



OFFICE OF INSPECTOR GENERAL

*Catalyst for Improving the Environment*

## **Audit Report**

# **Geothermal Heat Pump Consortium, Inc. Costs Claimed Under EPA Assistance Agreement Nos. X828299-01 and X828802-01**

**Report No. 2003-4-00120**

**September 30, 2003**

*This audit report contains findings that describe problems the Office of Inspector General (OIG) has identified and corrective actions the OIG recommends. The report represents the opinion of the OIG, and findings contained in this report do not necessarily represent the final EPA position. Final determinations on matters in this report will be made by EPA managers in accordance with established audit resolution procedures.*

**Report Contributors:**

Keith Reichard  
Patricia Brooks Taylor

**Abbreviations**

Consortium	Geothermal Heat Pump Consortium, Inc.
CFR	Code of Federal Regulations
DOE	Department of Energy
EPA	Environmental Protection Agency
GHPC	Geothermal Heat Pump Consortium, Inc.,
OMB	Office of Management and Budget



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

OFFICE OF  
INSPECTOR GENERAL

September 30, 2003

**MEMORANDUM**

SUBJECT: Report No. 2003-4-00120  
Geothermal Heat Pump Consortium, Inc.  
Costs Claimed Under EPA Assistance Agreement Nos. X828299-01 and  
X828802-01

FROM: /s/ *Michael A Rickey*  
Michael A. Rickey  
Director, Assistance Agreement Audits

TO: Richard Kuhlman  
Director, Grants Administration Division

As requested, we have examined the costs claimed by the Geothermal Heat Pump Consortium, Inc. (Consortium), located in Washington, DC, under Environmental Protection Agency (EPA) Assistance Agreement Nos. X828299-01 and X828802-01. The agreements were to provide financial support for the Consortium to increase awareness of geothermal heat pump technology through public outreach and information dissemination.

We questioned the total Federal share claimed of \$1,153,472 as unsupported, because the Consortium did not comply with the Federal rules, regulations, and terms of the assistance agreements.

This audit report contains findings that describe problems the Office of Inspector General (OIG) has identified and corrective actions the OIG recommends. The report represents the opinion of the OIG, and findings contained in this report do not necessarily represent the final EPA position. The OIG has no objection to the release of this report to any member of the public upon request.

On July 30, 2003, we issued a draft report to the Consortium for comment, and on August 27, 2003, comments were provided. The Consortium did not agree with the report's findings. A copy of the complete response with attachments has been provided to the action official. A summary of the Consortium's response is included in the report as Appendix B. We held a telephone exit conference on September 25, 2003, and informed the Consortium of the final results of our audit.

## **Action Required**

In accordance with EPA Manual 2750, the action official is required to provide this office with a proposed management decision specifying the Agency's position on all findings and recommendations in this report. The draft management decision is due within 120 days of the date of this transmittal memorandum.

If you have questions concerning this report, please contact Keith Reichard, Assignment Manager, at (312) 886-3045.

Attachment

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## Independent Accountant's Report

We have examined the total outlays (costs) claimed by the Geothermal Heat Pump Consortium, Inc. (Consortium) under the two EPA financial assistance agreements (Agreements), as shown below:

Assistance Agreement No.	Financial Status Report/Federal Cash Transaction Report			
	Date Submitted	Period Ending	Cumulative Total Outlays Claimed	Federal Share of Total Outlays Claimed
X828299-01	1/30/02	9/30/01	\$712,500	\$712,500*
X828802-01	7/31/02	6/30/02	\$440,972	\$440,972**
Total			\$1,153,472	\$1,153,472

\* Outlays were reported on a Financial Status Report.

\*\* Outlays were reported on a Federal Cash Transaction Report.

The Consortium certified that the outlays reported on the *Financial Status Report*, Standard Form 269A, and *Federal Cash Transaction Report*, Standard Form 272, were correct and for the purposes set forth in the Agreements. The preparation and certification of each claim was the responsibility of the Consortium. Our responsibility is to express an opinion on these claims based on our examination.

Our examination was conducted in accordance with the *Government Auditing Standards*, issued by the Comptroller General of the United States, and the attestation standards established by the American Institute of Certified Public Accountants. Accordingly, on a test basis, we examined evidence supporting the claimed costs 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.

As discussed in the "Results of Audit" section of this report, the Consortium's financial management system was not adequate to account for claimed costs in accordance with Federal regulations. The Consortium also did not comply with Federal requirements when procuring contractual services.

In our opinion, because of the effects of the matters discussed in the preceding paragraph, the claimed costs on the *Financial Status Report* and *Federal Cash Transaction Report* do not present fairly, in all material respects, the allowable costs in accordance with the criteria set forth

in the Agreements. As a result, the total costs of \$1,153,472 claimed are unallowable for Federal participation. The following sections provide details of our examination and conclusions.

*/s/ Keith Reichard*

Keith Reichard

Assignment Manager

Field Work End: April 1, 2003

## Background

On June 22, 2000, and September 26, 2001, EPA awarded Agreement Nos. X828299-01 and X828802-01, respectively, to the Consortium, located in Washington DC.

The following table provides some basic information about the authorized project periods and the amounts awarded under the Agreements covered by this audit.

Assistance Agreement No.	EPA Share *	Local Share	Total Cost	Project Period
X828299-01	\$712,500	\$0	\$712,500	05/15/00 - 09/30/01
X828802-01	\$748,300	\$0	\$748,300	10/01/01 - 09/30/02

\* The EPA share is 100 percent of total cost.

**Assistance Agreement No. X828299-01:** This Agreement was authorized under section 103 of the Clean Air Act to provide financial support for the Consortium to increase awareness of GeoExchange (geothermal heat pump) technology through public outreach and information dissemination. A GeoExchange heating and cooling system uses the consistent temperature of the earth to provide heating, cooling, and hot water for both residential and commercial buildings. Activities under the Agreement included operation of the GeoExchange Information Center, management of lead referral service, maintenance of the Consortium’s Internet web site, publication and distribution of the “Earth Comfort Update” newsletter, attendance at trade shows and conferences, and production of a national teleconference.

**Assistance Agreement No. X828802-01:** This Agreement was authorized under section 103 of the Clean Air Act to provide financial support for the Consortium to increase awareness of the benefits of geothermal heat pump technology through direct and indirect public and consumer information dissemination and specific outreach targeted to the education sector. Activities under the Agreement included operation of the GeoExchange Information Center, maintenance of the Consortium’s Internet web site, publication and distribution of the “Earth Comfort Update” newsletter, attendance at trade shows and conferences, and implementation of a Design Assistance Program and Technology Transfer Program.

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

**Claimed Costs:** Program outlays identified by the Consortium on the *Financial Status Report* (Standard Form 269A) and the *Federal Cash Transaction Report* (Standard Form 272).

**Unsupported  
Questioned Costs:**

Costs incurred and claimed that are not supported by adequate documentation and/or have not been approved by a responsible agency official.

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## Results of Audit

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The Consortium's financial management system and procurement system did not comply with the requirements of 40 Code of Federal Regulations (CFR) Part 30 and Office of Management and Budget (OMB) Circular A-122. The provisions of 40 CFR Part 30 establish uniform administration requirements for Federal grants and awards to non-profit organizations. OMB Circular A-122 establishes principles used by all Federal agencies in determining the costs of work performed by non-profit organizations under grants and cooperative agreements.

In accepting the Agreements, the Consortium agreed that: (1) its financial management system would comply with requirements in 40 CFR Part 30; (2) all procurement transactions would be conducted in a manner to provide, to the maximum extent practical, open and free competition; and (3) all costs incurred under the Agreements would comply with the provisions of OMB Circular A-122.

The Consortium's financial management system was inadequate in that the Consortium did not: (1) separately identify and accumulate the costs for all direct activities, such as membership support and lobbying; (2) account for program income generated by the activities funded by the EPA Agreements; (3) prepare or negotiate indirect cost rates; (4) prepare written procedures for allocating of costs to final cost objectives; (5) maintain an adequate labor distribution system; and (6) provide adequate support for direct cost allocations. In addition to the financial management system deficiencies, the Consortium also did not: (1) competitively procure contractual services or perform any of the required cost or pricing analyses; and (2) comply with all reporting requirements. As a result of these and other deficiencies described below, we have questioned all \$1,153,472 of costs claimed through June 30, 2002, under the two Agreements. Details follow.

