

U.S. DEPARTMENT OF COMMERCE
Office of Inspector General



**PUBLIC
RELEASE**

*NATIONAL OCEANIC AND
ATMOSPHERIC ADMINISTRATION*

AquaFuture, Incorporated
NOAA AWARD No. NA56FK0112

Audit Report No. ATL-10729-9-0001/ July 1999

Office of Audits, Atlanta Regional Office



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EXECUTIVE SUMMARY

In February 1995, the National Oceanic and Atmospheric Administration made a \$654,904 grant to AquaFuture, Inc., of Turners Falls, Massachusetts, as part of the Fishing Industry Grant (FIG) program. This program assists the depressed northeastern fishing industry by providing financial assistance to fishermen, processors and fishermen's associations, and to recipients who assist or train fishermen in research and management activities for marine and estuarine resources. AquaFuture was to contribute \$447,329 as in-kind match, bringing the total project budget to \$1,102,233.

The grant was intended to fund a demonstration project on raising flounder on land. The terms of the award required AquaFuture to build and equip a hatchery on the coast of New Hampshire to produce 120,000 flounder "juveniles" over the project's 18-month duration. Under the flounder nurturing process, the hatchery would use broodstock fish to spawn larval flounder. When the larvae reached about eight grams, in about six months, the hatchery would transfer the juvenile flounder to two "grow-out" farms to be raised until they were ready for market. All project facilities were to be located near coastal commercial fishing communities.

We performed a financial and compliance audit to determine if AquaFuture complied with the grant's terms and conditions, and if the company's claimed project costs were allowable, allocable and reasonable under applicable cost criteria. The audit covered the performance period from February 1, 1995 through December 31, 1997.

We found that AquaFuture achieved only limited program results from the award because it materially failed to comply with the grant agreement's terms and conditions. Specifically, AquaFuture (1) built and equipped a hatchery at its own inland location rather than at either of two coastal locations approved by NOAA, despite the agency's express prohibition of such activity, (2) provided only half the required flounder juveniles, which it purchased from another hatchery rather than producing at its own, and (3) failed to provide the requisite training and transfer of technological expertise because the grow-out manual and final project report it produced were wholly inadequate. Therefore, more than four years after the grant award, the project has not met either its specific objective of demonstrating the commercial viability of flounder aquaculture or the FIG program's general objective of assisting the depressed commercial fishing industry in the northeast. (See page 3.)

In addition, we found that AquaFuture did not maintain a financial management system that complies with federal cost accounting standards. (See page 5.) As a result, we are questioning \$191,539 in costs related to equipping and operating the hatchery at the unapproved location, and another \$490,128 due to financial management deficiencies, for a total of \$681,667 in questioned project costs. (See page 8.)

We are recommending that NOAA disallow all project costs claimed, including all costs questioned, terminate the grant for cause, and recover the full \$654,904 in NOAA grant funds disbursed to AquaFuture. (See page 8.)

In response to the draft report, AquaFuture officials generally disagreed with our findings and recommendation. They provided a lengthy narrative to explain and support their rationale for administering the grant project as they did. Based on AquaFuture's response, we have made some minor modifications to the draft report, but have not changed the substance of any material findings or the report's recommendation.

We have summarized AquaFuture's responses to individual issues and provided our comments after the appropriate sections of this report. We have included the company's complete response, excluding exhibits, as Appendix II.

INTRODUCTION

In March 1994, the Presidential contingency disaster fund, established by Public Law 103-211, provided \$30 million to the Department of Commerce to assist the depressed fishing industry in the northeastern states. The National Oceanic and Atmospheric Administration was charged with administering \$12 million of this assistance, and used \$9 million of the funding for the Fishing Industry Grant (FIG) program. NOAA's National Marine Fisheries Service Northeast Regional Office administers this program by providing grants to fishermen, processors and fishermen's associations, and to recipients who assist or train fishermen in research and management activities for marine and estuarine resources.

In February 1995, NOAA awarded a \$654,904 Fishing Industry Grant, No. NA56FK0112, to AquaFuture, Inc., of Turners Falls, Massachusetts. The grantee was to contribute \$394,409 as in-kind match, bringing the total project budget to \$1,049,313, and the federal and grantee cost shares to 62 and 38 percent, respectively. The project performance period was February 1, 1995 through July 31, 1996.

