompetitive basis. The contract was for a maximum amount of \$50,000 and was due to expire on March 31, 2000. The Foundation did not comply with the conflict of interest requirements at Title 40 CFR 30.42 when awarding the contract.

The chairman of The Grizzle Company, was also the Vice President of the Foundation's Board of Directors. Title 40 CFR 30.42 states that no employee, officer, or agent shall participate in the selection, award, or administration of contracts supported by Federal funds if a real or apparent conflict of interest would be involved. Such a conflict would arise when the employee, officer, or agent has a financial or other interest in the firm selected for award. As chairman of The Grizzle Company, the chairman would have an interest in The Grizzle Company being selected for a contract award; and as Vice President of the Foundation's Board of Directors, was potentially in a position to influence Foundation actions or decisions to make the contract award.

## ***Foundation's Response***

The Foundation indicated that Mr. Grizzle recused himself from all Board decisions and actions related to this contract, thus he was never in a position to influence the Foundation's actions or decision to make the contract award.

## ***OIG's Comments***

The Foundation did not provide any proof that Mr. Grizzle recused himself from any Board decisions or actions related to his contract. Even if Mr. Grizzle recused himself from any Board decisions related to his contract, he was potentially in a position to influence actions or decisions by other Foundation members. Recusing himself would not eliminate the influence his presence had on others.

## **Improper Contract Administration**

The Foundation continued to reimburse Validus for amounts billed even though the billings exceeded maximum amounts specified in the contracts or were for unbillable costs. The Foundation awarded four contracts to Validus in fiscal year 2002 through fiscal year 2005 to conduct on-farm assessments under the OFAER program. The contracts required various services, including program administration and refinement, program marketing or promotion, program training, database mining, and verification or oversight. Validus was to bill the Foundation for necessary and reasonable costs incurred up to the maximum aggregate amounts as specified in the contracts. Maximum billable amounts were specified by cost category, as well as for the contract as a whole. We found that Validus billed the Foundation for \$412,523<sup>3</sup> in excess of the categorical ceiling amounts under grant X82835301. The excess billings by cost category and by contract are summarized in Schedule 3, Note 5 (see page 28).

In addition, the Foundation reimbursed Validus for \$17,074 in program administration costs that were not billable by the terms and conditions of its contract. The billing occurred under contract ACWF-OFAER-02-99. Billing provisions are provided in Section 7.2 and attachment C of the contract. This contract only provided for the billing of assessments at a fixed price per assessment. Program administration costs were not specified. These costs are, therefore, not reimbursable, and are unallowable (see Schedule 3, Note 4 on page 28).

Title 40 CFR 30.47 requires the Foundation to maintain a system that ensures a contractor complies with the terms, conditions, and specifications of its contracts. The payments in excess of the contract ceilings indicated that the Foundation did not perform its contract administrative functions in accordance with Title 40 CFR 30.47.

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<sup>3</sup> In total, Validus exceeded the contract ceilings by \$1,429,507 under Grant X82835301, and \$50,362 under Grant X783142301. However, in Schedule 3, Notes 1 through 5, our questioned costs exceeded the costs in excess of the contract ceilings. Therefore, we did not question any additional costs over and above the \$412,523 amount.

***Foundation's Response/OIG's Comments***

The Foundation did not respond to this finding but see Schedule 3, Notes 4 and 5 for Validus' comments and the OIG's response.

## Recommendations

We recommend that the Director for the Grants Administration Division:

1. Disallow the Federal share claimed of \$25,372,590, and recover payments made of \$25,173,266, unless the Foundation reconstructs its accounting records to meet the financial management standards required by Title 40 CFR 30.21 through 30.28, including:
  - a. Correcting the distribution of labor costs and excluding all duplicate transactions.
  - b. Providing explanations and support for all general journal entries and ensuring that all transactions are supported by adequate source documentation.
  - c. Preparing and submitting indirect cost rate proposals for fiscal years 2000 through 2003 in accordance with OMB Circular A-122.
  - d. Resubmitting indirect cost rate proposals for fiscal years 1999 and fiscal years 2004 through 2006 based on reconstructed accounting records.
  - e. Assuring that unallowable preaward costs are excluded from grant claims.
  - f. Revising recorded EPA cash draws to accurately identify the source of the funds and the amount.
  - g. Submitting a final financial status report for grant X783142301 and revised final financial status reports for grants X82835301 and X82672301 that have been reconciled to amounts recorded in the Foundation's reconstructed accounting records.
2. Rescind provisional indirect rates for fiscal years ended June 30, 2005, and June 30, 2006.
3. Require the Foundation to obtain single audits for fiscal years ended June 30, 2003, June 30, 2004, and June 30, 2005.
4. Require the Foundation to prepare and submit overdue Standard Form 272 *Federal Cash Transactions Reports*.
5. Disallow contract costs procured, claimed, and administered in violation of the requirements in Title 40 CFR Part 30.
6. Disallow contract costs that were not authorized under the contract terms, including costs in excess of contract ceilings.
7. Stop work on all active grants.
8. Not award any new grants until the Foundation meets minimum financial management requirements and repays all disallowed costs.

