



OFFICE OF INSPECTOR GENERAL

Catalyst for Improving the Environment

Quick Reaction Report

Village of Laurelville, Ohio – Unallowable Costs Claimed Under EPA Grant XP97579701

Report No. 08-2-0039

December 5, 2007



Report Contributors:

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Abbreviations

CFR	Code of Federal Regulations
EPA	U.S. Environmental Protection Agency
Grantee	Village of Laurelville, Ohio
OIG	Office of Inspector General
OMB	Office of Management and Budget

Cover Photo: Village of Laurelville, Ohio, wastewater treatment lagoon
(EPA OIG photo)



At a Glance

Catalyst for Improving the Environment

Why We Did This Review

The U.S. Environmental Protection Agency (EPA) Office of Inspector General (OIG) conducted a review of earmarked grants known as Special Appropriation Act Projects issued to State and tribal governments. The Village of Laurelville, Ohio, was selected for review.

Background

In 2002, the Village of Laurelville received an EPA Special Appropriation Act Project grant, XP97579701. The purpose of the grant was to provide Federal assistance of \$376,000 to renovate the Laurelville wastewater treatment facility. The grantee was required to provide local matching funds equal to 45.75 percent of the EPA-awarded funds.

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

To view the full report, click on the following link:
www.epa.gov/oig/reports/2008/20071205-08-2-0039.pdf

Village of Laurelville, Ohio – Unallowable Costs Claimed Under EPA Grant XP97579701

What We Found

The Village of Laurelville (grantee) did not maintain an acceptable financial management system in accordance with Federal regulations to support drawdown requests submitted to EPA for \$278,448 in grant funds. In support of its drawdowns, the grantee provided spreadsheets that its consultant prepared, along with numerous invoices to support those spreadsheets. However, the invoices provided either did not reconcile to the drawdown spreadsheets, or included costs that were not allowable under cost principles, Agency guidance, and the grant agreement. As a result, we were unable to determine total project costs or the allocation of expenditures between the Federal grant and matching funds. Therefore, we are questioning the entire \$278,448 that the grantee has drawn down.

The grantee claimed costs of \$207,476 that were not allowable under Federal regulations and grant conditions. These costs were associated with pre-award expenses, repayment of a loan and interest, a garage extension, office and maintenance equipment, and consultant fees. We are also questioning costs the grantee claimed of \$5,018 for an ultraviolet disinfection system that was not installed as of August 2007.

What We Recommend

We recommend that the Regional Administrator, EPA Region 5:

1. Require the Village of Laurelville to (a) repay the \$207,476 in questioned Federal funds drawn; (b) install the ultraviolet disinfection system or repay the \$5,018 of Federal costs claimed for the system; and (c) develop an adequate accounting system to support the remaining \$65,954 of Federal funds drawn. If this cannot be accomplished, the Region should recover the funds.
2. Provide documentation to support matching costs. If the grantee cannot provide sufficient documentation, costs claimed will need to be revised.
3. Classify the Village of Laurelville as a high risk grantee in accordance with Title 40, Code of Federal Regulations, section 31.12, and apply special conditions on all future awards.



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

OFFICE OF
INSPECTOR GENERAL

December 5, 2007

MEMORANDUM

SUBJECT: Village of Laurelville, Ohio – Unallowable Costs
Claimed Under EPA Grant XP97579701
Report No. 08-2-0039

FROM: Melissa M. Heist *Melissa M. Heist*
Assistant Inspector General for Audit

TO: Mary A. Gade
Regional Administrator
EPA Region 5

This report contains time-critical issues the Office of Inspector General (OIG) identified and recommends recovery of Federal funds drawn down by the recipient. This report represents the opinion of the OIG and does not necessarily represent the final position of the U.S. Environmental Protection Agency (EPA). EPA managers will make final determinations on matters in this report.

The estimated cost of this report – calculated by multiplying the project's staff days by the applicable daily full cost billing rates in effect at the time – is \$79,582

Action Required

In accordance with EPA Manual 2750, Chapter 3, Section 6(f), you are required to provide us your proposed management decision for resolution of the findings contained in this report before any formal resolution can be completed with the recipient. Your proposed decision is due in 120 days, or on April 3, 2008. To expedite the resolution process, please email an electronic version of your proposed management decision to kasper.janet@epa.gov.

We have no objections to the further release of this report to the public. This report will be available at <http://www.epa.gov/oig>. If you have any questions, please contact Janet Kasper, Director, Assistance Agreement Audits, at 312-886-3059 or the email address above.