The grant project required AquaFuture to provide: (1) permitting experience, training and the transfer of technological expertise relative to summer flounder, (2) engineering assistance, and (3) three successive batches of "certified healthy" juvenile summer flounder. To accomplish this, AquaFuture would build and equip a hatchery to produce 120,000 flounder "juveniles" over the project's duration, and provide the juveniles to two "grow-out" farms that would raise them until they were ready for sale. All project facilities were to be located near coastal commercial fishing communities.

Under the flounder nurturing process, the hatchery would use broodstock fish to spawn larval flounder. When the larvae reached about eight grams, in about six months, the hatchery would transfer the juvenile flounder to the grow-out farms. After the juvenile fish grew to about three pounds at about 18 months of age, the grow-out farms would send the adult flounder to market.

AquaFuture formed a partnership with Great Bay AquaFarms to build the hatchery on the coast of New Hampshire. However, the two companies dissolved the partnership in August 1995. AquaFuture then requested NOAA's permission to build the hatchery at Quonset Point, on the coast of Rhode Island. Company officials assured NOAA that the hatchery would be completed and fully operational by September 1996, and that the project still would be successful and timely. NOAA approved the request in November 1995.

AquaFuture did not secure the necessary permits for the hatchery's construction during 1996 and did not build the facility at Quonset Point. In April 1997, AquaFuture asked to relocate the hatchery site to its own Turners Falls location, at least 140 miles inland from either grow-out farm. NOAA denied the request in June 1997 and directed AquaFuture to build the hatchery at Quonset Point. At that time, NOAA amended the grant award to extend the project performance period through December 31, 1997, at no cost to the federal government. AquaFuture also agreed to increase its match to \$447,329, bringing the total project budget to \$1,102,233, and the federal and grantee cost shares to 59 and 41 percent, respectively. NOAA has disbursed all grant funds, but has not yet closed the project.

PURPOSE AND SCOPE OF AUDIT

At NOAA's request, we performed a financial and compliance audit to determine whether AquaFuture had complied with Department of Commerce's *Financial Assistance Standard Terms and Conditions*, the cost principles contained in 48 CFR Part 31, *Contract Cost Principles and Procedures*, and the administrative procedures contained in OMB Circular A-110, *Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals, and Other non-Profit Organizations*. In particular, we wanted to determine whether the costs claimed by AquaFuture for the NOAA grant were allowable, allocable, and reasonable, and if the grantee's costs claimed complied with NOAA grant terms and conditions. We expanded the audit during fieldwork to examine project results.

We performed the audit fieldwork during February and March 1998 at NOAA's Grants Management and Northeast Fisheries Service offices, and at the grantee's and subrecipients' locations. The audit covered the grant award's extended performance period from February 1, 1995 through December 31, 1997. We examined pertinent project records and interviewed federal, grantee and subrecipient officials as deemed necessary.

We reviewed administrative and accounting internal controls relating to AquaFuture's administration of the grant award, including controls over financial management and related payroll, procurement and property management systems. However, we did not rely on the grantee's internal controls but instead determined that we could perform the audit more efficiently through substantive testing.

In conducting our review, we tested the accuracy of computer processed data by tracing the data to original source documents and by comparing it to the same data in other documents. Based on our tests, we concluded that we could not rely on the computer processed data in meeting our audit objectives and therefore conducted substantive testing.

We also evaluated the grantee's compliance with laws and regulations applicable to the award. We identified the Department of Commerce's *Financial Assistance Standard Terms and Conditions*, and NOAA's *Special Award Conditions*, as the applicable federal requirements. We found that AquaFuture did not comply with certain terms and conditions of the award. The noncompliance instances are material and are detailed in the "Findings and Recommendations" section of this report. We discussed these issues with grantee and NOAA officials in April 1998.

In March 1999, we issued a draft report to the grantee for its review and comments. We have summarized AquaFuture's responses to individual issues and provided our comments after the appropriate sections of this report. We have included the company's complete response, excluding the exhibits, as Appendix II.

We conducted the audit in accordance with generally accepted government auditing standards, and performed it under the authority of the Inspector General Act of 1978, as amended, and Department Organization Order 10-13, dated May 22, 1980, as amended.

FINDINGS AND RECOMMENDATIONS

GRANTEE MATERIALLY VIOLATED GRANT TERMS AND CONDITIONS

AquaFuture materially violated the NOAA grant's terms and conditions by failing to properly administer and perform the project--most significantly, by its failure to meet the basic project requirement of constructing a coastal hatchery to produce flounder juveniles and its failure to maintain an adequate financial management system. As a result, AquaFuture achieved only limited program results and was unable to properly account for its expenditure of federal grant funds. Due to the severity of these violations, NOAA should terminate the award.

