



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

Office of the Regional Administrator

October 26, 2016

MEMORANDUM

SUBJECT: EPA OIG Audit - Labor Charging Practices at the New Mexico Environment Department
Audit Report No. 13-4-0296 ("Audit Report")

FROM: Samuel Coleman
Deputy Regional Administrator

TO: John Trefry
Director, Forensic Audits
Office of Inspector General

Thank you for the opportunity to respond to the findings and recommendations in the subject audit report. Following is a summary of Region 6's overall position, along with our position on each of the report recommendations. EPA understood and agrees with the Inspector General's findings that three of the four NMED bureaus audited did not always comply with the federal requirements specified in 2 CFR Part 225. EPA's management decision on the five recommendations follow.

OIG Recommendations #1, #2, #3, and #4

NMED Bureaus: Air Quality Bureau and Drinking Water Bureau

Grant Numbers: AQB, PM96666701-4, and DWB, F00620311-4 and F00620309-3

Topic: Labor-charging Practices did not comply with Federal Requirements

Criteria: Title 2 CFR Part 225, Appendix B, Section 8.h. (5)

Condition Found: Air Quality Bureau and Drinking Water Bureau charged labor, fringe benefits, and indirect costs to federal awards based upon budget allocation instead of actual activities performed for three of the 13 grants sampled by the OIG from the four NMED bureaus that were audited. The noncompliance applied to one Air Quality Bureau and two Drinking Water Bureau grants. The remaining nine grants were in compliance and no costs were questioned.

Underlying Cause: NMED personnel stated that they charged based upon budget estimates because they thought it was an acceptable method.

Effect: Two of the four NMED bureaus audited by the EPA OIG did not comply with federal requirements for charging labor costs.

Recommendation #1: EPA Region 6 disallow and recover unsupported labor costs of \$298,159 from the Air Quality Bureau and \$2,974,318 from the Drinking Water Bureau, unless NMED can provide support that complies with 2 CFR Part 225, Appendix B, Section 8.h.

Recommendation #2: EPA Region 6 ensure that NMED does not claim unsupported costs of \$486,305 for the period October 1, 2011, to April 13, 2012, for grant F00620311, unless NMED can provide support that complies with 2 CFR Part 225, Appendix B, Section 8.h.

NMED's Response: Signed certifications were provided to EPA for DWB employees who worked 100 percent on a single EPA grant for state fiscal years 2010, 2011, and 2012.

EPA's Final Determination on Recommendations 1 and 2: EPA allowed the \$3,312,112 the OIG questioned.

From our layered approach to acquire complete support for the labor cost, NMED provided signed certifications for two DWB employees who worked 100 percent on a single EPA grant. These certifications documented labor cost totaling \$197,215. The certifications materially comply with 2 CFR Part 225, Appendix B, Item 8.h. (3) because they were signed either by the NMED employee or a supervisor with first-hand knowledge of the employee's work. On this basis, EPA allowed the \$197,215 in questioned labor costs.

EPA has granted NMED an exception to the Personnel Activity Report or equivalent documentation requirement and the standards for using budget estimate at 2 CFR Appendix B, Item 8 h. (5) to allow \$298,159 from the Air Quality Bureau and \$2,777,103 and \$486,305 from the Drinking Water Bureau in questioned personnel compensation costs for NMED employees who worked on EPA grants and other activities.

EPA worked with NMED and identified quantifiable measures of employee effort related to the AQB, PM96666701-4, and DWB, F00620311-4 and F00620309-3 based on employee contributions towards achieving specific outputs described in NMED's contemporaneous performance reports. The information NMED provided was sufficient to determine the amount of personnel compensation NMED charged to the EPA grants was adequately correlated to program outcomes to conclude the costs were reasonable and allocable based on budget estimates despite the absence of PARs or periodic adjustments to the budget estimates.

The purpose of the PAR requirement is to ensure that recipients properly allocate personnel compensation costs to grants and other activities of the entity in order to ensure that grant funds are used solely for authorized purposes. The risk of a state environmental agency such as NMED improperly using grant funds is low given the information EPA has regarding the State's internal control systems and own audit procedures. While the OIG properly found that NMED did not comply with regulatory requirements for documenting personnel compensation charges to EPA grants, neither the Audit report nor EPA's review of NMED records identified instances of improper uses of grant funds.

Although NMED's Air Quality and Drinking Water Bureaus practices of using budget estimates to allocate personnel compensation without periodic adjustments for the period April 2008 through April

2012 did not comply with regulatory standards, the information available to EPA regarding NMED's performance 2008 through 2015, and compensation based on actual hours worked after April 2012 indicates that the budget estimates were sufficiently reliable to warrant allowing the costs through regulatory exceptions. A spreadsheet with methodology for each of the two bureaus is attached that compares the budgeted to the subsequent actual personnel compensation costs, and supports the costs are reasonable.