Purpose

During our review of Special Appropriation Act Projects, the following condition came to our attention that we believe requires immediate attention. The Village of Laurelville, Ohio (grantee) did not maintain an acceptable financial management system, as required by Title 40, Code of Federal Regulations (CFR), sections 31.20(b)(2) and (b)(5), to support project costs of \$513,350. As a result, we were unable to determine total project costs or the allocation of grant funds and the recipient's matching funds. Therefore, we are questioning the entire Federal share of \$278,448 paid to the grantee.

Background

U.S. Environmental Protection Agency (EPA) Region 5 awarded Grant No. XP97579701 to the grantee on May 24, 2002. The purpose of the grant was to provide Federal assistance of \$376,000 to renovate the Laurelville wastewater treatment facility. The \$376,000 represents EPA's contribution of up to 54.25 percent of the eligible project costs and is limited by the amount of the congressional appropriation. The grantee was responsible for matching, at a minimum, 45.75 percent of the eligible project costs. Total project costs under the grant were estimated to be \$693,148, which represented construction costs and the purchase of equipment. In March 2005, EPA extended the budget and project period to December 30, 2006, to allow the grantee to complete unfinished tasks. However, the grantee did not make any progress after March 2005, and the project currently remains only 82 percent complete. Funds totaling \$97,552 still remain on the grant and have not been drawn down by the grantee.

Throughout the report we refer to questioned costs. Questioned costs are defined as costs that are (1) contrary to a provision of a law, regulation, agreement, or other documents governing the expenditures of funds; or (2) not supported by adequate documentation.

Scope and Methodology

We performed our audit in accordance with generally accepted government auditing standards, issued by the Comptroller General of the United States, with the exception of gaining a complete understanding of internal controls as required under Section 7.16 and gaining an understanding of information control systems as required under Section 7.23. We did not obtain a complete understanding of the internal control system because the limited nature of our review focused on the source documents that support costs claimed under the grant. We also did not test the recipient's grant drawdown process or process for entering information into its accounting system. Instead, we relied on the grantee's drawdown spreadsheets and supporting invoices. The grantee's consultant prepared the spreadsheets, and the spreadsheets were not part of the official accounting system. We did not obtain an understanding of information control systems because the review of general and application controls was not relevant to the assignment objectives.

We conducted our field work between August 27, 2007, and September 26, 2007. We made a site visit to the grantee and performed the following steps:

- Obtained and reviewed grantee support for drawdowns,
- Conducted interviews of current and former grantee personnel,
- Obtained printouts of grantee ledgers, and
- Obtained and analyzed loan information regarding grantee matching funds.

We also discussed issues related to this grantee with Region 5 grants management staff and the project officer.

Finding

The grantee was unable to support drawdown requests submitted to EPA for \$278,448 in grant funds. According to 40 CFR 31.20(b)(2) and (b)(5), the financial management systems of grantees must meet the following standards:

Accounting records – Grantees and subgrantees must maintain records which adequately identify the source and application of funds provided for financially-assisted activities. These records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income.

Allowable cost – Applicable OMB [Office of Management and Budget] cost principles, agency program regulations, and the terms of grant and subgrant agreements will be followed in determining the reasonableness, allowability, and allocability of costs.

We found that the grantee did not maintain an acceptable financial management system in accordance with Federal regulations to support drawdown requests submitted to EPA. In support of its drawdowns, the grantee provided spreadsheets that its consultant prepared, along with numerous invoices to support those spreadsheets. However, the invoices provided either did not reconcile to the drawdown spreadsheets, or included costs that were not allowable under cost principles, Agency guidance, and the grant agreement. As a result, we were unable to determine total project costs or the allocation of expenditures between the Federal grant and matching funds. Therefore, we are questioning the entire \$278,448 that the grantee has drawn down.

When grantees do not have a system of meeting financial management standards, EPA can identify them as “high risk.” According to 40 CFR 31.12, a grantee may be considered “high risk” if an awarding agency determines that the grantee:

- Has a history of unsatisfactory performance,
- Is not financially stable,
- Has a management system that does not meet management standards,
- Has not conformed to terms and conditions of previous awards, or
- Is otherwise not responsible.

The grantee meets at least one, and potentially two, of the five criteria for high risk. Therefore, EPA should classify the grantee as a high risk grantee. The grantee has not conformed to the terms and conditions of its award. It did not maintain adequate accounting records to support drawdowns or submit required quarterly progress reports and Financial Status Reports during the grant period. The grantee also might not be financially stable. According to current and former Village officials, the Village is currently \$35,000 in debt, and had run out of matching funds for the grant in late 2004.

