S. HRG. 108–366

GRANTS MANAGEMENT AT THE ENVIRONMENTAL PROTECTION AGENCY

HEARING

BEFORE THE

COMMITTEE ON ENVIRONMENT AND PUBLIC WORKS UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

SECOND SESSION

MARCH 3, 2004

Printed for the use of the Committee on Environment and Public Works

U.S. GOVERNMENT PRINTING OFFICE

92–394 PDF WASHINGTON : 2005

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

COMMITTEE ON ENVIRONMENT AND PUBLIC WORKS

ONE HUNDRED EIGHTH CONGRESS
SECOND SESSION

JAMES M. INHOFE, Oklahoma, *Chairman*

JOHN W. WARNER, Virginia
CHRISTOPHER S. BOND, Missouri
GEORGE V. VOINOVICH, Ohio
MICHAEL D. CRAPO, Idaho
LINCOLN CHAFEE, Rhode Island
JOHN CORNYN, Texas
LISA MURKOWSKI, Alaska
CRAIG THOMAS, Wyoming
WAYNE ALLARD, Colorado

JAMES M. JEFFORDS, Vermont
MAX BAUCUS, Montana
HARRY REID, Nevada
BOB GRAHAM, Florida
JOSEPH I. LIEBERMAN, Connecticut
BARBARA BOXER, California
RON WYDEN, Oregon
THOMAS R. CARPER, Delaware
HILLARY RODHAM CLINTON, New York

ANDREW WHEELER, *Majority Staff Director*
KEN CONNOLLY, *Minority Staff Director*

C O N T E N T S

Page

MARCH 3, 2004

OPENING STATEMENTS

Crapo, Hon. Michael D., U.S. Senator from the State of Idaho, prepared statement 26
Inhofe, Hon. James M., U.S. Senator from the State of Oklahoma 1
Jeffords, Hon. James M., U.S. Senator from the State of Vermont 3

WITNESSES

Ellis, Steve, vice president for programs, Taxpayers for Common Sense 10
Prepared statement 66
Heist, Melissa, Assistant Inspector General for Audit, Environmental Protection Agency 5
Prepared statement 27
Responses by Inspector General Nikki Tinsley to additional questions from Senator Inhofe 32
O'Connor, David, Acting Assistant Administrator for the Office of Administration and Resources Management, Environmental Protection Agency 8
Prepared statement 51
Responses to additional questions from:
Senator Crapo 65
Senator Inhofe 56
Senator Jeffords 64
Stephenson, John B., Director, Natural Resources and Environment, General Accounting Office 6
Prepared statement 33–50

ADDITIONAL MATERIAL

Audit Report, March 1, 2004, Consumer Federation of America Foundation-Costs Claimed Under EPA Cooperative Agreements CX825612–01, CX825837–01, X828814–01, CX824939–01, and X829178–01, Office of the Inspector General, Environmental Protection Agency 69–153
Chart, Percentage of Key Pre-Award Steps Not Completed 31
Letters from Consumer Federation of America 17–18

GRANTS MANAGEMENT AT THE ENVIRONMENTAL PROTECTION AGENCY

WEDNESDAY, MARCH 3, 2004

U.S. SENATE,
COMMITTEE ON ENVIRONMENT AND PUBLIC WORKS,
Washington, DC.

The committee met, pursuant to notice, at 9:30 a.m., in room 406, Senate Dirksen Building, Hon. James M. Inhofe (chairman of the committee) presiding.

Present: Senators Inhofe and Jeffords.

OPENING STATEMENT OF HON. JAMES M. INHOFE, U.S. SENATOR FROM THE STATE OF OKLAHOMA

Senator INHOFE. The hearing will come to order.

I want to thank our witnesses for their testimony. The committee will receive testimony this morning regarding the grants management at the Environmental Protection Agency. Each year the EPA awards over half its annual budget in grants to various recipients, including State, local, tribal government entities, educational institutions, nonprofit organizations, and others.

Historically, the EPA has awarded over $4 billion in grants each year for the past several fiscal years. The majority of the grants are awarded to governmental agencies. As a former mayor, I can tell you that the greatest problem that we faced was not crime and was not poverty, but it was unfunded mandates. These grants are well placed to take care of that. It is something that is very meaningful.

The mission of the EPA is to protect human health and the environment. I believe that grants to locate recipients can be one of the best tools to accomplish that mission. However, the EPA Inspector General, the General Accounting Office, and the Office of Management and Budget have consistently criticized the EPA for persistent problems in grants management.

The OMB, the EPA, and the IG recommend as recently as 2002, that the Agency designate grants management as a material weakness which is the most severe category of weakness under the Federal Management Financial Integrity Act. For nearly the last 10 years, the EPA has even acknowledged that grants management has been a weakness which, to me, proves that this should be a nonpartisan issue. These problems have persisted regardless of change in Administration. We have had the same problems when Carol Browner was here, as we do currently, and certainly during the Clinton administration, the Bush administration, or going on back into the past years.

The committee has an obligation to ensure that the EPA budget is consistent with its mission to protecting human health and the environment. One week from today we will have the EPA Administrator, Mike Leavitt, in for a budget hearing. He will testify before this committee. Most importantly, however, the EPA has an obligation to ensure taxpayers that it is accomplishing its mission with the funds it awards each year.

However, for the last 10 years, the story of grants management is seemingly a revolving door of the EPA, IG audits, the GAO reports, congressional hearings, and new EPA policies and response. Even with this constant cycle of criticism, hearings, and new policies, the GAO reported late last year that the EPA continues to demonstrate the same persistent problems in grants management. These problems include a general lack of oversight of the grantees, a lack of oversight of the Agency personnel, a lack of any measurement of environmental results, and a lack of competition in awarding grants. It is imperative that Agency personnel are accountable for monitoring grants. The measurable environmental results are clearly demonstrated.

Interestingly, the GAO characterized changing part of the deficiencies in the last 10 years of grants management as required a major cultural shift at the EPA. I realize GAO was specifically referring to implementing a new competition policy in awarding grants. However, it appears that a major cultural shift is only the beginning of a number of reforms needed to create the culture of accountable to which you, Mr. O'Connor, refer in your testimony that is necessary within the Agency for new and effective grants.

I want to announce to all of you today that this committee is going to take this oversight responsibility seriously in regards to grants management. I can remember back when the Nuclear Regulatory Commission had not an oversight hearing in something like 5 years. We started having very serious oversight hearings. It totally changed things. I think we are going to stay on top on this.

I am going to make a personal commitment that is going to change this time. They have always said that it is going to, but this time, Senator Jeffords, we are going to change it. We are going to have accountability and the revolving door will stop, with your help.

With that, I will recognize the Ranking Member, Senator Jim Jeffords.

[The prepared statement of Senator Inhofe follows:]

STATEMENT OF HON. JAMES M. INHOFE, U.S. SENATOR FROM THE STATE OF OKLAHOMA

Good morning. I want to open this hearing thanking our witnesses in advance for their testimony. The committee will receive testimony this morning regarding grants management at the Environmental Protection Agency. Each year the EPA awards over half its annual budget in grants to various recipients including State, local, and tribal governmental entities, education institutions, non-profit organizations, and others. Historically, the EPA has awarded over $4 billion in grants each year for the past several fiscal years. The majority of grants are awarded to governmental entities for implementation of environmental programs. As a former mayor I can appreciate the availability of funds to local governments to pay for local implementation of Federal programs designed to ensure such benefits as water pollution control and maintaining air quality. Last year my hometown, the city of Tulsa, Oklahoma received about $3 million from the EPA for such projects as implementation of air quality standards and city water supply security.

The mission of the EPA is to protect human health and the environment. I believe that grants to local recipients can be one of the best tools to accomplish that mission. However, the EPA Inspector General, the General Accounting Office, and the Office of Management and Budget have consistently criticized the EPA for persistent problems in grants management. The OMB and EPA IG recommended as recently as 2002 that the agency designate grants managements as a material weakness, which is the most severe category of weakness under the Federal Managers Financial Integrity Act. For nearly the last 10 years, the EPA has even acknowledged that grants management has been a weakness which to me proves that his should be a non-partisan issue. These problems have persisted regardless of changes in Administration.

This committee has an obligation to ensure that the EPA budget is consistent with its mission of protecting human health and the environment. One week from today, EPA Administrator Mike Leavitt will testify before this committee concerning the fiscal year 2005 EPA budget. Most importantly, however, the EPA has an obligation to ensure taxpayers that it is accomplishing its mission with the funds it awards each year. However, for at least the last 10 years, the story of grants management is seemingly a revolving door of EPA IG audits and GAO reports, congressional hearings, and new EPA policies in response. Even with this constant cycle of criticism, hearings, and new policies; the GAO reported late last year that the EPA continues to demonstrate the same persistent problems in grants management. These problems include a general lack of oversight of grantees, a lack of oversight of agency personnel, a lack of any measurement of environmental results, and a lack of competition in awarding grants. It is imperative that agency personnel are accountable for monitoring grants and that measurable environmental results are clearly demonstrated. Interestingly, the GAO characterized changing part of the deficiencies in the last 10 years of grants management as requiring a "major cultural shift" at the EPA. I realize GAO was specifically referring to implementing a new competition policy in awarding grants. However, it appears that a major cultural shift is only the beginning of a number of reforms needed to create the culture of accountability to which you, Mr. O'Connor, refer in your testimony that is necessary within the agency for new and effective grants management.

I want to announce to all of you today that this committee is going to take its oversight responsibilities seriously in regards to grants management. We are going to stay on top of this issue until real changes are made.

Senator INHOFE. Senator Jeffords.

OPENING STATEMENT OF HON. JAMES M. JEFFORDS, U.S. SENATOR FROM THE STATE OF VERMONT

Senator JEFFORDS. Thank you, Mr. Chairman.

The Environmental Protection Agency is charged with a very important mission: to protect human health and safeguard the natural environment. I am pleased that the committee is engaged in oversight of the EPA. However, I hope that in the near future this committee will also hold hearings on important health issues, such as lead levels in the water supply of the District of Columbia, and mercury pollution from power plants, as well as hearings on new source review, climate change, and water pollution.

Today we are looking at the ways EPA can improve its use of resources to protect the environment. These resources include a substantial amount of funding for grants. Last year, EPA grants funding amounted to over $4 billion. Much of this grant money has been put in very good use. Notable examples include the highly successful Clean Water and Drinking Water State Revolving Fund Program.

EPA grant money is also used to support continuing programs, such as the Clean Air Program for monitoring and enforcing clean air regulations, and to fund environmental research and training. In short, grants funding is a central means by which EPA can accomplish important environmental goals.

Unfortunately, for some time now, studies by the General Accounting Office and the EPA Office of Inspector General have documented persistent shortcomings in EPA's grants management. EPA continues to face several challenges in managing its grants. These challenges include selecting the most qualified applicants, effectively overseeing grantees, measuring the results of grants, and effectively managing staff and resources.

Addressing these challenges should be a priority for EPA. I am pleased to see that EPA recently has taken noteworthy steps to improve the grants management. EPA is moving in the right direction by instituting competition and oversight policies, and by developing a comprehensive 5-year grants management plan that is designed to address many of the shortcomings that we have seen in the past.

EPA now must successfully carry out these plans for improvement. At the same time, there is still more that EPA can do to enhance the effectiveness and efficiency of the grants programs. I am concerned about the Inspector General's recent report that alleges a group of illegally accepted Agency grant funds. However, I would like to know whether EPA knowingly awarded funds to an ineligible organization and whether any funds were actually misused.

I look forward to hearing more about EPA's progress and implementing the new policies and comprehensive plan, and also about how EPA is responding to further suggestions for improvement.

Thank you, Mr. Chairman.

[The prepared statement of Senator Jeffords follows:]

STATEMENT OF HON. JAMES M. JEFFORDS, U.S. SENATOR FROM THE STATE OF VERMONT

Thank you Senator Inhofe.

The Environmental Protection Agency is charged with a very important mission—to protect human health and safeguard the natural environment.

I am pleased that this committee is engaged in oversight of the EPA. However, I hope that in the near future this committee will also hold hearings on important health issues such as lead levels in the water supply of the District of Columbia and mercury pollution from power plants, as well as hearings on New Source Review, Climate Change, and water pollution.

Today we are looking at ways EPA can improve its use of resources to protect the environment. These resources include a substantial amount of funding for grants. Last year EPA grants funding amounted to over four billion dollars.

Much of this grant money has been put to very good use. Notable examples include the highly successful clean water and drinking water state revolving fund programs. EPA grants money is also used to support continuing programs, such as the Clean Air Program for monitoring and enforcing clean air regulations, and to fund environmental research and training. In short, grants funding is a central means by which EPA can accomplish its important environmental goals.

Unfortunately, for some time now, studies by the General Accounting Office and the EPA Office of the Inspector General have documented persistent shortcomings in EPA's grants management. EPA continues to face several challenges in managing its grants. These challenges include selecting the most qualified applicants, effectively overseeing grantees, measuring the results of grants, and effectively managing staff and resources.

Addressing these challenges should be a priority for EPA, and I am pleased to see that EPA recently has taken noteworthy steps to improve its grants management.

EPA is moving in the right direction by instituting competition and oversight policies and by developing a comprehensive 5-year grants management plan that is designed to address many of the shortcomings that have been identified.

EPA now must successfully carry out these plans for improvement.

At the same time, there is still more that EPA can do to enhance the effectiveness and efficiency of its grants programs. I am concerned about the Inspector General's recent report that alleges a group illegally accepted agency grant funds. However,

I would like to know whether EPA knowingly awarded funds to an ineligible organization and whether any funds were actually mis-used.

I look forward to hearing more about EPA's progress in implementing its new policies and comprehensive plan, and also about how EPA is responding to further suggestions for improvement.

Senator INHOFE. Thank you, Senator Jeffords.

We are going to go from left to right. We will first hear from Melissa Heist who is the Assistant Inspector General for Audits. Second, we will hear from Mr. John Stephenson, Director of Natural Resources and Environment at the General Accounting Office. Third will be David O'Connor, the Acting Assistant Administrator for the Office of Administration and Resources Management, Environmental Protection Agency. Last, we will hear from Steve Ellis, vice president for Programs, Taxpayers for Common Sense.

Without objection, your entire statements will be made a part of the record. You may go ahead and abbreviate as you so desire.

Ms. Heist, would you begin?

STATEMENT OF MELISSA HEIST, ASSISTANT INSPECTOR GENERAL FOR AUDIT, ENVIRONMENTAL PROTECTION AGENCY

Ms. HEIST. Thank you. Good morning, Mr. Chairman, and members of the committee. I am Melissa Heist, the Assistant Inspector General for Audit, at the Environmental Protection Agency. I am pleased to be here today representing Nikki Tinsley, the Inspector General.

Thank you for the invitation to inform you about the work we have done reviewing EPA's management of assistance agreements, also known as grants. Our recent audit work has focused on cross-cutting national issues and has included grants made to States, local and tribal governments, and not-for-profit organizations. Our audits have identified systemic problems in awarding and overseeing grants. These problems prevent EPA from achieving the maximum results from the more than $4 billion awarded in assistance agreements every year.

Inadequate review and oversight has both financial and environmental consequences. I am going to talk briefly about our findings in three areas: pre-award reviews, post-reward oversight, and staff accountability.

Pre-award review ensure that grants are planned to deliver results at an acceptable cost. We reported on pre-awards in 1998, 2002, and most recently in March of last year. For this audit, we selected a statistical sample of agreements awarded so that our findings would address EPA-wide issues. The chart I have brought along today summarizes what we have found. I will highlight a few of these findings.

In 79 percent of grants over $100,000, project officers did not document cost reviews or proposed budgets. Statistically this equates to over $500 million spent without a cost analysis. In 42 percent of the grants, EPA did not negotiate environmental outcomes. We saw a $200,000 grant proposal to regulate costs charged by power companies that said specific projects would be established later. The project officer wrote on the application, "Why this? Why now?", yet still approved the work plan. We even found one agreement where EPA awarded $700,000 without knowing specific objectives, milestones, deliverables, or outcomes.

Post-award reviews ensure that grants stay on track to deliver environmental results at a reasonable cost. We have reported on EPA shortcomings in overseeing assistance agreements for over 10 years. A particularly relevant example is a recent report in which we questioned $4.7 million because the work was performed by an ineligible lobbying organization. EPA awarded the cooperative agreements to an associated organization that did not have any employees, space, or overhead expenses.

In addition, the ineligible organization's financial management practices did not comply with Federal regulations. The recipient did not adequately identify and separate lobbying expenses in its accounting records. As a result, lobbying costs may have been charged to the Federal projects. The ineligible organization also claimed that it had not always followed Federal regulations because EPA employees directed the recipient to use a particular contractor.

The deficiencies I have discussed were not due to the lack of policies or training. They were due to staff not following existing policies, and to staff not being held accountable. If EPA is to improve its management of assistance agreements, it needs to ensure that adequate resources are devoted to the function, and that management and staff are held accountable for adhering to Agency policies that promote good management.

Let me conclude by saying that I believe that EPA takes its assistance agreement challenges seriously. However, after years of policy and staff training, the problems remain. EPA recently issued guidance requiring all employees involved with managing grants to have performance standards that address these responsibilities. EPA managers now need to carry through and hold staff accountable for managing EPA's grant programs in a way that maximizes results.

Thank you, Mr. Chairman and members of the committee, for the opportunity to participate in the discussion of such an important topic. We are committed to working with Congress and EPA to ensure that the money awarded through assistance agreements every year is producing the intended environmental and public health benefits.

This concludes my prepared remarks. I will be happy to respond to questions. I would ask that my written statement be placed in the record in its entirety.

Senator INHOFE. Thank you, Ms. Heist. You might instruct your staff to leave that chart up. There are some things that I do not understand about it. In the question and answer time, perhaps you could elaborate on that.

Mr. Stephenson.

STATEMENT OF JOHN B. STEPHENSON, DIRECTOR, NATURAL RESOURCES AND ENVIRONMENT, GENERAL ACCOUNTING OFFICE

Mr. STEPHENSON. Thank you, Mr. Chairman, and Senator Jeffords.

We are also pleased to be here today to discuss the Environmental Protection Agency's management of its grants. My testimony today is based primarily on our August report from last year.

As you have already stated, grants account for over half of EPA's annual budget, or about $4.2 billion annually. EPA's ability to accomplish its primary mission of protecting human health and the environment depends largely on how well it selects, manages, and optimizes the benefits of these grants. EPA has over 4,000 grant recipients, including State and local governments, tribes, universities, and nonprofit organizations. So, effective management of this broad portfolio is a daunting task.

Congressional hearings in 1996, 1999, and last year have highlighted EPA's long-standing grants management problems. GAO and EPA IG have chronicled them in numerous reports.

The bottom line is that EPA continues to face key grants management challenges despite its efforts to address them. These challenges, as you have mentioned, Senator Jeffords are, No. 1, selecting the most qualified grant applicants; No. 2, effectively overseeing grants; No. 3, measuring the results of grants; and No. 4, effectively managing its own grants staff and resources.

EPA has and is taking a series of actions to address these challenges by, among other things, issuing policies on competition and oversight, conducting training for project officers and nonprofit organizations, and developing a new data system for grants managements. However, these actions have had mixed results because of the complexity of the problems, weaknesses in design and implementation, and insufficient management attention.

EPA's new policies, and its 5-year grants management plan, requires strengthening, enhanced accountability, and sustained commitment to succeed. For example, EPA's September 2002 policy on competition should improve EPA's ability to select the most qualified applicants by requiring competition for more grants. However, effective implementation of the policy will require a major cultural shift for EPA managers and staff because the competitive process will require significant planning and take more time than awarding grants noncompetitively. Right now less than 15 percent of the grants are awarded competitively.

Similarly, EPA's December 2002 oversight policymakes important improvements in oversight, but it does not enable EPA to identify systemic problems in grants management. For example, the policy does not incorporate a statistical approach to selecting grantees for review. As a result, EPA cannot effectively use the reviews to better target corrective actions, or to ensure expenditure of its oversight resources.

Finally, while EPA's 5-year grants management plan does offer for the first time a comprehensive road map with objectives, goals, and milestones for addressing grants management challenges, it does not provide a mechanism for holding all managers and staff accountable for successfully fulfilling their grants management responsibilities. For example, EPA relies on about 1,800 project officers to oversee grants. These project officers are spread over headquarters and the ten field regions for EPA.

But their grant responsibilities often fall into the category of other duties as assigned. Without increased accountability for these project officers, as well as other staff and managers, EPA cannot ensure the sustained commitment needed for the planned success. While EPA has begun implementation actions in the plan, GAO be-

lieves that given EPA's historically uneven performance in addressing its grants challenges, continued congressional oversight will indeed be needed to ensure that EPA's administrator, managers, and staff remain firmly committed to implementing the 5-year plan's ambitious targets and timeframes.

In our report, we make specific recommendations to the EPA Administrator for addressing these weaknesses and strengthening grants management. The EPA has agreed to implement most of these recommendations as part of its 5-year plan. However, EPA is just entering the second year of the 5-year plan, and it is really too soon to tell whether its corrective actions will effectively address the problems.

Mr. Chairman, that concludes my statement. I will be happy to take questions as well. I would ask that my written statement be placed in the record in its entirety.

Senator INHOFE. Thank you, Mr. Stephenson.

Mr. O'Connor.

STATEMENT OF DAVID O'CONNOR, ACTING ASSISTANT ADMINISTRATOR FOR THE OFFICE OF ADMINISTRATION AND RESOURCES MANAGEMENT, ENVIRONMENTAL PROTECTION AGENCY

Mr. O'CONNOR. Good morning, Mr. Chairman, and Senator Jeffords. It is a pleasure to be here this morning. As has been noted, EPA awards some $4 billion in grants, representing about half of the Agency's budget each year. This is the key mechanism by which EPA and its grant recipients deliver important environmental protection to the public.

Most of these grant funds, about 89 percent, go to States, tribes, and local governments, with the remainder going primarily to nonprofit organizations and educational institutions. Some of this funding is the result, as you know, of congressional earmarks. In 2003, about 13 percent of our grant dollars were earmarked and about 51 percent of our total grant dollars to nonprofit organizations.

We at the EPA have an obligation to manage these grant dollars effectively and to ensure that they are used to further the Agency's mission. However, for a number of years, our grant management practices have been criticized by the General Accounting Office and the Inspector General, and our credibility has suffered. Grants to nonprofit organizations have been especially criticized for inadequate management and oversight.

Over the period of 1995 to 2001, EPA did take steps to respond to grant management concerns. For example, we virtually eliminated a backlog of 20,000 grants awaiting grant closeout. We trained over 4,000 project officers, and we issued a number of post-award monitoring policies.

While these steps resulted in some progress, it has been clear that we continue to face significant challenges in grants management, especially in the area of grantee selection, oversight, accountability, and environmental results. In 2001, we recognized the need to address grants management concerns in a much more comprehensive and strategic manner. In April 2003, as GAO just

noted, we did issue for the first time a long-term 5-year grants management plan with associated performance measures.

The plan commits EPA to accomplishing five goals: No. 1, enhancing the skills of EPA personnel involved in grants management; No. 2, promoting competition in the awarding of grants; No. 3, leveraging technology to improve performance; No. 4, strengthening our oversight of grants; and No. 5, identifying and documenting environmental results.

I would like to touch on some of these very briefly. In goal one, a key component of our strategy is ensuring that all of our project officers are certified to manage grants. Project officers now must complete a basic 3-day grants management training program and take periodic refresher courses to maintain their certification. We are improving our training program through the development of a long-term training plan linked to EPA's human capital strategy. This long-term plan will establish an Agency-wide process for ensuring that grants managers are timely trained on new policies and regulations and that we have measures for determining how our training activities contribute to improved grants management.

In goal two, EPA is firmly committed to increasing competition for grant awards. As was noted, our grants competition policy went into effect in October 2002. In its first year of implementation, EPA competed 75 percent of new awards that are covered under the policy. This means that over 900 grants were competed in 2003. This accounted for 85 percent of the dollars awarded subject to the policy.

In goal three, we recently deployed an enhanced Integrated Grants Management System which we consider essential to strengthening grants management. This is a paperless system that fully automates the grants process from cradle to grave. It provides electronic tracking of milestones, products, post-award activities, and other information vital to our project officers' ability to manage grants. We have now deployed this system across all 10 of our regions and are beginning to deploy it across our headquarters offices.

In goal four, in December 2002, we issued a comprehensive post-award monitoring policy that significantly expands our program for monitoring grants after they have been awarded. It requires baseline monitoring of all active grants and advance monitoring on at least 10 percent of active grantees. We focused our early attention on nonprofit organizations where we know there have been poor performing grant recipients. In 2003, we conducted 408 events monitoring reviews. Where we found problems, we were largely successful in having them corrected, or we placed controls on grantee expenditure pending resolution.

Mr. Chairman, in conclusion I would like to say that EPA has set in motion a comprehensive plan to address grants management weaknesses. It is a serious plan, and one that will require our full effort and attention to implement, but we are determined to do it. It will not be easy, and it will not happen overnight, but we have the full support of EPA's leadership as we implement this plan. I am very encouraged by the genuine commitment of our regional and program offices to work with us to make this plan a successful one.

Last, let me say that I am very proud to have a grant office under me that has the right leaders to make this plan successful and a staff that is very committed to the task. They are determined, and they are working very hard to make this plan a success.

Thank you very much, Mr. Chairman. I would ask that my written statement be placed in the record in its entirety.

Senator INHOFE. Thank you, Mr. O'Connor.

Mr. Ellis.

STATEMENT OF STEVE ELLIS, VICE PRESIDENT FOR PROGRAMS, TAXPAYERS FOR COMMON SENSE

Mr. ELLIS. Thank you very much, Chairman Inhofe. Good morning, Senator Jeffords. Thank you for inviting me to testify. Thank you for holding this hearing. I am Steve Ellis, vice president for programs at Taxpayers for Common Sense, a national nonpartisan budget watchdog organization.

Rather than revisiting the comments that have already been made, which we agree with, I would like to put some of this into context and provide a few additional recommendations.

The EPA must clearly define missions and goals expected from its grants program so that the taxpayer can be sure that every dollar is being spent wisely. After several false starts and criticism from virtually everyone, EPA appears to have instituted reforms that could lead the Agency toward responsible management of its grants portfolio. But time will tell whether they have truly turned the corner.

TCS recommends additional measures to help buttress EPA's reform efforts, including development and implementation of grants management, evaluation criteria for program officers, and other grant management personnel, annual progress reporting to Congress, and rapid deployment in the centralizing of the proposed grant database systems, which I understand is ongoing.

As has already been said, roughly half of the EPA budget is awarded in the form of assistance agreements or grants, but breaking it down would be instructive. In fiscal year 2002, $3.5 billion of this grant money was allocated in non-discretionary programs such as drinking and clean water State resolving funds, and a few other programs that are typically formula grants and earmarks.

The remaining amount, $719 million, was awarded in discretionary grants to State and local governments, tribes, non-profits, and universities. We applaud the committee for its role in reviewing these programs, and urge the committee to look more closely at the non-discretionary programs to ensure that they are properly structured and meeting the Nation's goals at appropriate costs.

The four key areas the EPA has to improve—and these parallel the GAO's—are competitive grant awards, effective grantee oversight, ensuring grants help achieve Agency goals, and supporting and holding staff accountable for performance.

EPA seems to be responding. In September 2002, EPA issued the first policy to govern the competitive awarded grants. In 2002, a new grant oversight policy was issued. Finally, in April 2003, the Agency issued its grants management plan for 2003 to 2008. This plan touched on all four of our key areas for improvement.

However, any EPA plan must be evaluated based on both the fine print and the follow through. The grants management plan outlines several objectives for training grants personnel. One of these is to increase the percentage of grants managed by certified project officers from the 2003 baseline of 85 percent to 100 percent in 2004. But considering that, as Ms. Heist indicated earlier, the IG identified glaring shortcomings in a large number of randomly sampled EPA assistance agreements shortly before the grants management plan was released. The certification process itself may be flawed.

Promoting competition for grant awards clearly comes down to Agency commitment. Plain and simple, if EPA cracks down on allowing sole source and similar type grants, competition will flourish. If the Integrated Grants Management System, IGMS, is fully deployed, it could significantly help in grant tracking. Strengthening oversight on achieving outcomes requires a commitment by EPA at both the national and regional level to look over grantee shoulders and demand basic information grantees are supposed to supply.

While we support the reforms that EPA has proposed, there are some additional improvements that must be made. To inject responsible grant management throughout the Agency, the EPA must develop performance standards for EPA grant management staff at all levels. Reform will only be effective if program officers and all staff charged with grant management embrace these efforts. If personnel are not evaluated on grant management performance, it will be perceived as a lower priority and we will be back discussing grant management failures at EPA every few years.

Similarly, EPA officials have to commit to making reforms stick. To concentrate their attention, we believe it is vital that EPA report to Congress annually on its progress and that this committee, the GAO, and the EPA IG exercise the vigorous oversight that has gotten us this far in the reform process.

Finally, we strongly believe that centrally and publicly available grant and tracking data will make reform efforts more enforceable and efficient. We urge the EPA to deploy the IGMS system as quickly as possible, but again, any system will only be as effective as the people inputting the data. To that end, we urge the EPA to investigate centralizing and streamlining grant management to fewer, more highly trained, individuals.

Although it is apparent that there has been much done to increase accountability in the EPA grants system, there is much more to do. However, we believe that with vigilant oversight, EPA has turned the corner on reforms. We are in difficult budget times, as you well know. With a $521 billion deficit, we have to be sure that every dollar we spend is being spent cost effectively to further our Nation's goals.

Thank you for the opportunity to testify. I would be happy to answer any questions you might have. I would ask that my written statement be placed in the record in its entirety.

Senator INHOFE. Thank you, Mr. Ellis, for an excellent opening statement. I thank all of you.

We are going to go ahead, if it is all right, Senator Jeffords, and do ours in a series of 5-minute questions. Other Senators will come and I would like to have them fall in line as they come in, if that is acceptable with you.

I would start off by saying in your one, two, three, four, you might add a fifth one and that is that those who are involved, obey both the intent and the letter of the law. It appears to me that there are many of them that are just being very nonchalant about the work that they are doing. That is what we anticipate should change.

Ms. Heist, you have your chart up there. I do not understand it.

Ms. HEIST. Let me explain. On mission relevance, this would be looking at whether or not the project officer, in reviewing the grant application, documented that there was some connection between the work that was to be performed and the Agency's strategic goals. We found in the end that there were 19 percent of the cases that we looked at, where that was not the case.

In 19 percent of the cases, we found that there was not a link between the work that was to be performed and a strategic goal of the Agency. On probable success, we found that there was 31 percent of the cases where the project officer did not look at whether or not the grantee was technically competent, and what their past performance was like for the Agency.

Senator INHOFE. On those two, how does that relate to $42 million and $88 million?

Ms. HEIST. We projected the results to the $1 billion universe we looked at. So, of the $1 billion, there would be $42 million where there was not a link to mission relevance, and there would be $88 million where there would not be a link or there was not an indicator that the grantee would be successful.

Senator INHOFE. Now, reasonable costs?

Ms. HEIST. Reasonable costs would be about half the dollars that we looked at in the universe. The person reviewing the grant application did not document that they had reviewed the costs and the costs seemed reasonable for the work that was being proposed.

Senator INHOFE. That is pretty shocking. Do all the costs on your chart from deficiencies in the pre-award process only relate to discretionary grant recipients?

Ms. HEIST. No, it goes beyond discretionary grants. We also looked at some continuing environmental programs which would be grants to States. These are air and water grants that we looked at as a part of this sample.

Senator INHOFE. Is the major problem in the discretionary grants?

Ms. HEIST. We found that there were problems with discretionary grants. We also found some instances where in the grants to States there was not a clear link, and there was not a clear statement of what environmental results should be happening.

Senator INHOFE. On your grants to States, and your grants to cities, having been a mayor, I am familiar with that. Is not part of that that they are given to the States to, say, upgrade a water purification system or something, and they make those determinations as to how that is being spent at the State level? Is that correct?

Ms. HEIST. That is correct. Although what we would like to see is some mutual agreement about what is going to happen. Now, the actual water project that you are talking about, we did exclude those from our samples.

Senator INHOFE. I see. You are testifying that the EPA mismanagement of only discretionary grants costs the taxpayers hundreds of millions of dollars each year?

Ms. HEIST. Of predominately discretionary funds; yes.

Senator INHOFE. Why do you focus on discretionary recipients in particular?

Ms. HEIST. In the past we found the most problems was with discretionary grants. We found problems with, as has been mentioned here today, competition. We found Agency managers continued to use the same grantees year-after-year and there has not been a lot of competition. Predominantly, that is where we found the problems, so we continue to focus in that area.

Senator INHOFE. Mr. Stephenson, the EPA largely awards either discretionary grants or non-discretionary grants. What is the average amount awarded in each category? Can you break that down in percentages?

Mr. STEPHENSON. Of the $4.2 billion—I do not know if I can do the percentages in my head—but there is about $719 million that are, in fact, discretionary. The majority, $1.2 billion, is like clean water revolving that goes primarily to the States on the basis of a formula. There is $0.8 billion in drinking water revolving funds. Then there is about another $1 billion in what is called continuing environmental programs. All those are what we would call formula grants or non-discretionary grants that go to the States primarily.

Senator INHOFE. OK; that is fine. Where does that leave discretionary grants?

Mr. STEPHENSON. $719 million of the $4 billion. So whatever percentage that is.

Senator INHOFE. Your testimony references grant recipients sometimes being subject to the Single Audit Act. But with the comparatively low average of a discretionary grant, would not recipients rarely be subject to a $500,000 a year expenditure threshold of the Act?

Mr. STEPHENSON. Yes, the Single Audit Act, of course, looks from a grantee perspective on how many total Federal grants they have, regardless of the Agency that it comes from. Therefore, EPA awards many small grants that fall below the threshold for audit. So it would not be picked up in that form of oversight. EPA, of course, does its own oversight. That is just another Federal requirement for grantees.

Senator INHOFE. All right.

Senator Jeffords.

Senator JEFFORDS. Ms. Heist, in your written testimony you report that senior resource officials at EPA cited the limited availability of resources for staffing, travel, and training as a factor that contributes to EPA's difficulties with oversight. Would you elaborate on that?

Ms. HEIST. We did a review. This is based on interviews of these officials. That is what they told us, that they did lack funding to do some of the oversight that they were being asked to do.

Senator JEFFORDS. Did the senior resource officials consider this a very serious problem, a limiting factor?

Ms. HEIST. I cannot really comment on that. They did believe that it was necessary to do this work, so they did consider it to be serious work. This is the reason they gave us for not doing it.

Senator JEFFORDS. What kinds of projects were supposed to be carried out using the grant money awarded to the Consumer Federation of American Foundation? Is there any evidence that the grant money was not used for these projects, or that the goals of the projects were not accomplished?

Ms. HEIST. The projects were for various indoor air projects. They were for educating the public about various indoor air issues. The work that we did was a financial audit. We focused on how the money was spent. We have been told by the recipient in responding to the report that EPA was satisfied with the work that was performed.

Senator JEFFORDS. Did you find that any of the EPA funding awarded to the Foundation was spent on lobbying?

Ms. HEIST. We were not able to determine that because of the way the accounting records were maintained by the recipients. So we could not determine that.

Senator JEFFORDS. Mr. O'Connor's written testimony indicates that 51 percent of the nonprofit grant dollars in fiscal year 2003 came from earmarks. Nonprofit organizations have been a focus of the concern about the use of EPA grants funding. Have you found that problem with nonprofit grant recipients are equally pervasive among earmarked and non-earmarked?

Ms. HEIST. We have not done a study that would specially address that. I cannot comment on that.

Senator JEFFORDS. Are there other groups besides non-profits that have been found to have problems managing their EPA grants funding?

Ms. HEIST. A few years ago we did a series of studies on tribal grants. We also found issues in that area. Many of these issues dealt with the need to have better accounting records.

Senator JEFFORDS. What kinds of problems are common and what kinds are most worrying?

Ms. HEIST. When we go out and do financial audits of grantees, the problems we typically find are inadequate support for labor costs, or the grantee is not competitively acquiring contracts. Those would be the predominant areas that we focus on or see when we go out and audit the actual grantees.

Senator JEFFORDS. Thank you.

Mr. Stephenson, EPA has a history of issuing policies to help remedy to grants management shortcomings. But problems have nevertheless persisted. Do you think that EPA's latest policies and plan are likely to change that pattern?

Mr. STEPHENSON. They have potential, but again it is important how effectively they are implemented. That is why we put so much stock in individual staff accountability. The 1,800 project officers are key in effectively overseeing grants, but it is not their primary function. They work in the Office of Water, the Office of Air, and the like. We think that individual accountability and even reducing the number of total project officers that are involved in grants over-

sight needs to happen to effect that cultural change that we talk about. So no, I do not think it will be effective unless there is that cultural change.

Senator JEFFORDS. In your written testimony you suggest that the decentralization of grants management staff—some working at EPA headquarters and others working at regional offices—presented a challenge to holding staff accountable and improvement of grant management. Do you think that this decentralization contributes significantly to EPA's grants management problem? How do you think the challenge can be best overcome?

Mr. STEPHENSON. Yes, that is the 1,800 project officers that I just mentioned. I think as a first step you need to build into their own performance statements and their job descriptions grants management as one of their key functions. Unless you do that, they are going to accept these as other duties as assigned and not as important as their primary duties. It seems like a simple step, but we think that would go a long way toward changing their behavior.

Senator JEFFORDS. In their new comprehensive grants management plan, EPA sets a number of goals for improving grants management. Which one of these goals, if achieved, would bring about the biggest improvement? Do you think the plan adequately outlines a path for achieving that goal?

Mr. STEPHENSON. I do. As I mentioned they are in the first year of the 5-year plan right now. What is missing is that individual accountability that we were looking for and how it is going to be built into performance evaluations of the individual staff responsible for grants oversight.

Senator JEFFORDS. Thank you. Thank you, Mr. Chairman.

Senator INHOFE. Mr. Stephenson, if we are relying solely on the EPA for monitoring to ensure proper use of grant funding, would not the discretionary grant recipients be the most difficult? It is my understanding that they would average around $150,000 of the discretionary grants; is that a ballpark figure?

Mr. STEPHENSON. I am not sure. They range all over the place.

Senator INHOFE. OK. Let us assume it is because I think it is. Would they be the most difficult to monitor?

Mr. STEPHENSON. I would think so. The non-discretionary grants go by formula to the States based on the need. There is a little more specificity in place as to how you oversee that category of grants. So I would agree that the non-discretionary grants are probably more problematic.

Senator INHOFE. Ms. Heist, you responded to a question from Senator Jeffords concerning money that might be going for illegal uses, such as lobbying. In your audit you said, "I am especially interested in your March 1, 2004 audit of the Consumer Federation of America Foundation."

How often does the IG review audit grantees?

Ms. HEIST. Often we will do these types of audits when the Agency has, in fact, gone out and done a review and believes that there are problems that need further audit work on investigation.

Senator INHOFE. Fifty percent?

Ms. HEIST. We do not know. Since they are covered by Single Audit, we will typically focus on ones perhaps were there is a prob-

lem in a Single Audit report, or one that the Agency brings to our attention. We probably do 20 of these a year ourselves.

Senator INHOFE. What type of recipient was the Consumer Federation of America Foundation?

Ms. HEIST. By type do you mean competitive, noncompetitive, discretionary?

Senator INHOFE. No, I mean, what do they do for a living?

Ms. HEIST. As far as I know they are an advocacy group.

Senator INHOFE. It is a lobbying group; is it not?

Ms. HEIST. I do not know that.

Senator INHOFE. You do not know?

Ms. HEIST. I know they do some lobbying because they are registered that way.

Senator INHOFE. OK. Then they are a lobbying group.

How much has this Foundation received from the EPA in grants?

Ms. HEIST. We looked at $5 million which I understand were the costs from 1996 to 2002.

Senator INHOFE. Yes, I think that is consistent with my information. I have $4.6 million since July 1997 to September 2003; do you think that is accurate?

Ms. HEIST. It should be fairly accurate.

Senator INHOFE. Your audit revealed that EPA was providing millions to nonprofit recipients that was simply a front for a lobbying organization. I understand that there is a subsidiary and they are a chain to someone else who receives grants.

Ms. HEIST. The grant was made to a foundation.

Senator INHOFE. Consumer Federation of America Foundation?

Ms. HEIST. Yes; that is correct.

Senator INHOFE. But then you said in answer to my question that the Foundation received this amount of money. However, the Consumer Federation of America is a lobbying group. Let me just ask you the question this way. Do you have any reason to believe that they are not recipients of grants; this lobbying group?

Ms. HEIST. Directly recipients?

Senator INHOFE. Either directly or indirectly. It makes no difference to me.