## **Status of Recommendations and Potential Monetary Benefits**

RECOMMENDATIONS						POTENTIAL MONETARY BENEFITS (in \$000s)	
Rec. No.	Page No.	Subject	Status <sup>4</sup>	Action Official	Planned Completion Date	Claimed Amount	Agreed To Amount
1	16	Disallow the Federal share claimed of \$25,372,590 and recover payments made of \$25,173,266 unless the Foundation reconstructs its accounting records to meet the financial management standards required by Title 40 CFR 30.21 through 30.28.	O	EPA Director for the Grants Administration Division	TBD	\$25,372	
2	16	Rescind provisional indirect rates for fiscal years ended June 30, 2005, and June 30, 2006.	O	EPA Director for the Grants Administration Division	TBD		
3	16	Require the Foundation to obtain single audits for fiscal years ended June 30, 2003, June 30, 2004, and June 30, 2005.	O	EPA Director for the Grants Administration Division	TBD		
4	16	Require the Foundation to prepare and submit overdue Standard Form 272 <i>Federal Cash Transactions Reports</i> .	O	EPA Director for the Grants Administration Division	TBD		
5	16	Disallow contract costs procured, claimed and administered in violation of the requirements in Title 40 CFR Part 30.	O	EPA Director for the Grants Administration Division	TBD		
6	16	Disallow contract costs that were not authorized under the contract terms, including costs in excess of contract ceilings.	O	EPA Director for the Grants Administration Division	TBD		
7	16	Stop work on all active grants.	O	EPA Director for the Grants Administration Division	TBD		
8	16	Not award any new grants until the Foundation meets minimum financial management requirements and repays all disallowed costs.	O	EPA Director for the Grants Administration Division	TBD		

<sup>4</sup> O = recommendation is open with agreed-to corrective actions pending  
 C = recommendation is closed with all agreed-to actions completed  
 U = recommendation is undecided with resolution efforts in progress

**Schedule of Claimed Outlays by Assistance Agreement,  
Unallowable Costs, and Amounts Due EPA  
America's Clean Water Foundation**

Description	Grant			Total
	X82835301	X783142301	X82672301	
Personnel	\$631,573	\$255,730	\$526,670	\$ 1,413,973
Fringe Benefits	160,048	193,776	99,061	452,885
Travel	204,882	54,527	146,804	406,213
Equipment	3,411	1,995	8,737	14,143
Printing	525	7,458	13,209	21,192
Meetings and Training	0	13,443	5,783	19,226
Supplies	0	1,468	1,146	2,614
Postage	0	1,023	218	1,241
Telecommunications	0	1,665	13,555	15,220
Legal	0	0	2,527	2,527
Publications and Subscriptions	0	207	492	699
Other	76,870	0	0	76,870
Contracts	12,794,735	8,961,897	385,497	22,142,129
Indirect	<u>723,260</u>	<u>343,143</u>	<u>373,544</u>	<u>1,439,947</u>
Total Cost (Note 1)	<u>\$14,595,304</u>	<u>\$9,836,332</u>	<u>\$1,577,243</u>	<u>\$26,008,879</u>
Less Unpaid Amounts (Note 2)	<u>0</u>	<u>(845,034)</u>	<u>0</u>	<u>(845,034)</u>
Total Incurred and Paid	\$14,595,304	\$8,991,298	\$1,577,243	\$25,163,845
Reported Outlays (Note 3)	\$14,438,750	\$9,424,479	\$1,534,361	\$25,397,590
Recipient Share of Reported Outlays	<u>0</u>	<u>0</u>	<u>25,000</u>	<u>25,000</u>
EPA Share of Reported Outlays	\$14,438,750	\$9,424,479	\$1,509,361	\$25,372,590
Unreconciled Difference between Total Incurred Cost and Reported Outlays	\$156,554	\$(433,181)	\$ 42,882	\$(233,745)
Total Cost Questioned	\$14,438,750	\$9,424,479	\$1,509,361	\$25,372,590
EPA Payments	\$14,438,750	\$9,225,155	\$1,509,361	\$25,173,266
Amount Due EPA	\$14,438,750	\$9,225,155	\$1,509,361	\$25,173,266

Source: The schedule of claimed outlays came from the Foundation's February 21, 2006, email to EPA's Grant Administration Division. The unallowable outlays, unreconciled difference, and amount due EPA were based on the OIG analysis of the claimed outlays. The EPA payments came from EPA's Financial Data Warehouse.