In addition to being unable to support its drawdowns, some of the costs the grantee claimed were not allowable under Federal regulations and grant conditions, as shown in Table 1. Details on each instance are provided in the paragraphs that follow the table.

Table 1: Schedule of Costs

Description	Total Cost	Federal Share (54.25%)	Matching Funds (45.75%)
Pre-award costs claimed from 2000-2002	\$260,015	\$141,058	\$118,957
Loan for grantee matching funds repaid with EPA grant funds	75,000	40,687	34,313
Loan interest claimed for matching funds	13,446	7,294	6,152
Garage extension	11,190	6,071	5,119
Purchase of computer, monitor, and printer	3,190	1,731	1,459
Purchase of a tractor/mower	14,400	7,812	6,588
Purchase of a tiller	1,054	572	482
Consultant costs	4,150	2,251	1,899
Total	\$382,445	\$207,476	\$174,969

Source: OIG analysis of grantee data

Pre-Award Costs

The grantee claimed pre-award costs that were not approved by EPA in accordance with EPA policy and therefore we are questioning the allowability of these costs for Federal reimbursement. EPA awarded grant XP97579701 to the grantee on May 24, 2002. In making the award, Region 5 retroactively approved the project and budget periods to December 1, 2000. The memorandum, "Award of Grants and Cooperative Agreements for the Special Projects and Programs Authorized by the Agency's FY 2002 Appropriations Act," dated April 15, 2002, and issued by Michael Cook, Director, Office of Wastewater Management, states:

Since 1995, EPA Headquarters (in accordance with established OMB and Agency procedures) have approved pre-award costs for more than 50 special Appropriations Act projects in the following two situations:

- 1. The pre-award costs were incurred after the start of the fiscal year for which the funds were appropriated but before grant award; and/or,*
- 2. The pre-award costs were for facilities planning or design work associated with the construction portion of the project for which the grant was awarded.*

...Accordingly, effective April 1, 2000, the Regions have the authority to approve pre-award costs for the two situations described above.

Any approval, of course, is contingent on the Regional Office determination that the pre-award costs in question are in conformance with the applicable Federal laws, regulations and executive orders that govern EPA grant awards and are allowable, reasonable and allocable to the project.

In a few situations, the project description in the Conference Report could require that the scope of work of a grant include pre-award costs in excess of those that could be approved for the two situations described above. The determining factor for approval of such pre-award costs in that case would be a comparison of the specificity of the project description contained in the Conference Report to the amount of future or potential work that could be included in the scope of work of the grant. If there is sufficient future or potential work that is in conformance with the project description contained in the Conference Report, approval of pre-award costs would, with the exception of the two situations described above, be inappropriate.

The Regions should not approve any pre-award for special Appropriations Act projects, other than those that involve the two situations discussed above, without written approval from Headquarters.

Because these pre-award costs were incurred prior to the fiscal year in which the appropriation was made and the grantee has not provided documentation that establishes that these costs were for facilities planning or design work, the Region did not have the authority to approve these costs under the guidelines. Therefore, we are questioning pre-award costs in the amount of \$260,015 incurred, unless EPA Headquarters approves a request from the Region to include these pre-award costs in the grant and finds that they are allowable under applicable policy. Otherwise, EPA should recover the Federal share of \$141,058. This basis for questioning the costs is in addition to the unacceptable financial management system described on page 2.

Loan Repayment and Loan Interest

The grantee did not obtain EPA approval to use grant funds to repay a bank loan and interest incurred on that loan. The grantee used grant funds to repay \$75,000 on a \$100,000 loan it borrowed from a local bank, as well as \$13,446 of interest incurred on this loan. Both of these actions are unallowable according to the Special Appropriation Act Project guidance and OMB Circular A-87. The memorandum, "Award of Grants and Cooperative Agreements for the Special Projects and Programs Authorized by the Agency's FY 2002 Appropriations Act," states:

Funds appropriated for the special projects should not be used solely to pay down loans received from a State Revolving Fund or other indebtedness unless there

are explicit instructions to do so in the Appropriations Act or accompanying Reports, or the facts of the case are such that this is the only way to award the funds that were appropriated for the project. Any request to use special Appropriations Act grant funds to pay down a loan must be approved, in writing, by EPA Headquarters.

OMB Circular A-87, Section 23.a, also indicates the interest costs are unallowable:

Costs incurred for interest on borrowed capital or the use of a governmental unit's own funds, however represented, are unallowable except as specifically provided in subsection b. or authorized by Federal legislation.