Ms. HEIST. We know that they indirectly receive money because the money went to the Foundation and the Foundation did not——

Senator INHOFE. Is this legal?

Ms. HEIST. It will be the Agency's final determination, but we do not believe it was legal.

Senator INHOFE. The EPA referred this group to the IG for an audit. At what point did this happen?

Ms. HEIST. In 2002.

Senator INHOFE. I would assume, then, that this recipient has been disbarred from receiving grant funding?

Ms. HEIST. That would not be correct. The group continues to receive funding. However, they have reorganized so that they are now an eligible recipient.

Senator INHOFE. Who has reorganized? Consumer Federation of America?

Ms. HEIST. Consumer Federation of America.

Senator INHOFE. And you are saying to this committee here that they are a lobbying group anymore; is that right?

Ms. HEIST. No, I am not saying that.

Senator INHOFE. Well, if you are trying to get over an act that is illegal, and you say that you are pinning your case on the fact that they have reorganized, you know, they can reorganize and still use Federal funds for lobbying; is that not correct?

Ms. HEIST. I believe that is correct.

Senator INHOFE. Senator Jeffords.

Senator JEFFORDS. To followup on that, is there any evidence that the CFA or CFA Foundation did not follow the law on EPA's instructions at any time regarding the separation between the organizations that was necessary for the Foundation to receive cooperative agreement funds?

Ms. HEIST. I do not know that we specifically looked at that. We looked at what happened when they received the grant and how the application was made. We looked at how the money was spent. I really cannot comment on that.

Senator JEFFORDS. Mr. Chairman, I would ask unanimous consent that a letter that I have here from the Consumer Federation of America be submitted for the record.

Senator INHOFE. Without objection, so ordered.

[The referenced document follows:]

CONSUMER FEDERATION OF AMERICA,
March 2, 2004.

Hon. JAMES M. INHOFE,
Chair, Senate Environment and Public Works Committee,
Washington, DC.

Hon. JAMES M. JEFFORDS,
Ranking Member, Senate Environment and Public Works Committee,
Washington, DC.

DEAR CHAIRMAN INHOFE AND RANKING MEMBER JEFFORDS: We understand that you will hear testimony tomorrow at your hearing on grants management by the U.S. Environmental Protection Agency (EPA) about a series of cooperative agreements the Consumer Federation of America Foundation (CFAF) has received from EPA since 1996. A representative of the EPA Office of Inspector General apparently will discuss an audit report they just issued, which contends that $4.7 million in cooperative agreements received by CFAF should be disallowed.

The Office of Inspector General (OIG) bases its conclusion on the allegation that CFAF is an "ineligible lobbying organization" that was not entitled to receive funds under Section 18 of the Lobbying Disclosure Act (LDA). The OIG contends that there was no discernible separation between CFA and its Foundation, ensuring that EPA funds received by the Foundation actually went to CFA, which was a lobbying 501(c)(4) organization ineligible to receive Federal funds. (CFA has since been approved by the IRS to be a 501(c)(3) organization.)

The OIG's conclusions are entirely without legal justification, not to mention unfair and unreasonable. The OIG report also completely ignores the high-quality, award winning work completed by CFAF for the EPA on important public health issues, like radon awareness and indoor air quality. (For more information on our concerns, please see the attached letter and CFA's complete rebuttal to the OIG, which is listed as Appendix B in the Audit Report the Committee has received.)

We urge you to question the OIG's conclusions for several reasons:

1. *OIG's interpretation of Section 18 has no basis in the statutory text of legislative history, nor any support in case law.* On the contrary, the legislative history, including a floor statement by Senator Simpson, clearly demonstrates that a close affiliation between a non-lobbying organization (such as the CFA Foundation) and a lobbying 501 (c)(4) (such as CFA) does not make the non-lobbying organization ineligible to receive Federal funds, directly contradicting the OIG interpretation. The OIG interpretation is also inconsistent with the purposes of Lobbying Disclosure Act Section 18, and raises serious First Amendment issues—issues that Congress recognized and tried to avoid. Finally, the OIG interpretation would reverse EPA's apparently established interpretation of Section 18, on which the CFA Foundation relied when it accepted EPA cooperative agreements between 1997 and 2002. Thus, OIG's

interpretation, even if permissible, cannot be applied to the CFA Foundation retroactively.

2. *CFAF's work for EPA was of high-quality and widely praised—even by the OIG.* In 1991, EPA solicited CFA to manage a program on indoor air quality; 2 years later, EPA asked CFA to manage a national public service campaign to educate consumers about the health risks of radon. Both awards were initiated by EPA. As a result of EPA awards received by the CFA Foundation just since 1996, over $100 million dollars in media was donated to air five public service advertising campaigns on radon dangers, as well as three environmental tobacco public service advertising campaigns. These advertisements reached millions of consumers who tested their homes for radon or who pledged to make their homes smoke-free. More than 40,000 consumers were counseled on how to rid their homes of high levels of radon. One of CFAF's radon campaigns received the 2000 National PSA Emmy Award from the National Academy of Television Arts and Sciences. The OIG has praised CFAF's work with EPA as well. Its website highlights EPA's work with CFAF on radon public services announcements as an example of good EPA management practices.

3. *CFAF's cooperative agreements were initiated, encouraged and closely supervised by EPA, which was well aware of the relationship between the CFA Foundation and CFA. The CFA Foundation closely cooperated with EPA and followed its directions explicitly.* In 1996 and 1997, when CFA—at that time a 501(c)(4) organization—became ineligible to receive Federal funds, EPA arranged for CFA's programs to be transferred from CFA to the CFA Foundation. In fact, EPA relied on the CFA/Foundation relationship to assure that the transferred programs would continue to be managed by the same personnel. On each program undertaken at EPA's request, the Foundation worked closely with EPA on a weekly and often daily basis. In fact, EPA was involved in all important program decisions, including the selection of subrecipients and contractors. EPA, was, without question, extremely satisfied with the Foundation's work, and made two additional sole source awards to the Foundation in 2001.

4. *The OIG conclusions focus on technical defects in documentation and lack of sophistication of CFAF's financial management system, ignoring the fact that the underlying transactions were sound and adequately documented.* The issues raised by the OIG relate almost exclusively to compliance with documentation requirements (such as procurement procedures, cost/price analysis, written procedures, and standard contract clauses) rather than with violation of substantive rules and regulations. These documentation issues were first called to CFAF's attention in March 2002 by EPA and were immediately corrected.

We appreciate your attention to these concerns.

Sincerely,

TRAVIS B. PLUNKETT,
Legislative Director.

CONSUMER FEDERATION OF AMERICA,
January 20, 2004

Michael A. Rickey, *Director,*
Assistance Agreement Audits,
Office of Inspector General,
Environment and Public Works Committee,
Washington, DC.

Subject: Draft Audit Report of "Costs Claimed under EPA Cooperative Agreements CX825612–01, CX825837–01, X–828814–01, CX 824939–01 and X 829178–01"; Comments of Consumer Federation of America

DEAR MR. RICKEY: This letter, and the Response and legal memorandum attached hereto, set forth the written comments of the Consumer Federation of America ("CFA") on the draft audit report ("DAR") on costs claimed by the Consumer Federation of America Foundation (the "Foundation") under the above-referenced EPA cooperative agreements ("CAs"). The *Response* proceeds through the DAR point-by-point, presenting CFA's detailed response to questions in the report regarding the Foundation's compliance with EPA regulations and OMB Circulars. The *legal memorandum* analyzes OIG's claim that the Foundation was not eligible to receive Federal funds under Section 18 of the Lobbying Disclosure Act of 1995, that each CA awarded to the Foundation was therefore illegal, and that the Foundation must therefore refund every penny of the $4.7 million it received under the CAs. This *letter* sets forth a brief overview of CFA's comments.

The DAR's analysis and recommendations are neither fair nor reasonable, for three reasons: *First*, the DAR is based on a fundamental misunderstanding of the circumstances under which the CAs were awarded and implemented. *Second*, it focuses on technical defects in documentation and lack of sophistication of CFA's financial management system, ignoring the fact that the underlying transactions were sound and adequately documented. *Third*, it proposes a $4.7 million disallowance based on a legal interpretation of LDA Section 18 that is untenable on its face, and whose retroactive application to the Foundation is prohibited by law.

[1] In 1991, EPA asked CFA to manage a program on indoor air quality; 2 years later, EPA asked CFA to manage a national public service campaign to educate consumers about the health risks of radon. Both awards were initiated by EPA—that is, EPA determined the need for Federal action, defined the scope of the program, established the amount of available funding, and only then approached CFA to implement the program on its behalf. Each CA was awarded to CFA without competition. In 1996 and 1997, when CFA, a 501(c)(4) organization, became ineligible to receive Federal funds, EPA arranged for CFA's programs to be transferred from CFA to the Foundation under new CAs. At the time, EPA was well aware of the CFA/Foundation relationship—and, in fact, relied on that relationship to assure that the transferred programs would continue to be managed by the same CFA personnel. In 1997, EPA asked the Foundation to undertake a public service campaign to alert consumers to the health effects of secondary smoke on children. This third CA was also awarded without competition.

On each program undertaken at EPA's request, the Foundation worked closely with EPA on a weekly and often daily basis. Indeed, EPA was involved in all important program decisions, including the selection of sub-recipients and contractors. EPA was, without question, extremely satisfied with the Foundation's stewardship of the CA programs. It expressed that satisfaction by repeatedly praising the programs to the Foundation's staff, consultants, and contractors; by providing substantial additional funding to the programs each year; and by making two additional sole-source awards to the Foundation in 2001.

[2] For each of its CAs, the Foundation kept detailed and accurate *financial records*, including job cost activity reports for each CA, that show the receipt and expenditure of the EPA funds disbursed under the CAs, and support the costs claimed under those awards.[1] Its employees prepared *personal activity reports and other timekeeping records* sufficient to support all (or substantially all) of the labor hours charged to the CAs.[2] Each of its *procurement contracts* was awarded on the basis of a competitive solicitation or, if awarded with less than "open and free competition," on the basis of specific instructions from EPA ("directed contract") or another well-recognized sole-source justification.[3] For each of those contract awards, it conducted a detailed *price analysis*, as required by EPA regulations.[4] Finally, it complied with its contractual obligations regarding submission of *indirect cost proposals*.[5] Moreover, final cost data for 1997 to 2002 show that the Foundation recovered significantly less in indirect costs than it was entitled to recover: the Foundation has under-recovered approximately $600,000 in indirect costs from EPA.

The issues raised in the DAR relate almost exclusively to compliance with documentation requirements (e.g., procurement procedures, cost/price analysis, written procedures, standard contract clauses) rather than compliance with substantive rules and regulations. These documentation issues were first called to our attention in March 2002 by the EPA Grants and Management Office. At that time, we took immediate steps to address EPA's concerns; by May 2002, EPA had approved our proposed plan of action, which we then implemented. Consequently, we do not believe that any of these documentation issues can reasonably support a disallowance of costs.

[3] Finally, with respect to the Foundation's eligibility to receive Federal funds: According to the DAR, the Foundation, a 501(c)(3) organization, was not sufficiently separated from CFA, then a 501(c)(4) organization, to be treated as a separate organization for purposes of LDA Section 18. In addition, at the time CFA engaged in a small amount of lobbying. On that basis, the DAR concludes that the Foundation was not a 501(c)(3) organization, but was instead a 501(c)(4) organization that engaged in lobbying, and it was therefore not eligible to receive Federal funds. Accordingly, every penny of the $4.7 million received by the Foundation must be refunded.

---

[1] Response, Parts 1, 3[A] and 3[B], and 4.
[2] Response, Part 2.
[3] Response, Parts 7[A], 7[C] and 7[D].
[4] Response, Parts 7[B], 7[C] and 7[E].
[5] Response, Part 6.

As explained in detail in the *legal memorandum*, the DAR's interpretation of Section 18 is based on factual misrepresentations and flawed legal analysis.

• The DAR misrepresents the Foundation's history and corporate purpose. The Foundation was not, as the DAR suggests, established "to receive the Federal funds" that CFA, a 501(c)(4) organization that engaged in lobbying, was no longer eligible to receive. In fact, the Foundation was established in 1972, more than 20 years before the enactment of the LDA, and in 1996, was a fully functioning 501(c)(3) organization. It was not a sham designed to mislead EPA

• The DAR understates the degree of separation between the Foundation and CFA. The organizations had separate Boards of Directors (including, in the Foundation's case, outside directors unconnected to CFA), separate financial accounts and separate funding.

• The DAR misreads the text of the LDA Section 18, where eligibility for Federal funds turns on the IRS classifications alone, and its legislative history, which suggests that separate incorporation and IRS recognition is sufficient to avoid the Section prohibition.

• EPA has no authority to adopt an expansive interpretation of Section 18. It is not the agency charged with enforcement of the statute, and it has no particular expertise in the issues arising thereunder, Furthermore, an expansive interpretation would raise difficult First Amendment issues, a situation that Congress anticipated when it passed Section 18, and attempted to avoid by making the statute clear and unambiguous.

• Even if the OIG interpretation were plausible, and EPA had the authority to adopt that interpretation and apply it to recipients, EPA could not apply that interpretation retroactively to the Foundation.

In fact, it appears that EPA already *considered* and *rejected* the OIG interpretation of LDA Section 18 [i] in 1996 and 1997, when it transferred CFA's radon programs to the Foundation under new CAs even though EPA officials were aware of the very facts and circumstances which, according to OIG, made the Foundation ineligible to receive Federal funds, and [ii] in May 2002, when, after considering, once again, the relationship between the Foundation and CFA, it continued disbursing Federal funds to the Foundation under five separate cooperative agreements through the end of 2002.

In light of the foregoing, OIG's proposed $4.7 million disallowance is entirely without legal justification. It is based on an interpretation of LDA Section 18 that is untenable and, indeed, has already been considered and rejected by EPA; and retroactive application of that interpretation to the Foundation would be arbitrary, capricious and a denial of due process of law.

The proposed disallowance is also patently unfair and reasonable. It ignores the fact that the programs were undertaken by CFA *at EPA's specific request*, and were later transferred intact from CFA to the Foundation *at EPA's specific request*. It ignores 5 years of successful program performance by the Foundation, and the considerable benefits for public health and education that flowed from those programs. Finally, it ignores the fact that Foundation acted, at all times and in all matters, in the utmost good faith.

Sincerely,

STEPHEN BROBECK,
Executive Director.

Senator JEFFORDS. Mr. O'Connor, does EPA have adequate resources, including staff, to successfully implement its new grants management plan? If not, what further resources does EPA need for this purpose?

Mr. O'CONNOR. Well, Senator, the plan we have laid out, and some of the components in particular, such as oversight of the grants once they are awarded, there is no way around the fact that they do require resources. The Agency in its budgeting this year, and I think it was acknowledged earlier, that this is a tight year, did provide some million dollars for us to use toward post-award management. Some small number of FTE have also been provided.

Yes, we could use more and yes, we could do more monitoring with more resources. But I have to say that resources is pretty far down the list of things that I would highlight right now. There are

a lot of things that are in our control with the resources that we have that we need to do before I would use resources as an excuse.

Senator JEFFORDS. Cases have been reported of grantees who mismanage funds but are nevertheless allowed to continue to apply for, and in some cases receive, further grant money. Why does not the EPA respond more severely when grantees violate policies and management funds?

Mr. O'CONNOR. Well, it is a matter of the nature of the violations and whether there is a persistent record. I do not know that we have had a system in the past to really track those as effectively as we should to know whether we have such track records. The new system that you heard discussed during our opening comments will give us that ability. But I think if we find that there have been willful violations of laws, that we are prepared to take such actions.

On many of our reviews, as I mentioned earlier, where we have found problems, we prefer to work those out with the grantees so that the important work that we are both engaged in can continue. But in some cases we are not satisfied and we do put controls on the expenditure of those grant funds until we are satisfied that they have been corrected.

Senator JEFFORDS. What kinds of policies does EPA have in place for responding when EPA staff fail to adequate perform their oversight duties?

Mr. O'CONNOR. Well, I think as Mr. Stephenson might have mentioned, that is probably the million dollar question. We have taken a number of steps. Perhaps one of the most important first steps this year is putting language in the performance agreements of all of the 1,800 project officers who are engaged in grants management, as well as all of the supervisors and managers across the Agency. We do require now that in our annual process that offices and regions certify to how they have conducted those performance appraisals to assure us that they are, in fact, assessing performance against the standards.

This is, by the way, an issue that goes far beyond grants management. The Agency right now is revising the performance agreement of all of its managers and by April to link our performance standards much more directly to the Agency's strategic plan and annual goals and crosscutting strategies. One of the most important of those crosscutting strategies is grants management.

So the mechanism to do this is coming in to place right now. The very difficult question that I think everyone has acknowledged is how do we make sure that for every one of these 1,800 individuals, it really happens. That is going to be our challenge. We are putting a lot of management attention on that issue. But I would not be truthful if I said that it is going to be easy and it is not going to take much of our attention.

Senator JEFFORDS. Thank you, Mr. Chairman.

Senator INHOFE. Thank you, Senator Jeffords.

First of all, Ms. Heist, I want to assure that I do not hold you responsible or certainly the IG responsible for the Consumer Federation grant. I just want to try to understand the facts in this case. This is something that we have the responsibility to do some-

thing about and we are going to. Your report, which could not be more current—it is March 1, 2004—says:

> "The Federation was a 501(c)(4), that, is a lobbying organization that was prohibited from receiving Federal funds under the Lobbying Disclosure Act and the arrangement between the Foundation and the Federation violated the Lobbying Disclosure Act prohibition."

To me that sounds like the EPA is giving money to groups who are lobbying. Again, I do not mean to single out this one Federation because I regretfully suspect that there are many others where this has taken place, too.

We do not want to overlook you, Mr. Ellis. We will be right with you in a minute. But let me finish up something with Mr. O'Connor. You said these things are not going to happen overnight. I understand that. But in competition, the EPA's new competition policy requires that all grants recipients over $75,000 be competitively bid but references a "managed competition."

How would this be any better than the previous policy that was supposed to ensure competition in this grants? Maybe you can define for us what "managed competition" is?

Mr. O'CONNOR. Sir, unlike in the world of direct Federal procurement where the regulations that govern competition have been set in stone for a long time and are very clear, there are not such regulatory provisions for grants competition. So we provide for the ability to conduct a competitive process in different ways.

To some extent it is driven by the size of the grant and the nature of the grant. For example, if it is a $75,000 grant, I am not so sure I want to spend a half million dollars doing a formal rigid competition, the type of which would be required if it were direct procurement. So we allow for there to be different ways to compete the grant. Of course, that is a complicating factor in trying to ensure that we are managing these competitions in a way that we are comfortable with.

Senator INHOFE. The IG reported in 2001 in their report that the EPA practice on soliciting grant recipients was "word gets out." What part of your 5-year management plan even addresses soliciting recipients?

Mr. O'CONNOR. "Word gets out," I am assuming meaning that people have their favorites. Obviously a principle way of addressing that is to the competition policy. As I mentioned, I think we have a pretty successful percentage of competitions in our first year under the policy. We are not necessary satisfied with how well those were done or documented, but nonetheless we did move significantly to competing grants. I think that first step is the most important step.

Senator INHOFE. What would be wrong with putting all of these on a website where the public and anyone interested would have access to them?

Mr. O'CONNOR. Well, we are actually moving toward that with our automated system—to be able to put all grant actions and announcements out electronically. That is something that we are participating in with much of the rest of the Government under an E-Government initiative.

Senator INHOFE. Good. All right.

Mr. Ellis, I appreciate very much your mission and what you are doing. I think you are trying to do the same thing that we are trying to do up here. Being a group that describes itself as environmentally conscious, has your organization done any publications documenting wasteful spending with EPA financial assistance?

Mr. ELLIS. I am not sure. You said something about environmentally conscious. I am not aware of that description of our organization.

Senator INHOFE. That is fine. I appreciate that clarification.

Mr. ELLIS. Right. But your question, Senator, was have we done work looking into this before?

Senator INHOFE. Has your organization done any publications documenting wasteful spending with reference to EPA financial assistance or grants?

Mr. ELLIS. Not prior to this actual hearing when we were publishing this information. This is something that we have followed. I know that we have talked with the Heritage Foundation on some of their analysis on grants governmentwide. They have documented $325 billion worth of Government grants that go out there and concerns about competition. I think this falls within that category. It is something that is of concern to us.

Senator INHOFE. Then you would say that working then with groups like the Heritage Foundation, you both would have that common goal in disclosure, openness, and so forth?

Mr. ELLIS. Absolutely. I think the real goal in any kind of grants is that they actually further the mission and the goals of both the Agency, the Government, and the Nation.

Senator INHOFE. All right. One last question. You identified discretionary grants as receiving "well-earned criticism." Have you found any particular problematic grant recipients?

Mr. ELLIS. We have not really looked particularly at the grant recipients. We have looked more at the process. We think that if you have a bad process, you are going to have a bad result, regardless of who the recipient is. If people have laudable goals, if we are not really making sure that we are spending the money wisely, then we are not really doing them a favor and we are certainly not doing the taxpayer or the EPA a favor.

Senator INHOFE. I would certainly agree with that. I might suggest that you consider expanding your realm into identifying some of these problematic areas. It makes it easier for others to go in to try to correct the problems.

Senator Jeffords.

Senator JEFFORDS. Mr. O'Connor, the August 2003 GAO report stated that effective implementation of EPA's competition policy would require a major cultural shift at EPA. In your written testimony you suggest that a cultural shift is now occurring at the EPA. What leads you to say this? What has changed EPA to bring about a cultural shift toward accountability in grants management?

Mr. O'CONNOR. Senator Jeffords, with respect to the competition as was noted, for years and years, our project officers were accustomed to just selecting their grantee which led to at least the appearance that we had favorites and that we were not necessarily going out there sure that we were getting the best value for the Government.

That policy, quite frankly, did not go over very well initially, with our 1,800 project officers because it does require quite a bit of additional work. This was something that they had to adjust to. Frankly, we set a goal of competing, I believe it was 30 percent of the covered grants in our first year. I was very pleased with achieving the 75 percent.

But that is one of a number of major mindsets that we are trying to change, and will change, over the next couple of years in how we manage our grants.

Senator JEFFORDS. In GAO's August 2003 report, the data seems to show that during 2002, no incidences of lobbying problems were found among over 1,200 in-depth reviews of grantees, including over 200 reviews of nonprofit organizations. Can you confirm that this is correct?

Mr. O'CONNOR. To the best of my knowledge, that is correct, sir.

Senator JEFFORDS. Mr. Ellis, in your written testimony, you recommended EPA investigate centralizing and streamlining grant management to fewer, more highly trained individuals. Can you elaborate on that recommendation?

Mr. ELLIS. Certainly. Much has been talked about with the 1,800 project officers. There is going to be a balancing act, as I think was mentioned. These project officers are in other areas of EPA such as the Office of Water, or Office of Air. So you want to have some of the subject matter expertise still housed with these people, but you also want them to feel that they are properly trained and are being watched also for their grant management expertise.

I think when you start looking at an Agency with a $8 billion budget, and they have 1,800 different project officers that are managing all these different grants, I think you need to start looking at ways to consolidate the functions in some respects. Also, if you can consolidate, then you can make training and grant management more of that person's job. In my mind, that also professionalizes that particular part of that person's activities to a greater extent. Then you are going to get a better performance and better product.

Senator JEFFORDS. The EPA Inspector General has found that EPA's problems with grants oversight can, in part, be attributed to its failure to sufficiently prioritize the activity. Do you think that the EPA's new grant management plan goes far enough in prioritizing oversight? What further steps, if any, do you think ought to be taken?

Mr. ELLIS. Well, before I got into this line of work, I was an officer in the military. I was an officer in the Coast Guard. I have to say that I did my job very well, thank you, but what I paid most attention to was what I was evaluated on and what I was going to have to respond to. I think that whatever you put together as far as words on paper and rules and guidelines are only going to be effective as the people who are implementing them, stick to them, and really require people to adopt those measures.

Part of that, as has been mentioned by Mr. Stephenson, is making people recognize that they are going to be evaluated on these particular areas. They are going to be evaluated on their grants management. So, to me, that is going to be the key of really making any of these reforms, whether it be competitive grants, over-

sight, or any of these other areas stick. The fact is that EPA, from the bottom to the top, demands that people perform and manage these contracts efficiently and effectively.

Senator JEFFORDS. Are you indicating that is not being done?

Mr. ELLIS. Well, I think that in the end it has not been done to date because that is why we are all sitting here. I think if this had been going on in the years past, then we would not have to be here. I am not going to pre-suppose a plan that just came out in April of last year, but I think the proof will be in the pudding as far as how we go forward from that date.

Senator JEFFORDS. Thank you.

That is all I have, Mr. Chairman.

Senator INHOFE. Thank you, Senator Jeffords.

Mr. Stephenson, there has been talk about the EPA needs more resources when they testified only a few months ago, that the EPA had too many working in grants. The GAO reports that 35 percent of project officers oversee only one grant. Would you not draw the conclusion here that they do not need more resources for that?

Mr. STEPHENSON. Our first step always is to spend the resources you get more efficiently. There are several ways we think they can more efficiently oversee grants. That is the statistical approach I mentioned that they are not doing a job with the resources that they have in targeting grants and finding where the systemic problems are. That is one step.

One project officer per grant is probably not an efficient way to oversee grants, but again there has to be this balance between technical expertise and air programs and water programs, and what the grantee and the grant are trying to accomplish. It just seems to me that 1,800 is too many.

Senator INHOFE. If 35 percent are only overseeing one project, what types of projects would those be that would require 100 percent of a person's time?

Mr. STEPHENSON. Remember, there is a grants management staff whose only function is to set policy and to provide guidance to the staff who are overseeing grants.

Senator INHOFE. That is much smaller than your project officers?

Mr. STEPHENSON. Right, much smaller.

Senator INHOFE. It is 1,800 versus 100?

Mr. STEPHENSON. Yes, the 1,800 are the ones with the technical expertise that are needed to effectively oversee grants. We have not done a specific analysis in that area, but one-per-one does not seem to be a good ratio.

Senator INHOFE. All right; fine.

Mr. O'Connor, it appears that you have a big job ahead of you. It concerns me that GAO identified a lack of management accountability and environmental results in competition and grant awards in its most recent report. More concerning is that GAO in that report identified a lack of methodology to identify systemic problems, lack of environmental results, and lack of accountability in grants management, even after reviewing the new EPA policies.

I understand your testimony today addresses some of the GAO's conclusions. However, audits such as the one of the Consumer Federation of America cannot go unnoticed. We cannot simply trust in the promise of new policies to remedy this type of a problem. The

witnesses have testified that particularly problematic are discretionary grants which compromise about one-quarter of grant awards each year. I would like to see who are receiving these grants and what they are producing.

Accordingly, I have an information request of the Agency for fiscal year 2002. I would like a listing of the discretionary grants awarded. My staff will provide you with office correspondence immediately following the hearing detailing the information I would like to have included. I would like to have this prior to our budget hearing where we will have the Administrator before this committee a week from today.

I like the idea of doing something, of opening the doors, and not just having a website where you show the various competitions coming up, but also where you show the grants that are issued. I think you will get a lot of help, Mr. Ellis, from the public if the questions are answered concerning the grants that go to various organizations.

I look forward to that.

I would say that I know that we have had initial hearings on this problem before, but the revolving door, as I said in my opening statement, just keeps revolving. I would like to tell you and look you in the eyes that the revolving door is going to stop.

Senator Jeffords, do you have any concluding remarks?

Senator JEFFORDS. I think you did a good job.

Senator INHOFE. Thank you very much.

We are adjourned.

[Whereupon, at 10:37 a.m., the committee was adjourned, to reconvene at the call of the chair.]

[Additional statements submitted for the record follow:]

STATEMENT OF HON. MICHAEL D. CRAPO, U.S. SENATOR FROM THE STATE OF IDAHO

Thank you, Chairman Inhofe, Senator Jeffords. Let me begin by saying that I appreciate your hard work and the work of the committee in addressing the issue of grants management within the U.S. Environmental Protection Agency (EPA).

Given the considerable amount of taxpayer dollars appropriated every year for EPA grants and the breadth of the agency's responsibility for assisting with environmental efforts, oversight of how this money is being spent is important.

As a member of the Senate Budget Committee, we have been working to produce a budget resolution, and as we all know it will be an extremely tough budget year.

With the current economic climate and our need to use the utmost discretion to ensure that hardworking Americans' dollars are wisely spent, it is now more timely than ever to address this issue.

One of the issues I would like to raise today is the distribution of Brownfields program grants. Let me begin by saying, I support the Brownfields Program.

Assistance through this program can go a long way toward assisting communities that contain property that is unavailable for development due to environmental contamination.

Many communities that are dealing with the rehabilitation of Brownfield properties lack the funding necessary to revitalize the properties. These grants are vital sources of assistance, and are good for local economies, local communities, and the environment.

However, it is essential that the EPA give all communities access to the program and make it truly a national program.

I was alarmed to discover that Brownfields funds are not distributed equitably between the eastern and western United States and among urban and rural communities. Furthermore, only 10 of these grants were awarded in the intermountain West.

This is an issue I have raised in the past with EPA. I have asked EPA to consider developing a specific "rural" component to the Brownfields program.

Unemployment rates are often as high in many small rural communities as they are in inner cities, and rural communities are no less impacted by contamination, or the possibility of contamination which has hindered the re-development of these properties in rural towns—a key objective of the Brownfields program.

I plan to ask the panel some questions regarding this important issue, but I will defer further discussion of this issue until later.

Again, I thank the committee and the witnesses here with us today for your hard work in addressing the oversight of EPA grants. I look forward to continuing to work to ensure our limited resources are well spent. Thank you, Mr. Chairman.

STATEMENT OF MELISSA HEIST, ASSISTANT INSPECTOR GENERAL FOR AUDIT, U.S. ENVIRONMENTAL PROTECTION AGENCY

Good morning, Mr. Chairman and members of the committee. I am Melissa Heist, Assistant Inspector General for Audit for the United States Environmental Protection Agency. I am pleased to be here today representing Nikki Tinsley, the Inspector General. Thank you for the invitation to inform you about the work we have done reviewing EPA's administration of assistance agreements, also known as grants.

Assistance agreements are a primary means EPA uses to carry out its mission of protecting human health and the environment. More than half of EPA's fiscal 2003 budget was awarded to organizations outside the Agency through assistance agreements. EPA primarily awards assistance agreements to State, local, and tribal governments; universities; and nonprofit organizations. Because the amount is large, approximately $4.4 billion dollars, and it is the primary mechanism EPA uses to fulfill its mission, it is imperative that the Agency use good management practices in awarding and overseeing these agreements to ensure that they effectively contribute to attaining environmental goals.

EPA's management of assistance agreements has been an area of emphasis for the Inspector General's office for many years. In fact, we have been issuing audit reports and raising concerns about EPA's management of assistance agreements for over 10 years. In addition to our audit work, we have also conducted a number of investigations related to the improper and illegal activities of some EPA grantees.

Our grants management work has focused on cross-cutting national issues and has included grants made to States, local and tribal governments, and nonprofit organizations. We have looked at major program areas in EPA headquarters and regions. We designed our work to identify systemic problems preventing the Agency from achieving the maximum results from the billions of dollars awarded in assistance agreements every year. In my testimony I will include examples from our work that illustrate the types of problems we have found in EPA's grants management activities. The entire reports for these examples can be found on the OIG web page at *www.epa.gov/oig*.

On Monday, March 1, 2004, we issued an audit report on an EPA grantee that we initiated at the Agency's request. We found an ineligible lobbying organization was performing work under cooperative agreements and the procurement process was circumvented. We questioned $4.7 million because the work was performed by an ineligible lobbying organization. EPA awarded the cooperative agreements to an associated organization that did not have any employees, space or overhead expenses. In addition, the ineligible organization's financial management practices did not comply with Federal regulations. For example, the ineligible organization did not adequately identify and separate lobbying expenses in its accounting records. As a result, lobbying costs may have been charged to the Federal projects. The ineligible organization also claimed that it had not always followed Federal regulations because EPA directed the recipient to use a particular contractor.

PRE-AWARD ACTIVITIES

In May 2001, the OIG reported that EPA did not have a policy requiring program officials to competitively award discretionary assistance funds. EPA had done little to promote competition, and often did not provide adequate justification for not using competition to award grants. Assistance agreements were awarded without competition based on the project officer's opinion that the recipient was uniquely qualified. There was no documented evidence that no other organizations existed that could perform the desired work. We also found that EPA was not performing a widespread solicitation for assistance agreements. Without widespread solicitation, EPA limited the potential applicants and created the appearance of preferential treatment. Without competition, EPA cannot be sure that it is funding the best projects based on merit and cost-effectiveness to achieve environmental objectives,

and accomplishing its mission with a reasonable return on the taxpayer's investment.

Before EPA awards an assistance agreement, the EPA project officer must conduct a programmatic and technical review of the application package in order to select those applications that will most effectively contribute to EPA program objectives and priorities. A main focus of the project officer's review is the work plan, which should describe what will be done, when it will be accomplished, and the estimated costs. The pre-award review is critical to ensure that the results of the assistance agreement will contribute to protecting human health and the environment.

In 1998, the OIG issued a report stating that project officers were not always negotiating work plans with well-defined commitments or adequately determining and documenting that costs for the assistance agreement were reasonable. In March 2002, the OIG reported that EPA was awarding assistance agreements without identifying expected outcomes, quantifying outputs, linking outputs to funding, or identifying milestone dates for completing work products.

In a report issued in March 2003, we reported that project officers did not perform all the necessary steps when conducting pre-award reviews. For this audit, we selected a statistical sample of 116 assistance agreements awarded by the Office of Air and Radiation, the Office of Water, and related regional offices. We found:

• EPA awarded $700,000 without knowledge of the work the recipient was going to perform. The work plan did not have clear objectives, milestones, deliverables, or outcomes.

The recipient stated in the work plan: "Because of the exploratory nature of these activities and the need to bring together various market players, exact deliverables and schedule will be determined based on what participants tell us they want from our project."

• In 79 percent of the sampled assistance agreements over $100,000, project officers did not document cost reviews of proposed budgets. For example, a recipient was awarded $1.3 million to operate its air pollution control program without determining the reasonableness of the proposed costs to the expected benefits of the projects.

• In 42 percent of the sampled assistance agreements, EPA did not negotiate environmental outcomes. For example, EPA awarded a recipient $200,000 to regulate costs charged by power companies. The work plan contained no environmental outcomes, and stated that specific projects would be identified at a later date. In fact, the work plan itself only provided possible activities, and stated specific projects would be established later. The project officer wrote on the application, "why this, why now?" yet still approved the work plan.

Without complete pre-award reviews of proposed projects, there was insufficient assurance that the funded projects would accomplish program objectives or desired environmental results. There was also insufficient assurance that proposed costs were reasonable, and that recipients were technically capable of performing the work. EPA may also have lost the opportunity to fund other projects that would have better achieved its mission.

POST-AWARD GRANTS MANAGEMENT

OIG reports continue to find that improvements are needed in EPA oversight of assistance agreements after they are awarded. In 1995, we found that EPA staff were not (1) making site visits, (2) timely processing financial status reports, (3) obtaining or reviewing required audit reports, and (4) ensuring that final reports were completed. In 2002, we followed up on EPA's progress in improving oversight and found that weaknesses continued to exist. While EPA had developed policies and training to improve the oversight of assistance agreements, it did not ensure that the policies were followed consistently.

OIG reports continue to identify examples of EPA staff not adequately overseeing awards to States for environmental programs and nonprofit organizations for specific projects.

• A February 2003 report found that EPA Region 6's oversight of Louisiana was insufficient and could not assure the public that Louisiana was protecting the environment. We initiated this review because EPA had received petitions from citizen groups to withdraw Louisiana's National Pollutant Discharge Elimination System, a water program; the Resource Conservation and Recovery Act, a hazardous waste program; and the Title V air permit program.

Region 6 leadership (1) did not develop and clearly communicate a vision and measurable goals for its oversight of the State or emphasize the importance of consistently conducting oversight, (2) did not hold Louisiana accountable for meeting goals and commitments, and (3) did not ensure that data of poor quality was cor-

rected so that it could be relied upon to make sound decisions. As a result, EPA was unable to assure the public that Louisiana was operating programs in a way that effectively protected human health and the environment. In its response, EPA's Region 6 said it would implement its new oversight protocol for use beginning in fiscal year 2005.

• A March 2002 report found that EPA had no assurance that as much as $187 million spent on procurements by assistance recipients was used to obtain the best products, at the best prices, from the most qualified firms. Recipients were not competing contract awards or performing cost or price analysis as required by the regulations. For example, a nonprofit recipient awarded two sole source contracts to its for-profit subsidiary. The recipient also awarded sole source contracts to three for-profit companies created by its for-profit subsidiary. The recipient entered into 23 contracts, 20 of which were awarded sole source. As a result, we questioned $1.3 million of costs claimed.

INSUFFICIENT EPA REVIEW AND OVERSIGHT CONTRIBUTED TO RECIPIENT'S PROBLEMS

Recent audits of grant recipients show how EPA's lack of review and oversight can contribute to problems for the grantee.

• We questioned $1.7 million in costs claimed because a recipient did not have an adequate time distribution system and an indirect cost rate, as required by EPA regulations. The EPA project officer focused his oversight on the technical performance of the recipient, with little emphasis on business and administrative aspects of the recipient's performance. The grants specialist did not respond to repeated requests from the recipient for assistance in developing the indirect cost rate. Further, the project officer did not conduct an onsite review of the recipient until almost 6 years after the first award.

• We questioned $1.6 million in costs claimed by another recipient for, among other things, improper procurement. The recipient did not competitively procure equipment and services, and did not perform cost or price analysis for the purchases. Furthermore, procuring goods and services for State agencies is not an authorized use of the funds provided under Section 103 of the Clean Air Act. EPA staff contributed to the problem when it wrote the sole source justification and scope of work for the contract. The justification for the sole source procurement was the EPA staff's familiarity with the contractor and the work that needed to be performed. EPA policy specifically prohibits employees from directing a recipient to award a contract to a specific individual or firm or participate in the negotiation of an award of a contract under an assistance agreement.

IMPROVED ACCOUNTABILITY NEEDED

The deficiencies in EPA's pre-award reviews and post-award oversight were not due to the lack of policies, but rather existing policies and guidance were not always followed. EPA policies and guidance identify the reviews EPA staff are to perform prior to and after assistance agreements are awarded. However, EPA staff did not always follow the policies and were not held accountable when they did not do so.

• The project officer function is often a collateral duty for EPA staff. In some instances, the performance agreements and position descriptions did not identify project officer responsibilities. Even when the performance agreement identified the individual as a project officer, the agreement did not reference specific project officer duties such as determining the programmatic and technical merit of a project or conducting cost reviews.

• Senior Resource Officials did not emphasize the importance of post award monitoring. Senior Resource Officials are charged with strengthening Agency-wide fiscal resources management. They are typically Deputy Assistant Administrators or Assistant Regional Administrators. These officials stated that the level of post award monitoring was affected by the limited availability of resources for staffing, travel, and training.

EPA'S ACTIONS TO ADDRESS WEAKNESSES

EPA has taken some corrective actions to address our recommendations to better manage assistance agreements.

• During 2002, the Administrator issued two orders to implement new changes—the Policy on Competition in Assistance Agreements and the Policy on Compliance, Review, and Monitoring. Through enhanced monitoring required by the new policy, EPA has increased the number of requests to the OIG for audit.

• During 2003, EPA issued its Grants Management Plan, a 5-year strategy designed to ensure that grant programs meet the highest management and fiduciary standards.

• EPA initiated a review of performance standards for all employees involved with grants management and required new standards to be in place by January 2004.

• EPA has drafted a Long-term Grants Management Training Plan designed to improve the skills of those responsible for grants management activities.

The challenge for EPA now will be to ensure that staff implement, and are held accountable for, following the new policies and for implementing the new grants management and training plans. Many of the deficiencies we found were due to EPA staff not following existing policies and not being held accountable.

In issuing its Grants Management Plan, EPA stated its vision was to ensure that its grants programs meet the highest management and fiduciary standards and further the Agency's mission of protecting human health and the environment. The OIG will monitor the Agency's progress in implementing the Plan, and we will evaluate whether the actions are effective in improving the accountability of recipients.

We are proud of the efforts the OIG staff have made in bringing these issues to light, and I thank you, Mr. Chairman and members of the committee, for the opportunity to participate in a discussion of such an important topic. We are committed to working with you and EPA to ensure that the money awarded every year through assistance agreements is producing the intended environmental and public health benefits.

This concludes my prepared remarks, and I will be happy to respond to questions.