NMED effectively performed the grants covered by the Audit Reports. The quantifiable outputs NMED produced were in line with the EPA approved work plans and Region 6's evaluations of NMED's performance were consistently positive. The Region 6 Program Managers have end-of-year documented reports that reflect the workplan deliverables were received, reviewed by qualified staff, and accepted by the Agency. Each Program has end-of-year reports from NMED and final annual EPA Program Review reports that document outputs and positive accomplishments.

Recommendation #3: EPA Region 6 identify and recover any unsupported personnel costs from AQB and DWB administered grants, which are not covered in the OIG cost-impact determination.

NMED's Response: NMED staff provided all requested documents during the EPA site visit in October 2014.

EPA Final Determination on Recommendation # 3: EPA did not identify any unsupported personnel costs from AQB and DWB administered grants that were not covered by the Audit Report.

The OIG clarified that Region 6 should include in its review all open and closed grants that are within the record-retention period established under 40 CFR 31.42. Subsection (c) requires records to be retained for 3 years from the date of the final expenditure report. Region 6, in consultation with the OGD, reviewed a sample of open and closed grants within the record retention period during a site visit October 6 – 9, 2014. EPA confirmed that NMED was recording actual labor hours worked on EPA grants. EPA also confirmed NMED staff were following the new Federal Time & Labor Reporting Policy. If the interviewees labor charging practices are representative of all NMED personnel who carry out EPA financial assistance agreements, NMED is in compliance with the time distribution requirements of 2 CFR Part 225, Appendix B, Item 8h. (3), (4) and (5).

A sample of NMED staff were interviewed during the site review to verify employees are recording actual hours. The interview findings were consistent with the overall results of the transaction testing of PARs and other financial records supporting NMED labor charges on our sample drawdowns. The financial reviews confirm that, if the transactions reviewed are representative of all payroll labor charging, NMED labor charges are charged based on actuals and comply with the federal requirements of 2 CFR part 225.

Recommendation #4: EPA Region 6 ensure that labor-charging practices at any of the remaining nine NMED bureaus that have EPA grants comply with federal requirements.

NMED's Response: NMED revised and implemented a new Time and Reporting Policy which was effective September 2013.

EPA Final Determination on Recommendation # 4: Region 6 advised the OIG of the following accomplishments.

- Unique term and condition in grant awards to NMED Bureaus that were not covered by the OIG's audit;
- NMED's new Time and Reporting Policy which was effective September 2013;
- Region 6's new Review Protocol that will enable Project Officers to further assess grantees financial management systems; and
- Region 6 and OGD conducted a site visit which included review of labor documents for a sample of grants and interview of NMED employee of labor charging practices.

NMED revised its policies and procedures for allocating personnel compensation charges to Federal grants in response to the OIG Audit. As the OIG recommended, EPA conducted an on-site review of NMED's records and practices to verify compliance with regulatory requirements. That review, which included interviews with NMED personnel, indicated that NMED was in compliance. The OIG accepted the Corrective Actions and identified Recommendation Number 4 as complete.

Condition Found: NMED was unable to provide the required personnel activity reports to support costs claimed by the Surface Water Quality Bureau for the period July 1, 2004 to June 30, 2006. SWQB employees maintained timesheets to accumulate actual hours and the timesheets were the basis for recording labor charges in the timekeeping system. The employees in the OIG sample were asked about their timekeeping practices for July 1, 2004 to June 30, 2005. Employees confirmed their use of timesheets to record actual labor hours.

NMED Bureaus: Surface Water Quality Bureau

Grant Number: C99961012-5

Criteria: Title 2 CFR Part 225, Appendix A and Appendix B

Underlying Cause: NMED used a different timekeeping system prior to July 1, 2006. The hard-copy timesheets have been destroyed and the bureau could not access the prior accounting system to obtain copies of the electronic timesheets.

Effect: SWQB was unable to provide the required personnel activity reports to support costs claimed.

Recommendation #5: EPA Region 6 disallow and recover unsupported SWQB labor costs of \$2,733,798 claimed under grant number C999610112, unless NMED can provide support that complies with federal requirements.

NMED's Response: NMED provided EPA Region 6 signed certifications for eleven SWQB employees who worked 100 percent on a single EPA grant for state fiscal years 2005 and 2006. Signed certification could not be provided for ten employees who have left NMED. For July 1, 2004 to June 30, 2006, NMED provided signed Time Tracking Worksheets for the Ground Water Bureau employees who

worked on this Clean Water Act 319 grant. To document labor cost from July 1, 2004 to June 30, 2005 for SWQB employees, NMED provided EPA Labor Distribution Report. To document labor costs from July 1, 2005 to June 30, 2006 for SWQB employees, NMED provided recovered electronic timesheet details from the old payroll system that included the approver's name. This documentation was not available to the OIG.