**Notes:**

1. Except for contracts, the Foundation reported incurred costs from its accounting system. The Foundation summarized amounts for contracts manually from invoices, cash draws, and contracts.
2. Unpaid amounts are for invoices submitted by Validus Services, LLC, a Foundation contractor.
3. The Foundation submitted a final Standard Form 269A *Financial Status Report* for grant X82835301 and X82672301 on September 28, 2004. It submitted a Standard Form 272 *Federal Cash Transactions Report* for grant X783142301 on September 22, 2005. Grant X783142301 is ongoing and a *Final Financial Status* report has not been submitted.



## Comparison of Claimed Outlays to Recorded Costs Validus Services, LLC

The purpose of this schedule is to compare the costs recorded in Validus' accounting system with the outlays that the Foundation claimed for Validus' contractual services. In total, the claimed contractual services exceeded the recorded costs by \$6,195,057.

Cost Category	Claimed Outlays	Recorded Costs	Excess of Claimed over Recorded Costs
<b>Grant X82835301</b>			
Assessments	\$ 7,760,183	\$ 5,117,550	\$ 2,642,633
Program Administration and Refinement			
License Fee	575,000	0	575,000
Facilities/Admin. Allocation	215,495	206,523	8,972
Labor	1,003,848	785,216	218,632
Misc. Admin	20,151	18,650	1,501
Program Refinement	94,737	94,772	(35)
Other	<u>1,156</u>	<u>0</u>	<u>1,156</u>
	<u>1,910,387</u>	<u>1,105,161</u>	<u>805,226</u>
Program Marketing or Promotion	387,784	380,890	6,894
Program Training	598,229	596,423	1,806
Database Mining	201,432	201,432	0
Verification or Oversight	<u>1,450,130</u>	<u>1,439,881</u>	<u>10,249</u>
Total	<u>\$ 12,308,145</u>	<u>\$ 8,841,337</u>	<u>\$ 3,466,808</u>
<b>Grant X783142301</b>			
Assessments	\$ 5,776,350	\$ 3,666,240	\$ 2,110,110
Program Administration and Refinement			
License Fee	675,000	0	675,000
Facilities/Admin. Allocation	599,481	1,074,802	(475,321)
Labor	1,041,616	267,358	774,258
Misc. Admin	<u>29,691</u>	<u>29,731</u>	<u>(40)</u>
	<u>2,345,788</u>	<u>1,371,891</u>	<u>973,897</u>
Program Marketing or Promotion	214,947	225,038	(10,091)
Program Training	66,307	66,943	(636)
Database Mining	52,791	120,272	(67,481)
Verification or Oversight	<u>343,170</u>	<u>620,720</u>	<u>(277,550)</u>
Total	<u>\$ 8,799,353</u>	<u>\$ 6,071,104</u>	<u>\$ 2,728,249</u>
<b>Grand Total</b>	<u>\$ 21,107,498</u>	<u>\$ 14,912,441</u>	<u>\$ 6,195,057</u>

Source: The schedule of claimed outlays came from the Foundation's February 21, 2006, email to EPA's Grant Administration Division. The recorded costs came from Validus' books and records. The excess of claimed over recorded costs is the difference between claimed outlays and recorded costs.

### ***Validus' Response***

According to Validus, the amounts identified as “Billed to the Foundation”<sup>5</sup> are not accurate. Validus stated that the billed amounts for Grant X82835301 and Grant X783142301 were \$12,474,067 and \$8,534,266, respectively. Because the billed amounts identified in Schedule 2 differ from the actual billed amounts, Validus was required to adjust the months associated with each contract in order to be able to reconcile its billed amounts with the EPA auditor’s billed amount (see Tab 22 of Validus’ response for the reconciliation spreadsheet).

Schedule 2 also purports to identify the amounts by which the Council and Validus “overbilled” the Foundation under the two assistance agreements. Both the Council and Validus complied with the terms of the contracts and to the extent that the billed amount was in excess of the recorded incurred costs, the Council and Validus did so in full compliance with the terms of the contracts, and with full knowledge of an acceptance by the Foundation and EPA.