Percentage of Key Pre-Award Steps Not Completed

	Percentage	Impact (in millions)
Mission Relevance	19	$42
Probable Success	31	$88
Reasonable Cost	79	$536
Environmental Outcomes	42	
Milestones	24	
Evaluation Process	96	

RESPONSES BY NIKKI TINSLEY TO ADDITIONAL QUESTIONS FROM SENATOR INHOFE

Question 1. The Inspector General has compiled numerous reports and audits concerning EPA grants management over the past several years identifying many criticisms of grants management. In questioning before the House Subcommittee on Water Resources and Environment on June 11, 2003, Inspector General Tinsley responded, "I am afraid hope is our strategy here," in [response] to a question concerning whether accountability will result from the new EPA policies in grants management. The General Accounting Office reported in a report titled Grants Management—EPA Needs to Strengthen Efforts to Address Persistent Challenges (GAO–03–846) that EPA's new grants policies and Five Year Grants Management Plan continues to not address issues of gathering adequate information to evaluate proper grants management, the need to demonstrate environmental outcomes, and personnel accountability. What continuing deficiencies does the Inspector General believe continue to exist in EPA grants management policies?

Answer. At this time, we are not aware of any other deficiencies in EPA grants management policies. As Ms. Heist stated in her testimony, the deficiencies in EPA's management of grants were not due to the lack of policies, but rather existing policies and guidance were not always followed.

Question 2. Much of the testimony in the hearing focused on the March 1, 2004, OIG Audit Report concluding, "The [Consumer Federation of America] Federation was a 501(c)(4) lobbying organization that was prohibited from receiving Federal funds under the Lobbying Disclosure Act, and the arrangement between the [Consumer Federation of America] Foundation and the Federation violated the Lobbying Disclosure Act prohibition." In part, the OIG recommended recovery of all grants under each cooperative agreement with the Consumer Federation of America Foundation. Is the OIG recommendation and particular treatment of the Consumer Federation of America Foundation a new policy based on a new reading of the Lobbying Disclosure Act?

Answer. No. Our recommendation as to the recovery of grant funds is based on Comptroller General decisions holding that grant funds erroneously awarded to an ineligible grantee must be recovered by the Government. 51 Comp. Gen. 162 (1971); B–146285/B–164031, April 19, 1972. Further, we do not believe we have adopted a "new policy" based on a "new reading" of the Lobbying Disclosure Act. The Lobbying Disclosure Act, and legislative history, recognize that a 501(c)(4) lobbying organization, which is ineligible from receiving Federal funds, can form or be affiliated with, an organization that does not engage in lobbying, and which, therefore, is eligible to receive Federal funds. As our report found, however, the arrangement and operations between the Consumer Federation of America Foundation and the Federation were, in fact, indistinguishable, and that the Foundation existed only on paper. Based on this, we believe our conclusion does not represent a new interpretation of the Lobbying Disclosure Act, but rather an interpretation that is consistent with the express language and intent of the Lobbying Disclosure Act.

United States General Accounting Office

GAO

Testimony
Before the Committee on Environment and Public Works, U.S. Senate

For Release on Delivery
Expected at 9:30 a.m. EST
March 3, 2004

GRANTS MANAGEMENT

EPA Needs to Strengthen Efforts to Address Management Challenges

Statement of John B. Stephenson, Director
Natural Resources and the Environment

GAO-04-510T

March 3, 2004

GAO
Accountability · Integrity · Reliability
Highlights

Highlights of GAO-04-510T, testimony before the Committee on Environment and Public Works, U.S Senate

GRANTS MANAGEMENT

EPA Needs to Strengthen Efforts to Address Management Challenges

Why GAO Did This Study

The Environmental Protection Agency (EPA) has long faced problems managing its grants, which constitute over one-half of the agency's annual budget, or about $4 billion. EPA uses grants to implement its programs to protect human health and the environment and awards grants to thousands of recipients, including state and local governments, tribes, universities, and nonprofit organizations. EPA's ability to efficiently and effectively accomplish its mission largely depends on how well it manages its grants resources.

This testimony, based on GAO's August 2003 report *Grants Management: EPA Needs to Strengthen Efforts to Address Persistent Challenges*, GAO-03-846, focuses on the (1) major challenges EPA faces in managing its grants and how it has addressed these challenges in the past, and (2) extent to which EPA's recently issued policies and grants management plan address these challenges.

What GAO Recommends

GAO made recommendations to the Administrator of EPA to strengthen the agency's efforts to address persistent challenges in effectively managing its grants. EPA agreed with GAO's recommendations and is in the process of implementing them as part of its 5-year grants management plan.

www gao gov/cgi-bin/getrpt?GAO-04-510T

To view the full product, including the scope and methodology, click on the link above. For more information, contact John B Stephenson at (202) 512-3841 or stephensonj@gao gov.

What GAO Found

EPA continues to face four key grants management challenges, despite past efforts to address them. These challenges are (1) selecting the most qualified grants applicants, (2) effectively overseeing grantees, (3) measuring the results of grants, and (4) effectively managing grant staff and resources. In the past, EPA has taken a series of actions to address these challenges by, among other things, issuing policies on competition and oversight, conducting training for project officers and nonprofit organizations, and developing a new data system for grants management. However, these actions had mixed results because of the complexity of the problems, weaknesses in design and implementation, and insufficient management attention.

EPA's recently issued policies and a 5-year grants management plan to address longstanding management problems show promise, but these policies and plan require strengthening, enhanced accountability, and sustained commitment to succeed. EPA's September 2002 competition policy should improve EPA's ability to select the most qualified applicants by requiring competition for more grants. However, effective implementation of the policy will require a major cultural shift for EPA managers and staff because the competitive process will require significant planning and take more time than awarding grants noncompetitively. EPA's December 2002 oversight policy makes important improvements in oversight, but it does not enable EPA to identify systemic problems in grants management. For example, the policy does not incorporate a statistical approach to selecting grantees for review so that EPA can project the results of the reviews to all EPA grantees.

Issued in April 2003, EPA's 5-year grants management plan does offer, for the first time, a comprehensive road map with objectives, goals, and milestones for addressing grants management challenges. However, in implementing the plan, EPA faces challenges in holding all managers and staff accountable for successfully fulfilling their grants management responsibilities. Without this accountability, EPA cannot ensure the sustained commitment needed for the plan's success. While EPA has begun implementing actions in the plan, GAO believes that, given EPA's historically uneven performance in addressing its grants challenges, congressional oversight is important to ensure that EPA's Administrator, managers, and staff implement the plan in a sustained, coordinated fashion to meet the plan's ambitious targets and time frames.

Mr. Chairman and Members of the Committee:

We are pleased to be here today to discuss the Environmental Protection Agency's (EPA) management of its grants. My testimony is based on our report on this topic issued last August.[1]

EPA has faced persistent challenges for many years in managing its grants, which constitute over one-half of the agency's budget, or about $4 billion annually. To support its mission of protecting human health and the environment, EPA awards grants to a variety of recipients, including state and local governments, tribes, universities, and nonprofit organizations. There were 4,100 EPA grant recipients when we conducted our review.[2] Given the size and diversity of EPA's programs, its ability to efficiently and effectively accomplish its mission largely depends on how well it manages its grant resources and builds accountability into its efforts.

Congressional hearings in 1996, 1999, and 2003, have focused on EPA's problems in effectively managing its grants. We and EPA's Inspector General have reported on a number of weaknesses throughout the grants management process—from awarding grants to measuring grant results.[3] EPA's efforts to address its grants management problems have not fully resolved them. To highlight these problems and hopefully focus greater attention on their resolution, we designated EPA's grants management as a major management challenge in our January 2003 EPA performance and accountability report.[4]

Late in 2002, EPA issued two new policies to address some of its grants management problems—one to promote competition in awarding grants and one to improve its oversight of grants. In April 2003, EPA issued a comprehensive 5-year grants management plan to address its long-standing grants management problems.

[1]U.S. General Accounting Office, *Grants Management: EPA Needs to Strengthen Efforts to Address Persistent Challenges*, GAO-03-846 (Washington, D.C.: Aug. 29, 2003).

[2]As of September 30, 2002.

[3]See U.S. General Accounting Office, *Environmental Protection Agency: Problems Persist in Effectively Managing Grants*, GAO-03-628T (Washington, D.C.: June 11, 2003).

[4]U.S. General Accounting Office, *Major Management Challenges and Program Risks: Environmental Protection Agency*, GAO-03-112 (Washington, D.C.: January 2003).

Our testimony today describes the (1) major challenges EPA faces in managing its grants and how it has addressed these challenges in the past, and (2) extent to which EPA's recently issued policies and grants management plan address these challenges.

To identify the challenges EPA faces in managing its grants and to examine how it has addressed these challenges in the past, we (1) analyzed 93 reports on EPA's grants management, including our reports, EPA's Inspector General reports, and EPA's internal management reviews conducted from 1996 through 2003, (2) systematically reviewed and recorded information from the 1,232 records of calendar year 2002 in-depth reviews of grantee performance—from financial management to progress in achieving grant objectives, and (3) interviewed EPA officials and reviewed documents obtained from them.[5] To determine the extent to which EPA's recently issued policies and grants management plan address these challenges, we (1) reviewed the new policies and plan and interviewed EPA officials responsible for key aspects of the plan, (2) attended EPA's grants management training courses, and (3) observed five EPA in-depth reviews of grantees.[6] This testimony is based on GAO's report for which audit work was conducted from June 2002 through June 2003 in accordance with generally accepted government auditing standards.

In summary, we found the following:

- EPA faces four key management challenges. These challenges are (1) selecting the most qualified grant applicants, (2) effectively overseeing grantees, (3) measuring the results of grants, and (4) effectively managing grant staff and resources. In the past, EPA has taken a series of actions to address these challenges by, among other things, issuing policies, conducting training, and developing a new data system for grants management. However, these actions had mixed results because of the complexity of the problems, weaknesses in design and implementation, and insufficient management attention.

[5]Federal financial assistance includes grants, cooperative agreements, loans, loan guarantees, scholarships, and other forms of assistance. For this report, we focused on both grants and cooperative agreements, and for simplicity, refer to both as "grants."

[6]For detailed methodology, see GAO-03-846, app.I.

- EPA's 2002 competition and oversight policies and 2003 grants management plan focus on the major grants management challenges we identified but will require strengthening, enhanced accountability, and a sustained commitment to succeed.

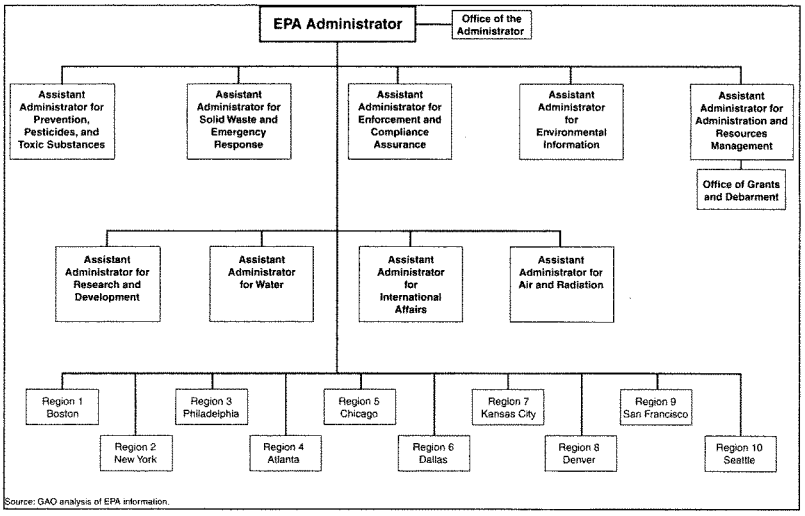
We made recommendations in our report to the EPA Administrator to strengthen grants management, specifically in overseeing grantees, measuring environmental outcomes, incorporating accountability for grants management responsibilities, considering promising practices, and reporting on the progress of its efforts in its annual report to Congress. EPA agreed with our recommendations and is in the process of implementing them as part of its 5-year grants management plan.

Background

EPA administers and oversees grants primarily through the Office of Grants and Debarment, 10 program offices in headquarters,[7] and program offices and grants management offices in EPA's 10 regional offices. Figure 1 shows EPA's key offices involved in grants activities for headquarters and the regions.

[7]According to EPA officials, two headquarters' offices, EPA's Office of General Counsel and the Office of the Chief Financial Officer conduct limited grant activity.

Figure 1: EPA's Key Offices Involved in Grant Activities



Source: GAO analysis of EPA information.

The management of EPA's grants program is a cooperative effort involving the Office of Administration and Resources Management's Office of Grants and Debarment, program offices in headquarters, and grants management and program offices in the regions. The Office of Grants and Debarment develops grant policy and guidance. It also carries out certain types of administrative and financial functions for the grants approved by the headquarters program offices, such as awarding grants and overseeing the financial management of these grants. On the programmatic side, headquarters program offices establish and implement national policies for their grant programs, and set funding priorities. They are also responsible for the technical and programmatic oversight of their grants. In the regions, grants management offices carry out certain administrative

and financial functions for the grants, such as awarding grants approved by the regional program offices,[8] while the regional program staff provide technical and programmatic oversight of their grantees.

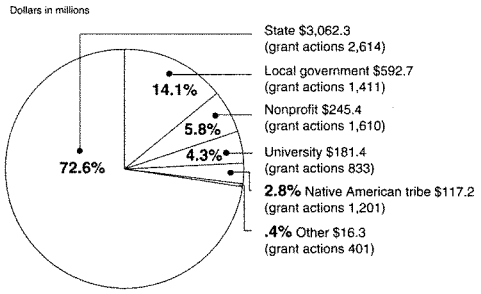
As of June 2003, 109 grants specialists in the Office of Grants and Debarment and the regional grants management offices were largely responsible for administrative and financial grant functions. Furthermore, 1,835 project officers were actively managing grants in headquarters and regional program offices. These project officers are responsible for the technical and programmatic management of grants. Unlike grant specialists, however, project officers generally have other primary responsibilities, such as using the scientific and technical expertise for which they were hired.

In fiscal year 2002, EPA took 8,070 grant actions totaling about $4.2 billion.[9] These awards were made to six main categories of recipients as shown in figure 2.

[8]Program offices in regions 4, 5, 6, 9, and 10 award grants directly.

[9]Grant actions include new awards, increase and decrease amendments. The 8,070 grant actions involving funding were composed of 4,374 new grants, 2,772 increase amendments, and 924 decrease amendments. In addition, EPA awarded 1,620 no cost extensions, which did not involve funding, in fiscal 2002.

Figure 2: Percentage of EPA Grant Dollars Awarded by Recipient Type, Fiscal Year 2002



Source: GAO analysis of EPA data.

EPA offers two types of grants—nondiscretionary and discretionary:

- *Nondiscretionary grants* support water infrastructure projects, such as the drinking water and clean water state revolving fund programs, and continuing environmental programs, such as the Clean Air Program for monitoring and enforcing Clean Air Act regulations. For these grants, Congress directs awards to one or more classes of prospective recipients who meet specific eligibility criteria; the grants are often awarded on the basis of formulas prescribed by law or agency regulation. In fiscal year 2002, EPA awarded about $3.5 billion in nondiscretionary grants. EPA has awarded these grants primarily to states or other governmental entities.

- *Discretionary grants* fund a variety of activities, such as environmental research and training. EPA has the discretion to independently determine the recipients and funding levels for grants. In fiscal year 2002, EPA awarded about $719 million in discretionary grants. EPA has awarded these grants primarily to nonprofit organizations, universities, and government entities.

The grant process has the following four phases:

- *Preaward.* EPA reviews the application paperwork and makes an award decision.
- *Award.* EPA prepares the grant documents and instructs the grantee on technical requirements, and the grantee signs an agreement to comply with all requirements.
- *Postaward.* After awarding the grant, EPA provides technical assistance, oversees the work, and provides payments to the grantee; the grantee completes the work, and the project ends.
- *Closeout of the award.* EPA ensures that all technical work and administrative requirements have been completed; EPA prepares closeout documents and notifies the grantee that the grant is completed.

EPA's grantees are subject to the same type of financial management oversight as the recipients of other federal assistance. Specifically, the Single Audit Act requires grantees to have an audit of their financial statements and federal awards or program-specific audit if they spend $300,000 or more in federal awards in a fiscal year.[10, 11] Grantees submit these audits to a central clearinghouse operated by the Bureau of the Census, which then forwards the audit findings to the appropriate agency for any necessary action. However, the act does not cover all grants and all aspects of grants management and, therefore, agencies must take additional steps to ensure that federal funds are spent appropriately. In addition, EPA conducts in-depth reviews to analyze grantees' compliance with grant regulations and specific grant requirements.[12] Furthermore, to determine how well offices and regions oversee grantees, EPA conducts internal management reviews that address grants management.

EPA's Inspector General testified before Congress in 1996 and again in 1999 that EPA did not fulfill its obligation to properly monitor grants. Acknowledging these problems, EPA identified oversight, including grant

[10]The Single Audit Act Amendments of 1996, Pub. L. No. 104-156, 110 Stat. 1396 (codified at 31 U.S.C. §§ 7501-7507).

[11]The Office of Management and Budget, as authorized by the act, increased this amount to $500,000 in federal awards as of June 23, 2003.

[12]EPA refers to these in-depth reviews as advance monitoring.

closeouts, as a material weakness—an accounting and internal control system weakness that the EPA Administrator must report to the President and Congress.[13] EPA's fiscal year 1999 Federal Managers' Financial Integrity Act report indicated that this oversight material weakness had been corrected, but the Inspector General testified that the weakness continued. In 2002, the Inspector General again recommended that EPA designate grants management as a material weakness. The Office of Management and Budget (OMB) also recommended in 2002 that EPA designate grants management as a material weakness. In its fiscal year 2002 Annual Report,[14] EPA ultimately decided to maintain this issue as an agency-level weakness, which is a lower level of risk than a material weakness. EPA reached this decision because it believes its ongoing corrective action efforts will help to resolve outstanding grants management challenges. However, in adding EPA's grants management to our list of EPA's major management challenges in January 2003, we signaled our concern that EPA has not yet taken sufficient action to ensure that it can manage its grants effectively.

EPA Faces Four Key Grants Management Challenges, Despite Past Efforts to Address Them

We identified four key challenges that EPA continues to face in managing its grants. These challenges are (1) selecting the most qualified grant applicants, (2) effectively overseeing grantees, (3) measuring the results of grants, and (4) effectively managing grant staff and resources. In the past,[15] EPA has taken a series of actions to address these challenges by, among other things, issuing policies on competition and oversight, conducting training for project officers and nonprofit organizations, and developing a new data system for grants management. However, these actions had mixed results because of the complexity of the problems, weaknesses in design and implementation, and insufficient management attention.

EPA has not selected the most qualified applicants despite issuing a competition policy. The Federal Grant and Cooperative Agreement Act of 1977[16] encourages agencies to use competition in awarding grants. To

[13]See 31 U.S.C. §3512.

[14]U.S. Environmental Protection Agency, *Fiscal Year 2002 Annual Report*, EPA-190-R-03-001 (Washington, D.C.: Jan. 31, 2003).

[15]EPA took these actions through early 2002.

[16]Federal Grant and Cooperative Agreement Act of 1977, Pub. L. No. 95-224, 92 Stat. 3 (codified as amended at 31 U.S.C. §§ 6301-6308).

encourage competition, EPA issued a grants competition policy in 1995. However, EPA's policy did not result in meaningful competition throughout the agency, according to EPA officials. Furthermore, EPA's own internal management reviews and a 2001 Inspector General report found that EPA has not always encouraged competition.[17] Finally, EPA has not always engaged in widespread solicitation of its grants, which would provide greater assurance that EPA receives proposals from a variety of eligible and highly qualified applicants who otherwise may not have known about grant opportunities.

EPA has not always effectively overseen grant recipients despite past actions to improve oversight. To address oversight problems, EPA issued a series of policies starting in 1998. However, these oversight policies have had mixed results in addressing this challenge. For example, EPA's efforts to improve oversight included in-depth reviews of grantees but did not include a statistical approach to identifying grantees for reviews, collecting standard information from the reviews, and a plan for analyzing the results to identify and act on systemic grants management problems. EPA, therefore, could not be assured that it was identifying and resolving grantee problems and using its resources more effectively to target its oversight efforts.

EPA's efforts to measure environmental results have not consistently ensured that grantees achieve them. Planning for grants to achieve environmental results—and measuring results—is a difficult, complex challenge. However, as we pointed out in an earlier report,[18] it is important to measure outcomes of environmental activities rather than just the activities themselves. Identifying and measuring the outcomes of EPA's grants will help EPA better manage for results. EPA has awarded some discretionary grants before considering how the results of the grantees' work would contribute to achieving environmental results.[19] EPA has also not developed environmental measures and outcomes for all of its

[17]EPA Office of the Inspector General, *EPA's Competitive Practices for Assistance Awards*, Report No. 2001-P-00008 (Philadelphia, PA: May 21, 2001).

[18]U.S. General Accounting Office, *Managing for Results: EPA Faces Challenges in Developing Results-Oriented Performance Goals and Measures*, GAO/RCED-00-77 (Washington, D.C.: Apr. 28, 2000).

[19]U.S. General Accounting Office, *Environmental Protection: Information on EPA Project Grants and Use of Waiver Authority*, GAO-01-359 (Washington, D.C.: Mar. 9, 2001).

grant programs.[20] OMB found that four EPA grant programs lacked outcome-based measures—measures that demonstrated the impact of the programs on improving human health and the environment—and concluded that one of EPA's major challenges was demonstrating program effectiveness in achieving public health and environmental results.[21] Finally, EPA has not always required grantees to submit work plans that explain how a project will achieve measurable environmental results. In 2002, EPA's Inspector General reported that EPA approved some grantees' work plans without determining the projects' human health and environmental outcomes.[22] In fact, for almost half of the 42 discretionary grants the Inspector General reviewed, EPA did not even attempt to measure the projects' outcomes. Instead, EPA funded grants on the basis of work plans that focused on short-term procedural results, such as meetings or conferences. In some cases, it was unclear what the grant had accomplished. In 2003, the Inspector General again found the project officers had not negotiated environmental outcomes in work plans. The Inspector General found that 42 percent of the grant work plans reviewed—both discretionary and nondiscretionary grants—lacked negotiated environmental outcomes.[23]

EPA has not always effectively managed its grants staff and resources despite some past efforts. EPA has not always appropriately allocated the workload for staff managing grants, provided them with adequate training, or held them accountable. Additionally, EPA has not always provided staff with the resources, support, and information necessary to manage the agency's grants. To address these problems, EPA has taken a number of actions, such as conducting additional training and developing a new

[20]U.S. General Accounting Office, *Environmental Research: STAR Grants Focus on Agency Priorities, but Management Enhancements Are Possible*, GAO/RCED-00-170 (Washington, D.C.: Sept. 11, 2000).

[21]The four EPA programs assessed were the Drinking Water State Revolving Fund, Leaking Underground Storage Tanks, Nonpoint Source Grants, and Tribal General Assistance programs. OMB evaluated these programs using its Program Assessment Rating Tool, a questionnaire that evaluated four critical areas of performance: purpose and design, strategic planning, management, results and accountability. These assessments were included in the President's 2004 budget submission.

[22]EPA Office of Inspector General, *Surveys, Studies, Investigations, and Special Purpose Grants*, Report No. 2002-P-00005 (Philadelphia, PA: Mar. 21, 2002).

[23]EPA Office of Inspector General, *EPA Must Emphasize Importance of Pre-Award Reviews for Assistance Agreements*, Report No. 2003-P-00007 (Washington, D.C.: Mar. 31, 2003).

electronic grants management system. However, implementation weaknesses have precluded EPA from fully resolving its resource management problems. For example, EPA has not always held its staff—such as project officers—accountable for fulfilling their grants management responsibilities. According to the Inspector General and internal management reviews, EPA has not clearly defined project officers' grants management responsibilities in their position descriptions and performance agreements. Without specific standards for grants management in performance agreements, it is difficult for EPA to hold staff accountable. It is therefore not surprising that, according to the Inspector General, project officers faced no consequences for failing to effectively perform grants management duties. Compounding the accountability problem, agency leadership has not always emphasized the importance of project officers' grants management duties.[24]

New Policies and Plan Show Promise but Require Strengthening, Enhanced Accountability, and Sustained Commitment to Succeed

EPA's recently issued policies on competition and oversight and a 5-year grants management plan to address its long-standing grants management problems are promising and focus on the major management challenges, but these policies and plan require strengthening, enhanced accountability, and sustained commitment to succeed.

EPA's competition policy shows promise but requires a major cultural shift. In September 2002, EPA issued a policy to promote competition in grant awards by requiring that most discretionary grants be competed.[25] The policy also promotes widespread solicitation for competed grants by establishing specific requirements for announcing funding opportunities in, for example, the *Federal Register* and on Web sites.

This policy should encourage selection of the most qualified applicants. However, the competition policy faces implementation barriers because it represents a major cultural shift for EPA staff and managers, who have had limited experience with competition, according to EPA's Office of Grants and Debarment. The policy requires EPA officials to take a more planned, rigorous approach to awarding grants. That is, EPA staff must determine the evaluation criteria and ranking of these criteria for a grant, develop the grant announcement, and generally publish it at least 60 days before the application deadline. Staff must also evaluate applications—

[24]EPA Office of Inspector General, Report No. 2003-P-00007.

[25]The policy applies to most discretionary grant programs or individual grants of more than $75,000.

potentially from a larger number of applicants than in the past—and notify applicants of their decisions. These activities will require significant planning and take more time than awarding grants noncompetitively.

Oversight policy makes important improvements but requires strengthening to identify systemic problems. EPA's December 2002 policy makes important improvements in oversight, but it still does not enable EPA to identify systemic problems in grants management. Specifically, the policy does not (1) incorporate a statistical approach to selecting grantees for review so EPA can project the results of the reviews to all EPA grantees, (2) require a standard reporting format for in-depth reviews so that EPA can use the information to guide its grants oversight efforts agencywide, and (3) maximize use of information in its grantee compliance database to fully identify systemic problems and then inform grants management officials about oversight areas that need to be addressed.[26]

Grants management plan will require strengthening, sustained commitment, and enhanced accountability. We believe that EPA's grants management plan[27] is comprehensive in that it focuses on the four major management challenges—grantee selection, oversight, environmental results, and resources—that we identified in our work. For the first time, EPA plans a coordinated, integrated approach to improving grants management. The plan is also a positive step because it (1) identifies goals, objectives, milestones, and resources to achieve the plan's goals; (2) provides an accompanying annual tactical plan that outlines specific tasks for each goal and objective, identifies the person accountable for completing the task, and sets an expected completion date; (3) attempts to build accountability into grants management by establishing performance measures for each of the plan's five goals;[28] (4) recognizes the need for greater involvement of high-level officials in coordinating grants management throughout the agency by establishing a high-level grants

[26]The grantee compliance database, developed by the Office of Grants and Debarment, is used to store EPA's in-depth reviews of grant recipients.

[27]For further details, see EPA Office of Grants and Debarment, *Grants Management Plan 2003 – 2008, Report No. EPA-216-R-03-001* (Washington, D.C.: April 2003).

[28]The plan's five goals are: (1) promote competition in awarding grants, (2) strengthen EPA's grants oversight, (3) support the identification and achievement of environmental outcomes, (4) enhance the skills of EPA personnel involved in grants management, and (5) leverage technology to improve program performance.

management council to coordinate, plan, and set priorities for grants management; and (5) establishes best practices for grants management offices. According to EPA's Assistant Administrator for Administration and Resources Management, the agency's April 2003 5-year grants management plan is the most critical component of EPA's efforts to improve its grants management.

In addition to the goals and objectives, the plan establishes performance measures, targets, and action steps with completion dates for 2003 through 2006. EPA has already begun implementing several of the actions in the plan or meant to support the plan; these actions address previously identified problems. For example, EPA now posts its available grants on the federal grants Web site http://www.fedgrants.gov. In January 2004, EPA issued an interim policy to require that grant funding packages describe how the proposed project supports the goals of EPA's strategic plan.

Successful implementation of the new plan requires all staff—senior management, project officers, and grants specialists—to be fully committed to, and accountable for, grants management. Recognizing the importance of commitment and accountability, EPA's 5-year grants management plan has as one of its objectives the establishment of clear lines of accountability for grants oversight. The plan, among other things, calls for (1) ensuring that performance standards established for grants specialists and project officers adequately address grants management responsibilities in 2004; (2) clarifying and defining the roles and responsibilities of senior resource officials, grant specialists, project officers, and others in 2003; and (3) analyzing project officers' and grants specialists' workload in 2004.

In implementing this plan, however, EPA faces challenges to enhancing accountability. Although the plan calls for ensuring that project officers' performance standards adequately address their grants management responsibilities, agencywide implementation may be difficult. Currently, project officers do not have uniform performance standards, according to officials in EPA's Office of Human Resources and Organizational Services. Instead, each supervisor sets standards for each project officer, and these standards may not include grants management responsibilities. Once individual project officers' performance standards are established for the approximately 1,800 project officers, strong support by managers at all levels, as well as regular communication on performance expectations and feedback, will be key to ensuring that staff with grants management duties successfully meet their responsibilities. Furthermore, it is difficult to

implement performance standards that will hold project officers accountable for grants management because these officers have a variety of responsibilities and some project officers manage few grants, and because grants management responsibilities often fall into the category of "other duties as assigned."

Although EPA's current performance management system can accommodate development of performance standards tailored to each project officer's specific grants management responsibilities, the current system provides only two choices for measuring performance—satisfactory or unsatisfactory—which may make it difficult to make meaningful distinctions in performance. Such an approach may not provide enough meaningful information and dispersion in ratings to recognize and reward top performers, help everyone attain their maximum potential, and deal with poor performers.

EPA will also have difficulty achieving the plan's goals if all managers and staff are not held accountable for grants management. The plan does not call for including grants management standards in managers' and supervisors' agreements. In contrast, senior grants managers in the Office of Grants and Debarment as well as other Senior Executive Service managers have performance standards that address grants management responsibilities.[29] However, middle-level managers and supervisors also need to be held accountable for grants management because they oversee many of the staff that have important grants management responsibilities. According to Office of Grants and Debarment officials, they are working on developing performance standards for all managers and supervisors with grants responsibilities. In November 2003, EPA asked key grants managers to review all performance standards and job descriptions for employees involved in grants management, including grants specialists, project officers, supervisors, and managers, to ensure that the complexity and extent of their grant management duties are accurately reflected.

Further complicating the establishment of clear lines of accountability, the Office of Grants and Debarment does not have direct control over many of the managers and staff who perform grants management duties—particularly the approximately 1,800 project officers in headquarters and regional program offices. The division of responsibilities between the

[29]The senior managers include the Director of the Office of Grants and Debarment, the Director of the Grants Administration Division, and the Grants Competition Advocate.

Office of Grants and Debarment and program and regional offices will continue to present a challenge to holding staff accountable and improving grants management, and will require the sustained commitment of EPA's senior managers.

If EPA is to better achieve its environmental mission, it must more effectively manage its grants—which account for more than half of its annual budget. While EPA's new 5-year grants management plan shows promise, given EPA's historically uneven performance in addressing its grants management challenges, congressional oversight is important to ensure that the Administrator of EPA, managers, and staff implement the plan in a sustained, coordinated fashion to meet the plan's ambitious targets and time frames.

To ensure that EPA's recent efforts to address its grants management challenges are successful, in our August 2003 report, we recommended that the Administrator of EPA provide sufficient resources and commitment to meeting the agency's grants management plan's goals, objectives, and performance targets within the specified timeframes. Furthermore, to strengthen EPA's efforts we recommended

- incorporating appropriate statistical techniques in selecting grantees for in-depth reviews;
- requiring EPA staff to use a standard reporting format for in-depth reviews so that the results can be entered into the grant databases and analyzed agencywide;
- developing a plan, including modifications to the grantee compliance database, to use data from its various oversight efforts—in-depth reviews, significant actions, corrective actions taken, and other compliance information—to fully identify systemic problems, inform grants management officials of areas that need to be addressed, and take corrective action as needed;
- modifying its in-depth review protocols to include questions on the status of grantees' progress in measuring and achieving environmental outcomes;
- incorporating accountability for grants management responsibilities through performance standards that address grants management for all managers and staff in headquarters and the regions responsible for grants

management and holding managers and staff accountable for meeting these standards; and

- evaluating the promising practices identified in the report and implementing those that could potentially improve EPA grants management.

To better inform Congress about EPA's achievements in improving grants management, we recommended that the Administrator of EPA report on the agency's accomplishments in meeting the goals and objectives developed in the grants management plan and other actions to improve grants management, beginning with its 2003 annual report to Congress.

EPA agreed with our recommendations and is in the process of implementing them as part of its 5-year grants management plan.

Mr. Chairman, this concludes my prepared statement. I would be happy to respond to any questions that you or Members of the Committee may have.

Contacts and Acknowledgments

For further information, please contact John B. Stephenson at (202) 512-3841. Individuals making key contributions to this testimony were Carl Barden, Andrea W. Brown, Christopher Murray, Paul Schearf, Rebecca Shea, Carol Herrnstadt Shulman, Bruce Skud, and Amy Webbink.

STATEMENT OF DAVID J. O'CONNOR, ACTING ASSISTANT ADMINISTRATOR FOR THE OFFICE OF ADMINISTRATION AND RESOURCES MANAGEMENT, U.S. ENVIRONMENTAL PROTECTION AGENCY

Mr. Chairman, thank you for the opportunity to appear before the committee to address the subject of today's hearing—Grants Management Practices within the Environmental Protection Agency (EPA).

Each fiscal year (FY), EPA awards an average of $4 billion in grants, approximately half of the Agency's budget. This funding is a key mechanism by which EPA's national media program managers, in partnership with grant recipients, deliver environmental protection to the public. Most of the grant funds—about 89 percent—go to States, Tribes and local governments. The remaining dollars are divided between non-profit organizations (6.6 percent), educational institutions (4.2 percent) and individuals, foreign recipients and profit-making organizations (.2 percent). Some of EPA's funding is the result of congressional earmarks. For example, in fiscal year 2003, funding for earmarks comprised approximately 13 percent of EPA's total grant dollars and 51 percent of the total grant dollars to non-profit organizations.

EPA has an obligation to the taxpayer to manage its grant dollars effectively and ensure they further the Agency's mission. However, since 1995, EPA's grants management practices have been criticized by Congress, the General Accounting Office (GAO) and EPA's Office of the Inspector General (OIG). Before discussing in more detail the problems EPA faces in grants management, and the Agency's progress in solving those problems, it is important to recognize the contributions that EPA's grants to our governmental partners have made to environmental protection over the past three decades. For example, in the 1970's and 1980's, working with this Committee, EPA administered the multi-billion dollar wastewater treatment works construction grant program under Title II of the Clean Water Act. This program, the second largest public works program in the nation's history, resulted in significant water quality improvements for thousands of municipalities.

Further, the Agency continues to provide critically needed infrastructure funding through its two State Revolving Fund (SRF) programs, the Clean Water SRF (CWSRF) and Drinking Water SRF (DWSRF). These two programs comprise nearly half of the Agency's grant dollars. Through fiscal year 2003, the CWSRF program has supported over 14,000 projects totaling $43.5 billion for secondary treatment, advanced treatment, combined sewer overflow correction, stormwater treatment and nonpoint source needs. Similarly, through fiscal year 2003, the newer DWSRF program has provided $6.4 billion which has resulted in more than 3,000 loans for drinking infrastructure needs to protect public health and ensure compliance with the Safe Drinking Water Act.

Moreover, EPA's grants for State and Tribal environmental programs have been a key factor in allowing States and Tribes to administer delegated or authorized regulatory programs across all environmental media. In fiscal year 2003, EPA awarded over $1 billion for these grants. This included $193.6 million under section 106 of the Clean Water Act to support water quality planning, water quality monitoring, the development of water quality standards and Total Maximum Daily Loads, the issuance of National Pollution Discharge Elimination System permits, compliance and enforcement activities, and groundwater protection.

EPA is also a recognized innovator in the State funding area as evidenced by its highly successful Performance Partnership Grant (PPG) program. PPGs provide States with the flexibility to combine funds from various EPA categorical grant programs into one grant. This allows States to streamline grant paperwork, adopt multi-media approaches, and better address national and State environmental priorities. In fiscal year 2003, EPA awarded over $300 million in PPGs to States and Tribes.

Additionally, as part of the fiscal year 2005 budget, the Administration is proposing a new $23 million State and Tribal Performance Fund that will award grants on a competitive basis for environmental programs. These funds will allow States and Tribes that can link their proposed activities to public health and environmental outcomes to receive additional assistance. EPA is pleased to be able to provide States and Tribes with another tool to protect and restore the environment.

Despite these success stories, EPA's credibility in grants management has been jeopardized by its inability to resolve longstanding concerns expressed by Congress, GAO and the OIG. These concerns have largely centered on non-State grants, particularly grants to non-profit organizations, with an emphasis on grant competition, pre-award review, oversight, environmental results and accountability. Over the period 1995 to 2001, the Agency did take steps to respond to these concerns. EPA issued formal post-award monitoring policies, virtually eliminated a grant closeout

backlog of some 20,000 grants, provided grants management training to over 4000 project officers, encouraged grant competition, and initiated development of an automated Integrated Grants Management System.

As evidenced by an OIG audit report entitled "Review of Assistance Agreements Awarded to Nonprofit Organizations" (Report No. 2001–P–00005, dated March 29, 2001), these actions produced improvements in some areas. In that audit, the OIG examined a sample of grants to nonprofit organizations awarded by EPA Headquarters and EPA's Atlanta Regional Office (Region 4). The report noted that EPA Headquarters and Region 4 had undertaken initiatives to improve the grants administration process. These included training of grants specialists and project officers, issuance of new or revised policy guidance, selective onsite reviews of recipient organizations to assess their performance, and implementation of an internal review process that analyzed specific aspects of grant programs on an ongoing basis. The report found that EPA maintained appropriate relationships with recipient organizations, avoided conflicts of interest, and that the specific grants reviewed complied with the Federal Grant and Cooperative Agreement Act, which prohibits the use of assistance agreements for acquisition activities. Based on these findings, the report concluded that a review of additional grant agreements based on the same objectives was not warranted.

These findings, however, are not representative of the total universe of EPA grants. As noted in GAO's August 2003 report, the Agency continues to face key grants management challenges in the areas of grantee selection, oversight, resources and environmental results. To address these challenges, EPA issued its first-ever long-term Grants Management Plan, with associated performance measures, in April 2003. GAO has described the Plan in positive terms, characterizing it as coordinated, integrated approach to improving grants management. As discussed below, the Agency is moving aggressively to implement the Plan, refining our corrective actions as necessary to incorporate recommendations for improvement contained in the GAO and OIG reports.

I am pleased to report that EPA has made significant progress in carrying out our long-term Plan. To date, we have met almost all of our performance measure targets and have completed more than 60 actions items in support of the Plan.

The Plan commits EPA to accomplishing five goals, namely: (1) Enhance the Skills of EPA Personnel Involved in Grants Management; (2) Promote Competition in the Award of Grants; (3) Leverage Technology to Improve Program Performance; (4) Strengthen EPA Oversight of Grants; and (5) Support Identifying and Achieving Environmental Outcomes.

Enhancing EPA Grants Management Skills—Goal 1: A key component of our strategy to enhance skills is to ensure that all project officers are certified to manage grants. Project officers must complete the basic grants management training program and take a refresher course every 3 years to maintain their certification. As of December 31, 2003, nearly 100 percent of our grants are being managed by certified project officers. We expect the mandatory certification program to equip project officers with the skills needed for proper grants oversight and will assess the effectiveness of the program in achieving that result.

We are also taking a systematic approach to improving our training programs through the development of a long-term training plan that is linked to EPA's Strategy for Human Capital. As suggested by GAO, the long-term plan will establish an Agency-wide process for ensuring that grant specialists, project officers and managers are timely trained on new policies and regulations and contain measures for determining how our training activities contribute to improved grants management. Building upon ongoing efforts to emphasize core competencies, the plan will require expanded training in areas identified in OIG audit reports, such as application, budget, and procurement review, conducting competitions, environmental outcomes, and prohibitions on the use of grant funds for lobbying or suing the Government. EPA recently updated its Project Officers Training Manual to address these issues and anticipates issuing a final version of the training plan later this year.

Promoting Competition—Goal 2: EPA is committed to increasing competition for grant awards under its new Competition Policy, which went into effect on October 1, 2002. In concurring in the Policy, the Office of Management and Budget (OMB) described it as ". . . a strong step in the right direction that should increase competition." The Policy is designed to promote fairness in the grant award process and help ensure that EPA funds high priority projects at the least cost to the taxpayer.