Project Administration and Performance Was Deficient

AquaFuture's project administration and performance was deficient in several respects. First, the company did not build a hatchery at the originally proposed coastal location or at the alternate coastal site approved by NOAA. Instead, AquaFuture built a hatchery at its own inland location and installed equipment acquired with project funds, but did not use the facility for project purposes. In addition, the company failed to produce *any* flounder juveniles and instead purchased 60,000 fingerlings (half the project's required number) to provide to the grow-out farms. Finally, NOAA officials informed us that AquaFuture failed to provide the requisite training and transfer of technological expertise because the grow-out manual and final project report it produced were wholly inadequate. Therefore, more than four years after the grant award, the project has not met either its specific objective of demonstrating the commercial viability of flounder aquaculture or the FIG program's general objective of assisting the depressed commercial fishing industry in the northeast.

The most serious of the deficiencies involves AquaFuture's use of grant funds to equip and maintain a hatchery at Turners Falls rather than Quonset Point. Company officials claimed that building the hatchery at AquaFuture's Turners Falls facility was necessitated by problems encountered in obtaining required building permits for Quonset Point. However, the officials did not diligently pursue securing the permits, which delayed the proposed construction schedule by about two years.

The *Administrative Special Award Conditions* incorporated into the amended grant agreement, dated June 1997, prohibited AquaFuture from using grant funds to construct or operate an inland hatchery at Turners Falls. The terms of the amended award required AquaFuture to retain the original project objective of a *coastal* hatchery site by building at Quonset Point. In addition, in its transmittal letter accompanying the amendment, NOAA expressly rejected AquaFuture's proposal to change the location of the hatchery to Turners Falls, and stated that no costs would be allowed for hatchery construction and operations other than at Quonset Point. This decision was entirely consistent with Public Law 103-211, the Emergency Supplemental Appropriations Act of 1994, which requires the FIG program to:

“Help restore overfished New England groundfish stocks through aquaculture or hatchery programs. This may include, but is not limited to, establishing small-scale aquaculture pilot and demonstration projects in *commercial fishing communities*.” (Emphasis added.)

Moreover, it is clear that AquaFuture understood and accepted NOAA’s restriction. In a June 1997 letter to the agency accepting the amended grant agreement, AquaFuture stated:

“We understand that the change in hatchery location is unsupportable under the FIG program. Accordingly, no project funds will be used for hatchery activities which are not at Quonset Point.”

Grantee officials claim that construction of the hatchery at Quonset Point was delayed because of problems in obtaining the necessary building permits. In reality, however, it appears that the delays occurred because AquaFuture was in the process of constructing a hatchery at Turners Falls and did not diligently pursue the permitting process for Quonset Point.

AquaFuture’s February 1997 report to NOAA, *Permitting for Land and Marine Based Aquaculture*, describes the company’s progress in obtaining the required permits. The document states that six major and five minor permits were needed to build the hatchery at Quonset Point, and that the permitting process began in November 1995. AquaFuture obtained all but three permits by September 1996. As of February 1997, however, the company still had not received state approval for building inspection, fire marshal and sewer permits.

To obtain the required building inspection permit, AquaFuture first had to get the permit from the fire marshal. To do this, AquaFuture had to provide certified engineering drawings of the facility, which company officials did not want to do. AquaFuture’s report states, “[T]he Company has been trying to avoid the high costs associated with these drawings and has spent a considerable amount of time trying to figure out a method for avoiding them.” Furthermore, a company official stated that AquaFuture did not have the \$933 fee required by the fire marshal to review the plans, and that the company tried to avoid purchasing the certified drawings by substituting a hatchery specifications book. As a result, AquaFuture did not obtain either the fire marshal or the building inspection permit.

AquaFuture applied for a sewer permit in January 1996, but had not received it by February 1997, approximately 13 months later. In its March 1997 report to NOAA, AquaFuture admitted that it had intentionally delayed the permitting process. The report states, “AquaFuture did not actively push to expedite completion of its remaining local permits during the fourth quarter of 1996 as this would have triggered the requirement to begin making lease payments on the Quonset Point site.”

Under the circumstances, it is apparent that AquaFuture’s failure to construct a hatchery at Quonset Point was not caused by the permitting process itself, but by the company’s failure to diligently pursue the process while advancing plans to construct a hatchery at its own inland

location. Despite NOAA's explicit instructions to the contrary, AquaFuture installed equipment acquired with project funds in a hatchery built at Turners Falls, which was not used for project purposes. As a result, we are questioning \$191,539 in costs for the equipment and related Turners Falls supply and maintenance expenses, which were claimed by AquaFuture as project costs.