### ***OIG's Comments***

Schedule 2 identifies the outlays that the Foundation claimed for Validus’ contractual services in comparison to the costs recorded in Validus’ accounting system. The excess of claimed outlays over recorded costs merely represent the difference between what the Foundation claimed and costs Validus recorded, and does not represent amounts by which Validus “overbilled” the Foundation.

In response to the draft report, Validus provided us with a revised summary of the claimed outlays and recorded costs for program administration and refinement (see Tab 22 of Validus’ response) under Grant X82835301. We have changed both Schedules 2 and 3 to reflect Validus’ revisions.

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<sup>5</sup> The term “Billed to the Foundation” was changed in the final report to claimed outlays.

## Results of Examination for Claimed Outlays Validus Services, LLC

Cost Category	Claimed	Unallowable	Notes
<b>Grant X82835301</b>			
Assessments	\$ 7,760,183	\$ 0	
Program Administration and Refinement			
License Fees	575,000	575,000	1
Facilities and Administration Allocation	215,495	215,495	2
Labor	1,003,848	1,003,848	3
Miscellaneous Administration	20,151	0	
Program Refinement	94,737	17,074	4
Other	<u>1,156</u>	<u>0</u>	
	\$ <u>1,910,387</u>	\$ <u>1,811,417</u>	
Program Marketing or Promotion	387,784	17,902	5
Program Training	598,229	157,299	5
Database Mining	201,432	7,207	5
Verification or Oversight	<u>1,450,130</u>	<u>230,115</u>	5
Total Grant X82835301	\$ <u>12,308,145</u>	\$ <u>2,223,940</u>	
<b>Grant X783142301</b>			
Assessments	\$ 5,776,350	\$ 0	
Program Administration and Refinement			
License Fees	675,000	\$ 675,000	1
Facilities and Administration Allocation	599,481	599,481	2
Labor	1,041,616	780,194	3
Miscellaneous Administration	<u>29,691</u>	<u>0</u>	
	\$ <u>2,345,788</u>	\$ <u>2,054,675</u>	
Program Marketing or Promotion	214,947	0	
Program Training	66,307	0	
Database Mining	52,791	0	
Verification or Oversight	<u>343,170</u>	<u>0</u>	
Total Grant X783142301	\$ <u>8,799,353</u>	\$ <u>2,054,675</u>	
<b>Grand Total</b>	\$ <u>21,107,498</u>	\$ <u>4,278,615</u>	

Source: The claimed outlays came from the Foundation's February 21, 2006, email to EPA's Grant Administration Division. The unallowable costs were based on the OIG's analysis of the claimed outlays.

Our fieldwork at Validus' offices indicated that the claimed outlays of \$21,107,498 included unallowable costs of \$4,278,615. In addition, we noted that \$845,034 of the claimed outlays remain unpaid. In total, we questioned the \$21,107,498 (\$12,308,145 under grant X82835301, and \$8,799,353 under grant X783142301) claimed because the Foundation was unable to demonstrate that the contract costs were reasonable, allowable, and allocable as discussed on page 12 of the report under *Procurement System Did Not Comply with Standards*.

## Background

Six contracts were awarded in fiscal years 1999 through 2005 to conduct on-farm assessments under the OFAER program. An on-farm assessment is a voluntary independent review of a livestock producer that provides an assessment of water quality, odor, and pest risk factors. According to Validus, the National Pork Producers Council and Validus conducted 5,419 initial assessments, 569 followup assessments, and trained 570 assessors to perform the assessments. Assessments were performed at multiple types and sizes of livestock operations, including pork, poultry, turkey, cattle, dairy, cow/calf, sheep, duck, and horse, and at small, medium, and large operations in 45 states.

The contract numbers and their performance periods are:

### **Grant X82835301**

ACWF-OFAER-02-99 <sup>6</sup>	May 1, 1999, to June 30, 2001 (i)
ACWF-OFAER-02-99-R1 <sup>6</sup>	October 1, 2000, to September 30, 2001 (ii)
ACWF-OFAER-01-02 <sup>7</sup>	July 1, 2001, to June 30, 2002
ACWF-OFAER-01-03 <sup>7</sup>	July 1, 2002, to June 30, 2003

### **Grant X783142301**

ACWF-OFAER-01-04 <sup>7</sup>	July 1, 2003, to August 30, 2004
ACWF-OFAER-01-05 <sup>7</sup>	September 1, 2004, to August 31, 2005

- (i) Validus stated that performance under this contract ended on September 30, 2000.
- (ii) Validus stated that performance under this contract ended on June 30, 2001.