While the Policy contains a number of exemptions, such as State and Tribal program grants and congressional earmarks, it covers a wide range of EPA grant activities, including many grants to non-profit organizations. It also created a Grants Competition Advocate (GCA) position within the Office of Grants and Debarment. The GCA has broad authority to administer the Order, including issuing interpre-

tive guidance, approving specified exemptions and resolving disagreements between program and grants management offices.

In the first year of implementation, the Agency competed 75 percent of new awards to non-profit organizations covered by the Policy. This exceeded the Agency's performance target of 30 percent. The GCA is currently conducting an independent review of the Policy's effectiveness, and in June of this year will be making recommendations for strengthening the Policy to the Assistant Administrator for Administration and Resources Management (OARM).

Given the Agency's limited experience with grant competition, we agree with GAO that the Policy represents a "major cultural shift" for EPA managers and staff and expect that the GCA's review will identify areas for improvement. Nevertheless, we are encouraged by the first year's statistics and are confident that as the Policy is revised to incorporate the GCA's recommendations, the Agency will achieve even higher levels of competition.

Leveraging Technology—Goal 3: EPA believes that the deployment and enhancement of the Integrated Grants Management System (IGMS) is essential to strengthening grants management. IGMS is a paperless, programmatic and administrative system which fully automates the grant process from cradle to grave. It provides a structured format for reviewing the key factors that must be considered and documented in awarding a grant, including competition and environmental results. It also provides electronic tracking of grant milestones, products and post-award activities, thereby strengthening project officers' oversight capabilities, and will accept applications and reports from Grants.gov, the Federal electronic portal for grant application and reporting. IGMS is now deployed in all ten EPA Regions, which in fiscal year 2003 submitted 80 percent of grant funding packages electronically. This exceeded our performance target of 65 percent. Over the next 2 years, IGMS will be fully deployed at EPA Headquarters.

In addition, EPA continues to participate in the interagency Grants.gov initiative under Public Law 106–107. This initiative is designed to streamline and simplify the award and administration of Federal grants by creating a simple, unified source to electronically find, apply and report on Federal grants. EPA is posting synopses on Fedgrants.gov (E-Find) and complying with the OMB mandate to begin providing electronic applications (E-Apply) through Grants.gov for selected grant programs. I am pleased to announce that the Office of Grants and Debarment and the Office of Research and Development recently posted an electronic application for the Science to Achieve Results (STAR) program. Other programs will be posted later this year. The STAR program pilot will provide valuable experience as we prepare to make all EPA-competitive grant programs available for electronic application on Grants.gov.

Strengthening Oversight—Goal 4: On December 31, 2002, OARM issued a comprehensive post-award monitoring policy, EPA Order 5700.6, that significantly expands the Agency's post-award monitoring program. It requires baseline monitoring for all active awards on an ongoing basis. It also provides for advanced monitoring (i.e., onsite reviews and desk reviews) on a minimum of 10 percent of EPA's active grantees and mandatory reporting of these activities in a Grantee Compliance Data base.

The new Order is a substantial improvement over previous post-award monitoring policies, which required baseline monitoring only once during the lifetime of an award, established a minimum 5 percent advanced monitoring goal, and did not mandate uniform compliance reporting. Program offices have responded positively to the new policy by submitting to OARM timely and comprehensive post-award monitoring plans that emphasize advanced monitoring of active grantees.

Under the new policy, the Agency completed over 1000 advanced monitoring reviews in 2003 or 18 percent of its recipients. This exceeded our performance target of 10 percent of recipients. Moreover, we have implemented, or are in the process of implementing, major GAO recommendations for strengthening post-award monitoring. In this regard, effective for calendar year 2004, we have required EPA staff to use a standard reporting format when entering advanced monitoring reviews in the Grantee Compliance Data base and have included in the Data base information on OIG and GAO reports, Agency advanced monitoring reviews, significant compliance actions taken by the Agency and A–133 audits. This will make it easier for EPA to identify systemic issues early on and take appropriate corrective action. Moreover, after consulting with statisticians, the Agency will pilot test in 2005 a statistical approach to selecting grantees for advanced monitoring. Based on the results of the pilot, we will implement a statistical approach Agency-wide.

In implementing its post-award monitoring program, EPA has increasingly focused on taking actions against non-profit recipients that are poorly performing from either an administrative or programmatic standpoint. While non-profit recipi-

ents have played a vital role in disseminating information to communities on EPA's voluntary programs, it is true that some of these recipients have not properly managed their grants. In calendar year 2003 alone, EPA conducted 408 advanced monitoring reviews of non-profit recipients, or 37 percent of the total 1093 advanced monitoring reviews conducted. Where noncompliance by non-profit recipients is identified, EPA has successfully, in many cases, required recipients to correct their financial management systems, or placed controls on recipient expenditures pending resolution of audit issues.

We have continued to take significant actions against specific non-profit grant recipients to address grants management performance problems. In 2003, our advanced monitoring reviews revealed that about 22 percent of our non-profit recipients had one or more grants management problems. In these cases, under EPA's new post-award monitoring policy, we require recipients to develop corrective action plans to address the deficiencies. If the grant management weaknesses are not addressed in the specified timeframes through corrective action plans, we take more significant action. This includes placing recipients on reimbursement payment, issuing stop work orders, imposing special terms and conditions, terminating awards, and making referrals to the OIG to initiate comprehensive audits. For example, the Agency recently placed two large non-profit recipients on reimbursement payment while we conduct further investigations into apparent financial irregularities involving commingling of Federal grant funds, statutory consultant cap violations, and violations of the Federal Cash Management Act. We are currently in the process of modifying our Grantee Compliance Data base to track the number of significant actions that we have taken, so that starting in 2004, we will be able to provide the Congress with a statistical summary of our actions.

While post-award monitoring is an important objective under Goal 4, the Plan also commits the Agency to take a variety of "early warning" approaches to prevent problems from occurring. This includes revamping EPA's internal grants management reviews, increasing technical assistance and training to recipients and developing a pre-award review program.

EPA is making substantial progress in all of these areas. For example,

• In 2003, the Agency instituted a new approach to internal reviews that provides EPA with an early warning system to detect emerging grant weaknesses. The approach consists of three types of reviews: Comprehensive Grants Management Reviews performed by the Office of Grants and Debarment (OGD); Grants Management Self-Assessments performed by headquarters and regional offices based on OGD guidance; and Grants Performance Measure Reviews conducted by OGD, which use information in Agency data bases to assess progress against Grants Management Plan performance measures. OGD completed seven comprehensive reviews in 2003 and is requiring offices with identified problems to submit and carry out corrective action plans.

• To educate recipients about their grants management responsibilities, OGD: (1) conducted several classroom training sessions for non-profit and Tribal recipients in 2003, (2) in partnership with the OIG, distributed an instructional video to non-profit grantees in January of this year, and (3) recently issued guidance to non-profit recipients on how to purchase supplies, equipment, and services under EPA grants.

• The Agency is developing a pre-award policy to help ensure that grants are not awarded to non-profit organizations that have weaknesses in their administrative capability to manage grant funds or the programmatic capability to carry out a project. The policy will focus on requiring non-profit applicants with identified weaknesses to correct them before receiving an award. Further, applicants that repeatedly refuse to take appropriate corrective action will be referred to EPA's Suspension and Debarment program for consideration. The Agency expects to have the new policy in place in 2005.

A major objective under Goal 4 is to strengthen accountability for quality grants management. Historically, the Agency has not always managed its grants in accordance with sound business principles, which has contributed to accountability problems. However, as evidenced by our work in the following areas, EPA is beginning to create a culture of accountable grants management.

First, in 2002, then Deputy Administrator Linda Fisher issued two directives requiring senior managers to hold employees accountable for effective grants management and to include compliance with grants management policies as part of mid-year performance discussions, which occurred in July 2003.

Second, as a supplement to these directives, EPA reviewed the performance standards of employees involved in grants management. The review found that the performance standards of Senior Executive Service (SES) employees adequately addressed grants management while the standards of non-SES employees did not. Based on the results of the review, the Assistant Administrator for OARM directed

EPA's Assistant Administrators (AAs) and Regional Administrators (RAs) to revise the performance standards of their non-SES employees to properly reflect grants management responsibilities. In accordance with this directive, the Agency is putting revised standards in place and will use them to evaluate employee performance during calendar year 2004.

Third, in fiscal year 2003, the Agency required the AAs and RAs, for the first time, to outline in their assurance letters under the Federal Managers' Financial Integrity Act (FMFIA) the steps they are taking to address the grants management weakness. In these letters, the AAs and RAs commit to the Administrator of EPA that they will ensure effective grants management in their offices. This requirement will be carried forward into the fiscal year 2004 FMFIA process.

Fourth, the Agency created in April 2003 an Excellence in Grants Management Program that will recognize and reward EPA offices that substantially exceed the performance targets in the Grants Management Plan. The AA for OARM and the Chief Financial Officer will announce the first winners of this competition in May 2004.

Fifth, EPA's new Strategic Plan includes language emphasizing the importance of grants management and links the activities in the Grants Management Plan with the attainment of the Agency's strategic goals. The need for this linkage is reinforced by the Agency's fiscal year 2003 Annual Report, which, as recommended by GAO, outlines performance targets and results achieved under the Grants Management Plan.

Sixth, to ensure senior management attention to grants issues, EPA established in 2003 the Grants Management Council, composed of the Agency's Senior Resource Officials. The Council has held two meetings to date, and under its charter, will provide coordination and leadership as the Agency implements the Grants Management Plan.

Seventh, we have developed a Tactical Action Plan, which outlines commitments and milestone dates under the Grants Management Plan and identifies who is responsible for completing these commitments. OGD reviews this Tactical Plan on a quarterly basis to ensure that actions are completed on a timely basis.

Finally, the Agency is addressing resource issues for accountable grants management on two fronts. To determine the most efficient use of existing resources, EPA initiated in 2003 an analysis of grant specialist and project officer workloads. The Agency expects to complete the analysis in 2004 and based on the results, will make appropriate changes to the structure of its grants work force. Additionally, as part of the President's fiscal year 2005 budget, we plan to invest an additional $1 million to further strengthen grants management. These resources will assist Regional Grants Management Offices by providing funding for an additional 60 onsite reviews, an on-line training program for at-risk recipients, and critical indirect cost rate negotiations for non-profit recipients. This investment will also enhance accountability by supporting mandatory, Agency-wide training for managers on their grants management responsibilities.

Achieving Environmental Results—Goal 5: Goal 5 is a recognition that EPA must improve its ability to plan, measure, and report the results of its grants and align them with the achievement of goals and objectives in the Agency's Strategic Plan. This is a subset of the larger issue faced by EPA under the Government Performance and Results Act (GPRA) in assessing how its programs contribute to realizing environmental outcomes. Goal 5 commits the Agency to incorporating outcome measures in grant work plans and strengthening performance reporting by grantees.

In support of Goal 5, EPA recently issued an interim policy on environmental results. The interim policy applies to grant funding packages submitted by the Agency's program offices to the Grants Management Offices (GMOs) on or after February 9, 2004. Under the interim policy, GMOs may not act on proposed funding packages unless the packages include a description of how a project or program will further the goals of EPA's Strategic Plan. As a followup to the interim policy, an Agency-wide work group is developing an EPA Order that will require program offices to consider environmental results in funding packages, competitive solicitations, grant work plans, and grant performance reports. The Agency expects to issue this Order in 2004. As a part of these efforts, and in response to a recommendation from GAO, EPA will be working to revise its advanced monitoring protocols to include questions on measuring and achieving environmental outcomes.

In conclusion, under the long-term Grants Management Plan, EPA has put in place a comprehensive system of management controls and initiatives to address the grants management weakness. We have been careful to make adjustments in the design and implementation of the system to incorporate GAO and OIG recommendations. Given EPA's past uneven performance in reforming grants management, it is

fair to ask whether this system will be any more successful than previous efforts. The answer, I believe, lies in the cultural shift within EPA toward accountable grants management. While the Agency cannot solve all of the challenges identified by GAO overnight, this emerging culture of accountability will allow EPA, over time, to become a "best practices" agency for grants management. As we continue to implement our long-term Plan, we remain committed to working with Congress, GAO, the OIG, and our partners, including States, Tribes, local governments, nonprofit organizations and educational institutions, to eliminate the grants management weakness.

Thank you for providing me the opportunity to discuss these important issues with you today. I would be happy to respond to any questions you that may have.

RESPONSES BY DAVID O'CONNOR TO ADDITIONAL QUESTIONS FROM SENATOR INHOFE

Question 1a. The General Accounting Office has reported and testified that most EPA discretionary grants have been awarded without competition. In response to Senator Jeffords' and my request for information concerning discretionary grants awarded in fiscal year 2003, a number of discretionary grants awarded were designated as "exempt from competition" or "justified non-competitive." How can EPA make a comprehensive analysis of the new competition policy with continued exemptions?

Answer. EPA's Policy for Competition in Assistance Agreements, which went into effect on October 1, 2002, created the position of Grants Competition Advocate (GCA). The GCA is responsible for overseeing implementation of the policy and is currently conducting a comprehensive evaluation of the Agency's competition performance during fiscal year 2003. The evaluation will include an analysis of whether the current exemptions and exceptions have been properly used. The GCA's review is also focusing on ways to enhance the policy and foster more effective competitions. As a result of this review, the GCA will likely recommend certain revisions to the competition policy, including a lower dollar value threshold for competition, more stringent requirements for certain non-competitive exceptions, and additional documentation requirements. In addition, the GCA intends to provide additional training to EPA programs on how to conduct effective grants competitions. The GCA's review will result in a revised policy to strengthen competition which the Agency expects to issue later this year.

Question 1b. What criteria is used to determine if a grant will be: (i) exempt from competition; (ii) justified non-competitive; (iii) subject to managed competition?

Answer. The grants competition policy includes program exemptions from competition, exceptions to competition for individual grants, and circumstances justifying managed competition.

Section 6 of the policy contains a list of programs which EPA determined should not be subject to the policy, including, for example, State and Tribal continuing environmental program grants and Congressional earmarks. Section 8 of the policy contains exceptions from competition for individual grants. These exceptions (e.g., unusual and compelling urgency and one responsible source) are largely modeled on the exceptions from competition that apply to direct Federal procurement, which are contained in the Federal Acquisition Regulations and the Competition in Contracting Act. Section 10(d) of the policy authorizes managed competition (i.e., competition among a subset of potential applicants) in cases where, with the concurrence of the GCA, full and open competition is determined to be impracticable. It should be noted that as part of the GCA's review of the policy, EPA is considering whether it should retain specific managed competition procedures.

Question 2. The EPA's competition policy has now been in place for a little over 1 year. Does the Agency plan to provide a written evaluation of the new competition policy?

Answer. As stated in the response to question 1, the GCA is conducting a comprehensive review of the effectiveness of the competition policy. This review will result in the issuance of a revised competition policy later this year designed to improve the Agency's ability to conduct effective grants competitions.

Question 3. How can the EPA ensure that the new competition policy will not be abused when it contains exceptions for such reasons as unique or innovative proposals or simply that competition is not in the public interest?

Answer. EPA does not believe that having appropriate exceptions to competition will lead to abuse or circumvention of the competition policy. Such exceptions are necessary, for example, where unusual and compelling circumstances make a com-

petitive award impracticable. As mentioned above, the section 8 exceptions to competition, including the unsolicited proposal and public interest exceptions, are largely based on exceptions to competition allowed for direct Federal procurement. Moreover, in fiscal year 2003, the non-competitive exceptions for unsolicited proposals and public interest were not frequently used to justify non-competitive grants. However, to address Congressional concern over the use of the unsolicited proposal exception, EPA is considering making changes to it, including requiring approval by the GCA in all cases.

Question 4. Please provide the number of personnel in fiscal year 2003 that had responsibility for awarding and monitoring grants in headquarters and regional offices.

Answer. In fiscal year 2003, there were 109 grant specialists and 1851 project officers (with active grants) that were responsible for awarding and monitoring grants in headquarters and regional offices.

Question 5. Please provide a description of all training and/or certification for grant officers, awarding officers, and any other EPA personnel responsible for awarding and monitoring grants. Please identify what training requirements are newly imposed and how the agency plans to enforce these training requirements.

Answer. As a pre-requisite to managing a grant, cooperative agreement or interagency agreement, project officers must complete the basic 3 day classroom training course entitled "Managing Your Financial Assistance Agreement—Project Officer Responsibilities." This is a national course offered primarily at Headquarters but is also offered in some Regional offices. Within 3 years of completing the basic course, project officers are required to complete a 1-day refresher course to recertify. Project officers have the option of completing the 1-day refresher via the class room or an on-line self-certification course. The Office of Grants and Debarment tracks Project Officer Certification status through the "National Project Officer Data base". This data base has safeguards built in to notify project officers within 60 days and again within 30 days to alert them that their certification is about to expire. Project officers that fail to recertify are prohibited from managing a grant, cooperative agreement or interagency agreement until they have retaken the basic 3-day course. If project officers fail to maintain their certification, the program must replace them on the assistance agreement with a certified individual.

The Grants Specialist Training program represents a joint effort between the headquarters Grants Administration Division and the Regional Grants Management Offices for grant and interagency agreement specialists. Comprised of three phases, this program focuses on the "Core Competencies" specialists need to perform their position. Phase One addresses key national issues, such as the Federal Grants and Cooperative Agreement Act, Office of Management and Budget (OMB) Circulars, EPA's Delegations of Authority, General Grant Regulations, cost reviews of budgets, and transaction testing for unallowable costs. Phase Two provides training on the individual implementation procedures governing each of the eleven national Grants Management Offices (including headquarters). Phase Three focuses on the specialist's individual career development plan, which includes taking external training courses on grants management. In many cases, specialists take courses from Management Concepts, Incorporated (MCI), which offers a Certified Grants Management Curriculum. The Curriculum contains the following recommended courses: (1) Introduction to Grants and Cooperative Agreements for Federal Personnel, (2) Cost Principles: OMB Circulars A–21, A–122 and A–87, (3) Grants and GPRA: A Performance-Based Approach to Federal Assistance, (4) Essential Skills for Grants Professionals, and (5) Appropriations Law.

EPA Regions also provide supplemental grant-related training to project officers and grant specialists. Supervisors, managers, and funds certifiers occasionally participate in this training, which covers areas such as (1) training on the Integrated Grants Management System (IGMS), EPA's electronic system for automating the grants process; (2) grant competition training; (3) post-award management training; (4) Tribal or State Performance Partnership Grant training; (5) mentor training for new grant specialists and grant assistants; (6) Interagency Agreement (IAG) training for project officers; (7) quality assurance principles and implementation; (8) National Environmental Policy Act compliance training; (9) Working Effectively with Tribal Governments; (10) Regulation Development Training; (11) Grantee Compliance Tracking Data base Training; (12) training to address Minority Business Enterprise/Women Business Enterprise requirements; and (13) training on pre-award cost review and procurement.

In addition to these training efforts, the Office of Grants and Debarment currently offers grants management training to supervisors and managers on an as-requested basis. As part of the President's fiscal year 2005 budget, the Agency is seeking fund-

ing to institute a mandatory grants management online training program for managers and supervisors.

Question 6a. The most recent edition of the EPA grants training manual (Project Officer Training Manual, 5th Edition) lists statutory references detailing the prohibitions of grantees using Federal grants for lobbying and litigation against the Federal Government. It also directs a project officer to notify their award official if they believe that a grant recipient has used or may have used grants for unallowable expenditures. How will this training assist personnel to know what to report?

Answer. Using the 5th edition, project officer training instructors cover in detail all of the statutory and regulatory prohibitions against using grant funds to lobby or sue the Federal Government. Project officers then participate in exercises involving budgets that contain unallowable costs. These exercises require them to identify those costs and explain why they are unallowable.

Question 6b. How does the EPA plan to train personnel to identify unallowable costs?

Answer. EPA currently trains both grant specialists and project officers in how to identify unallowable costs in the Grant Specialist Core Competency Class and the Basic Project Officer training course. Additionally, the Office of Grants and Debarment offers individual instruction to any project officer who needs training on allowable costs when the project officer has a recipient that has been placed on reimbursement payments. EPA Grants Management Offices have also offered basic transaction testing classes to grant specialists and plan to offer an additional half-day class this spring.

Question 6c. What does the EPA Five Year Grants Management Plan or other oversight policies do to incorporate transaction testing?

Answer. The Agency issued EPA Order 5700.6, "Policy on Compliance, Review and Monitoring," in December 2002, to consolidate existing post-award management policies. One component of the Order requires Grants Management Offices (GMO) to review the administrative and financial systems of a grant recipient. These reviews may be conducted either at the recipient's location (onsite) or through telephone conference calls (offsite). Both reviews require the use of the appropriate protocol.

The Order requires that onsite evaluations conducted by the GMO include transaction testing. Further, the required protocol contains a series of questions concerning transaction testing and guidance attached to the Order discusses how to conduct transaction testing. In addition, the required reporting format for on- or offsite evaluations includes a specific item for transaction testing results.

In November 2003, the Grants Administration Division (GAD) issued guidance on preparing Post-Award Management Plans for 2004. In this guidance, GAD restated the need for transaction testing in GMO on-site evaluations and noted that the requirement should be addressed in the 2004 Post-Award Management Plans.

Question 7. What indicators or standards are established in the EPA Five Year Grants Management Plan that will measure specific environmental outcomes? Please describe the milestones for each year toward the goal of demonstrating environmental outcomes from grant funding.

Answer. In the EPA Five Year Grants Management Plan, EPA will track its progress in supporting grantee identification and realization of environmental outcomes with the following performance measures:

• Percentage of grant workplans, decision memoranda, and terms of condition that include a discussion of how grantees plan to measure and report on environmental progress.

- Target for 2004: 70 percent
- Target for 2005: 80 percent
- Target for 2006: 100 percent

These performance measures are supplemented by the following milestones:

FOR 2004

• Issue an interim policy on environmental results under EPA grants programs. This policy requires funding packages submitted to Grants Management Offices by Headquarters or Regional Program Offices on or after February 9, 2004, to document how proposed EPA assistance agreements will further the Agency's strategic goals.

FOR 2005

• Issue EPA Order (anticipated effective date, January 2005) requiring that all grant workplans, decision memoranda, and/or terms of condition include outcome measures to the maximum extent practicable. The goals of the Order are to: (1) link proposed assistance agreements to the Agency's Strategic Plan/Government Performance And Results Act architecture; (2) ensure that not only outputs, but also outcomes, are appropriately addressed in assistance agreement workplans, competitive solicitations, advanced monitoring and performance reports; and (3) consider how the results from completed assistance agreement projects contribute to the Agency's programmatic goals and objectives.

• As part of the roll-out of the Order, provide training to project officers and recipients on outcome measures.

• Include a discussion of expected environmental outcomes and performance measures in grant solicitations.

• Require recipient performance reports to address progress in achieving agreed-upon outcomes.

FOR 2006

• Beginning January 2006, incorporate past performance in reporting on environmental outcomes as a significant ranking criteria in competitive grant solicitations.

Question 8. Please provide a listing of grantees that have been disbarred over the last 10 years. Please provide the reasoning for that disbarment, the process used in the disbarment, and time required for that process. Please provide whether those grantees continued to receive grant funding during the debarment investigation.

Answer. Over the past 10 years, EPA took twenty-nine actions involving grantee organizations or their principals. Principals include officers, directors, managers or key employees. EPA debarred one grantee organization and fifteen individuals who served as principals for grantees; suspended two grantee organizations and one principal; entered into eight settlement agreements; and currently has one grantee organization and principal proposed for debarment.

The process: Suspension and debarment authority is delegated directly from the Administrator to the Suspending and Debarring Official (the Debarring Official). Debarment actions are initiated by the Suspension and Debarment Division (SDD), Office of Grants and Debarment (OGD). A suspension action is a temporary action that prohibits new awards pending the outcome of legal or debarment proceedings. A debarment action is a final Agency determination after an investigation is completed which prohibits an entity/individual from receiving Federal funding (e.g., Federal grants or contracts) for a specified period of time. SDD makes recommendations to the Debarring Official that specific grantees or principals be suspended or debarred. The Debarring Official makes all decisions based on the administrative record. The Debarring Official's final decisions may be appealed to the Director, OGD. Material questions of fact are referred to an independent fact finder. Underlying investigations are conducted by the Office of Inspector General, the Criminal Investigations Division of the Office of Enforcement and Compliance Assurance, and SDD.

The procedural requirements for bringing discretionary debarment actions are set forth at 40 C.F.R. Part 32 (for grants) and Subpart 9.4 of the Federal Acquisition Regulation (for contracts). The elements of a statutory debarment are described in 33 U.S.C. Section 1368 for the Clean Water Act and 42 U.S.C Section 7606 for the Clean Air Act. Debarment and suspension is a prospective remedy. It prohibits a new grant or contract award after the date of the suspension or debarment determination.

Each year, EPA initiates over a hundred potential suspension and debarment cases. Most of these cases involve commercial entities that could perform work under Federal grants or contracts.

ONE EPA GRANTEE DEBARRED DURING THE LAST 10 YEARS

Liberty Family Learning Center.—Debarred for submitting false certification on an EPA grant; Processing time 2 months.

TWO EPA GRANTEES AND ONE PRINCIPAL SUSPENDED DURING THE LAST 10 YEARS

Environmental Compliance Organization.—Suspended for submitting false credentials; Processing time 1 month.

ECO Foundation.—Suspended for submitting false credentials; Processing time 1 month.

Patricia Ewald, Director.—Suspended for submitting false credentials; Processing time 1 month.

EPA DEBARRED FIFTEEN INDIVIDUALS WHO SERVED AS PRINCIPALS TO EPA GRANTEES

Onyundo Amram, Director of Liberty Family Learning Center.—Debarred for submitting false certification on an EPA Grant; Processing time 2 months.

Carol Vitales, Payroll Technician.—Debarred for embezzlement of funds from the Oglala Sioux Tribe; Processing time 4 months.

Estelle Goings, Director.—Debarred for embezzlement of funds from the Oglala Sioux Tribe; Processing time 4 months.

Vonnie Goings, Payroll Technician.—Debarred for embezzlement of funds from the Oglala Sioux Tribe; Processing time 4 months.

Wallace Jorgensen, Office Manager.—Debarred for embezzling grant funds from National Asian Pacific Center for the Aging; Processing time 4 months.

Debra O'Neil, Office Manager.—Debarred for embezzling grant funds from the Nevada Indian Environmental Coalition; Processing time 4 months.

Anita Collins, Executive Director.—Debarred for embezzling grants funds from the Nevada Indian Environmental Coalition; Processing time 4 months.

Dennis Arnold.—Facility specific statutory debarment under the Clean Water Act; Processing time 6 months.

Syed Hug, Environmental Manager.—Proposed for debarment for embezzlement of funds from the Rosebud Indian Tribe; Resolved through a compliance agreement; Processing time 2 years and 3 months.

Richard Moffet, President of Peoples Rights to a Clean Environment.—Debarred for convictions for hashish possession and tax evasions; Processing time 3 months.

Joseph Frazier, Treasurer of Pfohl Area Homeowners Association.—Debarred for a burglary conviction; Processing time 1 year and 4 months.

Day Niederhauser, Inspector of The Virginia Department of Environmental Quality.—Debarred for filing false reports while working on an EPA grant; Processing time 3 months.

Raymond Sinnamon, Jr., Plant Manager of City of Dalton, Georgia.—Debarred for civil and administrative violations, water permits and restrictions; Processing time 1 year and 2 months.

DeForrest Parrott, General Manager & CEO of City of Dalton, Georgia.—Debarred for civil and administrative violations, water permits and restrictions; Processing time 1 year and 2 months.

Carleen Murphy Moran, Executive Director of Hancock County Chamber of Commerce.—Debarred for embezzling EPA grant money; Processing time 1 month.

SETTLEMENTS WITH FIVE LOCAL GOVERNMENTS THAT PREVIOUSLY RECEIVED EPA GRANTS

City of New Haven, Markings Unit.—Facility debarred by statute under the Clean Water Act; Resolved through a compliance agreement; Processing time 10 months.

City of Waldport, Oregon.—Facility debarred by statute under the Clean Water Act; Resolved through a compliance agreement; Processing time 2 months.

City of Post Fall, Idaho.—Facility debarred by statute under the Clean Water Act; Processing time 9 months.

Northeast Public Sewer District.—Facility debarred by statute under the Clean Water Act; Resolved through a compliance agreement; Processing time 6 months.

Southwest Florida Water Management District.—Drug-Free Workplace violation; Recipient of Federal assistance from EPA in support of the Sarasota Bay Estuary Program; Processing time 9 months.

SETTLEMENTS WITH ONE EPA GRANTEE AND TWO PRINCIPALS

Global Rivers Environmental Education Network.—Use of grant funds for personal use; Processing time 8 months.

Mark Patrick, Financial Manager, Global Rivers Environmental Education Network.—Use of grant funds for personal use; Processing time 8 months.

David Schmidt, Financial Manager, Global Rivers Environmental Education Network.—Use of grant funds for personal use; Processing time 8 months.

ONE GRANTEE AND ONE PRINCIPAL CURRENTLY PROPOSED FOR DEBARMENT

Lower Mississippi River Conservation.—Proposed for debarment for embezzlement of grant funds; Processing time 3 months.

Debra Strickland, Finance Director.—Proposed for debarment for embezzlement of grant funds; Processing time 3 months.

Question 9. Please provide a listing of grantees that have been subject to disciplinary action by EPA over the last 10 years. Please provide the reasoning for that discipline, the process used in the discipline, and time required for that process. Please provide whether those grantees continued to receive grant funding during the disciplinary investigation.

Answer. Based on discussions with your staff, we are providing a list of EPA grantees that were subject to disciplinary actions during 2002 and 2003:

1.Iowa Rural Water Association
2. Haskell Indian Nations University
3. St. Vincent Home School
4. University of Missouri—Columbia
5. St. Louis Medical Waste Incinerator Group
6. Kickapoo Tribe in Kansas
7. Santee Sioux Tribe of Nebraska
8. Virgin Island Department of Planning and Natural Resources
9. University of the Virgin Islands
10. Puerto Rico Environmental Quality Board
11. New Jersey Department of Environmental Protection
12. New York State Department of Environmental Conservation
13. Rutgers University
14. Passaic Valley Sewerage Commissioners
15. City of Johnstown
16. Systema Universitario Ana G. Mendez
17. City of Schenectady
18. Burlington County
19. Virgin Islands Department of Public Works
20. Cornell University
21. Rockland County
22. City of Syracuse
23. Township of Pennsauken
24. Association of State Wetland Managers Inc
25. City of Newark
26. Universidad Metropolitiana
27. Hudson River—Hudson River Foundation
28. Borough of Carteret
29. Musconetcong Sewerage Authority
30. New Jersey Department of Health and Human Services
31. County Essex—County of Essex
32. Atlantic States Legal Foundation
33. Scenic Hudson Inc.
34. City of Rorchester New York
35. City of Buffalo New York
36. Perth Amboy
37. City of Elmira
38. Puerto Rico Industrial Development Co.
39. City of Ogdensburg New York
40. City of Atlantic City
41. Middlesex County Improvement Authority
42. California Department of Toxic Substances Control
43. Big Sandy Rancheria
44. Bridgeport
45. CA Air Resources Board
46. Cahto Tribe of Laytonville Rancheria
47. Cahuilla
48. Campo Band of Mission Ind
49. City of Pomona
50. Colorado River Indian Tribes
51. Confederated Tribes of Goshute
52. County of Sacto
53. Cuyapaipe Band of Mission Indians
54. C.Y.C.L.E.
55. Del Amo Action Committee—Montrose
56. Dry Creek Rancheria
57. Enterprise Rancheria
58. Ft. McDowell Yavapai Nation
59. Ft. Mojave
60. Grindstone Rancheria
61. HI Dept of Health

62. Hoopa Valley Tribal Council
63. La Jolla Band of Mission Ind
64. La Posta Band of Mission Ind
65. Manchester Pt Arena Band of Pomo Indians
66. Mesa Grande Band of Mission Ind
67. Navajo Nation
68. Pauma Band of Mission Indians
69. Pinoleville Rancheria
70. Pyramid Lake Paiute Tribe
71. Quartz Valley Indian Reservation
72. Ramona Band of Cahuilla Mission Indians
73. Rincon Luiseno Indians
74. Round Valley Indian Tribes
75. Salt River Pima—Maricopa Indian Community
76. San Manuel Band of Mission Indians
77. San Mateo County RCD
78. San Pasqual Band of Mission Indians
79. Santa Rosa Band of Mission Indians
80. South Fork Band Council
81. Te-Moak Tribe of Western Shoshone
82. Tohono O'Odham Nation
83. Washoe Tribe of NV & CA
84. Yomba Shoshone Tribe
85. Shoshone and Arapaho Tribes
86. Crow Tribe
87. Rosebud Sioux Tribe
88. District of Columbia Department of Health
89. Lake Wallenpaupack Watershed Management District
90. Future Harvest, Incorporated
91. Chehalis
92. Chickaloon Native Village
93. Circle Village Council
94. Emmonak Village
95. Healy Lake Village
96. Inupiat Community of the Arctic Slope
97. Mentasta Trad Council
98. Muckleshoot Tribe
99. Native Village of Deering
100. Native Village of Elim
101. Native Village of Nelson Lagoon
102. Nez Perce
103. Nooksack
104. Northway Village Council
105. Quinault Indian Nation
106. Stevens Village Council
107. St. George Traditional Council
108. Village of Iliamna
109. Wrangell Coop Association
110. ADEC
111. Allakaket Traditional Council
112. Asa'carsarmiut Tribal Council
113. Association of Village Council Presidents
114. Beaver Village Council
115. Chilkoot Indian Assoc
116. Chitina Traditional Indian Village
117. Huslia Tribal Council
118. Hughes Village Council
119. Muckleshoot
120. Native Village of Nuiqsut
121. Native Village of Point Hope
122. Native Village of Point Lay
123. Puyallup Tribe
124. AK Dept. of Health & Soc. Serv
125. Concilio for the Spanish Speaking
126. University of Idaho
127. Washington State University
128. Norton Sound Health Corp.
129. City of Blackfoot

130. City of Kake
131. Hoonah
132. Ivanhof
133. Kuigpugmuit
134. The All Indian Pueblo Council, Inc.
135. Central States Air Resource Agencies Association
136. Coordinating Committee for Automotive Repair
137. Haskell Indian Nations University
138. Association of State and Interstate Water Pollution Control Administrators
139. Michigan Biotechnology Institute International
140. National Council on Aging
141. Climate Neutral Network
142. Self Reliance Foundation
143. Tribal Association for Solid Waste and Emergency Response
144. Geothermal Heat Pump Consortium
145. National Asian Pacific Center on Aging
146. Consumer Federation of America
147. City of Atlanta
148. Hancock County Chamber of Commerce
149. Lower Mississippi River Conservation Commission
150. National Academy of Natural Sciences

The recipients listed above were subject to disciplinary actions for the one or more of the following reasons:

• Audits performed by the Office of Inspector General (OIG) and advanced monitoring performed by EPA staff identified financial management problems, including embezzlement of grant funds, duplicative payments, unsupported direct costs, failure to account for program income, missing documentation, failure to provide an indirect cost rate proposal and/or agreement, commingling of funds, unallowable costs, payroll problems, no travel policy, undocumented cost share and inadequate labor distribution systems.

• Procurement problems, including failure to perform cost or price analysis, conflicts of interest violations, and lack of written procurement procedures.

• Delinquent, incomplete or incorrect reports and deliverables.

• A–133 single audit findings involving unaccounted funds, incorrect financial status reports, missing Minority Business Enterprise/Women Business Enterprise (MBE/WBE) reports, noncompliance with terms and conditions, and property management findings.

The types of disciplinary actions for the above-listed recipients included: (1) stop work orders; (2) recipients placed on payment reimbursement; (3) termination of grant(s); (4) high risk designation which imposed special award terms and conditions; (5) warning/enforcement action letters; and (6) referral to the OIG for an audit.

The length of time for disciplinary actions varies depending on the nature of the problem and how quickly the recipient is able to address the deficiencies. In general, the disciplinary action continues until the recipient has completed all corrective actions. EPA monitors the status and if the grantee is not making significant progress without a justifiable reason, the Agency will initiate additional enforcement actions.

In general, recipients whose payments are specifically suspended or limited by a term and condition are not paid until they have satisfied the condition. With respect to the high risk grantees, some recipients continue to receive payments in accordance with the high risk condition for only those costs that: (1) are adequately supported with appropriate documentation required by the high risk condition; (2) have been reviewed and certified by its CPA firm prior to submission to EPA, if necessary; and (3) have been reviewed and approved by the EPA Grant Specialist and Project Officer.

Question 10a. The March 3, 2004, hearing raised two issues relating to disclosure: available grants and awarded grants. What steps is the EPA taking toward providing more public information on available EPA grants? Will the EPA post such information on the agency website?

Answer. EPA currently provides information to the public on grants through different websites. We provide general information on EPA assistance programs and the types of grants we award through *www.cfda.gov*. We provide information on active grants through EPA's Envirofacts warehouse at *http://www.epa.gov/enviro/html/gics/gics—query.html*. Some EPA program offices provide information on the projects they fund on their program web sites.

EPA also posts synopses of competitive grant opportunities on the grants.gov website as directed by the Office of Federal Financial Management in the Office of

Management and Budget. The purpose of doing so is to provide potential applicants with information about funding opportunities so they can decide whether they are interested in applying for them. In addition, the Agency's Office of Grants and Debarment website has a Grants Competition section which includes information on competitive grant opportunities, including a list of available competitive grants [*http://www.epa.gov/ogd/competition/index.htm*].

Question 10b. What steps is the EPA taking toward publicly disclosing all annual recipients of grants, the amounts of those grants, and the purpose for which the grant was awarded? Will the EPA post such information on the agency website?

Answer. EPA currently provides information on active grants through EPA's Envirofacts warehouse at *http://www.epa.gov/enviro/html/gics/gics—query.html*. Beginning April 30, 2004, EPA will be posting information on new grant awards, including the purpose and amount of each award, at the following web site: *http://www.epa.gov/ogd/grants/award.htm*. The Agency will update this information on a quarterly basis.

RESPONSES BY DAVID O'CONNOR TO ADDITIONAL QUESTIONS FROM SENATOR JEFFORDS

Question 1. Your written testimony indicates that a mandatory certification program for project officers is in place. You also report that the Agency will assess whether the program adequately equips project officers with the skills needed for proper grants oversight. When and how will this assessment be carried out? Is there an assessment protocol already in place?

Answer. As addressed in the Agency's "Long Term Grants Management Training Plan" EPA will be issuing the 6th edition of "Managing Your Financial Assistance Agreement—Project Officer Responsibilities." In offering training courses based on the 6th edition, we will begin pre- and post-testing of all trainees. This will allow us to demonstrate the basic knowledge of the project officers prior to taking the class and after completing the class. The pre-test will be administered online as part of the registration process for the class. Post-tests will be administered at the end of day three. We are in the process of developing the 6th edition training class and will pilot the pre- and post-testing concept this fall.

Question 2. According to the grants management plan, EPA set the following goal for 2003: to award competitively 30 percent of new grants that are subject to the competition policy. The same 30 percent target was set for new grants to non-profit organizations. Were those 30 percent targets met? What plans are in place to ensure that the 2004 and 2005 goals, which call for significant increases, are met?

Answer. EPA exceeded the 2003 goals to competitively award 30 percent of new grants subject to the competition policy and 30 percent of new grants to non-profit organizations that were subject to the competition policy. In the first year of implementation, the Agency competed 75 percent of new awards to non-profit organizations covered by the policy and over 85 percent of all new awards covered by the policy. The Agency is encouraged by the first year statistics. However, it also recognizes, given EPA's limited experience with grants competition, that the competition policy needs to be strengthened to ensure that the Agency conducts effective grant competitions. To that end, EPA's Grants Competition Advocate (GCA) is in the process of performing a comprehensive review of the policy. The results of the GCA's review will be incorporated in a revised policy, which the Agency expects to issue later this year. Possible changes to the policy include a reduction in the competition threshold to open up more grant opportunities to competition.

EPA believes that a revised, strengthened competition policy, coupled with continued vigorous oversight by the GCA, should enable the Agency to achieve the 2004 and 2005 goals. EPA will be reporting on its success in meeting these goals in its Annual Report to Congress.

Question 3. I understand that in fiscal year 2003 EPA provided a $55,000 grant to a researcher at the University of Georgia. The purpose of the grant was to bioengineer poplar trees to absorb mercury from contaminated soils and materials and transpire it into the air. This was done under contract or agreement number 68D02008. Why is EPA spending money developing or supporting technologies to move mercury from the soil into the air?

Answer. EPA has been asked about funding research that used phytoremediation to uptake mercury into the roots of trees and then to volatilize the mercury into the atmosphere. EPA has opposed the volatilization of mercury into the atmosphere from the beginning and EPA National Center for Environmental Research (NCER)

has not provided financial support for research supporting releases of mercury into the atmosphere.