### **Inadequate Accounting for Membership and Lobbying Expenses**

The Consortium did not separately identify and accumulate all the costs associated with its membership activities and lobbying efforts. OMB Circular A-122, Attachment A, subparagraph B (4), provides that the costs of activities performed primarily as a service to members, clients, or the general public when significant and necessary to the organization's mission must be treated as direct costs whether or not allowable and be allocated an equitable share of indirect costs. Some examples of these types of membership and lobbying activities include:

- Maintaining membership rolls, subscriptions, publications, and related functions.
- Providing services and information to members, legislative or administrative bodies, or the public.
- Promoting, lobbying, or other forms of public relations.
- conducting meetings and conferences, except those held to conduct the general administration of the organization.

The Consortium operated a membership organization that provided lobbying support on behalf of its members throughout the budget periods of the two EPA Agreements. The literature for prospective members outlined the benefits of joining the Consortium at various levels. These benefits included:

- A subscription to the “Earth Comfort Update” newsletter.
- Quarter or half page ads in the “Earth Comfort Update.”
- Copies of the Consortium publications.
- Free referrals from trade shows.
- Link to the Consortium web site.
- Banners on the front page of the Consortium web site.
- Distribution of members’ publications through the Consortium booth at trade shows.
- Use of Design Assistance and Strategic Outreach programs.
- Listing in Membership Directory.
- Membership Certification and Decal.
- Discount on the Consortium Conferences.
- Access to Business Planning and Development Services.
- Invitation to attend Roundtable Discussion with government officials and Congress.

The Consortium membership activities include all labor and expenses incurred to provide these benefits to existing members, as well as the cost for recruitment of new members.

The Consortium lobbying effort included the costs for outside legal counsel and legislative consultants, and the salary and expenses for: (1) the employees involved in the Consortium’s direct lobbying initiatives; (2) the activities of the Consortium’s lobbying compliance officer as outlined in the Consortium employees’ handbook; and (3) the employees responsible for the oversight and management of outside legal counsel and legislative consultants involved in the Consortium lobbying efforts.

In accordance with Circular A-122, all direct costs associated with membership and lobbying activities, including fringe benefits and overhead costs, should have been separately identified in the accounting records. However, the Consortium’s financial management system was not structured to allow for the treatment of membership activities and lobbying effort as direct cost activities. The Consortium’s employee time sheets did not include separate categories for either membership or lobbying labor, and the Consortium’s general ledger either did not use or include all accounts needed to accumulate all expenses relating to membership and lobbying activities.

### ***Consortium’s Response***

The Consortium’s financial management system properly accounted for membership and lobbying expenses. The Consortium did not perform any services or provide any benefits for members that were different from the services and benefits it provided to the general public. Contributions by members were not made based on obtaining benefits or services, but solely to support the Consortium’s public mission. Also, the Consortium maintained

that it had no line item on its Income Statement for membership program expenses, and as such, dedicated no separate resources to typical membership activities.

Since Consortium personnel did not spend more than 31 hours on lobbying activities during the entire duration of the two EPA Assistance Agreements cited in this report, the Consortium was not required to create time logs, calendars, or records for this minimal amount of lobbying activity according to OMB Circular A-122, Attachment B, paragraph 25 (c) (4). The 31 hours of lobbying activities were primarily for the purpose of managing the independent contractor hired by the Consortium to perform lobbying services. Based on the Consortium's actual indirect cost rate being three times higher than the indirect cost rate reimbursed by the two EPA Assistance Agreements cited in this report, the Consortium used no Federal funds for lobbying activities.

### ***Auditor's Reply***

We disagree with the Consortium's contention that it properly accounted for costs associated with its membership and lobbying activities. Even though required by OMB Circular A-122, Attachment A, subparagraph B (4), the Consortium did not identify and accumulate the costs associated with its membership and lobbying activities as a direct cost objective. Whether allowable or unallowable, these costs remained unidentified and commingled with other indirect and direct costs of the Consortium's operations, and were not allocated an equitable share of indirect costs as required by OMB Circular A-122.

Article III of the Consortium's By-Laws, entitled, "Membership," relates the Consortium's establishment as a membership organization. The Consortium, through adoption of these By-Laws, made a decision to operate a membership program and, therefore, incur such costs as necessary to solicit members, provide benefits, collect dues, and otherwise administer the program. Based on this decision, the Consortium's accounting structure should have also been designed to accumulate the costs related directly to the membership program.

The Consortium argued that it did not identify and accumulate costs for "membership activities" per se because it did not perform any services or provide any benefits for members that were different from the benefits and services it provided to the general public. We disagree. According to the Consortium's own *Earth Comfort Update* newsletter, "the merits of membership" include: (1) a national voice and national presence in Washington, (2) promotion of the member's business and providing lead referral service, (3) strategic outreach and design assistance, (4) marketing assistance, and (5) business development. The *Earth Comfort Update* related that one of the most successful member programs was design assistance. The design assistance program offered members access to nationally recognized GeoExchange design experts who could help to develop feasibility studies or highly cost-effective designs. The *Earth Comfort Update* also stated that the lead referral service was often identified by members as one of the most valuable assets of membership. These sales leads were gathered from the

GeoExchange Information Center, trade shows and the Strategic Outreach and Design Assistance programs.

In addition, the resumes for both the Consortium's EPA Program Manager and the Executive Director were provided as part of the application package for Assistance Agreement X-828299-01.<sup>1</sup> These resumes demonstrated the employees' recognition of the significance of their activities conducted to benefit the Consortium's members, and also recognized these benefits as not having been provided to the "general public," but to a defined 700-member organization. The Executive Director's responsibilities included establishing and directing all policies, positions, and activities of the membership organization. The EPA Program Manager's membership responsibilities included communication, public relations, and recruitment, including developing new membership brochures and devising new due structures, benefits, and services.

The importance of these stated membership responsibilities was further supported by the Executive Director's employment contract with the Consortium. The employment agreement provided for incentive compensation based on "Membership Dues" as follows:

*During each calendar year of the Agreement, Employer shall pay Employee an incentive payment equal to two percent (2%) of membership dues actually collected in such year.*

Based on these documents, it is reasonable to expect both the Executive Director and EPA Program Manager to have devoted considerable effort to membership-related activities and that a significant, not de minimus, portion of their salary and travel would have been attributable to membership efforts, and therefore must be separately accounted for according to OMB Circular A-122.

During the period covered by the two Agreements, the reports and travel records of the primary consultant employed by the Consortium, also known as the Consortium's "Key Accounts Manager," illustrated his involvement in recruitment of new members and retainment of current members for the Consortium. That portion of his \$10,000 per month fee and associated travel costs relating to membership issues should have been specifically identified and assigned to membership activities according to the requirements of OMB Circular A-122. However, none of the expenses described above were separately identified as solely benefitting the Consortium's membership program and remain commingled with other expenses in the Consortium's books and records.

In addition, the Consortium maintained that it had no line item on its Income Statement for membership program expenses, and as such, dedicated no separate resources to typical membership activities. We disagree. The Consortium has chosen not to separately identify the resources dedicated to generating the membership dues included on its Income Statement. In addition to the costs of providing membership benefits, additional

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<sup>1</sup> The EPA Program Manager was also called the Communications and Governmental Affairs Director.

resources were required for the costs of membership activities, such as processing of membership applications, tracking of members, processing of renewal notifications, and the collection and accounting for membership dues. Other resources typically dedicated to membership activities would be those associated with the development and production of the Consortium's membership information packets and brochures, stationery, and postage for membership communications, employee salaries, fringe benefits, travel, and business entertainment relating to membership solicitation and retention.

The Consortium's lobbying efforts are also a benefit provided to Consortium members. As related in its membership brochures, the Consortium determined a varying percentage of the membership dues "not deductible as a business expense because of GHPC's lobbying activities on behalf of its members." Each year, the Consortium updated the membership brochure to reflect its determination as to what percentage of the membership dues pertain to lobbying.

With respect to lobbying, the Consortium asserted that it was not required to create time logs, calendars, or records for the minimal amount of lobbying activities that it performed. However, the Consortium was already required to maintain an acceptable labor distribution system under OMB Circular A-122, Attachment B, subparagraph 7 (m), as a requirement for receiving Federal assistance funds. An acceptable labor distribution could have been based on the time sheets already in use by the Consortium, if these time sheets had included the membership and lobbying direct labor categories required by OMB Circular A-122, Attachment A, subparagraph B (4). Therefore, as the time sheets were already in use, there was no need for the Consortium to "create" any records to account for staff time spent on lobbying effort.

Further, the provisions of OMB Circular A-122, Attachment B, subparagraph 25 (c) (4), provide that the absence of time logs, calendars, or similar records will not serve as a basis for disallowing costs by contesting estimates of lobbying time spent by employees during a calendar month. However, we are not contesting the monthly lobbying estimates because the Consortium did not provide monthly lobbying estimates.