Because the grantee did not obtain approval from EPA to use grant funds to repay its loan, we are questioning the \$75,000 loan repayment and \$13,446 interest repayment claimed for reimbursement under the grant. Therefore, EPA should recover the Federal shares of \$40,687 and \$7,294, respectively. This basis for questioning the costs is in addition to the unacceptable financial management system described on page 2.

Garage Extension

The grantee used grant funds to construct a garage extension that EPA did not approve under the grant. According to OMB Circular A-87, Section 15.b (3):

Capital expenditures for improvements to land, buildings, or equipment which materially increase their value or useful life are unallowable as a direct cost except with the prior approval of the awarding agency.

The garage extension was used to store equipment, and was not necessary for the function of the treatment plant. The garage extension was not included in the budget for the grant and EPA did not approve the costs as a direct charge to the grant. Therefore, we are questioning the \$11,190 cost of the garage extension claimed for reimbursement under the grant, and EPA should recover the Federal share of \$6,071. This basis for questioning the costs is in addition to the unacceptable financial management system described on page 2.

Computer and Maintenance Equipment

The grantee used grant funds to purchase the following computer and maintenance equipment, totaling \$18,644, which EPA did not approve under the grant:

- Computer, monitor, and printer - \$3,190
- Tractor/mower - \$14,400
- Tiller - \$1,054

The grantee used the computer, monitor, and printer for administrative purposes, such as issuing bills for monthly sewer charges. The grantee used the tractor/mower for landscaping purposes, such as mowing the lawn at the treatment plant. We did not determine how the grantee was

using the tiller, but it also was not approved under the grant. A consultant had advised the grantee to purchase equipment to keep the plant orderly and safe for the next 10 years. However, these costs were not included in the grant budget and do not appear necessary for the renovation of the wastewater treatment facility. Therefore, EPA should recover the Federal share of \$9,898 for the equipment. This basis for questioning the costs is in addition to the unacceptable financial management system described on page 2.

Consultant Costs

The grantee did not comply with Federal regulations in procuring consultant services that cost \$4,150. Specifically, the grantee did not: (1) compete procuring the consultant's services, (2) maintain records regarding the procurement, and (3) ensure the consultant's rates were within Federal limits.

The consultant was responsible for preparing the grantee's electronic drawdown requests, and performing site visits to the treatment plant to inspect grant-related work. The consultant billed the grantee for costs related to compiling and reviewing invoices, and preparing supporting spreadsheets for drawdown requests.

The grantee did not use competition when procuring the consultants services, as required by Federal regulations. Title 40 CFR 31.36(c) requires all procurement transactions to be conducted in a manner providing full and open competition. Grantee officials said they hired the consultant because he was the former superintendent for the wastewater treatment plant and thus knowledgeable about the work performed under the grant. They also needed the consultant to submit their electronic drawdown requests to EPA because they did not have the capability or expertise to do so. Therefore, the Village hired the consultant via sole source procurement, without competition.

The grantee did not maintain the documentation Federal regulations require when procuring services. Title 40 CFR 31.36(b)9 states:

Grantees and subgrantees will maintain records sufficient to detail the significant history of a procurement. These records will include, but are not necessarily limited to the following: rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis for the contract price.

The grantee did not have a formal written agreement with the consultant. Grantee representatives said their agreement to pay the consultant an hourly rate of \$75 was recorded in the Village Council's monthly minutes, but the grantee was unable to produce those meeting minutes.

The grantee requested reimbursement for consultant fees that exceed those allowed under Federal regulations. Title 40 CFR 31.36(j) states: "EPA will limit its participation in the salary rate (excluding overhead) paid to individual consultants retained by grantees or by a grantee's contractors or subcontractors to the maximum daily rate for a GS-18" (Level IV of the Executive

Schedule). For the years 2002 through 2004, when the consultant was working for the grantee, the allowable hourly rates for a consultant ranged from \$62.29 to \$65.60 per hour, excluding overhead. The grantee and its consultant said that the consultant charged \$75 per hour, which exceeded the maximum rates specified by the Federal guidance. The consultant's invoices did not show hours worked, and we were unable to determine the amount of hours worked based on the dollar amounts provided.

Because the grantee did not compete the procuring of consultant services, maintain records documenting the consultant's procurement, and adhere to consultant salary requirements, we are questioning the entire \$4,150 paid for consultant costs. Therefore, EPA should recover the Federal share of \$2,251. This basis for questioning the costs is in addition to the unacceptable financial management system described on page 2.