About 10 years ago, Dr. Richard Meager of the University of Georgia initiated a research program to investigate the potential for using biotechnology to detoxify mercury in the environment (research not funded by EPA). He found that one bacterial gene, *MerB*, has the capability to break the environmentally toxic methyl-mercury with the release of ionic mercury which is subsequently taken up by the bacteria. He also found that a second bacterial gene, *MerA*, has the capability to reduce ionic mercury (potentially toxic to cells) to elemental mercury, a significantly less toxic chemical form. Elemental mercury tends to vaporize at the normal atmospheric pressure. Dr. Meager proceeded to isolate these two bacterial genes and, using biotechnology, he expressed them in plants. He subsequently proposed to use these transgenic plants to phytoremediate methyl-mercury via compound breakdown, ionic mercury uptake into roots, reduction of ionic mercury to elemental mercury, and subsequent volatilization (transpiration) of elemental mercury in the atmosphere.

From early beginnings EPA, has opposed this approach with the objection that elemental mercury transpired into the atmosphere will precipitate and will be washed down by rain in the very same geographical proximity. EPA has never endorsed this approach, and NCER has never provided financial support (in the form of a grant) for this research. Recently, NCER funded a phase 1 SBIR contract, which is proposing to use plants transformed with *MerB* gene but not *MerA*gene. In this project Dr. Laura Carreira, Applied PhytoGenetics, Inc., proposes to select mercury-tolerant cottonwood transformed with *MerB*. These trees will have the capability to break down methyl-mercury, absorb ionic mercury and sequester the ionic form in the above ground plant tissues without its release in the atmosphere as elemental mercury. Because of his expertise in biotechnology, Dr. Meager was chosen as a subcontractor in this research.

In summary: NCER has never provided financial support to Dr. Meager's work to release elemental mercury in the atmosphere. NCER has only supported a SBIR phase1 contract to support the removal of toxic mercury stored in plant tissue.

RESPONSES BY DAVID O'CONNOR TO ADDITIONAL QUESTIONS FROM SENATOR CRAPO

Question 1. The closure of mines and mills and consolidation of agri-business have been as devastating to rural western economies as the abandonment of industrial plants has been in the nation's cities. Contamination, or the possibility of contamination, has hindered the re-development of these properties in rural towns—an objective of the Brownfields program. This past fall, EPA informed me that guidelines for the fiscal year 2004 grant competition were being revised. How have the guidelines changed to better address the needs of small rural communities?

Answer. Based on feedback from the fiscal year 2003 competition, in the fiscal year 2004 guidelines, we took out the specific reference to "populations under 100,000" in the applicant information section of the guidelines. We made the special considerations more prominent in the fiscal year 2004 guidelines by having a section entitled, "What are the statutory and policy considerations that EPA may take into account?" and referenced urban and nonurban and other geographic factors. This change allows us to consider balance between large populations and smaller rural areas.

The distribution of Brownfields grants selected in fiscal year 2003 closely followed the national distribution of grant requests received. Out of the 214 grants announced for fiscal year 2003, 116 represented non-urban areas with populations of 100,000 or less. In fiscal year 2003 we received 465 requests from the Western Regions (6–10) which represent 35 percent of the total number of requests received. Of those 71 (33 percent of the national total of 214) were selected. This represents a success award rate of 15 percent of total applications submitted for Western Regions which is commensurate with the national success rate of 16 percent. For fiscal year 2004, proposals received from the Western Regions represent totaled 250 (33 percent of the total number of proposals received). Seven proposals have been received from the state of Idaho.

In addition to assessment, revolving loan fund and cleanup grants, EPA supports small rural communities brownfields efforts through a cooperative agreement with the National Association of Development Organizations (NADO). Over the past several years, NADO has issued a number of reports on improving support for small rural communities including their Brownfields Resource Guide for Rural and Small Communities which has gone through several reprintings due to popular demand.

NADO also holds brownfields workshops for small rural communities, with upcoming workshops scheduled in Idaho on June 17 and Montana on July 14.

Question 2. The fiscal year 2005 budget proposal would transfer the Brownfields Economic Development Initiative, currently managed by the Department of Housing and Urban Development, to EPA. Will EPA provide a similar program, with a bulk of those funds earmarked for state grants?

Will the program be a revised program to equitably distribute funds between the eastern and western United Sates and among urban and rural communities?

What are EPA's plans in this regard?

Answer. No, the fiscal year 2005 budget proposal does not transfer the HUD Brownfields Economic Development Initiative to EPA and EPA has no plans to manage the program.

The Department of Housing and Urban Development in fiscal year 2005 will continue to support the redevelopment of brownfields through its Community Development Block Grant (CDBG) program. EPA will continue to work collaboratively with HUD on brownfield sites. HUD's program has funded brownfield redevelopment activities (e.g., acquisition, demolition, and infrastructure redevelopment) which are not authorized uses of EPA's brownfield funds.

STATEMENT OF STEVE ELLIS, VICE PRESIDENT FOR PROGRAMS, TAXPAYERS FOR COMMON SENSE

Good morning. Thank you for inviting me to testify and thank you for holding this hearing on EPA grants management. I am Steve Ellis, Vice President of Programs at Taxpayers for Common Sense (TCS), a national, non-partisan budget watchdog organization. Our country is facing enormous budget deficits, and we must be sure that every dollar spent is spent wisely and advances the nation's goals.

I would also like to make it clear that TCS does not solicit or accept Federal grants. Obviously, however, a lot of other organizations do. According to the Heritage Foundation, in fiscal year 2001, the Federal Government distributed more than $325 billion in grants.[1] As you know, roughly half—$4.2 billion in fiscal year 02—of the Environmental Protection Agency's (EPA) more than $8 billion budget is awarded in the form of assistance agreements or grants. The agency awards grants to more than 3,300 recipients including tribes, non-profits, State and local governments and universities to implement programs and projects intended to further EPA's goals. Given the size of the program, EPA's success depends significantly on how well it manages these grants. Unfortunately, for the last decade EPA's grants program has perhaps been best known for mismanagement or simply failure to manage.

The EPA Inspector General (IG), the General Accounting Office (GAO), the Office of Management and Budget (OMB), this committee and it's parallel in the House of Representatives have all pointed out for years that the grants program was failing the agency and Federal taxpayers. After several false starts under consecutive administrations, EPA appears to have instituted reforms that could lead the agency toward responsible management of its grant portfolio. But, time will tell whether the agency has truly turned the corner. TCS recommends that additional measures to help buttress EPA's reform efforts, including development of grants management evaluation criteria for program officers, annual progress reporting to Congress, and rapid deployment and centralizing of proposed grant data base systems.

THE PROGRAM

Of the $4.2 billion in grants the EPA awarded in fiscal year 2002, $3.5 billion, or 85 percent, was allocated to non-discretionary programs such as the drinking and wastewater State revolving funds and a few other programs that are typically formula grants and earmarks. The remaining amount, $719 million, was awarded in discretionary grants to State and local governments, tribes, non-profits, and universities.

The Catalog of Federal Domestic Assistance (CFDA), administered by the General Services Administration, lists more than 70 different EPA assistance programs both discretionary and non-discretionary. However, the bulk of these are program grants or discretionary.[2] Discretionary grant programs have received a great deal of scrutiny and well-earned criticism over the past few years. We applaud the committee for its role in reviewing these programs, and urge the committee to look more closely at the non-discretionary programs to ensure that they are meeting the nation's goals at an appropriate cost.

PROGRAM PROBLEMS

In his June 2003 testimony, Mr. John Stephenson of the GAO clearly articulated four major areas EPA's grants program needs to address.[3] TCS strongly agrees with these comments. The four key areas EPA has to improve are:

• *Award discretionary grants competitively and solicit from a large pool of applicants.*—Sole source or directed grants fail to ensure that the taxpayer is receiving the best available product at the best price. If EPA deviates from competition, it should be the exception, not the rule, and the rationale must be fully documented. According to the GAO, although required, these decision memorandums are not always completed.[4] Additionally, if grant opportunities are more broadly published, we are more likely to receive competitive terms.

• *Effectively oversee grantees' progress and compliance with terms.*—The EPA does not require enough financial and progress information from grantees and does not consistently ensure that grantees comply with regulations; the EPA either does not conduct enough monitoring of contracts, or, if it does, the monitoring is not documented.

• *Manage grants so they are effective in achieving desired results.*—In some cases, the agency does not have a clear vision of either the goals of particular programs or how to measure results against its goals; either case significantly reduces the possibility of a grant helping the agency meet overall goals.

• *Hold staff accountable for performing duties, ensure staff are properly trained and have the right information.*—It is simple. EPA's grants program is only going to be as successful as its grant administrators and program officers. Adequate resources, training and accountability need to be directed at frontline grant personnel if EPA grants programs are to be successful.

The EPA IGs' March 2003 analysis of pre-award reviews, summed up the last point very clearly:

> Project officers are responsible for ensuring Federal funds are protected and prudently awarded. However, Agency leadership had not always emphasized the importance of project officer duties, nor held project officers accountable for conducting complete pre-award reviews. It is crucial that management create an environment that considers the management of assistance agreements and the project officer function vital to the Agency's mission.[5]

A key message from this EPA IG report is that the agency must clearly define missions and goals expected from its grant program so that the taxpayer can be sure that every dollar spent is helping EPA realize its goals and mission.

In the IG's random sample of 116 EPA assistance agreements, it found that in 19 percent program officers had not determined the link between the grant work plan and agency objectives. In 31 percent, program officers had not determined the technical feasibility of the grant applicant completing the work. In 79 percent of the applicable agreements, required cost reviews of whether costs are eligible and reasonable were not completed. In 42 percent, there were no environmental outcomes negotiated. In 24 percent, milestones or deliverables were not included.[6]

Rather than simply laying these failures at the feet of program officers, higher leadership at the EPA must address these training, incentive, and accountability needs. Staff will only be able to perform what they are trained to do, is demanded of them and they are evaluated on. It is incumbent on senior EPA officials to retrain agency norms if their reform approaches are to succeed.

EPA'S RECENT REFORM EFFORTS

After constant criticism from the EPA IG, GAO, and OMB, EPA issued the first policy to govern the competitive award of grants in September 2002.[7] This established several criteria governing competition: a $75,000 threshold; detailed justification for noncompetitive awards; standard procedures for steps in the application process; and a new Grants Competition Advocate to oversee the program.[8] However, there are exceptions for unsolicited grants and "managed competition". Clearly, a shift to a competitive grant process represents a significant change in agency culture. To be effective, active measurement and oversight of these new objectives will be essential.

In December 2002, EPA issued a new grant oversight policy,[9] intended to increase in-depth monitoring of grantees, in part by requiring all compliance activities be entered into a data base; and requiring all transactions be tested for unallowable expenditures during onsite reviews.[10]

Finally, the agency issued its Grants Management Plan for 2003–2008 in April 2003. This plan outlined five goals in response to much of the criticism EPA had received. These goals are:

1. Enhance the Skills of EPA Personnel Involved in Grants Management
2. Promote Competition in the Award of Grants
3. Leverage Technology to Improve Program Performance
4. Strengthen EPA Oversight of Grants
5. Support Identifying and Achieving Environmental Outcomes.

These reforms appear to be on the mark. However, any EPA plan must be evaluated based on both the fine print and the follow through. The Grants Management Plan outlines several objectives for training grants personnel, and requires that 100 percent of grants be managed by certified project officers. However, the 2003 baseline is 85 percent. Considering the problems documented by the EPA IG shortly before this plan was released, the certification process itself may be flawed. Promoting competition for grant awards clearly comes down to agency commitment. If EPA cracks down on allowing sole source and similar grants, competition will flourish, plain and simple. If the Integrated Grants Management System (IGMS) is fully deployed it could significantly help in grant tracking. Strengthening oversight on achieving outcomes requires a commitment by EPA at both the national and regional level to look over grantees shoulders and demand the basic information grantees are supposed to supply.

ADDITIONAL REFORMS AND CONSTANT VIGILANCE

We support the reforms the EPA has proposed, but there are some additional improvements that can be made. To truly inculcate responsible grant management throughout the agency, EPA must develop performance standards for EPA grant management staff. Reform will only be effective if program officers and grant management personnel embrace these efforts. If personnel are not evaluated on grant management performance, it will be perceived as a lower priority and we will be back discussing grant management failures at EPA every few years.

Similarly, senior EPA officials have to commit to making reforms stick. To concentrate their attention, we believe it is vital that the EPA report to Congress annually on its progress and that this committee, the GAO, and the EPA IG exercise the vigorous oversight that has gotten us this far in the reform process.

Finally, we strongly believe that centrally and publicly available grant and tracking data will make reform efforts more enforceable and efficient. We urge the EPA to deploy the IGMS system as quickly as possible, but again, any system will only be as effective as the people inputting the data. To that end, we urge the EPA to investigate centralizing and streamlining grant management to fewer, more highly trained individuals.

Although it is apparent that there has been much done to increase accountability in the EPA grants system, there is much more to do. However, we do believe that with vigilant oversight, EPA has turned the corner on reforms. We are in difficult budget times. With a $521 billion deficit, we have to be sure that every dollar we spend is being spent cost-effectively to further our nation's goals.

Thank you for the opportunity to testify and I would be happy to answer any questions you might have.

REFERENCES

1. Yablonski, Christopher, Heritage Foundation Backgrounder No. 1615: Expanding Competition for Federal Grants. November 25, 2002.
2. Catalog of Federal Domestic Assistance, available at *http://www.cfda.gov/public/browse—agy.asp?agy—id=66&st=1.* Last visited February 28, 2004.
3. Testimony of John B. Stephenson, Director, Natural Resources and Environment, General Accounting Office before the Subcommitte on Water Resources and Environment Committee on Transportation and Infrastructure. June 11, 2003.
4. Ibid. p. 4.
5. U.S. Environmental Protection Agency Inspector General Audit Report: EPA Must Emphasize Importance of Pre-Award Reviews for Assistance Agreements (Report No. 2003–P–00007). March 31, 2003. p. i.
6. Ibid. pp. 4–9.
7. EPA Order on Grants Competition (EPA Order 5700.5).
8. U.S. Environmental Protection Agency Grants Management Plan 2003–2008 (EPA–216–R–03–001). April 2003.
9. EPA Order on Compliance, Review and Monitoring (EPA Order 5700.6).
10. Testimony of John B. Stephenson, Director, Natural Resources and Environment, General Acounting Office before the Subcommittee on Water Resources and Environment Committee on Transportation and Infrastructure, June 11, 2003.
11. U.S. Environmental Protection Agency Grants Management Plan 2003–2008 (EPA–216–R–03–001). April 2003.

OFFICE OF INSPECTOR GENERAL

Catalyst for Improving the Environment

Audit Report

Consumer Federation of America Foundation - Costs Claimed Under EPA Cooperative Agreements CX825612-01, CX825837-01, X828814-01, CX824939-01, and X829178-01

Report No. 2004-4-00014

March 1, 2004

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
Stephanie Oglesby
Eric Hanger
Kyle La Londe

Abbreviations

CFR	Code of Federal Regulations
EPA	Environmental Protection Agency
Federation	Consumer Federation of America
Foundation	Consumer Federation of America Foundation (established by the Federation)
OIG	Office of Inspector General
OMB	Office of Management and Budget

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

OFFICE OF
INSPECTOR GENERAL

March 1, 2004

MEMORANDUM

SUBJECT: Report No. 2004-4-00014
Consumer Federation of America Foundation - Costs Claimed Under EPA Cooperative Agreements CX825612-01, CX825837-01, X828814-01, CX824939-01, and X829178-01

/s/ *Michael A. Rickey*

FROM: Michael A. Rickey
Director, Assistance Agreement Audits

TO: Richard Kuhlman
Director, Grants Administration Division

As requested, we have examined the outlays reported by the Consumer Federation of America Foundation (Foundation) for the Environmental Protection Agency (EPA) Cooperative Agreements CX825612-01, CX825837-01, X828814-01, CX824939-01, and X829178-01. These agreements provided financial support for various projects under section 103 of the Clean Air Act.

We concluded that the work under the cooperative agreements was not performed by the Foundation, but by an associated organization, the Consumer Federation of America (Federation). The Foundation had no employees, space, or overhead expenses that were separate from the Federation. The Federation was a 501(c)(4)[1] lobbying organization that was prohibited from receiving Federal funds under the Lobbying Disclosure Act[2], and the arrangement between the Foundation and the Federation violated the Lobbying Disclosure Act prohibition. As a result, we have questioned $4,714,638 as unallowable for Federal participation.

---

[1]Organizations described in the Internal Revenue Code, Section 501(c)(4) are social welfare organizations operated exclusively to promote social welfare. Section 501(c)(4) organizations may engage in an unlimited amount of lobbying, provided that the lobbying is related to the organization's exempt status. Section 501(c)(3) organizations are commonly referred to under the general heading of "charitable organizations." Unlike a Section 501(c)(4) organization, a Section 501(c)(3) organization may not attempt to influence legislation as a substantial part of its activities and it may not participate at all in campaign activity for or against political candidates.

[2]Lobbying Disclosure Act, as amended, 2 U.S.C. § 1611

Subsequent to the period covered by this audit, the Federation and the Foundation merged into a single 501(c)(3)[3] organization. This organization is not disqualified from receiving Federal assistance and has received new awards. Therefore, our report discusses observed financial management practices that are contrary to Federal requirements. If these accounting and management practices are not corrected, the funds received under new Federal awards will be unallowable for Federal participation, and subject to recovery.

These financial management and internal control issues are serious concerns, and the recipient does not agree with our findings and conclusions regarding compliance with Federal grants management requirements. For example, the recipient stated in its response that "its employees prepare personal activity reports and other time-keeping records sufficient to support all (or substantially all) of the labor hours charged to the CAs." As discussed in detail in the report, our observations disagree with the recipient's assertion. The time sheets that were available did not meet Federal requirements, and the recipient used budget estimates rather than the time sheets to identify cooperative agreement costs.

If EPA continues to award assistance to this recipient, it is paramount that EPA ensures the recipient understands its obligations and has the financial management capabilities to administer Federal monies according to Federal requirements. If there is any doubt about the recipient's capabilities or the internal controls in place to ensure the proper administration of an assistance agreement, current awards should be terminated and no new awards made.

We also have serious concerns about the role EPA may have had in the award and oversight of the subject cooperative agreements. In its response to the draft report, the Federation stated that EPA asked the Federation to manage a program on indoor air quality and to manage a national public service campaign to educate consumers about health risks of radon. According to the Federation, both awards were "initiated" by EPA, and EPA determined the need and the scope of the programs. When the Federation became ineligible to receive Federal funds due to the requirements of the Lobbying Disclosure Act, the Federation stated that EPA arranged these programs to be transferred to the Foundation under new cooperative agreements. Further, the Federation stated that EPA was aware of the relationship between the Federation and the Foundation, and, in fact, relied on this relationship to assure that the transferred programs would continue to be managed by the same Federation personnel. The Federation also claimed that some contracts were awarded at the direction or specific instructions from EPA. The activity described by the Federation in its response is contrary to EPA policy.

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.

---

[3]See footnote 1

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

Independent Auditor's Report

We have examined the total outlays reported by the Consumer Federation of America Foundation (Foundation) under the EPA cooperative agreements (agreements), as shown below:

Cooperative Agreement No.	Financial Status Report/Federal Cash Transactions Report		
	Date Submitted	Period Ending	Federal Share of Outlays Reported
CX825612-01	10/8/02	7/20/02	$1,789,396*
CX825837-01	1/2/03	12/31/02	$1,526,116**
X828814-01	1/2/03	12/31/02	$212,994**
CX824939-01	6/26/02	6/30/02	$1,037,761**
X829178-01	1/2/03	12/31/02	$148,371**
Total			$4,714,638

* Outlays were reported on a Financial Status Report.
** Outlays were reported on a Federal Cash Transactions Report.

The Foundation certified that the outlays reported on the *Financial Status Report*, Standard Form 269A, and *Federal Cash Transactions Report*, Standard Form 272A, were correct and for the purposes set forth in the agreements. The preparation and certification of each report was the responsibility of the Foundation. Our responsibility was to express an opinion on the reported outlays 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 for the United States by the American Institute of Certified Public Accountants. We examined, on a test basis, evidence supporting the reported outlays, 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.

Although EPA awarded the cooperative agreements to the Foundation based on applications that showed labor and other operating costs, the Foundation did not have any employees, space, or overhead expenses. Instead, the Consumer Federation of America (Federation), a lobbying organization described under Section 501(c)(4) of the Internal Revenue Code, effectively received the EPA funds and performed the work under the five cooperative agreements. The Lobbying Disclosure Act, as amended, 2 U.S.C. ¶ 1611 (Lobbying Disclosure Act), prohibits 501(c)(4) lobbying organizations from receiving Federal funds constituting an award, grant, or loan.

Further, our examination disclosed that: (1) the financial management system used to account for the Federal funds was not in compliance with the Code of Federal Regulations (CFR), Title 40,

Part 30, section 21; and (2) the procurement standards required by Title 40 CFR Parts 30.40 through 30.48 were not always followed. In addition, sub-grants were not administered in accordance with the provisions of Title 40 CFR Part 30.

In our opinion, because of the effects of the matters discussed in the preceding paragraphs, the reported outlays on the *Financial Status Report* and *Federal Cash Transactions Reports* do not present fairly, in all material respects, the allowable outlays incurred in accordance with the criteria set forth in the agreements. As a result, the total $4,714,638 reported is unallowable for Federal participation.

The following sections provide details on the results of our examination. In addition, we have included the Federation's response to the draft report in Appendix B. The responses are also summarized after each finding with our comments.

/s/ *Keith Reichard*
Keith Reichard
Assignment Manager
Field Work End: May 15, 2003

Background

EPA awarded five cooperative agreements to the Foundation under Section 103 of the Clean Air Act. The following table provides some basic information about the authorized project period and the funds awarded under each of the agreements.

Cooperative Agreement No.	Award Date	EPA Share *	Foundation Share	Total Awarded	Project Period
CX825612-01	07/09/97	$1,806,708	$0	$1,806,708	07/21/97 - 07/20/02
CX825837-01	09/22/97	$1,737,532	$0	$1,737,532	10/01/97 - 09/30/02
X828814-01	02/06/01	$255,161	$0	$255,161	02/01/01 - 01/31/03
CX824939-01	08/05/96	$1,062,472	$12,968**	$1,075,440	08/12/96 - 08/11/01
X829178-01	08/17/01	$359,000	$0	$359,000	08/16/01 - 08/15/04

* The EPA share is 100% of total costs.
** The original cooperative agreement included a 5-percent match from the Foundation. The corresponding amendments did not identify a required match and the Federal share became 100 percent of total costs.

Cooperative Agreement Number CX825612-01: This agreement was for the Foundation to develop and distribute a comprehensive media campaign to educate and inform the public about radon and other indoor air pollutants. The scope of work included the development, production, and promotion of television, radio, and transit public service announcements. The Foundation was to conduct various consumer studies.

Cooperative Agreement Number CX825837-01: This agreement was for the Foundation to create a national public communications media campaign to reduce childhood exposure to environmental tobacco smoke. The scope of work also included the development, production, and promotion of television, radio, and print public service announcements. In addition, the Foundation was to conduct consumer studies related to environmental tobacco smoke and children to determine which messages would best motivate parents and others to refrain from smoking around children.

Cooperative Agreement Number X828814-01: This agreement was for the Foundation to increase consumers' awareness of the importance of purchasing and using energy efficient products and to ultimately affect their buying decisions. The Foundation was to provide grants to the Consumer Federation of America's State and local members to further community outreach efforts.

Cooperative Agreement Number CX824939-01: This agreement was for the Foundation to educate individuals and groups about radon health risks, testing, and mitigation. On a national level, the Foundation was to operate a toll-free line to provide guidance and assistance to

consumers. On a local level, the Foundation was to work with the Consumer Federation of America's State and local members to provide community outreach, especially in areas with proven high levels of radon. The Foundation also was to educate individuals and groups about the health effects of indoor air pollutants.

Cooperative Agreement Number X829178-01: This agreement was for the Foundation to continue working with the Consumer Federation of America's State and local members to expand outreach on indoor air quality issues, particularly secondhand smoke and radon. The Agreement's scope of work also included the continued operation of the Radon Fix-It Program, and other indoor air research, promotion, and support.

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

Reported Outlays:	Program expenses or disbursements identified by the Foundation on the *Financial Status Report* (Standard Form 269A) or the *Federal Cash Transactions Report* (Standard Form 272A).
Unallowable Costs:	Outlays that are: (1) contrary to a provision of a law, regulation, agreement, or other documents governing the expenditure of funds; (2) not supported by adequate documentation; or (3) not approved by a responsible agency official.

Results of Audit

Ineligible Recipient

The Consumer Federation of America (Federation), a 501(c)(4)[4] lobbying organization, effectively received Federal funds under the EPA cooperative agreements in violation of the Lobbying Disclosure Act. The Lobbying Disclosure Act provides, in pertinent part, that "[a]n organization described in section 501(c)(4) of the Internal Revenue Code, which engages in lobbying activities, shall not be eligible for the receipt of Federal funds constituting an award, grant, or loan." From 1998 to 2002, the Federation estimated that it spent approximately $940,000 in direct lobbying costs. The estimated lobbying costs were included in semiannual reports to the U.S. Senate, as required by the Lobbying Disclosure Act

Year	Mid-Year Report	Year-End Report	Total
1998	$220,000	$200,000	$420,000
1999	$180,000	$60,000	$240,000
2000	$80,000	no report on file	$80,000
2001	$60,000	$40,000	$100,000
2002	$60,000	$40,000	$100,000
Total			$940,000

As stated in the *Background* section of the report, the Foundation was the official recipient of Federal funds under the five EPA cooperative agreements. The Foundation, a 501(c)(3)[4] nonprofit organization, was originally established by the Federation in 1972 as the Paul H. Douglas Research Center, Inc. The name was subsequently changed to the Consumer Research Council in 1997. The name was again changed in 1999 to the Consumer Federation of America Foundation.

Under the Lobbying Disclosure Act, we note that it is permissible for a 501(c)(4) lobbying organization to separately incorporate an affiliated 501(c)(4) non-lobbying

[4]Organizations described in the Internal Revenue Code, Section 501(c)(4) are social welfare organizations operated exclusively to promote social welfare. Section 501(c)(4) organizations may engage in an unlimited amount of lobbying, provided that the lobbying is related to the organization's tax exempt status. Section 501(c)(3) organizations are commonly referred to under the general heading of "charitable organizations." Unlike a Section 501(c)(4) organization, a Section 501(c)(3) organization may not attempt to influence legislation as a substantial part of its activities and it may not participate at all in campaign activity for or against political candidates.

organization, which could receive Federal funds. The legislative history to the Lobbying Disclosure Act, expressly recognizes such an arrangement.[5] In this case, the Federation used the previously established Foundation to receive the EPA assistance agreement funds.

Despite the legal separation, however, the Foundation had no employees, space, or overhead expenses that were separate from the Federation. Instead the Federation performed or managed all the work under the agreements. Thus, all labor costs proposed and claimed under the agreements were for Federation employees. Similarly, the overhead costs proposed and claimed were for the Federation's overhead costs. Therefore, although EPA funds were awarded to a 501(c)(3) organization, in actuality, a 501(c)(4) lobbying organization performed the work and ultimately received the funds. This arrangement clearly violates the Lobbying Disclosure Act prohibition on a 501(c)(4) organization which engages in lobbying from receiving Federal funds.

In summary, the Federation, a 501(c)(4) organization: (1) performed direct lobbying of Congress, and (2) received Federal funds contrary to the Lobbying Disclosure Act. Consequently, all the costs claimed and paid under the agreements are statutorily unallowable.

Recipient's Comments

The recipient argued that it disclosed to EPA grant officials the nature of the arrangement, that both organizations "shared staff and facilities" and that EPA approved of the separate incorporation. The recipient argued that at no time did any EPA program official or grants management official suggest that the receipt of Federal funds by the Foundation was illegal.

The recipient also argued that a 501(c)(3) or a non-lobbying 501(c)(4) may share directors, facilities and staff and may be all but indistinguishable from the non-lobbying 501(c)(4), without losing its eligibility under the Section 18 of the Lobbying Disclosure Act, as long as the organizations respect their separate incorporation and maintain separate books of accounts. The Foundation and the Federation did maintain separate books. The recipient also mentioned that the Federation was working under a contract with the Foundation for its administrative and technical support. The recipient further argued that the OIG's interpretation of the Lobbying Disclosure Act was wrong and unsupported and that OIG lacked authority to adopt a "broad interpretation."

---

[5] The House Report (Judiciary Committee) No. 104-339 states, in relevant part: "This Section provides that organizations described in Section 501(c)(4) of the Internal Revenue Code which engage in lobbying activities shall not be eligible for the receipt of Federal funds constituting an award, grant, loan or any other form. Under this provision, 501(c)(4) organizations may form affiliate organizations in which to carry on their lobbying activities with non-federal funds."

Auditor's Reply

The recipient's first argument ignores the fact that compliance with the Lobbying Disclosure Act is the sole responsibility of the Federation. EPA is not responsible for determining the correct status of the Federation and whether it was eligible to receive Federal funds. Second, the recipient argues that it was compliant with the Lobbying Disclosure Act because both organizations were separately incorporated and kept "separate books." Our audit, however, disclosed that the Foundation had no employees, space, or overhead expenses. Instead, the Federation provided the Foundation with the employees, space, and overhead, and charged the Foundation for the work performed under the EPA agreements.

The Federation argued that it had a valid contract with the Foundation. The "contract" was undated and unsigned. Even if there was a valid contract, we question the validity of awarding a contract without competition to an affiliate organization. The awarding of all contracts under assistance agreements must follow the procurement procedures under Title 40 CFR 30.40 through 30.48. The Foundation did not follow these procurement procedures when awarding work to the Federation. For instance, the provisions of Title 40 CFR 30.42 provides that no employee, officer, or agent shall participate in the selection, award, or administration of a contract supported by Federal funds if a real or apparent conflict of interest would be involved. Since, the Federation's executive director also signed the cooperative agreements as executive director of either the Consumer Research Council or the Consumer Federation of America Foundation, there was a conflict of interest between the organizations.

We agree with the recipient's argument that a 501(c)(3) or a **non-lobbying** (emphasis added) 501(c)(4) may share directors, facilities, and staff and may be all but indistinguishable from the non-lobbying 501(c)(4), without losing its eligibility under the Section 18 of the Lobbying Disclosure Act as long as the organizations respect their separate incorporation and maintain separate books of accounts. However, the Federation was not a **non-lobbying** 501(c)(4) organization and cannot receive Federal funds through either a grant or a contract.

In summary, our position is that the Federation received Federal funds in direct violation of the Lobbying Disclosure Act. Consequently, all costs remain questioned.

Inadequate Financial Management System

The recipient's[6] financial management system was not adequate to account for the source and application of funds for Federally-sponsored activities as required by Title 40 CFR 30.21. Specifically, the recipient did not or could not: (1) separately identify and accumulate the costs for all direct activities, such as membership support, lobbying, and

[6] For reporting purposes, the two entities associated with the EPA agreements, the Consumer Federation of America and the Consumer Federation of America Foundation, will be jointly referred to as the recipient.

public outreach; (2) maintain an adequate labor distribution system; (3) reconcile the reported outlays to the recipient's general ledger; (4) provide a summary of claimed contract costs by contractor; (5) submit indirect cost rates to EPA; and (6) prepare written procedures for allocating costs to final cost objectives.

Inadequate Accounting of Membership, Lobbying, and Public Outreach Activities

The recipient did not separately identify and accumulate all the costs associated with its membership, lobbying, and public outreach activities. Office of Management and Budget (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 activities include:

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

The recipient's membership activities include but are not limited to all labor and expenses to maintain the membership rolls and provide benefits to existing members; maintaining the recipient's web site; and costs to recruit new members.

The recipient's lobbying activities include all labor and expenses for: (1) the estimated 17 employees involved in the recipient's lobbying activities as defined by OMB Circular A-122, Attachment B, Paragraph 25; and (2) the employees responsible for the oversight of the recipient's lobbying activities.

The recipient's public outreach includes all labor and expenses to publish and distribute press releases, studies, guides, brochures, and web sites sponsored or managed by the recipient.

In accordance with OMB Circular A-122, all direct costs associated with membership, lobbying activities, and public outreach, including fringe benefits and overhead costs, should have been separately identified in the accounting records. However, the recipient did not structure its financial management system to identify membership, lobbying, and public outreach efforts as direct activities. Further, as discussed below, the recipient did not maintain an adequate labor distribution system to track labor efforts expended on any

project, and the recipient's general ledgers did not include accounts needed to accumulate all expenses relating to membership, lobbying, and public outreach activities.

Recipient's Response

With one minor exception, neither the Foundation nor the Federation incurred any costs providing "services" within the meaning of Attachment A, subparagraph B(4). During the period covered by the audit, the Federation did not recruit new members, had no benefit or service programs targeted primarily at members, did not lobby on behalf of members, and held no meetings or conferences primarily for the benefit of members. The Federation did not offer benefits to the Federation's members exclusively, or on terms or conditions different from those offered to non-members. Although the Federation members could receive benefits from its programs (i.e. publications, email information, technical assistance and conferences, and a small amount of consumer lobbying) these benefits were received primarily as consumers in general, not as a membership organization. The Federation functioned as public interest organization whose purpose was to serve the interests of consumers in general, not as a membership organization.

The Federation also stated that some travel costs estimated at about $11,000 per year may have been allocable to membership activities. However, nearly all of these costs were charged direct. Thus, the total amount arguably covered by Attachment A, subparagraph B(4), if any, certainly qualified as a "minor amount" within the meaning of Attachment A, subparagraph B(2) and may be treated as indirect costs.

The Federation also stated that it did account for lobbying costs. Individuals who engaged in lobbying activities submitted a record of the time spent on those activities twice a year. Lobbying expenses were excluded from the indirect expense pool and therefore not claimed for recovery under any Federal award.

Auditor's Reply

We disagree with the recipient's contention that it properly accounted for costs associated with its membership, lobbying, and public outreach activities. Even though required by OMB Circular A-122, Attachment A, subparagraph B(4) and OMB Circular A-122, Attachment B, Paragraph 25, the recipient did not treat all costs associated with its membership, lobbying, and public outreach activities as direct costs.

The recipient operates a membership program and maintains a membership list identifying over 300 current members. In order for the recipient to operate the membership program, it incurs costs to: (1) administer the program; (2) collect membership dues; (3) submit publications and e-mailed information; and (4) provide technical assistance to members. The recipient's accounting system should have been designed to accumulate costs related to these activities as direct costs. The regulation further states that costs of activities performed primarily as a service to members or the general public must be treated as direct costs.

For instance, in reviewing the recipient's single audit reports for the fiscal periods 1997 through 2001, we noted that the recipient received membership dues totaling $930,711. Yet the recipient did not identify any direct expenses associated with its membership activities. In fact, the recipient's indirect cost rate proposal for fiscal period 2002 identified membership activities as an indirect expense.

With respect to lobbying, the recipient stated that the individuals who engaged in lobbying activities submitted a record of time spent on those activities twice a year. It is true that the recipient reported total lobbying expenses twice a year to the United States Senate, however, the recipient did not provide support as to where these costs were accounted for in the accounting system. The lobbying reports were submitted for years 1998 through 2002 and were for direct lobbying of covered executive branch officials or covered legislative branch officials. During this period, the recipient reported that it expended $940,000 in direct Federal lobbying costs and had 17 lobbyists.

Further, the recipient's accounting system did not specifically identify lobbying expenses, except an annual awards dinner, which were treated as a direct cost and excluded from the indirect cost pool. There was no evidence that the 17 lobbyists had specifically identified their salary costs as a direct cost. For example, we noted in reviewing the recipient's 2002 indirect cost rate proposal that the Federation's legislative director and the legislative assistance both accounted for 100 percent of their time as indirect.

In addition, the provisions of OMB Circular A-122, Attachment B, Paragraph 25, provides that when an organization seeks reimbursement for indirect costs, total lobbying costs[7] shall be separately identified in the indirect cost rate proposal, and thereafter treated as other unallowable direct costs. Lobbying costs are treated as a direct cost in order to calculate the indirect cost rates and allocate a proportionate share of indirect costs to the recipient's lobbying activities.

Most importantly, the recipient's certified public accountant indicated that the recipient's financial management system was not structured to allow for the treatment of lobbying and membership activities, or public outreach efforts, like preparing and distributing publications, as direct cost objectives. Most of these costs were included as indirect costs although some lobbying and membership costs derived from an annual awards dinner were treated as a direct cost, but this amount was small compared to what the recipient reported as a lobbying expense each six-month period.

Consequently, accounting of membership, lobbying, and public outreach activities remained unidentified and commingled with the Federation's other indirect costs, and were not allocated an equitable share of indirect costs as required by OMB Circular A-122.

---

[7] Total lobbying costs under the provisions of OMB Circular A-122, Attachment B, Paragraph 25, includes those lobbying efforts at the state and local level as well as grass-roots lobbying.

Unsupported Labor Costs

The recipient did not maintain support for its salaries and wages as required by OMB Circular A-122. As a result, we were unable to determine whether labor costs recorded in the recipient's general ledgers were allowable.

Title 40 CFR 30.27 provides that nonprofit organizations shall follow the provisions of OMB Circular A-122 for determining allowable costs. That Circular requires that: (1) charges to awards for salaries and wages, whether treated as direct costs or indirect costs, will be based on documented payroll approved by a responsible official(s) of the organization; and (2) labor reports reflecting the distribution of activity of each employee must be maintained for all staff members (professionals and nonprofessionals) whose compensation is charged, in whole or in part, directly to awards. Reports maintained by nonprofit organizations to satisfy these requirements must meet the following standards:

- The reports must reflect an after-the-fact determination of the actual activity of each employee. Budget estimates (i.e., estimates determined before the services are performed) do not qualify as support for charges to awards.
- Each report must account for the total activity for which employees are compensated and which is required in fulfillment of their obligations to the organization.
- The reports must be prepared at least monthly and must coincide with one or more pay periods.

The recipient's time distribution system did not meet the minimum requirements of OMB Circular A-122, Attachment B, as required by Title 40 CFR 30.27. In fact, the recipient did not require its personnel to fill out time sheets. Even though some of the employees prepared time sheets, the recipient used budget estimates, which were determined before services were performed, as support for labor costs claimed under the agreements. Without an adequate labor distribution system, the reported labor costs were not allowable under the agreements.

Recipient's Response

The recipient had a complete set of time sheets meeting the requirements of Attachment B, subparagraph 7(m) for the three individuals whose time constituted approximately 70 percent of the labor hours charged to the cooperative agreements for the period covered by the audit. In addition, at the request of EPA, the individuals who supplied almost all the remaining labor hours prepared activity reports that recorded time spent on activities charged to the cooperative agreements.

The recipient recognized that budget estimates were used to support the claimed labor costs, rather than the time sheets prepared by the individuals. The recipient instituted a revised time-keeping system that included a revised time sheet and required all invoicing

for labor be based exclusively on the time sheets and the record of time actually spent on various activities.

Auditor's Reply

We disagree that the recipient had a complete set of time sheets meeting the requirements of OMB Circular A-122, Attachment B, subparagraph 7(m) for individuals who charged time to the cooperative agreements during the audit period. Some personnel completed time sheets reflecting hours worked on the cooperative agreements, yet the time sheets were not prepared at least monthly from August 1996 through 2002[8], which is required by Federal regulations. Other personnel who charged time to the cooperative agreements, including the executive director, never completed the required time sheets. In addition, one employee went back and summarized total hours worked on the EPA cooperative agreements from 1997 through 2002, however, the summary spreadsheet only identified the EPA cooperative agreements and not the total activities for which the employee was compensated, which is also required by Federal regulations.

OMB Circular A-122 specifically states that the reports (time sheets) must reflect an after-the-fact determination of the actual activity of each employee. Budget estimates do not qualify as support for charges to awards. The recipient agreed that it used budget estimates to support claimed labor costs rather than the few time sheets that were prepared. A recipient official mentioned that prior to 2003, the time sheets were reviewed only to compute the personnel budgets for the ensuing award amendments.

In summary, all labor costs claimed during our audit scope were based on budget estimates, which OMB Circular A-122 prohibits. Therefore, we were unable to determine whether the claimed labor costs recorded in the general ledger were allowable to the EPA cooperative agreements.

Unreconcilable Reported Costs

The recipient could not reconcile the reported costs by cost element with the general ledgers. Title 40 CFR 30.21(b) provides that the recipient's financial management system shall provide for accurate, current, and complete disclosure of the financial results of each Federally sponsored project or program in accordance with the reporting requirements set forth in Title 40 CFR 30.52. It also states the system shall provide for a comparison of outlays with budget amounts for each award.