Grantee Response

AquaFuture officials generally disagreed with our findings regarding the company's deficient administration and performance of the project. They contend that the project achieved virtually all of its major objectives, that all project deliverables and reports were completed in a timely manner, and that NOAA either approved or acquiesced in all modifications to the project work plan or changes in the scope of the award. AquaFuture provided a lengthy narrative response in support of these contentions, which is set forth in its entirety at Appendix II.

OIG Comments

We did not modify this report section on the basis of AquaFuture's response to the draft report because the contentions advanced by the company are refuted by the evidence obtained during our audit, and not supported by any additional information or documentation referenced in the response.

Grantee Financial Management Was Deficient

AquaFuture's financial management of the grant project did not comply with applicable federal requirements. The company's accounting system did not provide adequate cost documentation, which resulted in our questioning \$490,128 in project costs. In addition, AquaFuture did not obtain a project audit, as required by the terms of the grant award.

The cost principles set forth in 48 CFR Part 31 establish various criteria for determining if costs are allowable, reasonable and allocable to one or more cost objectives. In addition, OMB Circular A-110, *Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations*, requires that expenditure claims be based on actual costs incurred, and that they contain accurate, current and complete information supported by financial accounting records. Specifically, Subpart C.21 of the Circular requires grantees to maintain financial management systems that provide for:

- a. Accurate, current and complete disclosure of the financial results of each federally sponsored project,
- b. Procedures for determining reasonableness, allowability and allocability of costs in accordance with the provisions of the applicable Federal cost principles and the terms of the grant agreement, and

c. Accounting records that are supported by source documentation.

Since AquaFuture did not maintain an adequate accounting system, we were forced to reconstruct the company's available project disbursement records. These records were not always reconcilable with AquaFuture's financial reports to NOAA, especially with respect to personnel and subrecipient costs. As a result of the company's inadequate accounting system, we are questioning \$490,128 in project costs (see page 8). As further discussed in various reference notes to Appendix I, AquaFuture's financial management system did not account for costs by budget line item and did not provide adequate supporting records for costs incurred.

AquaFuture also failed to obtain a project audit, as required by the terms of its financial assistance award. The original grant agreement, dated February 16, 1995, incorporated the Department of Commerce *Financial Assistance Standard Terms and Conditions*, which provide at Section D. 01.b. that:

"For-profit Recipients shall have a project audit performed no less than once every two years in accordance with Federal Government auditing standards."

Based on that requirement, AquaFuture should have obtained an audit by February 1997, two years after the grant award; however, no such audit was performed.

After reviewing the company's grant application in 1995, the Department of Commerce obtained a Dun and Bradstreet report on the company's operations. The report disclosed that [REDACTED] [REDACTED]. Because of this, NOAA placed the company on a reimbursable payment system in making the grant award. In June 1998, three years later, Dun and Bradstreet reported that [REDACTED]

[REDACTED]. This significant change in the company's financial position would have likely been disclosed had the required audit been performed in a timely fashion.

Commerce Department Administrative Order 203-26, Section 6.05, requires award recipients to be competently managed, responsible, capable and committed to achieving the objectives of the awards they receive. An absence of adequate financial controls and a deteriorating financial condition are both indicators that a recipient is not competent or responsible, and provide ample bases for classifying an organization as a "high risk" recipient and for denying, suspending or terminating an award.

Grantee Response

AquaFuture officials generally disagreed with our findings regarding the company's financial management of the project. They stated that adequate documentation was available to support the costs claimed, and that the requirement for an independent audit was not contained in the original grant award but added to the amended award in August 1997. The officials contended that our audit satisfied the requirement since it took place within one year of that date.

OIG Comments

We have corrected the report to cite the audit requirement contained in the Department's *Financial Assistance Standard Terms and Conditions*, which was incorporated into the original 1995 grant award. Accordingly, the grantee's obligation to obtain a project audit was not satisfied by our audit three years later.

Conclusion

OMB Circular A-110, Subpart C.61(a)(1), allows a federal awarding agency to terminate an award if a recipient materially fails to comply with the award's terms and conditions. AquaFuture's deficient project administration and performance and its deficient financial management, independently and collectively establish a clear basis for termination of this award. Since all grant funds have been expended, NOAA should terminate the grant for cause and recover the full \$654,904 in grant funds disbursed to the company.