The issue in this report is that the Consortium did not recognize any of the Executive Director's salary or benefits, and only a small portion of the Consortium's EPA Program Manager's salary and benefits, as unallowable lobbying activities. However, their involvement in the Consortium's lobbying efforts seemed more extensive. For example, the cover letter from the lobbying contractor to the Executive Director indicated involvement in the lobbying activity by both the Consortium's Executive Director and the EPA Program Manager. The cover letter stated that:

*. . . to follow up on our discussion earlier this month and put into place our federal affairs program for the year 2001 . . . We will work with you to be sure that GeoExchange is one of the technologies which would benefit from any changes in the law . . . as we did last year, we will work with you and [name]*

*to expand the network of friends of the industry in the federal government in order to create sales opportunities to federal agencies. . . .*

In addition, the scope of work for the January 30, 2001, lobbying contract, included: (1) drafting and implementing strategies for generating federal funding within EPA and the Department of Energy (DOE); (2) developing and pursuing Congressional opportunities for GeoExchange to be a preferred heating and cooling technology for school construction and renovation; (3) drafting and implementing a strategy to change the Federal tax to encourage the use of GeoExchange technology; and (4) assisting in the design and execution of the program to improve Federal awareness of the GeoExchange technology.

We do not believe that the lobbying contractor could perform the types of lobbying tasks discussed in the contract without substantial discussion and coordination with the Consortium's Executive Director and EPA Program Manager.

This lobbying effort also corresponded well with the Executive Director's employment contract in effect with the Consortium during the same period. The employment contract provided the Executive Director with incentive-based compensation for "Grant/ Funding" as follows:

*During each calendar year of this Agreement, Employer shall pay Employee an incentive payment equal to one percent (1%) of public, private, Federal, state, or local government funds (or any combination thereof) actually collected by Employer in such year up to \$5 million, and one-half of one percent (0.5%) of such funds collected over \$5 million and up to an overall cap of \$10 million.*

The resume for the Consortium's EPA Program Manager included lobbying activities as follows:

*Establish and maintain relations with Members of Congress, Committees and staff to secure federal monies for the organization. Successfully secured funding for organization during fiscal years 1998 - 2000.*

Based on the lobbying contract, the January 30, 2001, cover letter, the Executive Director's employment contract, and the resume for Consortium's EPA Program Manager, it would appear reasonable to expect both the Executive Director and EPA Program Manager to have devoted considerable effort to lobbying-related activities, and that a significant, not de minimus, portion of their salary and travel would have been attributable to lobbying efforts unallowable according to OMB Circular A-122. In summary, it was and is the Consortium's choice to operate as a dues paying membership organization, and to incur the costs associated with providing member benefits and administering the membership program. According to OMB Circular A-122, Attachment A, subparagraph B (4), the Consortium has no choice while receiving Federal

funds but to treat its membership and lobbying activities as a direct cost objective by separately identifying and accumulating the costs associated with membership and lobbying activities.

## **Improper Treatment of Program Income**

The Consortium did not recognize the dues paid by its members as program income related to the EPA-supported activities under the two Agreements. As outlined in the membership literature, the Consortium membership benefits included publication of the “Earth Comfort Update” newsletter, design and maintenance of the Consortium web site, dissemination of the Consortium publications from the GeoExchange Information Center, lead referral service, trade show attendance, and use of the design assistance and strategic outreach programs. All of these activities were also identified as tasks completed and funded under the one or both of the EPA Agreements.

Title 40 CFR 30.2(x) defines program income as “gross income earned by the recipient that is directly generated by a supported activity or earned as a result of the award.” The Consortium collected dues from individuals and organizations in return for providing the membership benefits identified above. Since these membership benefits were included in the Agreements financed with EPA funds, the associated membership dues should be classified as program income according to 40 CFR 30.2(x). According to the Consortium’s OMB Circular A-133 annual audits, prepared by the Consortium’s Certified Public Accountant, membership dues for Calendar Years 2000, 2001, and 2002 were \$774,971, \$679,691, and \$468,584, respectively.

Title 40 CFR 30.24(a) states that the “Federal awarding agencies shall apply the standards set forth in this section in requiring recipient organizations to account for program income related to projects financed in whole or in part with Federal Funds.” Title 40 CFR 30.24(d) provides that, “In the event that the Federal awarding agency does not specify in its regulations or the terms and conditions of the award how program income is to be used, paragraph (b) (3) shall apply automatically to all projects or programs except research. . . .” Title 40 CFR 30.24(b)(3) states that program income will be deducted from the total project or program allowable cost in determining the net allowable costs on which the Federal share of costs is based.

Agreement No. X828299-01 does not specify the appropriate treatment of program income generated by the activities of the award. Therefore, the program income from the Consortium membership dues for the award period should have been deducted from the allowable costs claimed under the Agreement No. X828299-01 to determine the net allowable Federal share of costs.

The May 3, 2002, no-cost amendment to Agreement No. X828802-01 contained an administrative condition that provided that program income will be added to funds committed to the project by EPA and used to further eligible project or program objectives. Therefore, the Consortium should have identified the additional funds to be

committed and the additional activities to be completed under the Agreement resulting from the program income earned. However, the Consortium did not identify the program income earned or any additional activities to be undertaken.

### ***Consortium's Response***

The Consortium has not earned "program income" since contributions to the Consortium were made solely to further the overall objectives of the organization and were not generated by any specific activities funded by the EPA grants. Also, the May 3, 2002 no-cost amendment to Agreement No. X828802-01 allowed the Consortium to commit these funds to the Consortium's mission without having to deduct these funds from the allowable costs claimed under the Assistance Agreement to determine the net allowable federal share of costs.

The Consortium also stated that according to OMB Circular A-110, subparagraph (24) (e), contributions made from organizations which had already become members before May 15, 2000, or which joined the Consortium after September 30, 2002, would not be considered program income since those contributions came from organizations which had become members and made contributions either prior to or after the completion of the two EPA Assistance Agreements at issue in this audit. The Consortium maintained that the majority of contributions received during 2000 through 2002 cannot be considered "program income" as these were contributions from organizations which had been supportive to the Consortium prior to or after completion of the grants.

### ***Auditor's Reply***

We disagree with the Consortium and believe that it did earn program income generated by the specific activities funded by the Agreements. In our reply to the Consortium's response on *Inadequate Accounting for Membership and Lobbying Expenses*, we addressed how services provided under the Agreements related to membership benefits. Further, the Consortium's scope of work prepared for Agreement X-828299-01 also provided insight into member benefits funded by EPA. For example, in the description of sub task 1d, "Management of Lead Referral Service," the Consortium stated:

*GHPC provides those interested in purchasing a GeoExchange system with referrals to manufacturers' representatives and local installers. At the same time, GHPC provides its trade members with the same public contacts, as well as with many other contacts gathered from strategic outreach and trade show activities.*

In describing Task 2, "*GeoExchange Industry Web Site*," the Consortium stated, "GHPC maintains a password-protected Members Only site for its dues-paying members. Here, GHPC members can access industry leads gathered through the referral system (above), as well as a proprietary school project leads database."

The Consortium has not succeeded in demonstrating that contributions made to the Consortium as membership dues were made solely to further the overall objectives of the organization and not in response to any membership benefits provided by the organization. The Consortium has chosen to operate a membership program soliciting membership dues for providing membership benefits. To the extent these benefits are provided to Consortium members by activities funded under the EPA Assistance Agreements, the related yearly membership dues become program income of the EPA Assistance Agreements in accordance with 40 CFR 30.2(x). The program income recognized for the EPA Assistance Agreements would match the membership dues received by the Consortium related to the membership period during which EPA provided the member benefits, i.e., the performance period of the Assistance Agreements.

It should be noted that the May 3, 2002, no-cost amendment to Assistance Agreement No. X828802-01 required that any program income “be added to the funds committed to the project by EPA and used to further eligible project or program objectives.” This is contrary to the Consortium’s assertion that the program income could simply be added to funds supporting “the Consortium’s mission” in general. To demonstrate compliance with the amendment to the Assistance Agreement, the Consortium would have to identify the activities and expenses incurred supporting project or program objectives funded by the program income.

As stated previously, the Consortium has chosen to operate a membership program that resulted in funds received by the organization in the form of membership dues. However, if the Consortium continues to assert that this membership program provided no benefits to its members, and all funds generated by the program were contributions to the Consortium, then the membership program was in fact a fund-raising activity for the organization. OMB Circular A-122, Attachment B, subparagraph 23 (b), provides “Costs of organized fund raising, including financial campaigns, endowment drives, solicitation of gifts and bequests, and similar expenses incurred solely to raise capital or obtain contributions are unallowable.” Therefore, according to OMB Circular A-122, Attachment A, subparagraph B (3), the costs of operating the Consortium’s fund raising operations such as those necessary to solicit and collect donations, and otherwise administer the program, were unallowable and must be treated as direct costs for the purposes of determining indirect cost rates.