Prior to 2001, the recipient's general ledger did not account for the various cost elements identified in the agreements. The general ledger included only three cost elements: personnel, overhead, and contractual. However, the agreements included budgeted amounts for salaries, travel, postage, contractual, and supplies. Consequently, a comparison of outlays with the budget amounts could not be made. In 2001, the general

[8] Our audit scope was August 1996 through December 2002.

ledger changed to provide sufficient information on all the cost elements in the agreements.

In reviewing the general ledgers, we noted that some contractual costs were mis-classified as either printing or personnel costs. This resulted in inaccurate totals for the cost elements, which made it impossible for the recipient to accurately compare budgeted versus actual costs incurred. One recipient official, who was responsible for the programmatic aspects of the agreements, maintained spreadsheets for the agreements that detailed expended costs for each of the cost elements identified in the approved budgets. The spreadsheets were used by the recipient's program official to prepare the financial reports that were submitted to EPA. However, the recipient did not and could not reconcile the spreadsheet with the recipient's general ledger to ensure accuracy.

Recipient's Response

The recipient acknowledged that prior to 2001, a "comparison of outlays with budgeted amounts" could not be made using the Foundation's general ledger. However, nothing in Title 40 CFR 30.21 (b) or OMB Circular A-110 requires that this comparison be made using the general ledger. The Foundation prepared job cost activity reports on a consistent basis for each of its cooperative agreements. These job cost activity reports accurately reflected the amounts expended on each cooperative agreement, allowing the required comparison of "outlays to budgeted amounts."

In regard to misclassified contractual costs, the Foundation stated that all contractual costs were properly classified on the general ledger. Since 1997, the classification of costs was tested as part of an OMB Circular A-133 audit conducted by an independent auditor and found to be satisfactory.

Auditor's Reply

We agree that a recipient of Federal funds is not required to establish a new accounting system or subsystem to maintain financial data related to an assistance agreement or agreements. However, the recipient's accounting system must be capable of providing the financial information required by the agreements. The recipient can maintain separate records of the agreements' activities on worksheets and periodically reconcile the information to the general ledger. However, the recipient could not reconcile the job cost activity reports to the general ledger.

The primary objectives of an adequate accounting system are to: (1) ensure that the system for recording transactions separately identifies the receipts, disbursements, assets, liabilities, and fund balance for each grant, and (2) provide a summary of financial information that will enable the recipient to prepare reports required by the agreements.

The recipient's accounting system should be capable of organizing and summarizing transactions in a form that provides the basis for preparing financial statements. The accounting system should provide a system supported by source documentation for all

transactions. Plus, the recipient should be able to trace the amounts identified on the financial status reports for the agreements back to the general ledger and to the financial statements. Providing an audit trail is crucial for any audit of the reported financial transactions. However, as we previously stated, the recipient's job cost activity reports did not reconcile to the general ledger. Thus, we have no assurance that the financial status reports, the general ledger, or the financial statements were accurate and reliable.

One possible reason for the recipient's inability to reconcile the job cost ledger to the general ledger might be the misclassified contractual costs. As stated in the audit report, the recipient classified some of the contractual costs reported in the job cost activity reports as printing or personnel costs in the general ledger.

Unsupported Contract Costs

The recipient could not provide: (1) a summary of costs incurred by contract and reported under each cooperative agreement, and (2) copies of some of the contracts or purchase orders awarded under the cooperative agreements. Without this basic information, the recipient was unable to show that contract costs recorded in the accounting records were paid in accordance with the contract terms.

An adequate accounting system with proper internal controls would allow the recipient to compare invoice amounts with the terms of the contract or purchase order to ensure that the billings were allowable for payment. Also, the recipient was not able to identify all the contractors that performed work under the EPA agreements. Title 40 CFR 30.21 requires that a financial management system provide for: (1) records that identify adequately the source and application of funds for Federally-sponsored activities, and (2) the effective control and accountability for all funds. Further, Title 40 CFR 30.47 requires that the recipient maintain a contract administration system to ensure contractors conform with the terms, conditions, and specifications of the contracts, and ensure timely followup of all purchases. Since the recipient did not adequately control and account for contracts and purchase orders, the reported costs are not allowable under the agreements.

Recipient's Response

The recipient contended that the job cost activity reports contained a summary of costs incurred by contract and reported under each cooperative agreement, and were provided to the OIG audit team.

The recipient is confident that each procurement contract awarded during the period covered by the audit was adequately evidenced by written agreements, detailed written offers or proposals that were accepted by the Foundation, and/or by other relevant transactional documentation sufficient to show price, delivery dates and other material terms and conditions. During the audit period, no contractor invoice was paid without cross-checking the terms of the invoice, including price, against documents setting forth the contract terms. Thus, all contract costs recorded in recipient's accounting records were paid in accordance with the contract terms.

Auditor's Reply

Although the job cost activity reports contained a summary of claimed contractual costs, the reports did not provide a summary of costs by individual contractor for each cooperative agreement. Further, the recipient did not provide us with a summary of costs incurred by contract and reported under each cooperative agreement The provisions of Title 40 CFR 30.47 state that a system for contract administration be maintained to ensure contractor conformance with the terms, conditions, and specifications of the contract and to ensure adequate and timely followup of all purchases. Without a summary of costs claimed by contractor and vendor files with contracts/purchase orders and updated billing information, we cannot effectively evaluate the claimed contractual costs to ensure conformance with terms, conditions, and specifications of the contract and the regulations.

Absence of Written Procedures

The recipient did not have written accounting procedures identifying direct and indirect costs, and the basis for allocating such costs to projects, as required by the regulations. Title 40 CFR 30.21(b) states that the recipient's financial management system shall provide written procedures for determining that costs are reasonable, allowable, and allocable in accordance with the Federal cost principles and the terms of the agreement. The existence of these procedures would have established a basis for the recipient's consistent treatment of direct and indirect costs.

As illustrated in the table on page 5, the recipient estimated its direct lobbying effort from 1998 through 2002 to be $940,000, yet its financial management system was not structured to identify all lobbying efforts as a direct cost objective as required by OMB Circular A-122, Attachment A, subparagraph B(4). Consequently, there was no way to determine where or how these costs were recorded in the general ledger. Without written policies and procedures to distinguish between direct and indirect expenses, we cannot properly evaluate either the direct or indirect costs reported for the EPA agreements.

Recipient's Response

The Foundation had written guidance for "determining the reasonableness, allocability, and allowability" of costs and it was supplemented by OMB Circular A-122. However, the Federation did agree that more formal written procedures were preferable to the guidance on cost allowability that was used. The Federation promptly prepared and adopted a "Cost Policy Statement," which merely formalized procedures that were well-established in the assistance management field.

Auditor's Reply

We requested a copy of the recipient's written accounting procedures during our field work, and were told by a recipient official that accounting procedures did not exist. The

recipient did not provide us the guidance or "Cost Policy Statement" mentioned in the response above. Thus, written accounting procedures for determining the reasonableness, allocability, and allowability of costs is still needed to satisfy the requirements of Title 40 CFR 30.21 (b)(6).

Unsupported Indirect Cost Rates

The recipient did not prepare and submit to EPA its indirect cost rate proposals for years 1997 and 2002 as required by OMB Circular A-122. Also, although the recipient developed indirect cost rates for 1998 through 2001, the recipient did not submit these proposals to EPA.

OMB Circular A-122, Attachment A, subparagraph E(2), requires a nonprofit 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. Additionally, OMB Circular A-122, Attachment B, paragraph 25(c) requires that the recipient submit, as part of the annual indirect cost rate proposal, a certification that the recipient has complied with lobbying requirements and standards of paragraph 25.

In addition, the recipient's indirect cost rates for 1999 through 2001 were calculated incorrectly. Instead of using direct labor as the allocation base, the recipient used indirect costs. Further, as discussed on page 11, the recipient did not maintain support for its salaries and wages as required by OMB Circular A-122. As a result, we were unable to determine whether labor costs recorded in the recipient's general ledgers were allowable. Consequently, we cannot determine the acceptability of the proposed rates.

Recipient's Response

The Foundation contended that the terms and conditions of the award documents instructed them to not submit indirect cost rate proposals to EPA. Also, the Foundation acknowledged that the standard terms and conditions of the award documents required them to prepare an indirect cost rate proposal for 1997 and to maintain that proposal on file. The proposal was prepared in 1999 in connection with a U.S. Information Agency award, and it was shown to the OIG audit team.

The Foundation acknowledged that the indirect cost rates for 1999 through 2001 were miscalculated. The error was identified and corrected, and when the revisions are made to EPA, will lead to substantial increases in the indirect cost.

Auditor's Reply

Contrary to the cooperative agreements' terms and conditions, OMB Circular A-122, Attachment A, subparagraph E(2), requires a nonprofit organization to submit an indirect

cost proposal to the cognizant Federal agency no later than 3 months after the effective date of the award. The Circular further states 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. EPA does not have the authority to omit this requirement from award recipients.

The recipient did not provide us evidence that it had prepared an indirect cost rate proposal for 1997. Although the recipient had prepared an indirect cost rate for 2002, it was unacceptable because it was based on 2001 actual costs.

With respect to the 1999 through 2001 indirect cost rates, the recipient did not provide us the corrected indirect cost rates. In addition, OMB Circular A-122, Attachment A, subparagraph B(4), states that the recipient's membership and lobbying costs must be identified and treated as direct costs and allocated an equitable share of indirect costs. As mentioned in the report, the recipient did not account for all lobbying and membership costs as direct costs. Further, as discussed on page 11, the recipient did not maintain support for its salaries and wages as required by OMB Circular A-122. Consequently, it may not be possible to evaluate and negotiate the proposed indirect cost rates.

Improper Procurement Practices

The recipient did not: (1) always competitively procure contractual services in accordance with Title 40 CFR 30.43; (2) adequately justify the lack of competition for purchases over $100,000 as required by Title 40 CFR 30.46; (3) always perform the required cost or price analyses for the procurement of goods and services obtained under the EPA agreements as required by Title 40 CFR 30.45[9]; and (4) include any of the contract clauses required by Title 40 CFR 30.48. In one case, the contractor did not include a contract price in the contract.

Title 40 CFR 30.43 provides that all procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition. The recipient did not always comply with the provisions of Title 40 CFR 30.43 in that it awarded contracts both over and under the small purchase threshold of $100,000 without competition and had no justification to support this lack of competition.

For purchases over $100,000, Title 40 CFR 30.46 requires that procurement records and files 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 recipient provided no justification for this lack of competition or the basis for the award cost or price in the procurement files.

---

[9]We recognize that the recipient did comply with the requirements of Title 40 CFR 30.43 and 30.45 in some instances. However, because of the recipient's inadequate financial management system, we were unable to quantify any costs that might be allowable.

In addition, under the provisions of Title 40 CFR 30.45, some form of cost or price analysis shall be made and documented in the procurement files in connection with every procurement action. The recipient did not always conduct the cost or pricing data supporting the purchases of goods and services for the cooperative agreements to demonstrate compliance with Title 40 CFR 30.45. 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 whether the proposed costs are reasonable and allowable. Without sufficient cost or pricing analyses, we cannot be assured that fair and reasonable prices were obtained.

Examples of the recipient's improper procurement practices follow:

- Under agreement CX825612-01 which was awarded in 1997, the recipient used a contractor to develop and distribute public service announcements for the public outreach of indoor air pollution caused by radon. The contract was awarded in 1996, prior to the EPA agreement, without competition and the required cost or pricing analysis. The contract did not include a price and was not amended to include the subsequent work that was added by EPA amendment numbers 1 through 4. According to the recipient officials, two EPA officials requested that the public service announcements be developed and distributed by this specific contractor.

- Under agreement CX825837-01, the recipient awarded a contract to conduct consumer research studies to determine the number of people who smoke inside the home. The recipient did not have support that a cost or price analysis was conducted prior to contractor selection.

- The recipient did not perform the required cost or price analyses when selecting consultants for legal and consulting services. In addition, the recipient did not comply with Title 40 CFR 30.27, which provides the maximum daily rate consultants can be paid with Federal funds. The maximum daily rate cannot exceed level 4 of the Executive Schedule, which, in 2002, was $130,000, or $62.50 per hour. The recipient paid a contractor $185 per hour for professional consulting services. The recipient also paid attorneys for legal services, and the hourly rates for the two attorneys were $265 and $250.

Furthermore, the recipient did not ensure all contracts were complete and contained the required contract provisions cited in Title 40 CFR 30.48. According to the regulation, contracts in excess $100,000 shall contain (1) conditions that allow for administrative, contractual, or legal remedies; (2) suitable provisions for termination by the recipient; and (3) a provision to the effect that the recipient, EPA, and the Comptroller General of the United States shall have access to any books, documents, papers and records of the contractor that are directly pertinent to a specific program. The regulation also states that all contracts, including small purchases, shall contain the procurement provisions of

OMB Circular A-110, Appendix A, as applicable. None of the contracts we reviewed contained the required provisions.

Competition promotes obtaining the best goods and services at the best price. The lack of competition when procuring goods and services under a cooperative agreement 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.

Recipient's Response

Under agreement no. CX825612-01, the recipient alleged that the selected contractor was, in effect, EPA's designated contractor for production and distribution of the public service announcements, and EPA required the Foundation to award the contract without competition. EPA was also instrumental in the selection of the same contractor under an expired cooperative agreement. After the unacceptable performance by a large "Madison Avenue" agency on public service announcements on indoor air quality, EPA concluded that a small, specialized agency would offer lower costs and better results. Consequently, EPA suggested a specific contractor be engaged to produce the public service announcements under the previously cooperative agreement.

To the extent, if any, that the Foundation had discretion in the choice of a contractor for the public service announcement production and distribution, the sole-source selection was justified as a follow-on to the work the contractor was performing under the expired agreement.

In addition, the Foundation notified EPA in its application for the new cooperative agreement that it intended to use the existing contractor to perform services. The recipient believes that it was in compliance with the competition requirements in Title 40 CFR 30.43 based on the EPA approval of its scope of work for the new cooperative agreement which outlined the contractor selected for services. However, the recipient contended that it did not place in its procurement files a formal explanation of the basis for contractor selection, or a justification for its use of less than "open and full competition." Nor were such explanations placed in the procurement file when contracts were extended on the basis of EPA incremental funding of the corresponding cooperative agreement. These omissions have been or will soon be corrected.

The recipient also indicated that the contract was awarded in July 1997 just after the execution of the cooperative agreement. Further, from 1998 through 2002, as EPA amended the cooperative agreements, the Foundation also extended the public service announcement contract as well. Also, prior to the award of the contract, the Foundation compared prices for similar services that were paid to advertising agencies under another EPA cooperative agreement between 1994 and 1996 before negotiating price with the selected contractor.

The second procurement contract was awarded in October 1997 under cooperative agreement CX825837-01. From 1998 through 2002, as EPA amended the cooperative agreement, the contract was extended as well.

With respect to cost or price analyses, the Foundation stated that it did not prepare a formal memorandum or other formal written materials explicitly designed to record a price analysis. The Foundation did state that for cooperative agreement CX825612-01, there was a closeout report prepared for a previous cooperative agreement and it listed contractors funded by the previous agreement along with dollar amounts charged by the contractors. This closeout report suffices a cost/price analysis for cooperative agreement CX825612-01. For all other contracts, the recipient is now requiring that the preparation of contemporaneous price/cost analysis be included for each procurement action.

The Foundation stated that it performed a cost or price analysis when contracting for the legal and accounting services in question. The Foundation also stated that it did not prepare a contemporaneous memoranda or other formal written materials explicitly designed to record its cost or price analysis. The preparation of a contemporaneous price/cost analysis memorandum is now required by the Federation's procurement manual and has become standard organizational practice.

With respect to legal and accounting services paid in excess of the maximum daily rate specified by Title 40 CFR 30.27 (b), the Foundation contended that it had contracts with a law firm and an accounting firm and was not paying for "individual consultants." Thus, the maximum daily limit does not apply.

The Foundation admitted that not all of its contracts under the cooperative agreements contained all the standard contract clauses required by Title 40 CFR 30.48.

Auditor's Reply

Even though the recipient contended that the decision to award the public service announcement contract under agreement no. CX825612-01 without open and free competition was justifiable, we disagree. EPA's approval of the scope of work for agreement CX825612-01 did not equate to a waiver or deviation from the recipient's compliance with Federal regulations. Further, there was also no evidence to support the recipient's argument that EPA required the same program contractor selected in a previous cooperative agreement be used again. Even if there was any evidence, **no** EPA employee has the authority to direct a recipient to award a contract or contracts to any organization.

EPA's Code of Conduct at Title 5 CFR Part 2635.101 states that EPA employees must not use their Government positions to "coerce, or appear to coerce, anyone to provide any financial benefit to themselves or others." The code also states that EPA employees "must not take any action, whether specifically prohibited or not, which would result in or create the reasonable appearance of giving preferential treatment to any organization or person." In addition, the provisions of Title 40 CFR 30.43 provides that "all procurement

transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition." These regulations prohibit EPA staff from directing whom recipients should hire or whom they should contract with under a grant or cooperative agreement.

Further, although the recipient argued that the contract was awarded in July 1997 and a pricing analysis was conducted before the award, no documentation was provided to support the recipient's argument. The contract provided during our field work was dated October 10, 1996, not July 1997. Further, the October 10, 1996, contract did not have a contract price, and no amendments to this contract were provided to support the contract amendments. In addition, the contract was between the Federation and the contractor, not the Foundation, which further supports our position that the Federation was an ineligible recipient of Federal funds as discussed in the first finding.

As mentioned in the draft audit report, the recipient awarded a contract to conduct consumer research studies under cooperative agreement CX825837-01. The recipient did not have support that a cost or price analysis was conducted prior to contractor selection.

Finally, the cost or price analysis the recipient referred to was a list of contractors and corresponding billings from the contractors that were used in a previous cooperative agreement. The list was developed for a previous cooperative agreement, which does not support the recipient's compliance with Federal regulations. The provisions of Title 40 CFR 30.45 states that some form of cost or price analysis shall be made and documented in the procurement files in connection with every procurement action. The recipient referred to a document that only identified costs incurred under a previous cooperative agreement. There was no evidence that a cost or price analysis was conducted for cooperative agreement CX825612-01 in compliance with Federal regulations.

With respect to cost or price analyses for the legal and accounting services, the recipient did not provide any documentation to support that a cost or price analysis was performed. The recipient also alleged that the contracts were with firms and not individuals; thus, the maximum daily rate specified by Title 40 CFR 30.27 (b) does not apply. We disagree. The provisions of Title 40 CFR 30.27 provides that the maximum daily limit does not apply to contracts with firms for services which are awarded using the procurement requirements in this part (Title 40 CFR Part 30). The grantee has not demonstrated that the procurement requirements of Title 40 CFR Part 30 were followed in procuring the legal and accounting services. Accordingly, the maximum daily rate limitation does apply.

Sub-Award Costs Were Unsupported

The recipient issued almost $300,000 in sub-awards under three of its cooperative agreements with EPA and did not require sub-recipients to submit financial reports identifying expended funds. According to Title 40 CFR 30.5, sub-recipients are subject to OMB Circular A-110 or Title 40 CFR Part 31, as applicable. Both sets of rules require financial reporting at least annually and at the conclusion of the supported project.

According to the recipient officials, since the sub-awards were only between $2,000 and $8,000 each, they believed that requesting a financial status report was a burden. The recipient paid the sub-award recipients half the funds once a signed agreement was received, and the remaining half of the award was paid after the sub-recipient submitted the final performance report. The recipient did not question what the Federal funds were used for or how much it cost the recipient to do the assigned work. Accordingly, without final financial status reports, the actual costs for the sub-awards could not be determined.

Recipient's Response

Based on these three key elements - a discrete activity with fixed costs and easily measurable programmatic results, a detailed up-front budget analysis, and payment upon completion of easily established milestones - these small sub-awards are fixed-obligation sub-awards, rather than cost reimbursable sub-awards. It is unnecessary, indeed wasteful, to require the sub-recipient to track and report its actual award costs.

Auditor's Reply

The Federation does not have the authority to disregard Federal requirements when using Federal funds. The regulations require financial reports for the use of Federal funds. Further, in at least some instances, the sub-recipients were nonprofit organizations that may have engaged in lobbying activity. The Federation did require sub-recipients to provide certifications that the funds would not be used for lobbying activities. Without an accounting of the sub-award monies, any unused funds could eventually be used for unauthorized or unallowable activities[10].

Performance Reports

The recipient did not submit all the required performance reports specified by the cooperative agreements. Three of the agreements required the recipient to submit quarterly progress reports, one required semiannual reports, and one required annual reports. In addition, all five agreements required final performance reports. During the period covered by our audit, the recipient had only submitted 5 of the required 53 progress reports. Consequently, EPA did not have sufficient information to make an assessment of the recipient's progress in meeting the agreements objectives, or determine whether the unexpended funds were adequate to complete all work required.

Recipient's Response

The Foundation exceeded the reporting requirements in many respects by submitting more frequent reports than were mandated by the specific cooperative agreements. At no

---

[10]For instance, the recipient awarded the New Jersey Public Interest Research Group an $8,000 sub-award. According to the web site, the organization is a "Citizen Lobby and Law and Policy Center" and its membership dues support a staff of attorneys, scientists, and other professionals who monitor government and corporate decisions and advocate on the public's behalf.

point during the work on any cooperative agreement has an EPA project officer ever indicated that the Foundation failed to produce reporting documents in violation of the terms of a cooperative agreement. Each project officer received, on a monthly basis, a copy of the job cost activity report that summarized the budget versus actual financial activity under each cooperative agreement, in addition to frequent phone calls and emails providing updates on the Foundation's work for particular projects.

Auditor's Reply

We disagree with the recipient's contention that it exceeded the reporting requirements specified in the cooperative agreements. The provisions of Title 40 CFR 30.51 state that performance reports shall contain brief information on each of the following: (1) a comparison of actual accomplishments with the goals and objectives established for the period; (2) reasons why established goals were not met, if appropriate; and (3) other pertinent information including analysis and explanation of cost overruns or high unit costs. The progress reports are necessary to ensure the recipient is managing and monitoring each cooperative agreement.

The recipient provided EPA various reports on State and local outreach initiatives, Radon Fix-It program reports, and media usage reports for some of the cooperative agreements. However, these reports only discussed one or two of the cooperative agreements' project tasks. These reports did not satisfy quarterly, semi-annual, or annual progress reports because they did not include information on all goals and objectives established for the cooperative agreements.

Recommendations

We recommend that EPA:

1. Annul Cooperative Agreement Nos. CX825612-01, CX825837-01, X828814-01, CX824939-01, and X829178-01, and recover all funds paid to the recipient.

2. Suspend work under current grants or cooperative agreements not covered by this audit, and make no new awards until the recipient can demonstrate that its financial management practices and controls over Federal funds comply with all regulatory requirements. At a minimum, the recipient must:

   a. Demonstrate that its accounting practices are consistent with Title 40 CFR 30.21. The recipient's financial management system must:

      (1) Ensure that financial results are current, accurate, and complete.

      (2) Include records that adequately identify source and application of funds for Federally-sponsored programs. These records should be in sufficient detail to allow a comparison of the budgeted grant costs by cost element with the actual incurred and claimed costs.

      (3) Include written procedures to determine reasonable, allowable, and allocable costs in accordance with OMB Circular A-122.

      (4) Include accounting records that are supported by adequate source documentation.

      (5) Include 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 the specific activities and final cost objectives that the employees work on during the pay period, including membership and lobbying activities. It should also serve as the basis for charging labor costs to Federal grants and cooperative agreements.

   b. Demonstrate that its procurement practices are consistent with the provisions under Title 40 CFR 30.40 through 30.48. At a minimum, the recipient's system must:

      (1) Ensure that cost and pricing analyses are conducted for all purchases as required under Title 40 CFR 30.45, and that documentation is maintained to support all cost and pricing analyses.

      (2) Include documentation to support the basis of contractor selection; justification for lack of competition when competitive bids are not obtained; and the basis for award cost or price, as required under Title 40 CFR 30.46.

(3) Include files of all contracts, amendments, billings, amounts paid to contractors, etc., to ensure contract ceilings are not exceeded and that the contractors conform with the terms, conditions, and specifications of the contract as required under Title 40 CFR 30.47.

(4) Include in all contracts the required provisions in compliance with Title 40 CFR 30.48 and the Appendix to Title 40 CFR Part 30.

c. Demonstrate that its practices for awarding and administering sub-awards comply with the provisions of Title 40 CFR 30.5. Specifically, the recipient must ensure that all sub-recipients submit final financial status reports at the end of a project as required by the provisions of Title 40 CFR Parts 30 and 31.

d. Submit the required indirect cost rate proposals prepared in accordance with OMB Circular A-122.

3. Require the recipient to prepare and submit performance reports for current grants or cooperative agreements in accordance with EPA regulations and the terms and conditions of the awards. The performance reports need to include progress in meeting planned objectives in the cooperative agreements or grants.

Appendix A

Scope and Methodology

We performed our examination in accordance with generally accepted government auditing standards, and the attestation standards established for the United States by the American Institute of Certified Public Accountants. We also followed the guidelines and procedures established in the "Office of Inspector General Project Management Handbook," dated November 5, 2002.

We conducted this examination to express an opinion on the reported outlays, and determine whether the recipient was managing its EPA cooperative agreements in accordance with applicable requirements. To meet these objectives, we asked the following questions:

1. Is the recipient's accounting system adequate to account for cooperative agreement funds in accordance with Title 40 CFR 30.21?

2. Does the recipient maintain an adequate labor distribution system that conforms to requirements of OMB Circular A-122?

3. Is the recipient properly drawing down cooperative agreement funds in accordance with the Cash Management Improvement Act?

4. Does the recipient's procurement procedures for contractual services comply with Title 40 CFR 30.40 to 30.48?

5. Is the recipient complying with its reporting requirements under Title 40 CFR 30.51 and 30.52?

6. Are the costs reported under the cooperative agreements adequately supported and eligible for reimbursement under the terms and conditions of the cooperative agreements, OMB Circular A-122, and applicable regulations?

In conducting our examination, we reviewed the project files and obtained the necessary cooperative agreement information. We interviewed recipient personnel to obtain an understanding of the accounting system and the applicable internal controls as they related to the reported costs. We obtained and reviewed single audit reports and an On-Site Visit Report prepared by EPA to determine whether any reportable conditions and recommendations were addressed in those reports.

We reviewed management's internal controls and procedures specifically related to our objectives. Our examination included reviewing the recipient's compliance with OMB Circular A-122, Title 40 CFR Part 30, and the terms and conditions of the agreements. We also examined the reported costs on a test basis to determine whether the costs were adequately supported and

eligible for reimbursement under the terms and conditions of the agreements and Federal regulations. We conducted our fieldwork from March 3 through May 15, 2003.

We chose to conduct an in-depth review of personnel, contractual, and indirect costs for the five cooperative agreements. We chose those specific cost elements because of the risk associated with the costs and, for some of the cooperative agreements, the relatively high dollar amount. We also chose to review printing and public service announcement costs for two of the cooperative agreements because of the relatively high dollar value.

Appendix B

Consumer Federation of America

BY E-MAIL AND FEDERAL EXPRESS

January 20, 2004

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

SUBJECT: Draft Audit Report of "Costs Claimed under EPA Cooperative Agreements CX825612-01, CX825837-01, X-828814-01, CX 824939-01 and X 829178-01"
Comments of Consumer Federation of America

Dear Mr. Rickey:

This letter, and the Response and legal memorandum attached hereto, set forth the written comments of the Consumer Federation of America ("CFA") on the draft audit report ("DAR") on costs claimed by the Consumer Federation of America Foundation (the "Foundation") under the above-referenced EPA cooperative agreements ("CAs"). The **Response** proceeds through the DAR point-by-point, presenting CFA's detailed response to questions in the report regarding the Foundation's compliance with EPA regulations and OMB Circulars. The **legal memorandum** analyzes OIG's claim that the Foundation was not eligible to receive Federal funds under Section 18 of the Lobbying Disclosure Act of 1995, that each CA awarded to the Foundation was therefore illegal, and that the Foundation must therefore refund every penny of the $4.7 million it received under the CAs. This **letter** sets forth a brief overview of CFA's comments.

The DAR's analysis and recommendations are neither fair nor reasonable, for three reasons: **First**, the DAR is based on a fundamental misunderstanding of the circumstances under which the CAs were awarded and implemented. **Second**, it focuses on technical defects in documentation and lack of sophistication of CFA's financial management system, ignoring the fact that the underlying transactions were sound and adequately documented. **Third**, it proposes a $4.7 million disallowance based on a legal interpretation of LDA Section 18 that is untenable on its face, and whose retroactive application to the Foundation is prohibited by law.

[1] In 1991, EPA asked CFA to manage a program on indoor air quality; two years later, EPA asked CFA to manage a national public service campaign to educate consumers about the

health risks of radon. Both awards were initiated by EPA - that is, EPA determined the need for Federal action, defined the scope of the program, established the amount of available funding, and only then approached CFA to implement the program on its behalf. Each CA was awarded to CFA without competition. In 1996 and 1997, when CFA, a 501(c)(4) organization, became ineligible to receive Federal funds, EPA arranged for CFA's programs to be transferred from CFA to the Foundation under new CAs. At the time, EPA was well aware of the CFA/Foundation relationship - and, in fact, relied on that relationship to assure that the transferred programs would continue to be managed by the same CFA personnel. In 1997, EPA asked the Foundation to undertake a public service campaign to alert consumers to the health effects of secondary smoke on children. This third CA was also awarded without competition.

On each program undertaken at EPA's request, the Foundation worked closely with EPA on a weekly and often daily basis. Indeed, EPA was involved in all important program decisions, including the selection of sub-recipients and contractors. EPA was, without question, extremely satisfied with the Foundation's stewardship of the CA programs. It expressed that satisfaction by repeatedly praising the programs to the Foundation's staff, consultants, and contractors; by providing substantial additional funding to the programs each year; and by making two additional sole-source awards to the Foundation in 2001.

[2] For each of its CAs, the Foundation kept detailed and accurate **financial records**, including job cost activity reports for each CA, that show the receipt and expenditure of the EPA funds disbursed under the CAs, and support the costs claimed under those awards.[1] Its employees prepared **personal activity reports and other time-keeping records** sufficient to support all (or substantially all) of the labor hours charged to the CAs.[2] Each of its **procurement contracts** was awarded on the basis of a competitive solicitation or, if awarded with less than "open and free competition," on the basis of specific instructions from EPA ("directed contract") or another well-recognized sole-source justification.[3] For each of those contract awards, it conducted a detailed **price analysis**, as required by EPA regulations.[4] Finally, it complied with its contractual obligations regarding submission of **indirect cost proposals**.[5] Moreover, final cost data for 1997 to 2002 show that the Foundation recovered significantly less in indirect costs than it was entitled

---

[1] Response, Parts 1, 3[A] and 3[B], and 4.

[2] Response, Part 2.

[3] Response, Parts 7[A], 7[C] and 7[D].

[4] Response, Parts 7[B], 7[C] and 7[E].

[5] Response, Part 6.

to recover: the Foundation has under-recovered approximately $600,000 in indirect costs from EPA.

The issues raised in the DAR relate almost exclusively to compliance with documentation requirements (e.g., procurement procedures, cost/price analysis, written procedures, standard contract clauses) rather than compliance with substantive rules and regulations. These documentation issues were first called to our attention in March 2002 by the EPA Grants Management Office. At that time, we took immediate steps to address EPA's concerns; by May 2002, EPA had approved our proposed plan of action, which we then implemented. Consequently, we do not believe that any of these documentation issues can reasonably support a disallowance of costs.

[3] Finally, with respect to the Foundation's eligibility to receive Federal funds: According to the DAR, the Foundation, a 501(c)(3) organization, was not sufficiently separated from CFA, then a 501(c)(4) organization, to be treated as a separate organization for purposes of LDA Section 18. In addition, at the time CFA engaged in a small amount of lobbying. On that basis, the DAR concludes that the Foundation was not a 501(c)(3) organization, but was instead a 501(c)(4) organization that engaged in lobbying, and it was therefore not eligible to receive Federal funds. Accordingly, every penny of the $4.7 million received by the Foundation must be refunded.

As explained in detail in the **legal memorandum**, the DAR's interpretation of Section 18 is based on factual misrepresentations and flawed legal analysis.

- The DAR misrepresents the Foundation's history and corporate purpose. The Foundation was not, as the DAR suggests, established "to receive the Federal funds" that CFA, a 501(c)(4) organization that engaged in lobbying, was no longer eligible to receive. In fact, the Foundation was established in 1972, more than 20 years before the enactment of the LDA, and in 1996, was a fully functioning 501(c)(3) organization. It was not a sham designed to mislead EPA

- The DAR understates the degree of separation between the Foundation and CFA. The organizations had separate Boards of Directors (including, in the Foundation's case, outside directors unconnected to CFA), separate financial accounts and separate funding.

- The DAR misreads the text of the LDA Section 18, where eligibility for Federal funds turns on the IRS classifications alone, and its legislative history, which suggests that separate incorporation and IRS recognition is sufficient to avoid the

Section prohibition.

- EPA has no authority to adopt an expansive interpretation of Section 18. It is not the agency charged with enforcement of the statute, and it has no particular expertise in the issues arising thereunder, Furthermore, an expansive interpretation would raise difficult First Amendment issues, a situation that Congress anticipated when it passed Section 18, and attempted to avoid by making the statute clear and unambiguous.

- Even if the OIG interpretation were plausible, and EPA had the authority to adopt that interpretation and apply it to recipients, EPA could not apply that interpretation retroactively to the Foundation.

In fact, it appears that EPA already **considered** and **rejected** the OIG interpretation of LDA Section 18 [i] in 1996 and 1997, when it transferred CFA's radon programs to the Foundation under new CAs even though EPA officials were aware of the very facts and circumstances which, according to OIG, made the Foundation ineligible to receive Federal funds, and [ii] in May 2002, when, after considering, once again, the relationship between the Foundation and CFA, it continued disbursing Federal funds to the Foundation under five separate cooperative agreements through the end of 2002.

In light of the foregoing, OIG's proposed $4.7 million disallowance is entirely without legal justification. It is based on an interpretation of LDA Section 18 that is untenable and, indeed, has already been considered and rejected by EPA; and retroactive application of that interpretation to the Foundation would be arbitrary, capricious and a denial of due process of law.

The proposed disallowance is also patently unfair and reasonable. It ignores the fact that the programs were undertaken by CFA **at EPA's specific request**, and were later transferred intact from CFA to the Foundation **at EPA's specific request**. It ignores five years of successful program performance by the Foundation, and the considerable benefits for public health and education that flowed from those programs. Finally, it ignores the fact that Foundation acted, at all times and in all matters, in the utmost good faith.

Sincerely,

Stephen Brobeck
Executive Director

Appendix B

RESPONSE OF

CONSUMER FEDERATION OF AMERICA

TO AUDIT REPORT ON
CONSUMER FEDERATION OF AMERICA FOUNDATION

I. BACKGROUND

The Consumer Federation of America ("CFA"), established in 1967, is a consumer advocacy organization, working to advance pro-consumer policies on a variety of important issues before the U.S. Congress, the White House, Federal and State regulatory agencies, and the courts. It is also an educational organization, disseminating information on consumer issues to policymakers, the media and the public. In 1968, CFA was recognized by the Internal Revenue Service ("IRS") as an advocacy organization exempt from Federal taxation under Section 501(c)(4) of the Internal Revenue Code ("IRC"). CFA maintained 501(c)(4) status until January 2003, when it was recognized by the IRS as a charitable and educational organization, and the basis of its exemption was changed from IRC Section 501(c)(4) to IRC Section 501(c)(3).

CFA established the Consumer Federation of America Foundation (the "Foundation") in 1972 to serve as the CFA's research and education arm. The Foundation was known originally as The Paul H. Douglas Consumer Research Center, Inc. ("PHDCRC"); thereafter, its corporate name was changed twice - in March 1997, to the Consumer Research Council and, in March 1999, to the Consumer Federation of America Foundation. In 1972, the Foundation was recognized as a charitable and educational organization exempt from Federal taxation under IRC Section 501(c)(3). Thus, the Foundation has existed as a separate tax-exempt charitable organization without interruption for more than 30 years. During that period, the Foundation had its own board of directors, financial accounts, and funding, and conducted its own charitable and educational programs.

The Draft Audit Report ("DAR") prepared by the Office of Inspector General states that CFA established the Foundation in response to the enactment of the Lobbying Disclosure Act of 1995[1] ("LDA") in order "to receive the Federal funds"

---

[1] Lobbying Disclosure Act of 1995, 2 USC 1601 et seq.

that CFA, a 501(c)(4) organization that engaged in lobbying, would no longer be eligible to receive under LDA Section 18.[2] This statement is misleading on two counts. **First**, the Foundation was not organized in response to the enactment of LDA Section 18; it was organized nearly twenty-five (25) years earlier. **Second**, CFA's purpose in establishing the Foundation was not - could not have been - to avoid the effects of LDA Section 18. This misrepresentation of the Foundation's history and corporate purpose is highly significant. The DAR relies on it, and on a distorted interpretation of LDA Section 18 and its legislative history,[3] to propose the disallowance of **all** of the $4.7 million in funding received by the Foundation from EPA during the period covered by the audit.

Prior to 1991, neither CFA nor the Foundation was a significant recipient of Federal funds. However, in that year, the U.S. Environmental Protection Agency ("EPA") asked CFA to undertake work on EPA's behalf to increase consumer awareness of radon contamination of indoor air. EPA approached CFA and asked for its assistance because of CFA's expertise on indoor air quality ("IAQ") issues and because of its unique network of state and local consumer groups. When CFA agreed, EPA awarded CFA a sole-source cooperative agreement ("CA") to perform the work.

In light of CFA's successful performance of the IAQ CA, over the next few years EPA significantly expanded the scope of the IAQ program, and the amount of program funding. It also asked CFA to undertake several other CAs, including, in 1993, a CA to manage a national public service campaign to educate consumers about the health risks of radon. In each case, the new award was initiated by EPA - that is, EPA determined the need for Federal action, defined the scope of the program, established the amount of available funding, and only then approached CFA to implement the program on its behalf. Each CA was awarded to CFA without competition. CFA never sought additional program responsibilities or responded to a competitive solicitation. During the same period, the Foundation received no Federal funds; its funding - about $110,000 per year between 1993 and 1995 - came

---

[2] 2 USC 1611. Under Section 18, "[a]n organization described in section 501(c)(4) of title 26 [the Internal Revenue Code] which engages in lobbying activities shall not be eligible for the receipt of Federal funds constituting an award, grant, or loan."

[3] See Part II below, and the legal memorandum of Sonenthal & Overall P.C., submitted with this Response.

almost exclusively from private foundations.

In January 1996, the enactment of LDA Section 18 made 501(c)(4) organizations that engage in lobbying ineligible to receive Federal funds. CFA, which engaged in small amounts of lobbying on consumer issues, was swept up in the ban. But EPA wanted to maintain the programs that CFA was implementing on its behalf - including the public service campaign on radon pollution. Accordingly, EPA officials suggested that in the future, EPA funding would go, not to CFA, but to the Foundation. At the time they proposed this approach, it was clear that the responsible EPA officials knew about the relationship between CFA and the Foundation - in particular, they knew that the two organizations shared facilities and staff. In fact, the EPA officials required (and, on several occasions, specifically asked CFA to confirm) that the substitution of the Foundation as recipient would not mean a change in program staff - i.e., that the **CFA employees** who ran the program and the **CFA contractors** that provided services to the program would continue to do so under the new CA. At the same time, these EPA officials were clearly sensitive to the legal issues raised by program staff working for both CFA and the Foundation. For example, Mary Ellen R. Fise, then CFA's general counsel, was often asked to explain how key personnel (including Ms. Fise) could work on CA programs for the Foundation and, at the same time, appear before Congress and state legislatures as consumer advocates on behalf of CFA. In each case, Ms. Fise would explain that CFA and the Foundation shared staff and facilities, but that the organizations were legally separate and, moreover, took great care to assure that no CA funds received by the Foundation were used to support lobbying by CFA.[4]

In August 1996, EPA awarded the Foundation its first CA (CX 824939-01) covering work on radon and indoor air quality, including administration of the "Radon Fix It" program. In purpose and effect, this award replaced a CA between EPA and CFA that had expired in 1996, and was intended to transfer the IAQ program intact from CFA to the Foundation, where it continued to be managed and

---

[4] The relationship between CFA and the Foundation was also disclosed in CFA's OMB Circular A-133 audits for 1997 through 2002. The audit reports indicate that the Foundation paid no salaries, but each year made a payment for salaries and overhead to CFA. In addition, Note A to the each annual financial statements states clearly that CFA and the Foundation "share facilities and staff. Salaries and overhead expenses are reimbursed to CFA based on contractual agreements." For example: "Consumer Federation of America/Consumer Research Council: Audited Financial Statements, December 31, 1997" at 3, 7 (July 15, 1998) (Attachment #1).

implemented by the same personnel. In July 1997, EPA awarded the Foundation a second CA (CX 825612-01), with a five-year term, to conduct a public service campaign (including the production and distribution of public service announcements, or PSAs) on the health hazards of indoor radon pollution. In purpose and effect, this award replaced a CA between EPA and CFA that had expired in 1997, and was intended to transfer the program intact (including staff and contractors) to the new CA.[5] In September 1997, EPA awarded the Foundation a third CA (CX 825837-01), with a five-year term, to develop a public service campaign designed to alert the general public to the dangers of secondary smoke to children.