RESULTS OF FINANCIAL/COMPLIANCE AUDIT

As of March 31, 1998, AquaFuture had claimed \$1,098,036 in project costs and we are questioning \$681,667 of those costs. We are questioning \$191,539 because AquaFuture built a hatchery at a location not approved by NOAA (see pages 3 through 5, and Appendix I, Reference Notes 4, 5, 7A and 7C), and the remaining \$490,128 because of deficiencies in AquaFuture's financial management of the project (see pages 5 through 7, and Appendix I, Reference Notes 1, 2, 3, 6 and 7B). The audit results are summarized below and detailed in Appendix I.

Federal Funds Disbursed		\$654,904
Costs Claimed	\$1,098,036	
LESS: Costs Questioned	<u>681,667</u>	
Costs Accepted	\$ 416,369	
Federal Cost Sharing Ratio	<u>.594</u>	
LESS: Federal Funds Earned		<u>247,323</u>
Amount Due From Grantee		<u>\$407,581</u>

Appendix I shows the results of our audit of the project costs claimed based on federal cost principles. Its purpose is twofold: First and foremost, the findings detailed in the reference notes to the appendix illustrate AquaFuture's disregard for federal financial management and cost accounting standards, as well as NOAA grant terms and conditions. Secondly, the reference notes in the appendix provide the basis to disallow specific project costs.

Recommendation

We recommend that NOAA's Chief, Grants Management Office, disallow all project costs claimed, including all costs questioned above, terminate the grant for cause, and recover the full \$654,904 in NOAA grant funds disbursed to AquaFuture.

Grantee Response

AquaFuture officials responded to each questioned cost, contending that documentation provided in the company's response represented adequate support for all project costs claimed. The company's response to each questioned cost follows the applicable reference note in Appendix I.

OIG Comments

AquaFuture's explanations and documentation were not adequate to support any of the questioned costs. Therefore, we continue to question \$681,667 in project costs. Our comments on the company's response to each questioned cost are contained in the applicable reference notes to Appendix I.

for Robert F. O'Rourke Jr. 7/16/99
William F. Bedwell, Jr. Date
Regional Inspector General for Audits

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AQUAFUTURE, INC., TURNERS FALLS, MASSACHUSETTS
NOAA GRANT NO. NA56FK0112
SUMMARY OF FINANCIAL/COMPLIANCE AUDIT
FEBRUARY 1, 1995 THROUGH MARCH 31, 1998

Description	Grant Budget	Costs Claimed	Costs Questioned	Costs* Unsupported	Accepted Costs	Ref. Notes
Personnel	\$ 227,352	\$ 261,170	\$261,170	\$261,170	\$ -0-	1
Consulting	2,000	2,000	2,000	2,000	-0-	2
Travel	2,970	2,885	1,393	1,393	1,492	3
Equipment	211,797	148,187	148,187	-0-	-0-	4
Supplies	16,116	9,236	9,236	-0-	-0-	5
Subrecipients	474,352	483,152	173,275	173,275	309,877	6
Other	62,646	86,406	86,406	-0-	-0-	7
Great Bay	<u>105,000</u>	<u>105,000</u>	<u>-0-</u>	<u>-0-</u>	<u>105,000</u>	
TOTAL	<u>\$1,102,233</u>	<u>\$1,098,036</u>	<u>\$681,667</u>	<u>\$437,838</u>	<u>\$416,369</u>	

Federal Funds Disbursed		\$654,904
Costs Claimed	\$1,098,036	
LESS: Costs Questioned	<u>681,667</u>	
Costs Accepted	\$ 416,369	
Federal Cost Sharing Ratio	<u>.594</u>	
LESS: Federal Funds Earned		<u>247,323</u>
Amount Due from Grantee		<u>\$ 407,581</u>

*Unsupported costs are included in questioned costs.

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REFERENCE NOTES

1. Personnel

\$261,170 in salaries and fringe benefits is questioned because AquaFuture did not provide sufficient information to determine cost allowability and allocability. OMB Circular A-110, Subpart C, Item 21(b)(7), states:

“Recipients’ financial management systems shall provide for ... accounting records including cost accounting records that are supported by source documentation.”

In addition, 48 CFR Part 31.201-4 states:

“A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received ...”

AquaFuture did not maintain records such as time sheets, time summaries, or time distributions to support the salary percentages allocated to the grant project for employees whose entire salaries were not charged to the project. For two employees whose entire salaries were charged to the grant project, there were no time sheets, employment agreements or any other such documents or records to support the individuals’ claimed level of work effort.