The Consortium argues that if an organization became a member prior to the award of the Agreements, or after completion of the Agreements, that program income cannot be earned in accordance with OMB Circular A-110, subparagraph (24) (e). The provisions of OMB Circular A-110, subparagraph (24) (e) state:

*Unless Federal awarding agency regulations or the terms and conditions of the award provide otherwise, recipients shall have no obligation to the Federal Government regarding program income earned after the end of the project period.*

We agree that program income earned after the end of the project period is not considered program income. However, the argument that program income cannot be earned if an organization was a Consortium member prior to the awards of the Agreements is without merit and misapplied. If an organization continues to pay membership dues after the Agreements were awarded, then that organization continues to receive member benefits from the Consortium during the period of the Agreements. Thus, the Consortium continues to incur expenses to provide those membership benefits. Consequently, any program income earned during the period May 15, 2000, through September 30, 2001, should be deducted from the allowable costs claimed under the Agreement No. X828299-01. Program income earned during the period October 1, 2001, through September 30, 2002, should be used to support eligible project or program objectives under Agreement No. X828802-01.

## **Unsupported Indirect Cost Rates**

The Consortium did not provide us with evidence that it had prepared or submitted an indirect cost proposal supporting the indirect and fringe rates used in the calculation of costs claimed under the Agreements.

OMB Circular A-122, Attachment A, subparagraph E (2), requires a non-profit organization to submit an initial indirect cost proposal to the cognizant Federal agency no later than 3 months after the effective date of the award. The Circular also includes the requirement that organizations with previously negotiated indirect cost rates must submit a new indirect cost proposal to the cognizant agency within 6 months after the close of each fiscal year. In addition, both Agreements included special conditions that required the Consortium to prepare and maintain on file an indirect cost rate proposal within 90 days of accepting the assistance agreement.

The indirect cost and fringe rates used by the Consortium to claim costs under the Agreements were based on rates used by the Consortium under prior EPA and Department of Energy cooperative agreements. The Consortium did not provide us with a proposal supporting these rates or an indirect cost rate proposal prepared subsequently to the EPA awards.

### ***Consortium's Response***

The Consortium has prepared and negotiated indirect cost rates and submitted such rates to EPA. Since from its inception through fiscal year 2002, DOE was the Consortium's cognizant agency for purposes of negotiating its indirect rates, the Consortium was not obligated to provide EPA with an indirect cost rate proposal. The Consortium did provide EPA with the basis of its proposed rates in each Assistance Agreement, which was accepted and used as a basis for determining the funding for the Consortium's program. In January 2003, EPA became the cognizant Federal agency and the Consortium submitted an Indirect Cost Rate Proposal for review and approval to EPA in 2003.

## ***Auditor's Reply***

Except for fiscal year 2002, the Consortium did not provide us any evidence that it had prepared, submitted, and negotiated any annual indirect cost proposals with either DOE or EPA.<sup>2</sup> OMB Circular A-122, Attachment A, paragraph E, requires that assistance agreement recipients must submit to its cognizant agency an indirect cost proposal to substantiate its claim for indirect costs. In addition, paragraph E states that the results of any negotiation of indirect costs rates must be formalized in a written agreement between the cognizant agency and the non-profit organization. No such agreement or agreements were provided.

The Consortium appears to be arguing that once indirect rates have been established in the Assistance Agreements, no further action is needed by either the Consortium or the cognizant Federal agency. This is an incorrect assumption. Recipients are required under the provisions of OMB Circular A-122 to submit annual indirect cost rate proposals to its cognizant agency for negotiation. This was not done except for fiscal year 2002. Furthermore, the Consortium's OMB Circular A-133 audit, prepared by the Consortium's Certified Public Accountant, for fiscal year 2002 identified as a reportable condition that the Consortium did not submit an indirect cost rate proposal in accordance with the cooperative agreement.

With respect to the fiscal year 2002 indirect cost rate proposals, we noted that the Consortium did identify some lobbying expenses as a direct cost, but the expenses were incorrectly excluded from the Consortium's total direct costs allocation base. Further, the Consortium did not specifically identify any labor costs associated with managing the lobbying effort of the Consortium. We also noted that the Consortium did not identify membership activities as a direct cost as discussed above. According to OMB Circular A-122, Attachment A, subparagraph B (4), the Consortium's membership and lobbying costs must be identified and treated as a direct cost and allocated an equitable share of indirect costs. Consequently, given the level of detail provided in the submission, we were unable to determine if all of the Consortium's membership and lobbying activities were identified as a separate direct cost objective as required by OMB Circular A-122, Attachment A, subparagraph B (4).

## **Absence of Written Procedures**

The Consortium did not have written accounting procedures identifying direct and indirect costs, and the basis for allocating such costs to projects as required by 40 CFR 30.21(b). In addition, the Consortium did not prepare indirect cost rate proposals, as required by OMB Circular A-122, which would distinguish indirect costs from direct costs.

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<sup>2</sup> The Consortium submitted its fiscal year 2002 indirect cost rate proposals to EPA on June 23, 2003.

Title 40 CFR 30.21(b)(6) states that the recipient's financial management system shall provide written procedures for determining the reasonableness, allocability, and allowability of costs in accordance with the provisions of the applicable Federal cost principles and the terms and conditions of the award. The existence of these procedures would have established a basis for the Consortium's consistent treatment of direct and indirect costs. However, we noted during our examination that the Consortium claimed direct expenses for items such as postage, stationery, and general insurance under the Agreements. Costs for postage, stationery, and general insurance are typically treated as indirect expenses. Without written policies and procedures to distinguish between direct and indirect expenses, and an acceptable indirect cost proposal, we cannot properly evaluate the costs charged to the Agreements.

### ***Consortium's Response***

The Consortium possesses written procedures for allocating costs to final cost objectives and internal controls in place to assist the accounting office with proper document flow, approvals, and requirements. This system is supplemented by OMB Circular A-122, Attachment A, which is on file in the Consortium Accounting office. The Consortium also had written procurement policies and procedures in the GHPC Employee Manual which outlines many procedures and contains OMB Circular A-122, procurement policies, and administrative policies. The Consortium's own internal controls as supplemented by OMB Circular A-122 served as the written procedures for determining the reasonableness, allocability and allowability of costs in accordance with the provisions of the applicable Federal cost principles and the terms and conditions of the award. The Consortium continues to improve and update its written procedures.

### ***Auditor's Reply***

The Consortium's written procedures did not adequately address how costs would be treated in varying circumstances. For instance, the accounting procedures did not identify when costs would be charged: (1) only direct, (2) only indirect, or (3) to either direct or indirect activities. Also, the accounting procedures should identify the determining criteria when costs can be charged direct or indirect. The three pages of the Consortium's "Internal Control Procedures" only provide guidance on accounting procedures for: (1) the accounting manager's handling of checks; (2) the processing of membership applications and invoices; (3) the preparation of bank reconciliations; (4) the completion of payroll duties; (5) request for proposals, purchase orders, contracts, and task orders processing; and (6) the processing of accounts payable invoices. The additional policies and procedures contained in the GHPC Employee Manual and attached to those procedures (OMB Circular A-122 and the Lobbying Disclosure Act of 1995) do not provide the users with sufficient direction on the Consortium's specific policies for assignment of costs. Additional information satisfying the requirements of 40 CFR 30.21(b)(6) are written procedures for determining the reasonableness, allocability, and allowability of costs.

## **Inadequate Labor Distribution System**

The Consortium did not maintain an adequate labor distribution system to assure the proper recording of labor costs to all cost objectives. Therefore, the Consortium's labor distribution system did not meet the requirements of OMB Circular A-122, Attachment A, as required by 40 CFR 30.27. As a result, we were unable to determine whether the claimed labor costs as recorded in the Consortium general ledger were allowable and allocable to the EPA cooperative agreements.

OMB Circular A-122, Attachment A, subparagraph B (4), states: "The costs of activities performed primarily as a service to members, clients, or the general public when significant and necessary to the organization's mission must be treated as direct costs whether or not allowable and be allocated an equitable share of indirect costs."