The contracts state that the Foundation will reimburse the contractor for reasonable and necessary costs incurred associated with the services required in the agreement. The contracts provided that the assessments be billed at a fixed rate per assessment. The rate remains fixed for the contract period but varies for each contract. For all other services, such as program training, program administration, and program marketing or promotion, the Foundation is to be billed for necessary and reasonable costs incurred up to the maximum aggregate amounts as specified in the contracts.

We reviewed the billings to determine if the costs were reasonable, allowable, and allocable in accordance with the applicable regulations<sup>8</sup> and contract terms and conditions. We performed our review at Validus' offices in Des Moines, IA from May 8 to May 18, 2005.

We noted that \$845,034 of the amounts that Validus billed to the Foundation from June to September 2005 are unpaid. The unpaid invoices are:

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<sup>6</sup> Awarded to the National Pork Producer's Council - a nonprofit organization.

<sup>7</sup> Awarded to Environmental Management Solutions/Validus, a wholly owned subsidiary of the National Pork Producers Council, and a limited liability company.

<sup>8</sup> According to the provisions of Title 40 CFR 30.27, allowable costs incurred by commercial organizations are determined in accordance with the provisions of Federal Acquisition Regulations (FAR) at 48 CFR Part 31. The allowable costs incurred by nonprofit organizations are determined in accordance with OMB Circular A-122.

Invoice	Invoice Date	Amount Billed
241	June 16, 2005	\$ 343,320
278	July 15, 2005	241,748
282	August 12, 2005	162,019
303	September 15, 2005	97,947
	Total	\$ 845,034

Source: The schedule of unpaid invoices came from the Foundation's February 21, 2006, email to EPA's Grant Administration Division.

The unpaid invoices are included in the Foundation's reported outlays. We have shown the unpaid amount as a separate item in Schedule 1.

Our review disclosed that the contractors (both Validus and the National Pork Producers Council) did not comply with contract terms and conditions and the applicable regulations when billing the Foundation. As a result, \$4,278,615 in unallowable costs was billed (\$2,223,940 under grant X82835301, and \$2,054,675 under grant X783142301). The results of our review are detailed in Schedule 3 on page 21 and the following explanatory notes.

Note 1: License fees of \$575,000 for grant X82835301 and \$675,000 for grant X783142301 represent billings for amounts that were not incurred. Validus billed the Foundation a flat rate of \$25,000 per month for the use of an on-farm assessment checklist that the Council developed under a contract with the National Pork Board. The licensing agreement with the National Pork Board provided that the Council would not pay any royalties to the National Pork Board for Validus' use of the checklist for the first 5 years of the license beginning with calendar year 2001. In years 6 to 15, the Council was to pay the National Pork Board a royalty equal to 5.875 percent of revenues Validus collected annually from the use of the checklist. The contracts we audited were performed within the 5-year period during which no royalties were paid. Our review of accounting records and discussion with Validus personnel indicated that Validus did not incur any costs for licensing fees.

Contract provisions in Section 8.3 and Section C state that administrative functions necessary to support assessment activities including salary, office rent, postage, supplies, telephone, services, accounting, and license fees are to be billed at cost. Actual costs, as defined by Part 31.001 of FAR, means amounts determined on the basis of costs incurred. Since Validus did not incur any costs for licensing fees, they are not allowable for reimbursement.

### ***Validus' Response***

Validus responded that the premise that somehow the license fee had to correspond with costs incurred is a mistaken one. There was never any question among parties to this transaction that the license fee was anything other than a fee. The license fee was never represented as a cost. The Foundation fully agreed to the payment of a license fee of \$25,000 a month in exchange for the exclusive rights to the OFAER assessment tool. The assessment tool was developed with private funding from pork producers through the use of the National Pork Board check-off funds. The license fee was reasonable in amount and billed in accordance with the parties agreement and the express terms of the contract. The EPA program officer most knowledgeable about the OFAER contracts and program did not reject the license fee. It was simply included in the Program Administration category for billing purposes as a matter of convenience and convention. Thus, there is no basis for characterizing the license fee as either over billed or unallowable.

### ***OIG's Comments***

The contract terms between Validus and the Foundation specifically stated that license fees were part of program administration which were to be billed based on actual costs. The contract(s) did not specifically mention the \$25,000 amount, and no documentation was provided to demonstrate the basis for the \$25,000 fee or how the \$25,000 monthly amount was determined to be necessary and reasonable as required by FAR Part 31.