EPA made these awards to the Foundation even though the details of the CFA/Foundation relationship - in particular, their sharing of facilities and staff - were disclosed to EPA officials on numerous occasions. At no time did any EPA program official or grants-management official suggest that the CFA/Foundation relationship - including the sharing of facilities and staff - might transform the Foundation from a duly established 501(c)(3) organization eligible to receive Federal funds into a 501(c)(4) organization whose receipt of Federal funds was illegal. On the contrary, the message that EPA consistently delivered was that separate incorporation was sufficient to meet the requirements of LDA Section 18. For example, the standard terms and conditions set out in each of the Foundation's CAs contains the following provision, designed to determine eligibility for Federal funds under LDA Section 18:

> "Pursuant to Section 18 of the Lobbying Disclosure Act of 1995, PL. No. 105-65, 109 Stat. 691, the recipient affirms that:
>
> (1) it is not a non-profit organization described in Section 501(c)(4) of the Internal Revenue Code of 1986; or
>
> (2) it is a non-profit organization described in Section

[5] In its application for funding, the Foundation indicated that the advertising agency hired by CFA to work on the campaign for CFA - PlowShare Group - would continue to supply those services under the new CA. See Jack Gillis to Kristy Miller, EPA Indoor Environments Division (May 7, 1997) (Attachment #2).

> 501(c)(4) of the Internal Revenue Code of 1986 but does not and will not engage in lobbying activities as defined in Section 3 of the Lobbying Disclosure Act of 1995."[6]

There is nothing in this request for affirmation to suggest any basis for LDA Section 18 eligibility other than separate incorporation, no reference to laws, regulations or policies that would alert the recipient to the existence of a different standard of eligibility.[7]

Having disclosed the details of the CFA/Foundation relationship to EPA, and having received from EPA clear indications that it was an eligible recipient, the Foundation, in good faith, agreed to execute the CAs and, each year thereafter (through 2002), to execute CA amendments providing additional increments of funding for each program. Its performance during the period was outstanding. The public service campaigns, in particular, were recognized as highly effective (one of its PSA was awarded an Emmy); the competence and efficiency of its program administration were never questioned. In March 2002, however, the EPA Grants Management Office abruptly suspended all of the Foundation's CAs and, **for the first time**, expressed concern about the relationship between the Foundation and CFA, and about a number of the Foundation's financial management and procurement practices. The Foundation maintained (and continues to maintain - see Part II below) that, as a duly incorporated non-profit corporation exempt from Federal taxation under IRC Section 501(c)(3), it is fully eligible under LDA Section 18 to receive Federal funds. But, in deference to EPA concerns on that issue, it was agreed that CFA would change its tax-exempt status from 501(c)(4) to 501(c)(3),[8] and that the Foundation would then merge its operations into the reorganized CFA.

---

[6] See, for example, Cooperative Agreement No. CX 825837-01-0 at 4-5 (September 22, 1997) Attachment #3.

[7] In fact, there was (and is) no standard for LDA Section 18 eligibility other than separate incorporation in the statute and its legislative history, or in any regulation, policy statement or program rule issued by the Federal government or the EPA. See Part III below, and the legal memorandum of Sonenthal & Overall submitted with this Response.

[8] Because the amount of CFA's lobbying activities was de minimus, it was easily able to satisfy the limitations on lobbying activities imposed on organizations exempt under Section 501(c)(3).

In addition, while not conceding any violations of law or regulation, it was agreed that CFA would take additional steps to assure the effectiveness and transparency of its financial systems and procurement practices, as detailed in its correspondence with EPA Grants Management. On that basis of these assurances, in May 2002, EPA lifted its suspension of the Foundation's CA activities. Since then, EPA has awarded the Foundation a new CA extending the ETS Campaign (XA 830590-01 in October 2002), and two new CAs for an energy efficiency program (XA 830875-01 in February 2003, and XA 831201-01 in October 2003), and increased funding for another (X 829178-01 in August 2002), and has awarded CFA a new CA for a radon indoor air quality program (in March 2003). Each award was made under a competitive solicitation.

II. THE LOBBYING DISCLOSURE ACT OF 1995.

The positions taken by OIG/EPA on the meaning of Section 18 and on the applicability of Section 18 to the Foundation, are untenable, for the following reasons. **First**, although its statement of the facts is generally accurate as far as it goes, the DAR misstates the historical relationship between the Federation and the Foundation and understates the actual "degree of separation" between the organizations. **Second**, the OIG/EPA's interpretation of Section 18 - that is, its **extension** of the Section 18 prohibition from the 501(c)(4) organizations identified in the statute to duly constituted 501(c)(3) organizations - is inconsistent with Section 18's plain and unambiguous terms, and has **no support** in the section's legislative history. To the contrary, the extension of Section 18 proposed by OIG/EPA crosses an important constitutional boundary that Congress, when it enacted the section, explicitly recognized and tried to avoid. Third, EPA does not have the authority to adopt the OIG interpretation of Section 18; and if EPA does adopt that interpretation, it should be vulnerable to legal challenge. **Finally**, even if EPA has the authority to adopt the OIG/EPA interpretation, under well-established legal precedent, it cannot apply that interpretation retroactively to the Foundation.

These arguments are discussed at length in a memorandum for our legal counsel, Sonenthal & Overall PC, submitted along with this response.

The OIG's interpretation of LDA Section 18 - that is, its **expansion** of the statutory disqualification beyond the 501(c)(4) organizations referred to in the statute - is incorrect as a matter of law, and unenforceable against the Foundation.

As a matter of law, a 501(c)(3) or a non-lobbying 501(c)(4) may share directors, facilities and staff — may be all but indistinguishable from the non-lobbying 501(c)(4) — without losing its eligibility under LDA Section 18, as long as the organizations respect their separate incorporation and maintain separate books of account. Our conclusion is based on the following considerations:

First, OIG's interpretation of LDA Section is inconsistent with the statute's plain and unambiguous terms.

Second, the legislative history of LDA Section 18, cited by OIG to support its expansion, appears instead to contradict its position — i.e., it appears to exclude separately incorporated 501(c)(3) organizations from the statute's coverage. The legislative history also suggests that Congress was concerned about the effect that LDA Section 18 would have on important First Amendment interests - interests which, in our view, could be chilled or compromised if eligibility for Federal funds were to depend on an undefined "degree of separation" between 501(c)(3) and 501(c)(4) organizations.

Third, EPA does not have the legal authority to adopt a broad interpretation of LDA Section 18. as it is not the only Federal agency charged with administering the statute, and it has no special expertise with respect thereto. If EPA does adopt that interpretation, its view would be entitled to no deference in a court of law, and should be vulnerable to legal challenge.

Fourth, even if EPA has the authority to adopt the OIG interpretation of LDA Section 18, under well established legal precedent, it cannot apply that interpretation retroactively to the Foundation.

III. FINANCIAL MANAGEMENT SYSTEM

According to the DAR, the Foundation's "financial management system was not adequate to account for the source and application of funds for Federally-sponsored activities as required by Title 40 CFR 30.21."

A. GENERAL RESPONSE

Many of the OIG allegations assume that CFA, not the Foundation, was the recipient of the EPA CAs. In fact, there is no legal basis for the OIG to ignore the

fact that CFA and the Foundation were separate corporations, with inter alia separate governing bodies, separate budgets, and separate financial accounting systems. The independent corporate status of the organizations was scrupulously observed. The fact that the Foundation obtained its administrative and technical support under contract from CFA does not negate this independent status, or make the Foundation a mere alter ego of CFA.

The DAR questions costs incurred by the Foundation, but then cites no basis for its questioning. To be allowable, costs charged to Federal awards must be allowable per OMB Circular A-122 and the Federal award, allocable to the Federal award, and reasonable. The DAR does not provide a basis for (unallowable, unallocable and/or unreasonable) or quantification of questioned costs. Instead, the DAR seems to take the view that perceived inadequacies in our financial management system are a sufficient basis for questioning all costs we incurred under the Federal awards subject to audit. We disagree with the underlying premise - that our systems were inadequate for audit and reporting on Federal awards - and we are perplexed that the contract files provided to OIG, which contained job cost accounting reports and the supporting documentation for each, and which had previously been audited under OMB Circular A-133, were not audited and reported upon by OIG for criteria of allowability, allocability, and reasonableness.

Finally, we note that nearly all of the issues raised in the DAR relate almost exclusively to compliance with documentation requirements (e.g., procurement procedures, cost/price analysis, written procedures, standard contract clauses) rather than compliance with substantive rules and regulations. These documentation issues were first called to our attention in March 2002 by the EPA Grants Management Office. At that time, we took immediate steps to address EPA's concerns; by May 2002, EPA had approved our proposed plan of action, which we then implemented. Consequently, we do not believe that any of these documentation issues can reasonably support a disallowance of costs.

B. SPECIFIC RESPONSES

Set forth below are the OIG's specific allegations, followed by the detailed response of CFA management.

1. The Foundation did not structure its financial management system to "separately identify and

> **accumulate all of the direct costs associated with its membership, lobbying and public outreach activities" as required by subparagraph B(4) of OMB Circular A-122, Attachment A.**

As noted, OMB Circular A-122 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."[9] For that reason, the DAR asserts these costs must be "separately identif[ied] and accumulate[d]." The DAR fails to note, however, that Attachment A, subparagraph B(4) applies only when these costs are "significant." Attachment A, subparagraph B(2) reinforces this point, providing that

> "any direct cost of a minor amount may be treated as an indirect cost for reasons of practicality where the accounting treatment for such cost is consistently applied to all final cost objectives."

In fact, with one minor exception, neither the Foundation nor CFA incurred

---

[9] According to the Circular, examples of these types of activities include:

> "a. Maintenance of membership rolls, subscriptions, publications, and related functions.
>
> b. Providing services and information to members, legislative or administrative bodies, or the public.
>
> c. Promotion, lobbying, and other forms of public relations.
>
> d. Meetings and conferences except those held to conduct the general administration of the organization.
>
> e. Maintenance, protection, and investment of special funds not used in operation of the organization.
>
> f. Administration of group benefits on behalf of members or clients, including life and hospital insurance, annuity or retirement plans, financial aid, etc."

any costs providing "services" within the meaning of Attachment A, subparagraph B(4). During the period covered by the audit, the Foundation had no members, no benefit or service programs, did not lobby or engage in public relations, and conducted no meetings and conferences. CFA did have members, but it did not recruit new members, had no benefit or service programs targeted primarily at members, did not lobby on behalf of members, and held no meetings or conferences primarily for the benefit of members (other than meetings held to conduct the general administration of the organization). It is true that CFA members could receive benefits from its programs - including publications, e-mailed information, technical assistance and conferences, as well as the small amount of consumer lobbying that CFA did each year - but they received these benefits primarily as members of the general public. CFA did not offer benefits to CFA members exclusively, or on terms or conditions different from those offered to non-members. Indeed, CFA functioned as a public-interest organization whose purpose was to serve the interests of consumers in general, not as a membership organization.

There was one exception. During the period covered by the audit, it was CFA's practice to reimburse certain CFA member representatives for the travel expenses they incurred to attend CFA meetings and conferences. As a result, each year CFA paid the travel expenses for about 50 trips by member representatives to attend CFA meetings or conferences. The total amount of these reimbursements was approximately $16,000 per year. However, a significant portion of these reimbursements were for the "general administration of the organization" – e.g., trips by CFA directors to attend meetings of the CFA Board of Directors, and trips by CFA member representatives to CFA's policy subcommittee meetings and the CFA annual membership meeting. Thus, the total amount arguably covered by Attachment A was approximately $11,000 per year. Finally, nearly all of these travel reimbursements were treated on the organization's books as direct costs - i.e., they were charged by CFA to specific funds provided to the organization to cover such costs and not included in indirect costs. Thus, the total amount arguably covered by Attachment A, subparagraph B(4), if any, certainly qualified as a "minor amount" within the meaning of Attachment A, subparagraph B(2).

Accordingly, we believe that Attachment A, subparagraph B(4) did not require the Foundation (or CFA) to separately identify and accumulate the direct costs associated with its membership activities. Furthermore, CFA did treat those expenditures, such as they were, as direct costs, and did not include them in its indirect cost pool.

CFA accounted for its lobbying expenses. The individuals who engaged in lobbying activities on behalf of CFA submitted a record of the time spent on those activities twice a year. Lobbying expenses were excluded from the indirect expense pool and therefore not claimed for recovery under any federal award.

Therefore, because we properly accounted for costs under Attachment A, subparagraph B(4), this portion of the DAR, and any recommendations based thereon, should be regarded as resolved.

* * * *

2. The Foundation's time distribution system did not require all personnel to prepare timesheets, and used budget estimates, rather than after-the-fact activity determinations, to support claimed labor costs, and therefore did not meet the minimum requirements of OMB Circular A-122, Attachment B.

OMB Circular A-122, Attachment B, subparagraph 7(m) advises that the distribution of salaries and wages to awards must be supported by "personal activity reports," prepared at least monthly, reflecting an after-the-fact determination of the actual activity of each employee for the total activity for which the employee is compensated.

CFA has a complete set of personal activity reports ("PARs") meeting the requirements of Attachment B, subparagraph 7(m), for the three individuals whose time constituted approximately 70% of the labor hours charged to the CAs during the period covered by the audit. These PARs were made available to the OIG auditors during their visit to the CFA offices. In addition, at the request of the EPA Grants Management Office, the individuals who supplied almost all of the remaining labor hours charged to the CAs (approximately 30% of the total), prepared activity reports which record, activity by activity, the time they spent on activities that were charged to the CAs. This documentation can be used to make an accurate determination of the actual labor costs chargeable to each CA. If such a determination is required by EPA Grants Management Office, we expect that, given the amount of work performed by program staff, the labor costs chargeable to the CAs will be at or near

the labor costs actually charged.

We acknowledge, however, that we used budget estimates to support our claimed labor costs, rather than the personal activity reports and other after-the-fact documentation reference above. In March 2002, the EPA grants manager called our attention to the requirements of Attachment B, subparagraph 7(m). After discussions with the Grants Management Office, we instituted a revised time-keeping system covering all employees who charge their time, in whole or in part, to Federal awards. This new system - which includes a revised time-sheet, and is supported by specific instructions on time-keeping in the CFA Employee Manual - satisfies the requirements of Attachment B.[10] In addition, our internal procedures now require all invoicing for labor be based exclusively on these time-sheets and the record of time actually spent that it contains. Accordingly, this audit issue should be regarded as closed.

* * * *

3. [A] Prior to 2001, the Foundation's general ledger did not account for the various cost elements identified in the EPA Cooperative Agreements, preventing a comparison of outlays with budget amounts.

Section 30.21(b) of EPA's Uniform Administrative Requirements for Grants and Cooperative Agreements, 40 CFR §30.21(b), requires that a recipient's financial management system provide for "[c]omparison of outlays with budget amounts for each award." Although CFA acknowledges that prior to 2001, a "comparison of outlays with budgeted amounts" could not be made using the Foundation's general ledger only, nothing in 40 CFR §30.21(b) or OMB Circular A-110 requires that this comparison be made using the general ledger. During the period covered by the audit, the Foundation prepared Job Cost Activity Reports ("JCARs") on a consistent basis for each of its EPA CAs, and maintained those reports in the CA project file, and were provided to the OIG auditors for examination. These JCARs accurately reflect the amounts expended on each CA, allowing the required comparison of "outlays to budgeted amounts," and reconciling back to the OMB Circular A-133

[10] A copy of the CFA time sheet is attachment #4.

audit report. Accordingly, we believe that the Foundation fully complied with 40 CFR §30.21(b) for the period covered by the audit.

As a result of discussions with the EPA Grants Management, CFA has instituted additional internal controls that directly address the concerns raised in the DAR. The independent public accountant performing the OMB Circular A-133 audit will now conduct compliance testing during the fiscal year. Compliance testing will be conducted between the six and nine months of each fiscal year to assure that the JCARs reconcile to the general ledger at year end and the transactions comply the CA terms and conditions, and OMB Circular A-122.

[B] On the general ledgers, certain contractual costs were mis-classified, resulting in inaccurate cost element totals and making it impossible to accurately compare budgeted versus actual costs.

At the outset, we strongly object to the DAR questioning the classification of contractual costs on the Foundation's general ledger without specifying the nature of the alleged errors, or identifying specific examples of the contract costs in question. Under the circumstances, it is impossible for us to prepare an effective response on this point. Because of this failure to provide any specifics, we submit that this portion of the DAR, and any recommendations based thereon, should be stricken from the final report.

In addition, to the best of our knowledge, all contractual costs were properly classified on the general ledger. In fact, each year since 1997, our classification of costs was tested as part of an OMB Circular A-133 audit conducted by an independent auditor, and found to be satisfactory. Accordingly, it seems clear that the DAR's objection to our classification of costs amounts, at the very worst, to a disagreement about proper classification with our A-133 auditor, and not to a finding of non-compliance. For this reason as well, this portion of the DAR, and any recommendations based thereon, should be stricken from the final report.

* * * *

4. The Foundation was unable to provide

[A] a summary of costs incurred by contract and

reported under each CA, and [B] copies of some contracts and purchase orders awarded thereunder, and was therefore "unable to show that contract costs recorded in the accounting records were paid in accordance with the contract terms."

The DAR's allegations are untrue. With respect to 4[A], the Foundation's Job Cost Activity Reports (referred to in Part 3[A] above) contain a summary of costs incurred by contract and reported under each CA. These JCARs were provided to the OIG audit team during their visit to our offices.

With respect to 4[B], we strongly object to the DAR's allegation that "[t]he Foundation was unable to provide . . . copies of some contracts or and purchase orders awarded" under the CAs because the report gives no indication of **which** contracts and purchase orders are alleged to be missing. Without such information, it is impossible for us to prepare an effective response. Therefore, we submit that this portion of the DAR, and any recommendations based thereon, should be stricken from the final report.

We are confident that each procurement contract awarded by the Foundation during the period covered by the audit is adequately evidenced by written agreements, by detailed written offers or proposals that were accepted by the Foundation, and/or by other relevant transactional documentation sufficient to show price, delivery dates and other material terms and conditions. In fact, during the period covered by the audit, no contractor invoice was paid without cross-checking the terms of the invoice, including price, against documents setting forth the contract terms. On that basis, we can show that all contract costs recorded in our accounting records were paid in accordance with the contract terms.

* * * *

5. The Foundation failed to have "written accounting procedures [for] identifying direct and indirect costs and . . . allocating such costs to projects," which prevented proper evaluation of reported direct and indirect costs under the cooperative agreements.

Section 30.21(b)(6) of the EPA Uniform Regulation, 40 CFR §30.21, requires that a recipient's financial management system 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." Significantly, the regulation does **not** require that the recipient have a formal "accounting manual" or similar document; it is sufficient for purposes of the regulation if there are "written procedures" that accomplish the same practical result.

In fact, during the period covered by the audit, the Foundation did have some written guidance on which the responsible officials relied "for determining the reasonableness, allocability and allowability of costs."[11] That guidance was supplemented by OMB Circular A-122. However, we agree in principle that more formal written procedures are preferable to the guidance on cost allowability that was used. In fact, when the EPA Grants Management Office called the requirements of 40 CFR §30.21 to our attention in March 2002, we promptly prepared and adopted a more detailed "Cost Policy Statement" covering the relevant cost accounting principles. The "Cost Policy Statement" merely formalized procedures that are well-established in the assistance management field, and that our financial management staff was already applying during the period covered by the audit.

The DAR suggests that the Foundation's alleged failure to have written accounting procedures "prevented proper evaluation of reported direct and indirect costs under the cooperative agreements." This comment is ambiguous. It may mean that, without "written accounting procedures," **OIG** was unable to evaluate reported direct and indirect costs. But it is difficult to understand how this could be the case. Our Circular A-133 auditor had no difficulty evaluating our direct and indirect costs. Moreover, the OIG has access to volumes of guidance on this point, and could easily have resolved any uncertainties by discussing them with us.

On the other hand, if the DAR is suggesting that, without "written accounting procedures," **the Foundation** was unable to "evaluat[e] reported direct and indirect costs," we strongly disagree. It does not follow that we failed to use consistent cost allocation practices. On the contrary, all our decisions on cost allocation were made by professionals with extensive experience in accounting, with the assistance (on

---

[11] An example of such guidance is the "Notes to Spreadsheet on Indirect Cost Rate" from the indirect cost rate proposal submitted to EPA in September 1994, included as Attachment #5.

indirect cost rate proposals) with experts in the field of Federal grants accounting and administration. Direct and indirect costs are supportable as such by examination of the invoice(s) from the vendor(s) that identifies the purpose of the expense. The propriety of direct costs can further be examined by tying the purpose of the expense to the program objective or workplan. Such information was provided to the OIG. Furthermore, one would expect that errors or inconsistencies in our practice, if any, would have been noted in our Circular A-133 audits between 1997 and 2002. But the independent auditor who conducted those audits and reviewed our allocation of direct and indirect costs found no reportable conditions or other problems.

We believe it would be unreasonable to conclude that direct and indirect costs were misallocated simply because of alleged shortcomings in our "written procedures."

* * * *

6. The Foundation-

[A] failed to prepare and submit indirect cost rate proposals for 1997 and 2002 as required by OMB Circular A-122;

The basis of the DAR's finding is OMB Circular A-122, Attachment A, subparagraph E(2), which requires a non-profit organization to submit an initial indirect cost proposal to its cognizant Federal agency not later than three months after the effective date of award, and organizations with a negotiated indirect cost rate to submit a new indirect cost rate proposal within six months of the close of each fiscal year. However, the standard terms and conditions in each of the Foundation's CAs specifically instructed the Foundation **not** to submit any indirect cost rate proposals to EPA. For example, the "Terms and Conditions" incorporated in CA CX 825837-01 provide that:

> "The recipient's authorized budget includes indirect costs in the amount of $36,854. The recipient agrees with 90 days of accepting this assistance agreement/amendment to prepare and maintain on file for review an indirect cost rate proposal based on [EPA] guidance."

Furthermore, when we prepared a formal indirect cost rate proposal based on 1998 cost data for an award from the U.S. Information Agency ("USIA"), and sought to submit it to EPA as well, we were told by Joan Clark, our EPA Grants Management officer, that "EPA does not accept indirect cost rate proposals from non-profit organizations." In light of the fact that EPA was the Foundation's "cognizant federal agency," the standard "Terms and Conditions," confirmed by the Grants Management Office, superseded the requirements of Attachment A, subparagraph E(2). Consequently, during the period covered by the audit, the Foundation was **not** required to prepare and submit an indirect cost rate proposal to EPA.

The OIG is surely aware of EPA's policy of refusing new indirect cost rate proposals from non-profits, and of the basis for that policy - namely, that EPA has a significant backlog of indirect cost rate proposals from non-profit organizations submitted but not yet reviewed. In fact, CFA submitted an indirect cost rate proposal to EPA in **1994**; ten years later, that proposal has not yet been reviewed or approved.

We acknowledge, however, that the standard "Terms and Conditions" did require the Foundation to **prepare** an indirect cost rate proposal for 1997, and to maintain that proposal in its files. We did not prepare such a proposal until 1999, in connection with our award from US Information Agency. Nevertheless, we believe this to be, at worst, a technical violation of our agreements that caused no prejudice to EPA, considering the fact that the proposal would have remained locked in our files, and that a comprehensive review of our indirect cost rates, and the establishment of final rates, will take place as part of CA close-out. If the final rates show that, over the life of the CAs, we recovered more in indirect costs than we were entitled to recover, EPA will, of course, be entitled to a refund.

In that connection, we note that we have already prepared an indirect cost rate proposal for 1997, which was shown to the OIG audit team, and are in the process of completing a proposal for 2003 (based on 2002 data), which we will submit once the OIG audit process is completed. In addition, we have reviewed our final cost data for the other years covered by the audit. Our preliminary analysis indicates that, for the period covered by the audit, we recovered **significantly less** in indirect costs than we were entitled to recover, and that the Foundation has under-recovered approximately $600 thousand in indirect costs. We will present our findings on this point to EPA as soon as they are completed.

[B] calculated its indirect cost rates for 1999 through 2001 incorrectly, using indirect costs rather than direct labor as the allocation base.

We acknowledge that our indirect cost rates for 1999 through 2001 were miscalculated; it appears that, in the fraction used to calculate the rate, the numerator and denominator were inadvertently reversed. That error was identified and corrected during the review and analysis referenced in Part 6[A].

As noted above, we expect this correction, along with other appropriate corrections and revisions, will lead to a **significant increase** in the indirect costs payable to the Foundation under the CAs.

* * * *

7. The Foundation did not always follow proper procurement practices for contracts awarded under its CAs, and therefore the reasonableness of contract costs could not be adequately assessed. In particular-

[A] Contracts over the $100,000 small purchase threshold were awarded without competition, and without justification to support the lack of competition.

Section 30.43 of the EPA Uniform Regulation, 40 CFR §30.43, provides that "all procurement transactions" under a cooperative agreement "shall be conducted in a manner to provide, to the maximum extent practical, open and free competition." In addition, for each procurement transaction in excess of the small purchase threshold ($100,000), the recipient must maintain "procurement records and files" that include, at a minimum, "the basis for contractor selection; justification for lack of competition when competitive bids or offers are not obtained; and basis for award cost and price." 40 CFR §30.46. On request, these records and files must be made available for EPA review. 40 CFR §30.44(e).

During the five-year period covered by the audit, the Foundation had only two (2) procurement contracts in excess of the $100,000 small purchase threshold.

The first contract (the "Radon PSA Contract") was awarded just after the execution of CA CX825612-01 in July 1997 to PlowShare Group ("PlowShare") of Stamford, Connecticut, an advertising firm specializing in public service campaigns for non-profit organizations. The contract called for the development and delivery of public service announcements ("PSAs") for a public service campaign to increase consumer awareness about the health hazards of radon, and to encourage consumers to test their homes for the presence of radon. From 1998 through 2002, as EPA amended CA CX825612-01 to provide annual increments in funding for the Radon PSA campaign, the Foundation extended the Radon PSA Contract as well. Each annual extension increased the total contract amount by more than the $100,000. So although there was only a single procurement **contract** under CA CX825612-01, there were a total of five (5) procurement **transactions** under that CA in excess of the $100,000 small purchase threshold.

The second procurement contract (the "ETS Contract") was awarded in October 1997 under CA CX825837-01, also to PlowShare. The contract called for the development and delivery of PSAs for a public service campaign - the ETS campaign - to alert the general public to the dangers of secondhand smoke to children. From 1998 through 2002, as EPA amended CA CX825837-01 to provide annual increments in funding for the ETS campaign, the ETS Contract was extended as well. Each annual extension except the last (in 2002) increased the total contract amount by more than the $100,000. So although there was only a single procurement **contract** under CA X825837-01, there were a total of four (4) procurement **transactions** under that CA in excess of the $100,000 small purchase threshold.

These nine (9) procurement transactions - five (5) under CA 825612-01, and four (4) under CA X825837-01 - were the **only** procurement transactions in excess of the $100,000 small purchase threshold under the Foundation's CAs during the period covered by the audit.

The DAR alleges that these contracts, and the extensions thereto, were awarded without competition, and without justification to support the lack of competition. On this point, the DAR is incorrect.

The **Radon PSA Contract** was awarded to PlowShare after the CA for Radon PSA campaign expired, and the program was transferred from CFA to the Foundation. As noted above, EPA wanted the existing Radon PSA campaign

transferred into the new CA without change - i.e., it wanted the same scope of work, performed by the same program staff and program contractors. Because PlowShare was already engaged under the expired CA to produce and distribute the Radon PSA, the Foundation notified EPA in its application for funds that it intended to continue using PlowShare for those services under the new CA. After EPA approved the application, the Foundation entered into a contract with PlowShare as indicated in the application. Under the circumstances, there were at least two well-recognized sole-source justifications available to the Foundation to support its award to PlowShare. **First**, because of EPA's desire to transfer the Radon PSA campaign intact, PlowShare was, in effect, EPA's **designated contractor** for production and distribution, requiring the Foundation to contract with PlowShare without competition.[12] **Second**, to the extent, if any, that the Foundation had discretion in the choice of a contractor for PSA production and distribution, the sole-source selection of PlowShare was justified as a follow-on to the work PlowShare was performing under the expired CA. Indeed, given the nature of the services that PlowShare was providing to the Radon PSA campaign, and the contractor's special expertise in public service campaigns (in particular, those involving radon), this justification is particularly compelling.[13]

The **ETS Contract** was awarded on the basis of a competitive procurement, conducted from August to October 1997, in which four (4) competing offers were received and evaluated.[14] PlowShare's offer was one of the two lowest in price, and included more services and more distribution options than the other offers submitted.[15] Furthermore, in negotiations, we were able to obtain additional price

---

[12] EPA was also instrumental in the selection of PlowShare as a contractor under the expired CA. After the unacceptable performance by a large "Madison Avenue" agency (Bates) on PSAs on indoor air quality, EPA concluded that a small, specialized agency would offer lower costs and better results. Around that time, PlowShare's president, who had managed a radon PSA campaign while at the Ad Council, contacted EPA, and EPA in turn suggested that PlowShare be engaged to produce and distribute the Radon PSA.

[13] This point is discussed in greater depth in connection with contract extensions on page 18 below.

[14] Mary Ellen Fise to Files, "Advertising Agency Selection for ETS Campaign" (October 3, 1997)(Attachment #6).

[15] Id.

concessions from PlowShare, further reducing its already low competitive price.[16] As a result, PlowShare was awarded the contract as the offeror whose proposal was deemed most advantageous, price, quality and other factors considered. See 40 CFR §30.43.

Each subsequent contract extension in excess of the $100,000 small-purchase threshold had a well-recognized sole-source justification - namely, to permit the incumbent to continue the work that it had started during the initial term. Given the nature of the services, this sole-source justification is particularly compelling. **First**, it takes years of focused effort to build a successful public awareness campaign whose message "burns through" public ignorance (or indifference) - especially where there are conflicting messages in the marketplace (for example, regarding the health impact of secondary smoke). For both campaigns, a consistent creative approach was indispensable. A change in advertising agency would have lead, almost inevitably, to a change in creative approach. Such a change might have made sense if the existing campaigns were unsuccessful, but they were not. PlowShare's work was extremely well received and effective. One of its public service announcements won an Emmy. **Second**, the specialized nature of the services required for the campaigns meant that a replacement agency would take considerable time - perhaps months - to become familiar with the scientific and policy issues. This would amount to a substantial duplication of cost, which was unlikely to be recovered by competition, and would have cause unacceptable delays in the production and distribution of PSAs. Therefore, once the Radon PSA and ETS Contracts were in place and their respective campaigns successfully launched, a change of advertising agency would almost certainly have disrupted the campaigns and diminished their effectiveness, and would have imposed significant costs on the Government for no compensating benefit.

With respect to documentation: When the ETS Contract was awarded in October 1997, a memorandum was placed in the Foundation files describing the procurement process, the evaluation of offers and the basis for award.[17] However, when the Radon PSA Contract was awarded, the Foundation did not place in its

---

[16] PlowShare's initial proposal set a total contract price of $285,300; after negotiation, PlowShare reduced the price to $257,357.

[17] Mary Ellen Fise to Files, "Advertising Agency Selection for ETS Campaign" (October 3, 1997)(Attachment #6).

procurement files a formal explanation of the basis of contractor selection, or a justification for its use of less than "open and full competition." Nor were such explanations placed in the procurement file when the contracts were extended on the basis of EPA incremental funding of the corresponding CA. These omissions have been (or will soon be) corrected, bringing the Foundation into compliance with 40 CFR §§30.44(e)(2) and 30.46 with respect to all procurement transactions in excess of the $100,000 small purchase threshold. In addition, in order to ensure that, in the future, procurement decisions (including sole-source awards) are appropriately documented, we have adopted a manual on "Procurement Procedures for Federal Funds," which provides clear guidance on "competitive bidding for contracts" and requiring that documentation complying with 40 CFR §30.46 be prepared for each procurement and placed in the procurement file at the time of award.

The Foundation's failure to comply in a timely manner with the documentation requirements of 40 CFR §§30.44(e)(2) and 30.46 should not be a basis for any disallowance of costs. For each procurement transaction in excess of the $100,000 small purchase threshold, the Foundation either made the award using "open and free competition," or can demonstrate a well-recognized justification for making a sole source award. Our untimely compliance does not alter the fact that, in each instance, the Foundation, acting on behalf of EPA, received high quality services from a responsible contractor at a competitive price.

[B] The Foundation failed to make and document cost or price analyses in connection with every procurement action.

Section 30.45 of the EPA financial assistance regulation, 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, 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."

In addition, 40 CFR §30.46 requires that, for purchases in excess of $100.000, the recipient's "procurement records and files" include an explanation of the "basis for award cost or price."

The DAR alleges that the "Foundation failed to make . . . cost or price analyses in connection with every procurement action." This allegation is untrue. **First**, with respect to the Radon PSA Contract awarded to PlowShare in 1997, the Foundation compared the prices offered by PlowShare with prices for similar services that were paid to advertising agencies under CA CX 822244-01 between 1994 and 1996 - including such agencies as Bates USA, Campbell Mithun Esty (CMA), Pia Promotions, Commercial Works and PlowShare - before negotiating price with PlowShare.[18] **Second**, with respect to the ETS Contract, as noted above, the Foundation conducted a competitive procurement from August to October 1997. It received and evaluated four competing offers. The price of PlowShare initial proposal was one of the two lowest; in addition, the Foundation was able to negotiate additional price concessions, further reducing PlowShare's already low competitive price. From that time forward, the competitive price information gathered from the ETS competitive procurement, PlowShare's low competitive bid, and the even lower prices included in the contract after negotiations with PlowShare, served as a benchmark for price negotiations when the two contracts with PlowShare came up for extension.

In addition, it was the Foundation's standard practice each time an extension to the Radon PSA or ETS Contracts was negotiated with PlowShare, to require that PlowShare submit a written contract proposal, broken down into specific contract tasks. With the contract proposal in hand, the responsible Foundation officials analyzed the proposed prices for each activity against the baseline established by the original ETS procurement and subsequent price adjustments, if any. They then conducted a careful line-by-line negotiation with PlowShare in a concerted effort to limit price increases over the baseline established in previous years. The Foundation was able [i] to obtain, on a regular basis, significant price reductions from the initial PlowShare proposal, [ii] to limit year-to-year price increases, and [iii] on occasion, to obtain year-to-year price reductions. For example, after PlowShare submitted its initial contract proposal for the 2001-02 extension of the Radon PSA Contract, the

---

[18] See Mary Ellen R. Fise and Jack Gillis to Kristy Miller, "Closeout Report" (December 30, 1997) (Attachment #7)

Foundation required the PlowShare to resubmit the proposal three times before the prices were deemed acceptable. As a result, PlowShare reduced its agency production fees from 17.65% in the initial proposal to 15.00% in the final proposal, and its creative fees by a total of $10,073.

In this context, we believe that the benchmark provided by the competitive information gathered in the first ETS procurement, the requirement of a detailed breakdown of prices by activity, the review and analysis of those prices conducted by the Foundation officials, and, finally, the intensive negotiation of final contract prices with PlowShare on a line-by-line basis - all this, taken together, amount to substantial compliance with the "price or cost analysis" requirement of 40 CFR §30.45.

The DAR also alleges that the "Foundation failed to . . . document cost or price analyses in connection with every procurement action." With respect to the award of the initial ETS contract in October 1997, the allegation is demonstrably untrue. The memorandum prepared by Foundation counsel at the time sets forth the "basis of the award in cost or price" - i.e., the evaluation of proposals in connection with the competitive solicitation. For the remaining procurement actions - that is, the extensions of the Radon PSA and ETS Contracts - we believe that the detailed proposals submitted by PlowShare, the spreadsheet analyses that the Foundation's officials used to conduct price negotiations, and the resulting contract budgets, considered in light of the benchmark provided by the 1997 competitive solicitation, qualify as contemporaneous documentation of the "basis for award cost or price" within the meaning of 40 CFR §§30.45 and 30.46. Thus, we believe that the Foundation substantially complied with those provisions.

To be sure, Foundation officials did not prepare a formal memorandum or other formal written materials explicitly designed to record their price analysis. This omission has now been corrected, bringing the Foundation into compliance with the documentation requirements of 40 CFR §§30.45 and 30.46. Furthermore, the preparation of a contemporaneous price/cost analysis is now required for each procurement by the CFA manual on "Procurement Procedures for Federal Funds," and has become standard organizational practice.

In any event, the Foundation's failure, if any, to comply in a timely manner with the documentation requirements of 40 CFR §§30.45 and 30.46 should not be the basis of a disallowance of costs. For each of its contracts, the Foundation analyzed

prices against a low competitive benchmark, negotiated successfully to keep year-to-year prices increases to a minimum (and even achieved year-to-year reductions), and in the end contracted for and received high quality services at a competitive price.

[C] A contract to develop and distribute PSAs for indoor radon pollution, awarded prior to the execution of CA CX825612-01, was awarded without competition and the required cost or pricing analysis; the contract did not include a price, and was not amended to include additional work as and when the CA was amended.

The referenced "contract to develop and distribute PSAs for indoor radon pollution, awarded prior to the execution of CA CX825612-01" was awarded under a different CA by a different recipient. This award is clearly outside the scope of this audit, and any alleged defect in the procurement process for that contract cannot be the responsibility of the Foundation under of CA CX 825612-01.

If however DAR's reference is to the Radon PSA Contract awarded by the Federation to PlowShare after the execution of CA CX 825612-01, the initial award and subsequent extension of that contract is discussed at length in Parts 7[A] and [B]. With respect to the DAR's specific allegations:

[1] The Radon PSA Contract was awarded without open an free competition; but the decision to do so was fully justifiable. See Part 7[A]

[2] The Foundation conducted the required cost/price analysis by comparing the price offered by PlowShare to the prices charged by other advertising agencies for PSAs recently produced and distributed for the EPA under other CAs. See Part 7[B].

[3] The contract documents for the Radon PSA Contract, including without limitation a written offer (price proposal) submitted by PlowShare and accepted by the Foundation, did include specific prices covering all the activities to be performed by PlowShare under the contract.

[4] In tandem with each amendment of CA CX825612-01, the Foundation negotiated an extension of the Radon PSA Contract, evidenced in each instance by a

detailed PlowShare offer (price proposal), negotiation spreadsheets, and a final PlowShare offer (price proposal) that was accepted by the Foundation.

[D] Under CA CX825837-01, the recipient had no support to demonstrate how it selected the contractor for a research contract to determine the number of people who smoke inside the home.

The Foundation did not select the above-referenced contractor, nor was it a party to the above-referenced contract. The parties to the contract were PlowShare and Bruskin Research of Edison, New Jersey. Thus, the fact that the Foundation has nothing in its files to demonstrate how the contractor was selected, if true, is certainly not surprising.

To the best of our knowledge, PlowShare engaged Bruskin Research on EPA's instructions to undertake urgently needed research on an expedited basis. Based on contemporaneous experience with similar research contracts (at the time, we awarded three or four such contracts each year, paid for out of non-Federal funds), the cost of the research was reasonable.

[E] The recipient did not perform the required cost or price analysis when selecting consultants for legal and consulting services, and paid its attorneys and consultants in excess of the maximum daily rate prescribe for Level 4 of the Executive Service (i.e., $62.50 per hour).

The Foundation did, in fact, perform a cost or price analysis when contracting for the legal and accounting services in question, and as a result received expert professional services at a reasonable cost - in the case of legal services, at a cost considerably below the rates charged by attorneys of similar background and seniority.