The Consortium operated as a membership organization that provided lobbying support on behalf of its members. As required by OMB Circular A-122, the Consortium should have identified its membership services and lobbying activities as direct activities. However, the Consortium's employee time sheets did not include these labor categories, which would have allowed employees to record their labor effort for membership services or lobbying activities. For salary expense to be correctly allocated to all direct cost objectives, the Consortium employees should have been able to assign time to these activities. Further, since the Consortium did not properly account for membership and lobbying activities, we have no way of knowing whether these activities were improperly charged direct to the EPA Agreements or the labor costs were recorded as indirect labor.

Also, during the budget period for Agreement No. X828802-01, the Consortium allocated labor costs to direct projects using a combination of budgeted and negotiated rates, rather than actual labor rates. For Agreement No. X828802-01, the Consortium used the proposed employee labor rates as contained in the applications rather than actual employee labor costs. OMB Circular A-122, Attachment B, subparagraph 7 (m) (1) states: "Charges to awards for salaries and wages, whether treated as direct costs or indirect costs, will be based on documented payrolls approved by a responsible official(s) of the organization." The Consortium's use of budgeted rates as the source of labor costs on the EPA Agreement did not meet the requirements of Circular A-122.

### ***Consortium's Response***

The Consortium maintained an adequate labor distribution system to assure the proper recording of labor costs to cost objectives. The Consortium charged either actual or lower than actual labor rates to the Assistance Agreements. The labor cost was charged to each cost objective based on the percentage of hours worked by each employee during that particular month - thereby ensuring that the distribution of labor was based on actual work performed by the employee as required by OMB Circular A-122, Attachment B, paragraph (7). Due to changes in salary rates during the calendar year, and a clerical error, there were under applied labor costs to the projects. During 2000 through 2002 the Consortium undercharged the EPA Assistance Agreements \$28,447.68.

## ***Auditor's Reply***

We disagree with the Consortium's contention that it maintained an adequate labor distribution system. The labor distribution system cannot be adequate if: (1) labor costs are not assigned to all known direct cost objectives as required by OMB Circular A-122, and (2) actual labor rates are not used to calculate both the direct and indirect labor.

The Consortium did not require employees to identify and record the direct labor effort for either membership or lobbying activities as required by OMB Circular A-122. Without the allocation of labor to all known cost objectives, we were unable to determine whether the claimed labor costs are allowable.

Further, the Consortium did not always use actual labor rates in calculating both the direct and indirect labor. The Consortium's accounting practice was to record the actual payroll amounts in its indirect salary account and then allocate the direct labor charges to direct cost objectives. Any differences between the salary expense allocated to direct cost objectives and the actual employees' salary remained in the indirect salary account. This method of accounting results in direct labor costs being understated and indirect labor being overstated. Consequently, the indirect cost rate would be overstated.

Notwithstanding the fact that the Consortium did not account for membership and lobbying activities, we agree that the claimed direct labor costs for the two Agreements may have been understated because the Consortium did not consistently use actual employee labor rates in recording labor costs to final cost objectives. For Assistance Agreement X-828299-01, the Consortium used incorrect labor rates for two employees for several months. This error resulted in a \$13,782 understatement of direct labor charges to the EPA Assistance Agreement. For Assistance Agreement X828802-01, the Consortium incorrectly used budgeted rates rather than actual employee labor rates. This error resulted in a \$5,003 understatement of direct labor charges to the EPA Assistance Agreement from October 1, 2001 through June 30, 2002. The Consortium also used negotiated labor rates for other final cost objectives instead of actual labor rates which as previously stated resulted in the indirect labor costs being overstated and direct labor being understated.

## **Unsupported Allocations of Direct Costs**

Our examination also determined that direct costs claimed under the EPA Agreements included unsupported costs benefitting more than one program. For example:

- In December 2000, the Consortium reclassified \$7,884 of contract costs for its information center to Agreement No. X828299-01. The Consortium did not provide a rationale for the reclassification of these costs, which had originally been charged to a DOE grant.
- The Consortium claimed consulting costs of \$46,063 under Agreement No. X828801-01. However, during the period that the costs were claimed, the

consultant also worked on a New York State contract and additionally provided membership services to the Consortium. Neither the Consortium nor the consultant's invoices provided sufficient detail to support the costs charged to the Agreement.

### ***Consortium's Response***

The Consortium provided adequate support for direct cost allocations. The operation of the GeoExchange Information Center was an activity included in the scopes of work for both the DOE and EPA Assistance Agreements. A portion of three invoices or \$7,884 for this activity was reclassified from the DOE grant to the EPA Agreement. This \$7,884 represents the Consortium's best estimate of the EPA share of the operation of the GeoExchange Information Center for the period when the DOE and EPA Agreements overlapped.

The Consortium also has sufficient detail to support claiming consulting costs of \$46,063 under Agreement X828802-01. Each activity and expense report submitted by the Consultant clearly designated that it was an activity performed pursuant to Agreement X828802-01. The Consultant had written the acronym "EPA" at the top of each activity report and in the "Comments" section of each expense report provided to the Consortium's Project Manager. The level of effort spent on the activities, as designated by the activity reports, was charged to the EPA Agreement at the consultant's hourly rate.

### ***Auditor's Reply***

Costs are to be allocated in accordance with the relative benefit received. The Consortium has not provided an adequate rationale for how it determined that \$7,884 was allocable to the EPA Agreement. In addition, the Consortium has not provided a rationale for the 4- to 6-month delay in transferring the costs from DOE to the EPA Assistance Agreement. The costs were associated with invoices the Consortium paid in June and August 2000, but the adjustment was not made until December 2000.

With respect to the consulting costs of \$46,043, the activity and expense reports provided in support of the consultant's activities during Agreement No. X828802-01 did not provide sufficient detail to allow for an allocation of the consultant's expenses among all cost objectives for which the consultant provided services to the Consortium. The consultant was paid a monthly fee, which should be allocated based on the hours worked on each Consortium activity, direct and indirect. The support for the consultant's billings did not include a contemporaneous record of time spent on all activities, which would allow the Consortium to allocate the consultant's fee and expenses between activities. The consultant's activity and travel reports also repeatedly identify "membership in GHPC" as a topic of discussion for meetings and telephone calls, and as a purpose of business meals. That portion of the consultant's \$10,000-per-month fee, and associated travel costs relating to membership issues, should have been specifically identified and assigned to membership activities according to the requirements of OMB Circular A-122, Attachment A, subparagraph B (4). However, none of the expenses described above were

separately identified as benefitting the Consortium's membership program and remained commingled with other expenses in the Consortium's books and records.

## **Improper Procurement Practices**

The Consortium did not: (1) competitively procure contractual services in accordance with 40 CFR 30.43, and (2) adequately justify the lack of competition as required by 40 CFR 30.46. In addition, the Consortium did not perform the required cost or price analyses for the procurement of goods and services obtained under the EPA Agreements as required by 40 CFR 30.45.

The provisions of 40 CFR 30.43 provide that all procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition. The Consortium did not comply with the provisions of 40 CFR 30.43 in that it awarded contracts under the EPA Agreements based on the results of prior competitive procurement actions conducted under other Federal awards. The Consortium provided no justification for this lack of competition or the basis for the award cost or price in the procurement files. Title 40 CFR 30.46 requires that procurement records and files for purchases in excess of the small purchase threshold of \$100,000 shall include the following at a minimum: basis for contractor selection; justification for lack of competition when competitive bids or offers are not obtained; and basis for award cost or price. The Consortium's written procurement procedures also state that the Consortium will award all contracts in excess of \$25,000 through competitive solicitations, except in exceptional circumstances in which a sole source justification can be demonstrated.

Examples of the Consortium's improper procurement practices follow:

- For Agreement No. X828299-01, the Consortium awarded a \$168,357 fixed price contract for a video teleconference in September 2000, based on the previous selection of the contractor under a 1996 request for proposals.
- Also for Agreement No. X828299-01, the Consortium claimed \$153,939 under cost reimbursement contracts to provide information center services. The Consortium had continuously contracted with Integrated Marketing Concepts since its selection under a 1998 solicitation. The Consortium did issue a Request for Proposals during July of 2001 for \$165,000 of budgeted information center activities under Agreement No. X828802-01. However, the Consortium chose the existing contractor over seven respondents, even though the existing contractor had not prepared a proposal in response to the solicitation, was not included in the prepared cost and price analyses, and was selected based on the unknown results of an anticipated renegotiation of the existing contract.
- The Consortium contracted separately with two individuals to provide the \$100,000 of consulting services budgeted for the Technology Transfer Program under Agreement No. X828802-01. The Consortium selected one of the

individuals as a result of a 1996 request for proposal and the other based on a 1999 solicitation.