As we stated in the finding, the licensing agreement for the OFAER assessment tool provided that the Council would not pay the National Pork Board for any royalties for the first five years of the licensing beginning in calendar year 2001. Thus, no royalties were due and payable to the National Pork Board until the year 6. Since Validus did not incur any costs for the use of the OFAER checklist, the license fees are not allowed.

Note 2: Facilities and Administration costs of \$215,495 for grant X82835301 and \$599,481 for grant X783142301 represent allocations of indirect costs to the contracts that are not supported by indirect cost rate proposals and negotiation agreements. As a nonprofit organization, the Council was required in accordance with OMB Circular A-122, Attachment A, Paragraph E(2) to submit new indirect cost rate proposals within 6 months after the close of each fiscal year. Similarly, as a commercial organization, Validus was also required by the FAR to submit indirect cost rates proposals. Specifically, FAR 31.103(b) requires a contracting officer (in this case, the Foundation) to use FAR 42.7 for negotiating billing and final indirect cost rates with commercial organizations. FAR 42.705-1 requires a contractor to submit to the contracting officer a final indirect cost rate proposal within 6 months following the end of each fiscal year. Neither the Council nor

Validus provided any documentation to demonstrate that indirect rates were submitted and negotiated.

We noted during our review that the contractor(s) recorded more indirect costs than it billed to the Foundation. Recorded indirect costs amounted to \$1,074,802 for grant X783142301, which was \$475,321 (\$1,074,802 - \$599,481) more than what was billed. We discussed these differences with Validus personnel. They stated that the billed amount is based on their budgeted amounts. Incurred costs were greater than the budget but the President and Chief Executive Officer chose not to bill the Foundation for the additional costs because the variance from estimated was too great.

**Validus’ Response**

Validus does not agree that OMB and FAR regulations apply to the contracts under audit. None of the contracts with the Foundation incorporated OMB Circular A-122 or FAR Part 31, and none of the contracts otherwise required the submissions of indirect cost rate proposals or to negotiate indirect cost rates. As a result, the costs should not be disallowed.

**OIG’s Comments**

We disagree. Both Title 40 CFR 30.27 and OMB Circular A-122 provide that allowable costs are determined in accordance with the regulations applicable to the entity incurring the costs. Thus, for nonprofit contractors, allowable costs are determined in accordance with OMB Circular A-122. For commercial contractors, allowable costs are determined in accordance with the provisions of FAR Part 31. Under both OMB Circular A-122 and FAR Part 31, the organizations were required to submit indirect cost rate proposals within 6 months after the close of each fiscal year. Neither organization provided indirect cost rate proposals or negotiation agreements. Consequently, there is no basis for determining the reasonableness and allowability of the facilities and administration costs of \$215,495 for grant X82835301 and \$599,481 for grant X783142301.

Note 3: The labor costs of \$1,003,848 for grant X82835301 and \$780,194 for grant X783142301 are unallowable because neither the Council nor Validus maintained supporting records required by OMB Circular A-122 and FAR. The unallowable costs are summarized as follows:

Contractor	Reported Outlays		Note
	X82835301	X783142301	
National Pork Producers Council	\$198,211	\$0	a
Validus	\$805,637	\$780,194	b
Total	\$1,003,848	\$780,194	

Source: OIG’s analysis of the contractor’s claimed labor.

- a. The Council billed \$198,211 in labor costs to the Foundation but was unable to provide any personnel activity reports to support the labor charges. OMB Circular A-122, Attachment A, Paragraph (7) (m) requires nonprofit contractors to maintain personnel activity reports to support the charges for salaries and wages to awards. Since the Council was unable to furnish the requested personnel activity reports, the labor costs of \$198,211 are unallowable.

### ***Validus' Response***

Validus stated that the Council used a computerized time distribution system that its employees, including those who worked on the OFAER contracts, used to record their daily time. The system converted the employee time entries into labor charges that were recorded in the general ledger. General ledger account numbers corresponded to the projects employees used to charge their time. Validus reviewed documents that the Council submitted and determined that the Council incurred \$198,211 for labor and billed the Foundation for the same amount. Since the Council's billed labor amounts were based on recorded costs and the Council maintained a time distribution system, the costs are allowable.

### ***OIG's Comments***

We requested copies of the daily time records to determine if the Council had a time keeping system that complied with the requirements of OMB Circular A-122. In response, Validus stated that the Council no longer had the time records we requested. The contractor said the document retention period in the Council's contracts expired several years ago.