Other Issues

Ultraviolet Disinfection System

The grant work plan included costs for the purchase of a \$9,250 ultraviolet disinfection system to be installed in spring 2003. However, when we visited the site in August 2007, we found that although the grantee used grant funds to purchase the equipment, the equipment had not been installed. A grantee official told us the system was never installed because the grantee exhausted its matching funds for the grant. During our site visit, a former Village official and the plant operator said the plant was functioning properly and meeting its permits, and the effluent was of drinking water quality without the ultraviolet system.

One of the determining factors when considering the allowability of costs is reasonableness. When Region 5 closes the grant, the Region needs to determine whether the equipment needs to be installed and, if not, whether it is reasonable to pay for the cost of the equipment. If it is not reasonable to pay for the costs, EPA should recover the Federal share of \$5,018 from the grantee.



The unused ultraviolet disinfection system (EPA OIG photo)

Matching Costs

The issues in the report not only affect the Federal funds associated with the project but matching costs as well. Just as we were not able to reconcile Federal drawdowns, we were not able to determine the project costs that comprised the grantee's match or the source of the matching funds. According to current and former grantee officials, the grantee was to use the \$100,000 loan for matching costs. However, the grantee repaid with grant funds \$75,000 of the loan and \$13,446 in loan interest, as previously noted. Further, the grantee needs to provide documentation of matching costs incurred to support Federal funds drawn.

Recommendations

We recommend that the Regional Administrator, EPA Region 5

1. Require the Village of Laurelville to:
 - a. Repay the \$207,476 in questioned Federal funds drawn.
 - b. Install the ultraviolet disinfection system or repay the \$5,018 of Federal costs claimed for the system.
 - c. Develop an adequate accounting system to support the remaining \$65,954 of Federal funds drawn. If this cannot be accomplished, the Region should recover the funds.
2. Provide documentation to support matching costs. If the grantee cannot provide sufficient documentation, costs claimed will need to be revised.
3. Classify the Village of Laurelville as a high risk grantee in accordance with 40 CFR 31.12, and apply special conditions on all future awards.

Auditee's Comments

We held an exit conference with grantee representatives on October 26, 2007. The Mayor of Laurelville said that the garage extension, computer equipment, tractor/mower, and tiller were all necessary purchases under the EPA grant, and the equipment is used solely at the treatment plant. He also said that the Village intends to install the ultraviolet disinfection system after it works out an agreement with a neighboring town to hook up to the Laurelville treatment plant. The Mayor also objected to the Village being classified as a high risk grantee.

OIG Response

Our position remains unchanged. EPA did not approve the purchases of the garage extension and the equipment we questioned, and the Village did not include any of these items in the grant work plan. The treatment plant functions properly without the ultraviolet disinfection system, which has remained in storage since it was purchased in 2003. Finally, considering the extent of the financial management weaknesses identified in the report, we continue to believe that the grantee should be classified as high risk.

Status of Recommendations and Potential Monetary Benefits

RECOMMENDATIONS						POTENTIAL MONETARY BENEFITS (in \$000s)	
Rec. No.	Page No.	Subject	Status ¹	Action Official	Planned Completion Date	Claimed Amount	Agreed To Amount
1	8	Require the Village of Laurelville to: <ul style="list-style-type: none"> a. Repay the \$207,476 in questioned Federal funds drawn. b. Install the ultraviolet disinfection system or repay the \$5,018 of Federal costs claimed for the system. c. Develop an adequate accounting system to support the remaining \$65,954 of Federal funds drawn. If this cannot be accomplished, the Region should recover the funds. 		Regional Administrator, Region 5		\$278	
2	8	Provide documentation to support matching costs. If the grantee cannot provide sufficient documentation, costs claimed will need to be revised.		Regional Administrator, Region 5			
3	8	Classify the Village of Laurelville as a high risk grantee in accordance with 40 CFR 31.12, and apply special conditions on all future awards.		Regional Administrator, Region 5			

¹ O = recommendation is open with agreed-to corrective actions pending;
C = recommendation is closed with all agreed-to actions completed;
U = recommendation is undecided with resolution efforts in progress

Distribution

Regional Administrator, Region 5
Director, Office of Wastewater Management, Office of Water
Director, Office of Wastewater Management - Municipal Support Division,
Office of Water
Director, Office of Grants and Debarment
Director, Grants and Interagency Agreements Management Division
Agency Followup Official (the CFO)
Agency Followup Coordinator
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Associate Administrator for Public Affairs
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