The Consortium also did not perform the required cost or price analyses for the procurement of goods and services obtained under the EPA Agreements. Title 40 CFR 30.45 provides that some form of cost or price analysis shall be made and documented in the procurement files in connection with every procurement action. Price analysis may be accomplished in various ways, including the comparison of price quotations submitted and market prices and similar indicia, together with discounts. Cost analysis is the review and evaluation of each element of cost to determine reasonableness, allocability, and allowability. The Consortium did not provide any cost or pricing data supporting the purchases of goods and services for the Agreements to demonstrate compliance with 40 CFR 30.45.

Competition promotes obtaining the best goods and services at the best price. The lack of competition when procuring goods and services under a grant can result in lower quality services and wasted funds. As a result of this lack of competition and cost or pricing analysis, there was no assurance that the contract costs paid under the cooperative agreements were reasonable. Therefore, these costs are not allowable under Federal rules.

### ***Consortium's Response***

The Consortium did competitively procure contractual services in accordance with 40 CFR 30.43 and adequately justify contractual services in accordance with 40 CFR 30.46. OMB's choice of the term "to the maximum extent practical" in the drafting of A-110 proves that OMB understood that not each and every single procurement could or would be competitively bid. Rather, OMB Circular A-110 required recipients of federal funds to have a procurement system in place to ensure maximum competition. The Consortium documented that all purchases exceeding the small purchase threshold of \$100,000 were competitively selected. The Consortium maintains an acceptable procurement system which promotes competition to the maximum extent practical; taking into account dollar thresholds, past performance, follow-on effort, customer needs, and availability of products and services from other sources. The Consortium believes that it was in compliance with the competition requirement in 40 CFR 30.43 based on the EPA approval of its Scopes of Work for the two Assistance Agreements which outlined the basis for contractor selection.

### ***Auditor's Reply***

The Consortium did not provide the contemporaneous bidding information or cost or pricing data required by Federal regulations to support the procurement conducted for Agreements Nos. X828299-01 and X828802-01. Therefore, the procurement costs are unsupported and should not be included in any costs claimed for these Agreements.

EPA's approval of the scope of work for the two Agreements did not equate to a waiver or deviation from the Consortium's compliance with applicable Federal regulations

governing procurement. These regulations applied to the current procurement actions conducted for the Agreement Nos. X828299-01 and X828802-01 and are not satisfied by the Consortium's previous procurement activities for awards from EPA or DOE. As an example, basing the Consortium's fiscal year 2000 selection of the teleconferencing services' provider on responses to a 1996 request for proposals does not illustrate "an acceptable procurement system which promotes competition to the maximum extent practical." This teleconferencing activity represented 24 percent of the total award under Agreement No. X828299-01. This lack of current competition for significant procurement under both Agreements provided no assurance that reasonable prices were obtained for goods and services received. Also, the Consortium may have performed some form of current cost or price analysis for procurement actions for the Agreements under review. However, the absence of the required documentation precludes any demonstration of compliance with 40 CFR 30.45, which requires that a cost or pricing analysis shall be made and documented with every procurement.

Furthermore, the Consortium's Fiscal Year 2002 OMB Circular A-133 audit, prepared by the Consortium's Certified Public Accountant, reported as a "reportable condition" that the Consortium's procurement procedures do not fully conform to applicable Federal law and regulations and standards identified in OMB Circular A-110.

## **Noncompliance With Reporting Requirements**

We identified several areas where the Consortium either did not comply with the regulations or did not comply with the administrative terms of the Agreements in relation to reporting. The Consortium did not: (1) submit a timely final financial status report, (2) comply with some of the administrative conditions contained in the Agreements, and (3) submit complete quarterly reports.

For Agreement No. X828299-01, the Consortium did not submit a final financial status report within 90 days of project completion as required by 40 CFR 30.52. The Consortium submitted the final report on January 30, 2002, which was 120 days after the end of the cooperative agreement's budget period, or 30 days late.

Also, for Agreement No. X828299-01, the Consortium did not:

- Produce an annual report including a full description of work and expenditures to date as required by the Agreement's administrative condition number 4.
- Submit an annual business plan as required by the Agreement's administrative condition number 14.
- Provide EPA with information regarding energy performance and concurrent energy reduction in terms of "million metric tons of carbon equivalent" in 10 to 30 buildings as required by the Agreement's administrative condition number 15.

For Agreement No. X828802-01, the Consortium did not comply with the Agreement's administrative condition number 4 and include a discussion of expenditures to date in the quarterly reports.

As a result of the Consortium's noncompliance with reporting requirements, EPA did not have sufficient information to make an informed assessment of the Consortium's progress in meeting the objectives of the agreements or determine whether the unexpended funds were adequate to complete all work.

### ***Consortium's Response***

The Consortium has complied with most of the reporting requirements. Based on its quarterly and final report submitted under both Assistance Agreements, the Consortium believes that it has provided sufficient information on the Consortium's progress in meeting the objectives of the Agreements. For Agreement No. X828299-01, the Consortium regrets not filing an annual report and not filing the final financial status report within 90 days of project completion. For Agreement No. X828802-01, the Consortium regrets not adding a discussion of expenditures to its quarterly reports. The Consortium has since implemented monthly compliance reports that require the Consortium's Project Manager to go through a checklist of all reporting and administrative conditions of the Agreements.

Also, under EPA Agreement No. X828299-01, the Consortium was unable to comply with administrative condition number 15 and document emission reductions for 10-30 buildings. The Consortium informed EPA that it did not have the funds to perform such an activity which required professional engineering effort and expense not included in the original Scope of Work approved by EPA.

### ***Auditor's Reply***

The Consortium agreed that it did not comply with all the reporting requirements as contained in the regulations and the administrative terms of the Assistance Agreements. The Consortium's noncompliance with the reporting requirements prohibited EPA from completing timely evaluation of the Consortium's progress under both Assistance Agreements.

The new monthly compliance reports, if updated to reflect the terms and conditions of each new award, and completed on a timely basis, should assist the Consortium in avoiding future reporting noncompliance.

Since EPA did not remove administrative condition number 15 from the Agreement, the recipient was still obligated to comply.



## Recommendations

We recommend that EPA:

1. Evaluate the need and scope of the Assistance Agreements considering that there were other sources of income to support the activities; i.e., membership dues and agreements with other Federal agencies. If EPA determines that there was not a need for the assistance, take action to annul the Assistance Agreement(s).

If EPA decides not to annul the Agreements, we recommend that EPA:

2. Recover the \$1,153,472 of unsupported costs.
3. Suspend work under the current Agreements and make no new awards until the Consortium can demonstrate that its accounting practices are consistent with 40 CFR 30.21. At a minimum, the Consortium's system must:
  - a. Ensure that financial results are current, accurate, and complete.
  - b. Include written procedures to determine reasonableness, allocability, and allowability of costs in accordance with OMB Circular A-122.
  - c. Include accounting records that are supported by adequate source documentation.
  - d. Require the Consortium to establish an adequate time distribution system that meets the requirements of OMB Circular A-122, Attachment B, paragraph (7). The system should account for total hours worked and leave taken, and identify all the specific activities and final cost objectives that the employees work on during the pay period, including membership and lobbying activities.
  - e. Require the Consortium to follow all procurement standards under 40 CFR 30.40 through 30.48.
4. Require the Consortium to submit an indirect cost rate proposal prepared in accordance with OMB Circular A-122.
5. Require the Consortium to provide detailed documentation supporting its use of program income to fund additional activities furthering eligible project or program objectives under Assistance Agreement X828802-01. If the Consortium cannot provide documentation, program income should be deducted from any costs EPA determines to be allowable under the Assistance Agreement.

If EPA determines that some costs are allowable, we recommend that EPA:

6. Deduct from allowable costs any program income earned by the membership activities funded under Assistance Agreement X828299-01.
7. Consider using program income from Agreement No. X828802-01 to fund the study which was never completed under Agreement No. X828299-01 per administrative condition number 15.

## ***Scope and Methodology***

EPA discovered a weaknesses in the Consortium's financial management system during an on-site review. Consequently, EPA requested the OIG to conduct an audit of the Consortium. 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 Audit Process Handbook dated November 5, 2002.

We conducted this examination to express an opinion on the total costs claimed under the EPA Agreements, and determine whether the Consortium was managing its EPA Assistance Agreements in accordance with applicable requirements. To meet these objectives, we asked the following questions:

- Is the Consortium's accounting system adequate to account for Assistance Agreement funds in accordance with 40 CFR 30.21?
- Does the Consortium maintain an adequate labor distribution system that conforms to requirements of OMB Circular A-122?
- Is the Consortium properly drawing down assistance agreement funds in accordance with the Cash Management Improvement Act?
- Are the Consortium's procurement procedures for contractual services in compliance with 40 CFR 30.40 to 30.48?
- Is the Consortium complying with its reporting requirements under 40 CFR 30.51 and 30.52 and the administrative conditions of the Agreements?
- Are the costs claimed/incurred under the Agreements adequately supported and eligible for reimbursement under the terms and conditions of the Agreements, OMB Circular A-122, and applicable regulations?
- Is the Consortium properly accounting for any program income related to projects financed with Federal funds in accordance with 40 CFR 30.24?