In March 2002, when EPA temporarily suspended the Foundation's CAs, the Foundation's Executive Director contacted one of its outside counsel - Gail Harmon of Harmon, Curran, Spielberg & Eisenberg, LLP, the most prominent law firm in Washington DC serving nonprofit organizations. Mr. Brobeck and Ms. Harmon discussed the Foundation's options at length - large law firms, pro bono services, and

specialized boutiques, such as Sonenthal & Overall, with experience in the award and administration of Federal grants and cooperative agreements.[19] Based on her knowledge of local firms, Ms. Harmon recommended Sonenthal & Overall. Mr. Brobeck also consulted Mary Ellen Fise, the Foundation's general counsel for additional recommendations. After contacting a number of firms, Mr. Brobeck settled on Sonenthal & Overall as the best combination of expertise and competence, at a moderate cost.[20]

Subsequently, Mr. Sonenthal advised us that a significant portion of the work on the EPA suspension could be done, with equal effectiveness and at considerably lower cost, by a non-lawyer - e.g., an accountant with experience in the administration of Federal cooperative agreements. He recommended that we contact RSM McGladrey LLP regarding the services of Stephen Kroll, formerly head of the Contract Audit Management at the U.S. Agency for International Development. RSM McGladrey offered Mr. Kroll's services at an hourly rate of $180.00. Mr. Brobeck determined that these rates were reasonable based on Mr. Kroll's special expertise, and on Mr. Brobeck's knowledge of the hourly rates charged by accounting firms for similar work, and considering in addition the benefits (e.g., in quality control) of engaging a recognized international accounting firm such as RSM McGladrey.

In light of the foregoing, we believe that the price/cost analysis conducted by Foundation in connection with its engagement of Sonenthal & Overall and RSM McGladrey met the requirements set forth in 40 CFR §30.46. To be sure, the Foundation did not prepare a contemporaneous memoranda or other formal written materials explicitly designed to record its cost or price analysis. This omission has been (or will soon be) corrected, placing the Foundation in compliance with 40 CFR §§30.45 and 30.46 with respect to these engagements. Furthermore, the preparation of a contemporaneous price/cost analysis memorandum is now required by the CFA procurement manual and has become standard organizational practice.

---

[19] A copy of the firm's brochure - "Introduction to Sonenthal and Overall" - and the resume of Robert Sonenthal, the Foundation's principal counsel, are attached as Attachment #8.

[20] Mr. Sonenthal's hourly rate of $265.00 per hour is approximately 10-15% below his normal billing rates, which in turn is considerably below the going rate in Washington DC for an attorney of his education and experience.

Even if the Foundation failed to comply with the documentation requirements of 40 CFR §§30.45 and 30.46 in a timely manner, its tardiness should not be the basis of a disallowance of costs. For its engagement of Sonenthal & Overall and RSM McGladrey, the Foundation sought competitive quotations, analyzed prices and costs, and on that basis contracted for and received high quality services at reasonable prices.

With respect to the DAR allegation that the Foundation "paid its attorneys and consultants in excess of the maximum daily rate prescribe for Level 4 of the Executive Service (i.e., $62.50 per hour)": The EPA regulation on which the DAR relies - 40 CFR §30.27(b) - applies only to "salar[ies] (excluding overhead) paid to individual consultants retained by a recipient's contractors or subcontractors." The limitation is **not** applicable to "contracts with firms." The Foundation did not retain "individual consultants" to provide legal and accounting services; it retained a law firm (Sonenthal & Overall) and an accounting firm (RSM McGladrey). It is obvious therefore that the salary limitation set forth in 40 CFR §30.27 does not apply to those engagements. In terms of cost allowability, the only question is whether the costs incurred by the Foundation for legal and accounting services were reasonable, allocable to the CAs and allowable under OMB Circular A-122. As discussion above clearly demonstrates, the hourly rates paid by the Foundation to Sonenthal & Overall and RSM McGladrey were reasonable. The DAR suggests no other basis on which these costs can be questioned.

[F] The Foundation failed to ensure that contracts under the cooperative agreements included all provisions required under 40 CFR §30.48.

The Foundation admits that not all of its contracts under the CAs contained all the standard contract clauses required under Section 30.48 of the EPA Uniform Regulation, 40 CFR §30.48. However, we note that [i] EPA was not prejudiced in any manner by these omissions, and [ii] our new manual on "Procurement Procedures for Federal Funds" requires that henceforth the standard contract clauses be included in all our procurement contracts.

* * * *

IV. SUBAWARDS

8. The Foundation did not always require CA sub-recipients to submit the final financial status reports required under 40 CFR Parts 30 and 31, preventing a determination of actual costs for the sub-awards.

Given the size of the typical subaward, and the basis for payment, the final program report and request for disbursement submitted by the sub-recipient was the substantial equivalent of a final financial status report, and that a separate "final financial status report" labeled as such would have been a needless additional burden and expense, and would provide the recipient no additional information.

The typical subaward under the EPA CAs was between $2,000 and $5,000, made to a CFA state or local affiliate. Each subaward was intended to finance a discrete activity, with easily measurable results, whose total cost could be established at the outset with reasonable certainty. To establish total cost, we reviewed the proposed budget in detail prior to the commitment of funds in order to verify that the proposed costs were reasonable and that there was little risk of subsequent change. After an initial payment, further payment was contingent on the successful completion of the activity and submission of the final program report. If the activity was not completed as contemplated, no further payment was made - even if the sub-recipient had incurred "allowable costs."

Based on these three key elements - a discrete activity with fixed costs and easily measurable programmatic results; a detailed up-front budget analysis; and payment upon completion of easily established milestones - these small subawards are **fixed-obligation subawards**, rather than cost reimbursable subawards. As fixed-obligation subawards, from an audit standpoint, **it is unnecessary - indeed wasteful - to require the sub-recipient to track and report its actual subaward costs** - as would be the case with a fixed-price procurement contract. Accordingly, we believe that, with respect to these fixed obligation subawards, the requirement that sub-recipients submit a "final financial report" is inapplicable.

* * * *

9. [A] The Foundation did not competitively solicit and award sub-agreements.

As demonstrated in the legal memorandum prepared by Sonenthal & Overall PC, and submitted with this response, there is no requirement in the EPA Uniform Regulation, in the any of the CAs, or in official EPA policies or procedures, that require a recipient to "competitively solicit and award sub-agreements."

On the contrary, the Uniform Regulation actually **prohibits** EPA from applying the requirement to the Foundation. It provides that EPA may not, by policy or by contract, impose requirements on its recipients that are not set forth in the Uniform Regulation, or are inconsistent with its provisions, without obtaining a special deviation from the agency (for case-by-case deviations) or from the Office of Management and Budget (for class deviations), or unless specifically required by Federal statute or Executive Order. We are not aware that any deviation regarding competition for subawards applicable to the Foundation has been approved by either EPA or OMB, and the DAR provides no reference to any such deviation. If no such deviation exists, EPA enforcement of a sub-award competition requirement against the Foundation would be **a violation of EPA's own regulations**.

Furthermore, even if there were a formal EPA "policy" requiring competition of sub-awards, and that policy did not violate the EPA Uniform Regulation (i.e., OMB had approved a class deviation as required by 40 CFR §§30.1 and 30.4) that "policy" could not be binding against the Foundation, because it was not incorporated into (or even referenced) in any of the Foundation's CAs, and the Foundation did not otherwise agree to abide by its terms. In fact, the Foundation had no notice of the existence of the "policy" or of its alleged applicability to the CAs. Therefore, to enforce the "policy" against the Foundation would be a denial of due process of law, especially if that enforcement were to result in a disallowance of costs.

Finally, one of the principal reasons that EPA solicited CFA's (and, later, the Foundation's) participation in the IAQ, Radon PSA and ETS campaigns was the relationship between CFA (and, later, the Foundation) and CFA's many state and local members and affiliates. In fact, it is clear that EPA expected the Foundation to implement certain CA programs primarily through its members and affiliates. Under the circumstances, it is fair to say that the Foundation was authorized by the CAs to make sub-awards to its members and affiliates. The "full and fair competition" of sub-awards that (according to the DAR) is required by EPA "policy," would have been as inconsistent with EPA's expectations as it would have been with the requirements of the EPA Uniform Regulation.

[B] In soliciting only dues-paying members for sub-awards as a general rule, the Foundation did not comply with EPA policy requiring full and fair competition in the award of cooperative agreements.[21]

As noted in our response in Part 9[A], there is no provision in the EPA Uniform Requirements mandating of "full and fair competition" in the award of sub-awards. Therefore, as noted above, any EPA "policy" purporting to require such competition would amount to an "additional requirement" in violation of the Uniform Regulation, unless a class deviation endorsing that "policy" has been approved by the Office of Management and Budget. To our knowledge, no such class deviation has been approved. Furthermore, to our knowledge, the EPA "policy" was never publicly announced or otherwise communicated to the Foundation - in particular, there is no mention of it in any of the CAs. Accordingly, even if the "policy" exists and (notwithstanding the limitation impose by 40 CFR §30.1) it is legally enforceable, it cannot be enforced against the Foundation.

Also as noted, EPA expected the Foundation to direct sub-awards primarily to its members and affiliates. Thus, "full and fair competition" of sub-awards would have been inconsistent with EPA's expectations and with the explicit requirements of the CAs.

* * * *

V. PERFORMANCE REPORTS

10. The Foundation did not submit all required performance reports, preventing the EPA from assessing progress in meeting the CAs' objectives or determining whether the unexpended funds were adequate to complete the required work.

The DAR does not accurately reflect the number and frequency of

[21] The DAR never quotes, or provides any citation to, the alleged EPA "policy" requiring competition of sub-awards.

performance reports provided to EPA project officers. In fact, the Foundation exceeded the reporting requirements in many respects by submitting more frequent reports than were mandated by the specific CAs.

The nature of the Foundation's relationship with EPA project officers meant that we were in regular contact with the project officers. We communicated regularly through day-to-day e-mails, phone calls, and specialized reports provided upon request. Project officers were well-informed of our progress through this regular communication and, at least monthly, could see that we drawing down funds to pay for our efforts on a reimbursement basis. At no point during the Foundation's work on any cooperative agreement, has an EPA project officer ever indicated that the Foundation failed to produce reporting documents in violation of the terms of a CA.

Each project officer received, on a monthly basis, a copy of the Job Cost Activity Report that summarized the budget versus actual financial activity under each CA, in addition to frequent phone calls and emails providing updates of the Foundation's work on particular projects. The Job Cost Activity Reports showed that activity had taken place and showed when and how it had been paid for (on a reimbursement basis). They also showed under which line item the activity had taken place. Samples are attached.

Copies of written performance reports issued for each cooperative agreement are included in the attachments:

X824939-01 Radon IAQ (requiring Annual Reports and a Final Report)

The project officer received a monthly report on the activity of the Radon Fix-It Program. Copies of these monthly reports for the five-year project period are attached. The Foundation also submitted annual reports for the Radon Fix-It Program for the project period.

The Foundation submitted reports on the state and local outreach component of this agreement. Mid-term reports are available for 1996-1997 and 1997-1998. Annual reports on the state and local outreach results were submitted for each year of the project period. Copies are attached as Attachment #12.

The Foundation provided a written summary of the other types of national

outreach executed under this cooperative agreement for 1998-1999, 1999-2000, and 2000-2001. Copies of these performance reports are in Attachment #12.

Finally, the Foundation submitted final financial and technical reports for this CA and copies of these are in Attachment #13.

X829178-01 Radon IAQ2 (requiring quarterly, mid-year, annual, and final reports)

The Foundation submitted monthly Radon Fix-It program reports from the beginning of the project period until September 2003, when the program was shifted to the National Safety Council. Annual Reports for the Radon Fix-It Program are available for the two years the program was operative under this CA. Copies of these reports are included as Attachment #14.

The Foundation submitted semiannual and annual performance reports on the state and local outreach program for the year in which state and local outreach was executed. An annual report also summarized the results of the Foundation's national outreach. Copies of these reports are included in Attachment #15.

A final technical and financial report is not due for this agreement until November 2004.

X825837-01 ETS Public Service Advertising (requiring quarterly and final reports)

The Foundation customized reports for this project officer upon request on several occasions. Examples of these reports are included as Attachment #16.

The project officer also received at least quarterly (and sometimes more often upon request) copies of media usage reports. These reports indicate where the advertisements aired, frequency of airings and donated media value - the key indicators used to measure the effectiveness of the advertising. The project officer also received periodic cumulative media usage reports. Examples of these reports are included in Attachment #17.

The Foundation submitted the final financial and technical reports for this CA. Copies are included as Attachment #18.

X825612-01 Radon Public Service Advertising (requiring quarterly and final reports)

For each of the five media campaigns developed and distributed under this CA, media usage reports were submitted to the project officer on a quarterly basis. Frequently, the project officer requested weekly reports. The project officer also received cumulative media usage reports. Examples of these reports are included as Attachment #19.

The Foundation submitted the final financial and technical reports for this CA. Copies are included as Attachment #20.

X28814-01 Energy Efficiency (requiring quarterly and final reports)

The Foundation submitted annual reports for 2001-2002 and 2002-2003, the project period covered by this agreement. The Foundation has also submitted the final financial and technical report for this agreement. Copies of these reports are included as Attachments #21 and #22.

VI. CONCLUSION

The DAR's analysis and recommendations are neither fair nor reasonable, for three reasons: **First**, the DAR is based on a fundamental misunderstanding of the circumstances under which the CAs were awarded and implemented. **Second**, it focuses on technical defects in documentation and lack of sophistication of CFA's financial management system, ignoring the fact that the underlying transactions were sound and adequately documented. **Third**, it proposes a $4.7 million disallowance based on a legal interpretation of LDA Section 18 that is untenable on its face, and whose retroactive application to the Foundation is prohibited by law.

In addition, the DAR ignores the fact that the programs were undertaken by CFA **at EPA's specific request**, and were later transferred intact from CFA to the Foundation **at EPA's specific request**. It ignores five years of successful program performance by the Foundation, and the considerable benefits for public health and education that flowed from those programs. Finally, it ignores the fact that Foundation acted, at all times and in all matters, in the utmost good faith.

Appendix B

SONENTHAL AND OVERALL P.C.
1120 Nineteenth Street, N.W.
Suite 600
Washington, D.C. 20036

January 20, 2004

MEMORANDUM

TO: Stephen Brobeck
Executive Director
Consumer Federation of America

FROM: Sonenthal & Overall P.C.

SUBJECT: [1] Section 18 of the Lobbying Disclosure Act of 1995; and [2] Competition of SubAwards under EPA Cooperative Agreements,

I. INTRODUCTION

At your request, we have reviewed the draft audit report ("DAR") dated November 21, 2003, prepared by the Office of Inspector General, U.S. Environmental Protection Agency ("OIG/EPA"), and submitted to the Consumer Federation of America ("CFA") for comment.[1] The DAR covers costs claimed by the Consumer Federation of America Foundation (the "Foundation") under five cooperative agreements ("CAs") administered by the Foundation on EPA's behalf between 1997 and 2002, and makes a series of recommendations to EPA regarding, among other things, the allowability of costs claimed. In particular, you asked that we express our views on two significant legal questions raised in the DAR:

A. Whether from the time the first CA was awarded through the end of 2002, CFA was ineligible to receive Federal funds under Section 18 of the Lobbying Disclosure Act of 1995, as amended, 2 U.S.C. §1611 ("LDA"), and whether EPA can require CFA, the Foundation's successor in interest, to return all of the funds received by the Foundation from EPA to implement the CAs (approximately $4.7 million).

---

[1] Office of Inspector General, "Audit Report: Consumer Federation of America Foundation - Costs Claimed under EPA Cooperative Agreements," Report No. 2004-x-xxxxx (November 21, 2003)(draft - not for public distribution).

Telephone: (202) 785-0227 Telefax: (202) 785-5904 e-mail: rsonenthal@psi.org

B. Whether the Foundation was required, by EPA regulation, policy or otherwise, to award the assistance subawards authorized under three of its CAs on a competitive basis.

This memorandum sets forth our preliminary analysis and conclusions on these two questions. It is based on information made available to us by CFA staff, and research regarding the LDA, its legislative history, and the cases and materials relating to agency enforcement of Federal law. If the questions discussed in this memorandum become the subject of a court proceeding, further research and analysis is likely to be required.

II. SUMMARY OF CONCLUSIONS

A. In our view, the OIG's interpretation of LDA Section 18 - that is, its **expansion** of the statutory disqualification beyond the 501(c)(4) organizations referred to in the statute - is incorrect as a matter of law, and unenforceable against the Foundation. We believe that, as a matter of law, a 501(c)(3) or a non-lobbying 501(c)(4) may share directors, facilities and staff — may be all but indistinguishable from the non-lobbying 501(c)(4) — without losing its eligibility under LDA Section 18, as long as the organizations respect their separate incorporation and maintain separate books of account. Our conclusion is based on the following considerations:

First, OIG's interpretation of LDA Section 18 is inconsistent with the statute's plain and unambiguous terms.

Second, the legislative history of LDA Section 18, cited by OIG to support its expansion, appears instead to contradict its position — i.e., it appears to exclude separately incorporated 501(c)(3) organizations from the statute's coverage. The legislative history also suggests that Congress was concerned about the effect that LDA Section 18 would have on important First Amendment interests - interests which, in our view, could be chilled or compromised if eligibility for Federal funds were to depend on an undefined "degree of separation" between 501(c)(3) and 501(c)(4) organizations.

Third, we question whether EPA has the legal authority to adopt a broad interpretation of LDA Section 18, as EPA is not the only Federal agency charged with administering the statute, and it has no special expertise with respect thereto. If EPA does adopt that interpretation, its view would be entitled to no deference in a court of law, and should be vulnerable to legal challenge.

Fourth, even if EPA has the authority to adopt the OIG interpretation of LDA Section 18, under well established legal precedent, it cannot apply that interpretation retroactively to the Foundation.

B. With respect to the alleged obligation of an EPA recipient to compete subawards: There is no requirement in the EPA Uniform Regulation, in the any of the CAs, or in official EPA policies or procedures, that require a recipient to "competitively solicit and award sub-agreements." EPA regulations actually prohibit the agency from imposing requirements on its recipients, by policy or by contract, that are not already set forth in the regulations, or are inconsistent with their provisions, without obtaining a special deviation from the agency (for case-by-case deviations) or from the Office of Management and Budget (for class deviations), or unless specifically required by Federal statute or Executive Order. To our knowledge, no deviation, statute or Executive Order authorizes EPA to require competition of subaward.

II. THE LOBBYING DISCLOSURE ACT.

1. OIG's Interpretation of LDA Section 18

LDA Section 18, as amended, provides that "[a]n organization described in section 501(c)(4) of the Internal Revenue Code of 1986 which engages in lobbying activities shall not be eligible for the receipt of Federal funds constituting an award, grant or loan." In the DAR, OIG acknowledges that, at all relevant times, the Foundation was not "an organization described in section 501(c)(4) of the Internal Revenue Code of 1986"; it was, instead, a organization described in IRC Section 501(c)(3) — a charitable and educational organization. OIG maintains, however, that the Foundation was ineligible to receive Federal funds because of its close relationship with CFA. According to OIG, "[t]here was no discernible separation between [CFA] and the Foundation other than having separate general ledgers for each organization."

> "The Foundation had no employees, space or overhead expenses separate from [CFA]. All personnel proposed in the assistance agreement applications and used under the agreements were [CFA] employees. The overhead costs claimed under the agreements were based on [CFA]'s overhead costs. Consequently, [CFA] and the Foundation did not have the

> **required degree of separation** between Federal grant money and the private lobbying effort by the Federation."[2]

Because the Foundation and CFA did not have the "required degree of separation," OIG concludes that [i] the Foundation and CFA must be treated as a single organization; [ii] CFA was therefore the effective recipient of all CA funds; [iii] because CFA was a 501(c)(4) organization that engaged each year in a small amount of lobbying,, CFA's receipt of Federal fund was a violation of LDA Section 18, and, as a result [iv] "all the costs claimed [by the Foundation] and paid under the [CAs] are statutorily unallowable."[3]

2. Statement of Facts.

At the outset, we note that the DAR misstates the historical relationship between the Foundation and CFA, and understates the actual "degree of separation" between the two organizations. As noted, OIG acknowledges that the Foundation was a duly established 501(c)(3) charitable organization. It acknowledges, as well, that the Foundation and CFA kept separate books of account, but it passes quickly over this point and focuses instead on the fact that [i] the Foundation was housed in CFA space, and [ii] the Foundation relied almost exclusively on CFA personnel, working under a contract between the Foundation and CFA, for its administrative and technical support.[4] But OIG ignores other significant evidence of legal and practical separation between the two organizations. For example, it fails to note that each organization had its own Board of Directors, and that during a portion of the relevant period, a majority of the Foundation's Board were directors with no affiliation to CFA. In addition, the OIG's statement that "all personnel proposed and used under the CAs were Federation employees" is not accurate.[5] While the Foundation had no permanent employees, we understand that, under several of the Foundation's CAs, a

---

[2] DAR at 6 (emphasis added).

[3] DAR at 6.

[4] In this respect, the Foundation was no different from many small 501(c)(3) and 501(c)(6) organizations whose Boards economize — personnel costs (salary and benefits) and space in particular — obtaining administrative and technical support from a management services company.

[5] DAR at 6.

portion of the program work was done by consultants engaged directly by the Foundation.

Furthermore, as noted in the CFA's Response to the DAR,[6] OIG misstates the historic relationship between the CFA and the Foundation. According to OIG, CFA established the Foundation "to receive federal funds, while CFA retained its rights to lobby as a 501(c)(4) organization." This statement implies that the Foundation was a CFA front, created in response to the enactment of LDA Section 18 in order to keep EPA funds flowing to CFA. The implication is incorrect. The Foundation was not formed by CFA "to receive Federal funds" on its behalf. In fact, the Foundation was incorporated in 1972. It was recognized by the IRS as a tax-exempt charitable organization in August 1972.[7] From the date of its incorporation, the Foundation conducted its activities separately from CFA, under its own Board of Directors, its own accounting system, and its own budget.[8] Until 1996, the Foundation operated substantially without Federal funds.[9] That changed, according to the Response, in 1996 and 1997 when the EPA awarded the Foundation three separate CAs. In each case, the award was initiated by EPA, and was intended by EPA to transfer CAs previously administered by CFA on EPA's behalf, from CFA, a 501(c)(4) organization precluded by LDA Section 18 from receiving Federal funds, to the Foundation, an eligible 501(c)(3) recipient.

Although OIG's description of the Foundation's history and its relationship to CFA, is inaccurate and misleading, we do not agree that the "degree of separation" between the organizations has any effect, one or the other, on the Foundation's eligibility for Federal funds under LDA Section 18. In fact, we believe that, as a matter of law, a 501(c)(3) or a non-lobbying 501(c)(4) may share directors, facilities and staff — may be all but indistinguishable from the non-lobbying 501(c)(4) in all material respects — without losing its eligibility under LDA Section 18, as long as the organizations respect their

---

[6] Response of the Consumer Federation of America to Draft Audit Report on the Consumer Federation of America Foundation at 1-2 (January 20, 2004) ("Response").

[7] The Foundation's original corporate name was the "Paul H. Douglas Consumer Research Center, Inc." In March 25, 1997, its name was changed to the "Consumer Research Council," and then, in March 1999, to the "Consumer Federation of America Foundation." See Response at 1.

[8] See Response at 1.

[9] See Response at 2-3.

SONENTHAL AND OVERALL P.C.

separate corporate status and maintain separate books of account. our conclusion is based on the text of LDA Section 28, its somewhat meager but instructive legislative history, and the statutes underlying purposes and policies.

3. Statutory Interpretation.

LDA Section 18 prohibits Federal financial assistance to a 501(c)(4) organization that engages in lobbying activities — specifically, to "[a]n organization described in section 501(c)(4) of the Internal Revenue Code of 1986." By it terms, therefore, the coverage of LDA Section 18 is predicated, in the first instance, on tax-exempt status. Organizations described in section 501(c)(4) are covered by the section if they lobby; organizations described in IRC section 501(c)(4) that do not lobby, organizations described in IRC 501(c)(3), and others organizations are not. There is nothing ambiguous in the text - that is, there are no words or phrases in the text whose meaning or reference is unclear. As a result, the text cannot be interpreted to provide that close affiliation with a lobbying 501(c)(4) organization brings a 501(c)(3) organization within the ambit of the section. Support for OIG's broad interpretation of LDA Section 18, if it exists at all, must come from outside the statutory text.

4. Legislative History

OIG appears to concede that its interpretation of LDA Section 18 finds no support in the statutory text. It offers no argument on this point, but turns immediately to the section's legislative history. One might question whether resort to legislative history is permissible where the statutory text is plain and unambiguous. Furthermore, one of the sources of legislative history on which OIG relies - a report on the LDA first prepared by the Congressional Research Service ("CRS") in 1996, after the statute was enacted — does not, strictly speaking, qualify as legislative history. Still, the excerpts offered by OIG in support of its interpretation are instructive, as much for what they omit as for what they quote.

First, OIG cites an excerpt from H.R. 104-339, a report of the House Committee on the Judiciary:

> "This Section [Section 18] provides that organizations described in Section 504(c)(4) of the Internal Revenue Code which engage

> in lobbying activities shall not be eligible for the receipt of Federal funds constituting an award, grant, loan or other form. Under this provision, 501(c)(4) organizations may form affiliate organizations in which to carry on their lobbying activities with non-federal funds'"[10]

The **second excerpt** is from the CRS Report. As quoted by OIG, it reads as follows:

> "[T]he legislative history of [Section 18] clearly indicates that a 501(c)(4) organization may separately incorporate an affiliated 501(c)(4), which would not receive any federal funds, and which could engage in unlimited lobbying. The method of separately incorporating an affiliate to lobby . . . was apparently intended to place a degree of separation between federal grant money and private lobbying, while permitting an organization to have a voice through which to exercise its protected First Amendment rights of speech, expression and petition."[11]

It is immediately obvious that neither the House Report nor the CRS report contain any statement directly supporting the extension LDA Section 18 coverage beyond 501(c)(4) organizations that lobby. The CRS excerpt notes that one purpose of LDA Section 18 was to place a "degree of separation between federal grant money and private lobbying." But, significantly, the required "degree of separation" appears to be satisfied by "separately incorporating." There is no suggestion that a 501(c)(3) organization, "separately incorporated" from a 501(c)(4) affiliate, would be subject to any further test regarding the precise "degree of separation" needed to qualify for Federal funding under LDA Section 18.

This reading is supported by the first sentence of the quoted text — i.e., "The legislative history of the provision clearly indicates that a 501(c)(4) organization may separately incorporate an affiliated 501(c)(4), which would not receive any federal funds, and which could engage in unlimited lobbying." A 501(c)(4) organization created by a 501(c)(4) parent for the sole purpose of receiving Federal funds will likely — will almost

---

[10] DAR at 5n.2.

[11] DAR at 6.

certainly — share directors, facilities, and staff with its parent, but that fact would not seem to affect the eligibility of the new 501(c)(4) for Federal funds under LDA Section 18. Indeed, the issue is not even mentioned. Separate incorporation alone appears sufficient.

This reading is clearly confirmed when the text that OIG deleted from the quoted paragraph is replaced. This deleted text is crucial because it reports real "legislative history" — statements made by the Congressional sponsors of LDA Section 18 — and because it bears directly on the validity of OIG's interpretation. When the paragraph is read in its entirety, it is clear that the sponsors intended that separate incorporation, by itself, was enough to shelter the affiliates of a lobbying 501(c)(4) from disqualification under LDA Section 18. The text deleted from the paragraph by OIG is underlined:

> "The legislative history of the provision clearly indicates that a 501(c)(4) organization may separately incorporate an affiliated 501(c)(4), which would not receive any federal funds, and which could engage in unlimited lobbying. The method of separately incorporating an affiliate to lobby, **which was described by the amendment's sponsor as "splitting,"** was apparently intended to place a degree of separation between federal grant money and private lobbying, while permitting an organization to have a voice through which to exercise its protected First Amendment rights of speech, expression and petition.) **As stated by Senator Simpson: "If they decided to split into two separate 501(c)(4)'s, they could have one organization which could both receive funds and lobby without limits."**[12]

According to Senator Simpson, when a 501(c)(4) organization "splits" into two separately incorporated 501(c)(4) affiliates, but remains "one organization," the non-lobbying 501(c)(4) is treated as independent for purposes of LDA Section 18, and is therefore eligible to receive Federal funds. On the same basis, where a 501(c)(3) and a lobbying 501(c)(4) are "one organization," the 501(c)(3) should also be treated as independent for purposes of LDA Section 18, and should therefore be eligible to receive Federal funds. Separate incorporation is sufficient. When the language deleted by OIG is included, the

---

[12] Congressional Research Service, Report No. 96-809, Lobbying Regulations on Non-Profit Organizations" (updated May 19, 1998), available on-line at http://www.ncseonline.org/NLE/CRSreports/Risk/rsk-53.cfm

"legislative history" on which OIG relies to support its interpretation of LDA Section 18 turns out to contradict that interpretation.

5. Statutory Purpose/Public Policy

It is not difficult to see why the text of LDA Section 18 defines its coverage solely in terms of tax-exempt status, and the legislative history, both authoritative and non-authoritative, speaks in terms of "separate incorporation." **First**, separate incorporation is sufficient to serve the basic purposes of the statute. Separate incorporation means separate books of account. This, in turn, allows greater transparency in the use of Federal funds, and provides the Government additional assurance that its funds are not being used for lobbying. No similar benefit appears to flow from prohibiting separately incorporated organizations from sharing facilities and staff.

Second, separate incorporation is an objective fact. Using separate incorporation as a benchmark, an organization affiliated to a lobbying 501(c)(4) can determine its eligibility to receive Federal funds under LDA Section 18 with reasonable certainty. In contrast, the test proposed by OIG — i.e., the "degree of separation" between the two organizations - is neither easy to apply nor certain of result. What precisely is the "degree of separation" required by LDA Section 18? Does it demand different directors, different personnel, or both? And how different? In the absence of detailed guidance,[13] any organization - 501(c)(3), or 501(c)(4) or otherwise - with a lobbying 501(c)(4) affiliate would be unsure of its status. A board resignation, a secondment of personnel or something equally trivial could erase the required "degree of separation," and make it ineligible to receive Federal funds.

Similarly, a recipient of Federal funds with a lobbying 501(c)(4) affiliate may discover only **after the fact** that the "degree of separation" between the two organizations was somehow insufficient for purposes of LDA Section, and that it was, without knowing it, ineligible to receive Federal funds. The Foundation, of course, is in precisely that situation. Relying on recognized tax exempt status and separate incorporation, the

---

[13] It is highly unlikely that such detailed guidance could be written, given the variety of integration that can exist between organizations. Such guidance would also seem to interfere unacceptably with the freedom of non-profit organizations to structure their internal affairs, and might make it difficult for small non-profits to achieve economies of affiliation.

SONENTHAL AND OVERALL P.C.

Foundation received Federal funds for five years on five different cooperative agreements. Now, well after the fact, in circumstances in which the Foundation can take no remedial action, OIG announces that, for five years, the "degree of separation" between the Foundation and CFA was "inadequate," making the Foundation's receipt of Federal funds during that entire period illegal. OIG does not indicate on what basis, or by applying what standard, it determined that the "degree of separation" was inadequate; it does not suggest when or how the Foundation could have discovered that standard in advance, and adjusted its conduct accordingly.

In brief, it is unreasonable to read LDA Section 18 as OIG suggests. To do so would produce an unending succession of unprincipled ex post facto disallowances, limited only by the definition of "degree of separation" adopted by the Government from time to time. Congress could not have intended that result.

Third, important First Amendment concerns also argue for a narrow construction of LDA Section 18 and against the broad and unprincipled interpretation offered by OIG. As Congress recognized, the prohibition imposed on lobbying 501(c)(4)s affects their First Amendment interests by, in effect, imposing the penalty of ineligibility on organizations that exercise their right to petition the Government. As a result, Congress had an interest in making the statute clear, precise and easily enforceable, and in allowing the broadest possible freedom for lobbying 501(c)(4)s to organize or affiliate with organizations that are eligible to receive Federal funds. The legislative history of Section 18 clearly shows that Congress encouraged such affiliations — precisely in order to assure that the LDA Section 18 prohibition would not unduly restrict the First Amendment rights of 501(c)(4) members. A broad, unprincipled reading of LDA Section 18 such as OIG proposes could significantly restrict those First Amendment rights. Statutes which impinge on fundamental rights must be narrowly construed. Woodward v. Rogers, 344 F.Supp. 974 (D.D.C.), aff'd, 486 F.2d 1313 (D.C. Cir.)(1974).

5. **Other Sources of Law**.

OIG cites no other sources, in law, regulation, case law or commentary, to justify its reading of LDA Section 18. Accordingly, in light of clear statutory language, the legislative history, the underlying statutory purposes and policies, the unacceptable consequences of unprincipled ex post fact enforcement, and the possible chilling affect on First Amendment rights — LDA Section 18 should be read narrowly to exclude all

questionable in three respects: [i] the interpretation departs from the plain and unambiguous meaning of the statute; [ii] EPA does not have LDA enforcement authority, or any special expertise that would require the courts to accord any special consideration to its views; and [iii] the OIG interpretation is not well-established at EPA; on the contrary, it reverses a position that EPA took with respect to LDA Section 18 in 1996 and 1997 and again, as recently as late 2002.

7. Retroactive Enforcement

In this section, we assume, for the sake of argument, that a federal court has approved OIG's proposed interpretation of LDA Section 18, has identified and adopted a legal standard defining the "degree of separation" between 501(c)(3) recipients and their 501(c)(4) affiliates required by LDA Section 18, and has determined that, under the adopted standard, that the Foundation and CFA did not have the required "degree of separation." Even in these circumstances, however, a court is likely find a disallowance based on the OIG interpretation of the section to be "arbitrary, capricious and contrary to law" because [i] the expansion of Section 18 to 501(c)(3) recipients would be a departure from EPA's established practice; [ii] the Foundation relied on that established practice each time it agreed, at EPA's specific request, to perform services for EPA under a cooperative agreement; [iii] retroactive application of an expanded Section 18 would impose a serious financial penalty on the Foundation U.S. Court of Appeals set aside a National Labor Relations Board ("NLRB") decision applying retroactively a new rule that was contrary to a "well settled" rule on which the respondent employer had relied. The issue before the court was whether retroactive application was "arbitrary, capricious or contrary to law."

> "Among the considerations that enter into a resolution of the problem [of retroactivity] are (1) whether the particular case is one of first impression, (2) whether the new rule represents an abrupt departure from well established practice or merely attempts to fill a void in an unsettled area of law, (3) the extent to which the party against whom the new rule is applied relied on the former rule, (4) the degree of burden which a retroactive order imposed on a party, and (5) the statutory interest in applying the new rule despite the reliance of a party on the old standard." 466 F.2d at 390.

The application of LDA Section 18 to the Foundation is **not** a case of first impression, at least not for EPA. In fact, as recounted in the Response, at the time EPA transferred CFA's programs to the Foundation (1996/1997), it appears that EPA [i] clearly understood the nature of the relationship between the Foundation and CFA — including the specific facts and circumstances on which OIG bases its claim that the Foundation is ineligible under LDA Section 18; [ii] considered the implications of that relationship for the Foundation's eligibility under LDA Section 18; and [iii] determined that the relationship did not render the Foundation ineligible to receive Federal funds.[17]

EPA confirmed that initial determination repeatedly thereafter - each time it awarded a new CA, added funding to an existing CA, or simply disbursed funds to the Foundation thereunder. More recently, in 2002, EPA suspended performance of all five of the Foundation's CAs pending clarification of certain legal and regulatory compliance issues. One of those issues was the relationship on-going relationship between the Foundation and CFA. In May 2002, after full disclosure and discussion, but without any change in the Foundation/CFA relationship, EPA lifted the suspension and began once again to make disbursements under each of the five CAs. EPA would not have restarted its disbursements to the Foundation and continued those disbursements through the end of 2002 if it had not made a determination that the Foundation was an eligible recipient under LDA Section 18. (Indeed, if the OIG interpretation of LDA Section 18 is correct, all EPA's disbursements to the Foundation in 2002 were illegal.)

Accordingly, if EPA adopts the OIG's interpretation of LDA Section 18, and applies that interpretation to the Foundation, the result would qualify as "an abrupt departure" by EPA from its established interpretation of LDA Section 18, the interpretation under which it had, on numerous occasions, determined the Foundation to be an eligible CA recipient. The change is not likely to qualify as an "attempt to fill a void in an unsettled area of law" - e.g., the clarification of ambiguous language in the statute. See Retail, Wholesale and Department Store Union v. NLRB, supra, 466 F.2d at 391. As noted above, the statute is not unclear or ambiguous, and the proposed OIG interpretation reaches organizations that the plan and unambiguous terms of the statute do not cover.

With respect to reliance and injury: There can be no question that the Foundation specifically relied on EPA's determination that the Foundation was an eligible recipient under Section 18 when it agreed to accept the CAs transferred to it from CFA at EPA's

---

[17] See Response at 3.

behest. It relied as well on EPA's implicit confirmation of its eligibility each time EPA approached the Foundation to take on a new CA, or to accept additional funding under an existing CA. Similarly, the extraordinary burden that a change in EPA policy with respect to LDA Section 18 would impose on the Foundation — namely, a $4.7 million disallowance and refund — is too obvious to require comment.

Finally, it is difficult to see what statutory purpose would be served by apply the OIG interpretation retroactively, and many equitable arguments to the contrary. On the contrary, it is fair to say that the Foundation acted in good faith and in the absence of any guidance in law, regulation or precedent suggesting that its relationship with CFA might make it ineligible for Federal funding. Under the circumstances, retroactive enforcement of the OIG interpretation would not vindicate any public interest, penalize the misuse of Federal funds for lobbying activities, or lead to the recovery any funds for which the Government, and the general public, did not receive full value. As noted in Retail, Wholesale and Department Store Union v. NLRB, "[a] distinction must . . . be made between the purpose of the statute and the necessity of a particular remedy to effectuate that purpose." 466 F.2d at 392. Here, it does not appear that the "particular remedy" sought by OIG -- a $4.7 million forfeiture — is reasonably necessary to support the purposes of the statute.

The Foundation does not contest EPA's right to change its policies, and to insist that its recipients conform to those policies **prospectively**. Indeed, when the EPA Grants Management Office first raised the question of the Foundation's LDA Section 18 eligibility in March 2002, the Foundation and CFA hastened to arrange a corporate reorganization to respond to EPA's concerns. However, EPA would not have the authority to enforce that new policy retroactively against a party that relied in good faith on the old policy, now discarded, and would suffer extreme hardship if the policy were enforced.

* * * *

B. **COMPETITION of SUBAWARDS**..

In the DAR, OIG criticizes the Foundation for its failure to use the competitive procedures required by 40 CFR Part 30 to award subagreements under three of its CAs.[18] According to IOG-

[18] DAR at 2, 13.

> "It is EPA policy to promote competition in the award of cooperative agreements to the maximum extent practicable. Further, it is EPA policy that the competitive process be fair and open and that no applicants receive an unfair competitive advantage. Soliciting only dues paying members does not promote competition and is not fair and open."[19]

The first sentence in the quote above may well be an accurate statement of EPA policy with respect to "the award of cooperative agreements." However, we are aware of no regulation, policy or practice that requires the recipient of a cooperative agreement to compete - "to the maximum extent practicable" or otherwise - in the award of sub-agreements.

OIG supports the sub-award competition requirement by citing Section 30.5 of the EPA financial assistance regulation, 40 CFR 30.5. By its terms, Section 30.5 makes the provisions of OMB Circular A-110 applicable to certain "subrecipients performing work under awards." It does not speak to the obligations of recipients, either in general, or with reference to the award of subagreements.

40 CFR Part 30 is EPA's version of the OMB common rule for administration of cooperative agreements and grants to institutions or higher education, hospitals and other non-profit organizations. The requirements of the regulation rule are uniform across agencies and therefore difficult to change. For example, under the common rule agencies "may not impose additional or inconsistent requirements" on their recipients and grantee without obtaining a deviation from the agency (case-by-case deviations) or from OMB (class deviations), or unless specifically required by Federal statute or Executive Order. These provision of the common rule are incorporated in 40 CFR 30.1 and 30.4.

Consequently, absent a provision in 40 CFR Part 30 requiring the use of competitive procedures to award subagreements, or a formal deviation from 40 CFR Part 30 imposing such an obligation, EPA is not required to do so. Furthermore, to impose that requirement as a matter of EPA policy, as suggested by OIG would be a violation of EPA's own regulations — i.e., 40 CFR 30.1, cited above.

---

[19] Id. at 13.

Appendix C

Distribution

EPA Headquarters

Director, Grants Administration Division (3903R)
(responsible for report distribution to recipient)
Director, Office of Grants and Debarment (3901R)
Comptroller (2731A)
Agency Followup Official (the CFO) (2710A)
Agency Audit Followup Coordinator (2724A)
Associate Administrator for Congressional and Intergovernmental Relations (1301A)
Associate Administrator for Public Affairs (1101A)
Audit Followup Coordinator (GAD)
Deputy Assistant Administrator for Air and Radiation (6101A)

EPA Office of Inspector General

Inspector General (2410)