Title 40 CFR 30.53 requires supporting documents to be retained for a period of three years from the date of the final expenditure report. The final financial status report for grant X82835301 was dated September 28, 2004. The retention period will expire three years later or on September 28, 2007. As a result, the labor costs remain unallowable.

- b. Labor costs of \$805,637 and \$780,194 that Validus billed the Foundation under grants X82835301 and X783142301, respectively are unallowable. The costs are unallowable because Validus did not have a time distribution system to identify, accumulate, and report labor costs for contracts and was unable to provide employee timesheets to support labor costs charged to the contracts. Validus personnel stated that predetermined percentages of employees' time were used to charge the contracts for labor. The percentages were determined in discussions with the Foundation and were not formally documented.



FAR 31.201-2(d) states that a contractor is responsible for accounting for costs appropriately and for maintaining records adequate to document that costs claimed have been incurred and are allocable to the contract. Since Validus did not maintain documentation required to determine the allocability of labor charges we have questioned the amounts billed.

Under grant X783142301, we noted that Validus began using a time distribution system, including employee timesheets, in January 2004 and that it recorded \$261,422 in labor costs in its accounting system that was based on timesheets. However, Validus billed the Foundation \$747,334 in labor costs, which is \$485,912 in excess of the amount supported by timesheets. The excess billing resulted from Validus' continued use of predetermined percentages of employees' time to charge labor to the Foundation.

In total, the unallowable labor for grant X783142301 was \$780,194 which is the difference between the billed amount of \$1,041,616 and the \$261,422 that was supported by timesheets.

### ***Validus' Response***

Validus did not utilize a time keeping system when it was formed in 2001 because it had only one billable project (the OFAER contract) and there was no need for such a system. In addition to working on the OFAER contract, three Validus employees spent a small fraction of their time on work for the National Pork Board. In 2003, Validus began other projects to which its employees charged time. Labor billed to the OFAER contracts in 2003 was based on predetermined percentages of an employee's monthly labor costs. The percentages were based on actual charges to the OFAER contracts in previous years plus any changes that were expected to occur. The same allocation method was followed for each of the Validus OFAER contracts.

Validus provided a number of declarations from its employees to show what percentage of time the employees recollected that they worked on the OFAER contracts. Based on the employee's declarations, Validus determined that it had overbilled the Foundation by \$283,779 for all four of its contracts, and that this overbilled amount should be offset by the \$845,034 in billings that the Foundation has not paid, plus any unbilled labor costs related to business development and independent research and development labor.

### ***OIG's Comments***

We have not changed our opinion on the allowability of labor costs of \$805,637 for grant X82835301 and \$780,194 for grant X783142301.

Validus was unable to provide adequate time records to support labor costs charged to the contracts. Without contemporaneous time records, we were unable to determine if the labor costs were incurred and properly allocated to the contract(s), and complied with all the applicable costs principles as required by FAR 31.201-2(d). Consequently, we do not consider employees' recollections of what percentage of time they worked on the OFAER contracts as an acceptable alternative to contemporaneous time records.

Note 4: We noted that Validus billed the Foundation for \$17,074 in unbillable program refinement costs under contract ACWF-OFAER-02-99. Billing provisions are provided in Section 7.2 and Attachment C of the contract. This contract only provided for the billing of assessments at a fixed price per assessment. Program refinement costs were not specified. These costs are, therefore, not allowable for reimbursement.

### ***Validus' Response***

Validus agreed that contract terms between the Foundation and the Council did not provide for program refinement. It stated that the Foundation and the Council agreed to begin program refinement work before the start of the next contract. Although the parties did not officially execute a modification or addendum to the contract, the parties understood that program refinement activities would be performed and paid by the Foundation. Validus also stated that if program refinement costs were not directly chargeable to the contract, the costs would have been billable as an indirect cost. Thus, the costs were in conformance with the parties' understanding and agreement and cannot be disallowed.

### ***OIG's Comments***

The contract terms did not provide for program refinement. The costs are outside the scope of the contract and are, therefore, unallowable. The contracted fixed rates for assessments included costs for salaries, training, certification, verification, and building overhead. We have no assurance that the program refinement costs are not included in the fixed rates.

Program refinement costs are not subject to treatment as an indirect cost. FAR 31.203(a) states that an indirect cost is any cost that is not directly identifiable with a single, final cost objective. Since program refinement costs have been identified to the OFAER contracts, they are not allowable as indirect costs.