In conducting our examination, we reviewed the project files and obtained the necessary Assistance Agreement information for our examination. We interviewed the grants specialist to determine whether any concerns needed to be addressed during our examination. We also interviewed the Consortium personnel to obtain an understanding of the accounting system and the applicable internal controls as they relate to the claimed costs. We obtained and reviewed the

single audit reports of the Consortium to determine whether there were any reportable conditions and recommendations addressed in those reports.

We reviewed management's internal controls and procedures specifically related to our objectives. Our examination included reviewing the Consortium's compliance with OMB Circular A-122, 40 CFR Part 30, and the terms and conditions of the Assistance Agreements. We also examined the claimed costs on a test basis to determine whether the costs were adequately supported and eligible for reimbursement under the terms and conditions of the Assistance Agreements, OMB Circular A-122, and applicable regulations. We conducted our field work from December 16, 2002, to April 1, 2003.

## Consortium's Summary Response<sup>3</sup>

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August 27, 2003

Mr. Michael A. Rickey  
Director, Assistance Agreement Audits  
Office of Inspector General  
U.S. Environmental Protection Agency  
Washington, D.C. 20460

RE: Draft Audit Report of Costs Claimed by the Geothermal Heat Pump Consortium  
EPA Assistance Agreement Nos. X828299-01 and X828802-01

Dear Mr. Rickey:

We have been retained by Geothermal Heat Pump Consortium, Inc. (the "Consortium") to assist the Consortium in responding to the above-mentioned draft audit report. We appreciate the opportunity to explain the facts with regard to the Consortium's financial management system and procurement system. As our response will prove, the Consortium's financial management system and procurement system are adequate in light of the Consortium's role as a non-profit grantee whose sole mission is to advance the use and improvement of electric geothermal heat pump technology. This letter sets forth a summary of the Consortium's response.

EPA granted Assistance Agreement Nos. X828299-01 and X828802-01 to the Consortium in accordance with 31 U.S.C. § 6304(1) "to carry out a public purpose." As a recipient of such Assistance Agreements, the Consortium agreed to abide by Office of Management and Budget ("OMB") Circular No. A-122 regarding Cost Principles for Non-Profit Organizations ("OMB Circular No. A-122"), EPA's own regulations set forth at 40 C.F.R. Part 30 and the terms and conditions set forth in the Assistance Agreements themselves. To a great

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<sup>3</sup>In response to the draft report, the Consortium submitted a summary and a detailed response and included two volumes of attachments. Due to the length of the detailed response and attachments, we have elected to only include the summary response in the report. A copy of the complete response with attachments has been provided to the action official. We will make the detailed response and attachments available upon request.

extent, the Consortium's financial management system and procurement system complied with these rules. Where the Consortium did not comply with a certain requirement, it has taken immediate remedial measures to address the problem.

First, the Consortium's financial management system properly accounted for membership expenses. According to OMB Circular A-122 Attachment A, Paragraph B(4), "The costs of activities performed primarily as a service to members, clients or the general public when significant and necessary to the organization's mission must be treated as direct costs whether or not allowable and be allocated an equitable share of indirect costs." The Consortium did not identify and accumulate costs for "membership activities" per se because the Consortium did not perform any services or provide any benefits for members that were different from the services and benefits it provided to the general public. Even though organizations have made contributions to the Consortium and were called "members," these contributions were not made for the purpose of gaining access to any special services or private benefits but rather to support the Consortium's public mission. For example, the organizations which chose to become a part of the multi-year National Earth Comfort Program collaboration were identified as "members" of the national effort to increase the awareness of renewable energy technology, but did not receive increased services or benefits in exchange for those contributions. The Consortium is unique in this way; it does not provide its so-called members with anything different from what it provides to the general public.

The Consortium's financial management system also properly accounted for lobbying expenses. According to OMB Circular A-122, Attachment B, Paragraph 25 (c)(4), "Time logs, calendars or similar records shall not be required to be created for any month when (1) the employee engages in lobbying 25 percent or less of the employee compensated hours of employment during that calendar month and (2) within the preceding five-year period, the organization has not materially misstated allowable or allocable costs of any nature, including legislative lobbying costs." Since the Consortium personnel did not spend more than 31 hours on lobbying activities during the entire duration of the two Assistance Agreements cited in the draft audit report, the Consortium was not required to create time logs, calendars or records for this minimal amount of lobbying activity. In fact, the Consortium hired an independent contractor to perform lobbying services. The Consortium's own 31 hours of lobbying activities were primarily for the purpose of managing administering of the lobbying contract. Furthermore, the Consortium's actual overhead rate/indirect cost rate as documented in the Consortium's internal income statement (90% -125%) was at least three times higher than the indirect cost rate reimbursed by the two Assistance Agreements cited in this draft audit report (30%). Thus, the Consortium did not use any federal funds for lobbying activities.

Second, the Consortium has not earned "program income" generated by the activities funded by the two Assistance Agreements. According to EPA regulations, "program income" means gross income earned by the recipient that is directly generated by a supported activity or earned as a result of the award. 40 C.F.R. § 30.2(x). Under this definition, the Consortium has not earned "program income" since contributions to the Consortium were made solely to further the overall objectives of the organization and were not generated by any specific activities funded by the grants. If, for example, these grants had been for the specific purpose of publishing reports on geothermal heat pumps and the Consortium earned income from the sales of those particular

reports, that revenue would properly be defined as "program income." In this case, contributions were made in generalized support of the Consortium. Such income is not properly classified as "program income." Furthermore, the May 3, 2002 no cost amendment to Assistance Agreement No. X828802-01 allowed program income to be added to funds committed to the project by EPA and used to further eligible project or program objectives. This Amendment allowed the Consortium to commit these funds to the Consortium's mission without having to deduct these funds from the allowable costs claimed under Assistance Agreement No. X828802-01 to determine the net allowable federal share of costs.

Furthermore, the contributions made to the Consortium from organizations which had already become members before May 15, 2000 or which joined the Consortium after September 30, 2002 would not be considered program income since those contributions came from organizations which had become members and made contributions either prior to or after the completion of the two Assistance Agreements at issue in this audit. As OMB Circular A-110 (24)(e) makes clear, "Unless Federal awarding agency regulations or the terms and conditions of the award provide otherwise, recipients shall have no obligation to the Federal Government regarding program income earned after the end of the project period." Since neither EPA's August 27, 2003 regulations nor the conditions of these two Assistance Agreements contradict the rule set forth in OMB Circular A-110, this rule applies to the facts in this case. Here, \$772,717.43 of the \$774,971.33 collected in 2000 (99.71%), \$652,867.30 of the \$679,691.0000 collected in 2001 (96.05%), and \$389,417.30 of the \$468,684.00 collected in 2002 (83.09%) were contributions from organizations which had been supportive to the Consortium prior to or after completion of the grants. Thus, even if EPA continues to misinterpret program income as it relates to the Consortium's mission, a majority of the Consortium's funds cannot possibly be considered "program income."

Third, the Consortium has prepared and negotiated indirect cost rates and submitted such rates to EPA. According to OMB Circular A-122, Attachment A (E)(2)(emphasis added):

Negotiation and approval of rates.

- a. Unless different arrangements are agreed to by the agencies concerned, the Federal Agency with the largest dollar value of awards with an organization will be designated as the cognizant agency for the negotiation and approval of the indirect cost rates and, where necessary, other rates such as fringe benefit and computer charge-out rates. Once an agency is assigned cognizance for a particular non-profit organization, the assignment will not be changed unless there is a major long-term shift in the dollar volume of the Federal awards to the organization. All concerned Federal agencies shall be given the opportunity to participate in the negotiation process, but, after a rate has been agreed upon, **it will be accepted by all Federal agencies.**

From its inception through its fiscal year 2002, the Consortium's cognizant agency for purposes of negotiating its indirect rates was the Department of Energy ("DOE") and not the EPA since most of the Consortium's funding had been provided by DOE. Thus, the Consortium was not obligated to provide EPA with an indirect cost rate proposal. The Consortium did provide EPA with the basis of its proposed rates in each Assistance Agreement, which was accepted and

used as a basis for determining the funding for the Consortium's program. Beginning in January of 2003 when the Consortium received EPA Assistance Agreement XA-83055901, the EPA became the Federal agency that provided the Consortium with the largest dollar value of awards. Therefore, the Consortium submitted an Indirect Cost Rate Proposal for review and approval to the EPA in 2003.