EPA Final Determination on Recommendation #5: EPA has allowed \$2,572,683 and disallowed \$161,115.

From our layered approach to acquire complete support for the labor cost, EPA received signed certifications for eleven SWQB employees who worked 100 percent on a single EPA grant for labor cost totaling \$1,006,272 for state fiscal years 2005 and 2006 which materially comply with 2 CFR Part 225, Appendix B, Item 8.h.(3). These certifications were signed by SWQB employees or supervisory personnel with first-hand knowledge of the employee's work. On this basis, EPA allowed the \$1,006,272 in questioned labor costs.

EPA has made exceptions to the requirement at 2 CFR Part 225, Appendix B, Item 8(h)(3) for the ten employees where neither the employee nor their supervisor are still at NMED to certify that the employee worked 100 percent of the time on a single EPA grant. EPA will allow \$469,231 in personnel costs on this basis. Given that it is not possible for NMED to obtain the requisite certifications, a regulatory exception to 40 CFR 31.22 to waive the requirement at 2 CFR Part 225, Appendix B, Item 8 h.(3) for signed certifications is appropriate under the circumstances.

For GWB employees whose time was split between EPA grants and other work, Time Tracking Worksheets were provided to support \$174,419 in questioned personnel costs. EPA has determined that these Timesheets are equivalent to the personnel activity reports required by 2 CFR Part 225, Appendix B, Item 8.h.(4) and (5) because they were signed by the employee and their supervisor. The labor cost for 2005 and 2006 totaled \$174,419 is allowed by EPA on this basis.

Two instances of regulatory noncompliance did not materially impact the reliability of the process NMED used to determine personnel compensation charges for EPA grants. In the case of CWA 319 grants, NMED provided electronic timesheets for state fiscal year 2006 recovered from a prior timekeeping system for employees who worked on a specific CWA 319 grant as well as other activities. The hours charged to the grant appear to be actual hours worked rather than program budgets because the hours charged to the CWA 319 grant varied by day for the pay periods reviewed. These time cards were approved by supervisors. This practice did not yield signed PARs as required by 2 CFR Part 225, Appendix B, Item 8 h. (5) (d) but the reliability of the hours worked on EPA grants does not appear to be compromised. The labor cost for 2006 totaled \$739,499 is reasonably supported and EPA has made an exception to the requirement at 2 CFR Part 225, Appendix B, Item 8(h) (5) (d) for employee signatures.

For state fiscal year 2005, the employee's timesheets were no longer available, but NMED could provide Labor Distribution Reports which reflected a variance of hours charged between pay periods. In the audit report the OIG indicated, "Although SWQB employees maintained timesheets to accumulate

actual hours and the timesheets were the basis for recording labor charges in the timekeeping system, the timesheets are no longer available. Employees interviewed by the OIG confirmed their use of timesheets to record actual labor hours.” The labor cost for 2005 totaled \$183,261. EPA has made an exception to 40 CFR 31.22 to waive the requirement at 2 CFR Part 225, Appendix B, Item 8 h. (5) for signed personnel activity reports or equivalent documentation to allow these costs.

EPA disallowed \$161,115 for labor charges not supported by the source document which materially complied with 2 CFR Part 225, Appendix B, Item 8.h. or was sufficiently reliable to merit a regulatory exception.¹ Disallowance on these grounds is costs authorized by 40 CFR 31.43(a)(2). The disallowed cost is for the 319 grant. The NMED provided documentation to support labor charges from the Payroll system. The OIG questioned costs from the General Ledger. NMED provided a pivot table that showed the General Ledger labor charges were \$92,578 high than Payroll. NMED could not explain this discrepancy; therefore this amount is disallowed.

The Payroll system cost exceeded hours charged on the timesheets totaling \$68,537. The timesheets are the source document to support actual hours charged to the 319 grant. For fiscal year 2006 SWQB employees adjustments of \$68,128 are disallowed because the labor charges are not supported by the electronic timesheets. Hours charged on the timesheets were different from payroll for 16 of 25 employees reducing the amount by \$2,498, and the timesheets did not include Labor Distribution code 540020 for four employees reducing payroll by \$64,961. For one GWB employees, the hours on the timesheet were less reducing payroll by \$409.

If you have any questions regarding this response, please contact Susan Jenkins, Audit Follow-up Coordinator at (214) 665-6578.

cc: Ms. Lela Wong, Office of Inspector General

¹ As provided at 2 CFR 1500.12(c)(1) decisions not to grant regulatory exceptions are not subject to review under EPA’s assistance agreement dispute procedures.