Note 5: The Foundation claimed unallowable outlays of \$412,523 that were in excess of the maximum amount allowed under two contracts. The unallowable outlays are summarized as follows:

	<b>Program Marketing or Promotion</b>	<b>Program Training</b>	<b>Database Mining</b>	<b>Verification or Oversight</b>	<b>Total Questioned</b>
<b>Grant X82835301</b>					
<b>ACWF-OFAER-01-02</b>					
Maximum Amount	\$ 160,000	\$ 80,000	\$ 50,000	\$ 400,000	
Billed	147,406	218,311	57,207	630,115	
Amount Billed in Excess of Maximum	0	138,311	7,207	230,115	
<b>ACWF-OFAER-01-03</b>					
Maximum Amount	160,000	85,000	55,000	555,000	
Billed	177,902	103,988	10,476	384,855	
Amount Billed in Excess of Maximum	17,902	18,988	0	0	
<b>Total Amount Billed in Excess of Maximum</b>	<b>17,902</b>	<b>157,299</b>	<b>7,207</b>	<b>230,115</b>	<b>\$412,523</b>

Source: OIG's analysis of the recipient's claimed contractual outlays.

### ***Validus' Response***

Validus responded that the budgets were not meant to be firm ceilings that would prohibit Validus from receiving payment for its incurred costs that exceed the budget thresholds. Instead, the budget thresholds were set based on projected performance requirements during the course of a particular contract, and were adjusted as necessary when the performance requirements shifted and Validus incurred costs greater than expected under one or several cost categories in the contract. Whenever Validus realized its costs would exceed a budget threshold for a particular cost category, it notified the Foundation and gained the Foundation's acknowledgement that it would be acceptable to exceed the budget threshold. Thus, costs in excess of the budget threshold were not indicative of Validus' or the Foundation's failure to comply with the terms and conditions of the contracts.

### ***OIG's Comments***

We disagree. Title 40 CFR 30.47 provides that the recipient is required to maintain a system for contract administration to ensure contractor conformance with the terms, conditions, and specification of the contract and to ensure adequate and timely follow up of all purchases. Also, the agreements between Validus and the Foundation provided that no modification of the agreements or waiver of the terms and conditions will be binding upon either party unless in writing and signed by both parties. Neither the Foundation nor Validus provided any contract amendments that authorized Validus to exceed each cost category ceiling.

## ***Scope and Methodology***

We performed our examination in accordance with the *Government Auditing Standards*, issued by the Comptroller General of the United States, and the attestation standards established by the American Institute of Certified Public Accountants. We also followed the guidelines and procedures established in the *Office of Inspector General Project Management Handbook*, dated January 14, 2005. We conducted this examination to express an opinion on the incurred costs, and determine whether the recipient complied with all applicable laws and regulations, as well as any special requirements under the agreement. We conducted our field work from November 15, 2005, through May 18, 2006. Our audit was conducted at the Foundation's office in Washington D.C., and Validus's office in Urbandale, Iowa. Our audit covered the periods June 1, 1998 through June 30, 2005.

In conducting our examination, we performed the following procedures:

- We reviewed grant and project files to obtain background information on the Foundation and the agreement.
- We interviewed recipient personnel to understand the accounting system and the applicable internal controls as they relate to the reported outlays.
- We reviewed the most recent single audit reports to identify issues which may impact our examination.
- We reviewed costs incurred by a Foundation contractor, Validus Services, LLC.

We examined the incurred costs on a test basis to determine whether the costs were adequately supported and eligible for reimbursement under the terms and conditions of the agreements and Federal regulations and cost principles. The Foundation's internal controls were found to be weak and financial records were unreliable. We did not rely on internal controls and based our review on transactions testing only.

On September 29, 2006, we issued the draft report to the Foundation's attorney for comments. On December 7, 2006, we received a response from the Foundation's attorney which also included comments from Validus. The Foundation and Validus either disagreed or did not respond to the reports findings. We did not receive the response, as requested, in an acceptable electronic format to include in the report. A copy is available on request. We have summarized the Foundation's pertinent comments after each finding in the report.

## **Prior Audit Coverage**

We issued two previous memos to the Office of Grants and Debarment on these grants. The first memo was dated December 15, 2005 (Memo No. 2006-00003), and provided EPA with our preliminary observations on potential accounting issues, control weaknesses and regulatory non-compliance that we identified at the Foundation. The second memo was dated June 15, 2006 (Memo No. 2006-M-00011), and provided EPA with additional information in resolving the Foundation's request to deviate from the applicable grant regulations related to procuring Validus' contracts under two grants. Our initial field work at Validus indicated that fair and reasonable contract prices were not obtained.

## ***Distribution***

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