Fourth, the Consortium possesses written procedures for allocating of costs to final cost objectives. Title 40 C.F.R. § 30.21(b)(6) states:

- (b) Recipients' financial management systems shall provide for the following:
  - (6) Written procedures for determining the reasonableness, allocability and allowability of costs in accordance with the provisions of the applicable Federal cost principles and the terms and conditions of the award.

The Consortium has internal controls in place to assist the accounting office with proper document flow, approvals, and requirements. The Consortium requires, for example, that before an expense is logged in, a payment authorization form be completed. This form identifies the account number that the expense is charged to and requires verification by the program manager, accounting office and final approval by the Executive Director. This system is supplemented by OMB Circular A-122, Attachment A which is on file in the Consortium's Accounting office. The Consortium also had written procurement policies and procedures in the GHPC Employee Manual, a copy of which each employee receives on the first day of employment at the Consortium. The employee manual outlines many procedures and contains OMB Circular A-122, procurement policies, and administrative policies. The Consortium's own internal controls as supplemented by OMB Circular A-122 served as the written procedures for determining the reasonableness, allocability and allowability of costs in accordance with the provisions of the applicable Federal cost principles and the terms and conditions of the award. The Consortium continues to improve and update its written procedures.

Fifth, the Consortium maintained an adequate labor distribution system to assure the proper recording of labor costs to cost objectives. The Consortium charged either actual or lower than actual labor rates to the Assistance Agreements. GHPC entered employee timesheet information into a spreadsheet containing monthly salary information. GHPC then entered the number of hours worked for each employee and calculated the percentage of time worked by each employee on each project (cost objective). The labor cost was charged to each cost objective based on the percentage of hours worked by each employee during that particular month -thereby ensuring that the distribution of labor was based on actual work performed by the employee as required by OMB Circular A-122, Attachment B (7).

Due to changes in salary rates during the calendar year, and a clerical error in November and December of 2000, there were under-applied labor costs to the projects. For 2000, the Consortium charged \$24,570.23 to the EPA. The actual labor allocated to EPA should have been \$28,937.40 for a difference of \$4,367.17. For 2001, the Consortium charged \$105,056.22 to the EPA. The actual labor allocated to EPA should have been \$119,869.74 for a difference of \$14,813.52. For 2002, the Consortium charged \$178,724.74 to the EPA. The actual labor allocated to EPA should have been \$187,991.73 for a difference of \$9,266.99. In all, the

Consortium undercharged the EPA Assistance Agreements \$28,447.68.

Sixth, the Consortium provided adequate support for direct cost allocations. This activity, operation of the Geoexchange Information Center, was an activity under a grant from the DOE, before the EPA Assistance Agreement came into effect. Since the DOE and EPA Scopes of Work for this activity were identical and overlapped, a portion of three invoices (totaling \$7,884.28) for the Geoexchange Information Center activities were reclassified from the DOE grant to the EPA Agreement. Once the DOE grant ended, this activity, which was included in the EPA Scope of Work, was then fully funded under Agreement No. X828299-01. The reclassified amount of \$7,884.28 represents the Consortium's best estimate of the EPA share of the operation of the Geoexchange Information Center for the overlapping period.

The Consortium also has sufficient detail to support claiming consulting costs of \$46,063 under EPA Assistance Agreement X828802-01. The Consortium contracted with a consultant to assist with activities under Task 2, Indirect Public and Consumer Information Dissemination. In summary, those activities included attendance at trade shows and conferences and conducting technology transfer presentations to various audiences. Specifically this consultant attended seven of the thirteen trade shows for the Consortium. This consultant conducted forty-seven of the seventy-four presentations for the Consortium. Each report submitted by the consultant -- whether an expense or activity report -- clearly designated that it was an activity performed pursuant to EPA Assistance Agreement X828802-01. The Consultant had written the acronym "EPA" at the top of each activity report and in the "Comments" section of each expense report provided to the Consortium's Project Manager (a.k.a. Communications and August 27, 2003 Government Affairs Director). Each activity report included the following information: Title and subject of presentation, sponsor of presentation, date of presentation, number of hours spent on activity, number of attendees, description of attendees; description of hand-out materials, expected results of presentation, and other relevant information, such as follow-up activities. The level of effort (number of hours) spent on the activities, as designated by the activity reports, was charged to the EPA Agreement at the consultant's hourly rate.

Seventh, the Consortium did competitively procure contractual services in accordance with 40 C.F.R. § 30.43 and adequately justify contractual services in accordance with 40 C.F.R. § 30.46. OMB's choice of the term "to the maximum extent practical" in the drafting of Circular A-110 proves that OMB understood that not each and every single procurement could or would be competitively bid. Rather, OMB Circular A-110 required recipients of federal funds to have a procurement system in place to ensure maximum competition. The Consortium maintains an acceptable procurement system which promotes competition to the maximum extent practical; taking into account dollar thresholds, past performance, follow-on effort, customer needs, and availability of products and services from other sources. Furthermore, the Consortium provided information on its procurement activities in each of the Scopes of Work for the two assistance Agreements that were submitted to the EPA. The Consortium believes that it was in compliance with the competition requirement in 40 CFR § 30.43 based on the EPA approval of its Scopes of Work which outlined the basis for contractor selection.

Eighth, the Consortium complied with most of the reporting requirements. The Consortium regrets not filing the final financial status report for Assistance Agreement No.

X828299-01 within 90 days of project completion. This was an oversight within the accounting office. The Consortium has since implemented monthly compliance reports that require the Consortium's Project Manager to go through a checklist of all reporting and administrative conditions to make certain that it is in full compliance with all reporting and administrative conditions of the Agreement.

The Consortium also erred in not filing an annual report for Assistance Agreement X828299-01. The Consortium inadvertently missed this condition, which became effective upon EPA's approval of a six-month extension of the Agreement. That extension caused the budget/project period to exceed one year. The Consortium has since implemented monthly compliance reports that require the Consortium's Project Manager to go through a checklist of all reporting and administrative conditions to make certain that it is in full compliance with all reporting and administrative conditions of the Agreement.

During implementation of Agreement No. X828299-01, the Consortium discussed administrative condition number 15 with the EPA Program Manager. The Consortium initially inquired about how to document such emissions reductions. The Program Manager explained that a current EPA program that was documenting building energy performance was underway but required the services of a professional engineer for proper documentation. The scenario provided noted that the engineer would need to obtain energy use data, heating and cooling load data and square footage of a particular building, monitor that building for a time period and then incorporate the data into an EPA software program to obtain emissions results. The Consortium's manager of this Agreement recalls that buildings which achieved a certain level of emissions reductions would receive a certain designation from the EPA. The EPA Program Manager told the Consortium that because the exercise required the services of a professional engineer to document the data, monitoring one building would cost approximately \$5,000. The Consortium told the EPA Program Manager that this was not in the original Scope of Work approved by EPA and, therefore, could not be conducted under the Agreement. The Consortium asked if EPA provided the funds for the engineering services and was told that it did not. The consortium responded that it would be unable to document 10-30 buildings because it did not have the funds to perform such an activity, estimated at \$150,000. This is the reason that the Consortium was unable to provide this information. The Consortium did provide the audit team with the information based on a survey of actual building installation data conducted by D&R International for the Consortium in March 2000.

The Consortium erred in not adding a discussion of expenditures to its quarterly reports for Assistance Agreement No. X828802-01 and regrets this oversight. The Consortium has since implemented monthly compliance reports that require the Consortium's Project Manager to go through a checklist of all reporting and administrative conditions to make certain that it is in full compliance with all reporting and administrative conditions of the Agreement. The EPA Program Manager did follow up upon receipt of the quarterly reports noting their timeliness and completeness. The Consortium was not informed that the reports were missing information. Based on its quarterly and final report submitted to the EPA Program Manager under both Assistance Agreements, the Consortium believes that it has provided sufficient information on the Consortium's progress in meeting the objectives of the Agreements.

In conclusion, the facts prove that the Consortium's financial management system and procurement system are adequate in light of the Consortium's role as a non-profit grantee whose sole mission is to advance the use and improvement of electric geothermal heat pump technology. Thus, the Consortium very strongly believes that all \$1,153,472 of costs should be allowed under the two Agreements. We invite the EPA to call us to discuss any of the issues mentioned in the draft audit report. We look forward to resolving this matter in an expeditious fashion.

Respectfully submitted,

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Attorney for the Consortium

#### Attachments

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