Grantee Response

Grantee officials provided employee payroll records, activity sheets and samples of work performed. They stated that time sheets were not used because of the professional nature of the responsibilities and the fact that all project employees were salaried.

OIG Comments

We continue to question the \$261,170 because the grantee’s response provides no evidence that the costs are allowable and allocable to the NOAA grant award. For six of the seven employees documented in the response, the project eligible costs claimed differ from those claimed during our audit fieldwork. Moreover, the response did not provide any documentation for two other employees the grantee claimed had worked on the project.

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2. Consulting

\$2,000 in consulting costs is questioned because AquaFuture did not maintain adequate documentation to support the costs. OMB Circular A-110, Subpart C, Item 21(b)(7), states: "Recipients' financial management systems shall provide for ... accounting records including cost accounting records that are supported by source documentation."

Grantee Response

Grantee officials stated that they would provide information on these costs later.

OIG Comments

We continue to question the \$2,000.

3. Travel

\$1,393 in travel costs is questioned because AquaFuture did not maintain adequate documentation to support the costs. OMB Circular A-110, Subpart C, Item 21(b)(7), states:

"Recipients' financial management systems shall provide for ... accounting records including cost accounting records that are supported by source documentation."

Furthermore, DOC Standard Terms and Conditions Paragraph L.04, Foreign Travel, states:

"The Grants officer must pre-approve foreign travel when a foreign air carrier is anticipated to be used for any part of foreign travel."

The air fare was for the company's consultant who traveled from Denmark to help finalize the design of the hatchery and grow-out facilities. AquaFuture did not have documentation to support the air carrier used or NOAA's pre-approval of a foreign air carrier.

Grantee Response

Grantee officials stated that they would provide information on these costs later.

OIG Comments

We continue to question the \$1,393.

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4. Equipment

\$148,187 in equipment costs is questioned because AquaFuture used the equipment in the hatchery built at Turners Falls. The grant award's Amendment No. 1, dated June 3, 1997, specifically prohibits NOAA reimbursement of costs for a hatchery located anywhere other than Quonset Point.

Grantee Response

Grantee officials stated that the costs were incurred before NOAA's June 1997 denial of AquaFuture's proposal to locate the project hatchery at Turners Falls.

OIG Comments

We continue to question the \$148,187 because the grantee's response provides no evidence that the costs related to the Turners Falls hatchery are allowable and allocable in accordance with the terms of the NOAA grant award. The timing of the purchase is not material to the allowability of the cost since the equipment was ultimately installed at Turners Falls and not used for project purposes.

5. Supplies

\$9,236 in supplies costs is questioned because AquaFuture bought the supplies to support the hatchery built at Turners Falls. As discussed in Note 4 above, NOAA specifically prohibited the reimbursement of any costs related to this hatchery.

Grantee Response

Grantee officials stated that the costs were incurred before NOAA's June 1997 denial of AquaFuture's proposal to locate the project hatchery at Turners Falls.

OIG Response

We continue to question the \$9,236 because the grantee's response provides no evidence that the costs related to the Turners Falls hatchery are allowable and allocable in accordance with the terms of the NOAA grant award. The timing of the purchase is not material to the allowability of the cost since the supplies were used at Turners Falls and not used for project purposes.

6. Subrecipients

\$173,275 in subrecipient costs for VG SeaFarms is questioned because the company did not provide sufficient information to determine cost allowability and allocability. OMB Circular A-110, Subpart C, Item (b)(7), states:

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“Recipients’ financial management systems shall provide for ... accounting records including cost accounting records that are supported by source documentation.”

Also, 48 CFR Part 31.201-4 states:

“A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received ... ”

VG SeaFarms did not provide adequate documentation to support the salary, equipment, lease and other costs claimed. For instance, lease costs were not supported by a lease agreement or rental payments and \$78,668 in personnel costs (\$24,000 in grant funds and \$54,668 in match) were not supported with employment agreements, time sheets or other proof of the claimed level of work effort. Also, VG SeaFarms claimed \$9,000 for the cost of fish feed which the company did not purchase.

Grantee Response

Grantee officials provided invoices and other documents furnished by VG SeaFarms. The officials stated that they had continually visited the subrecipient’s site and thus were able to physically verify the project work performed.

OIG Comments

We continue to question the \$173,275 because the documentation did not provide sufficient evidence that the costs are allowable and allocable to the NOAA grant award. It also did not address the specific problems discussed above.

7. Other

\$86,406 in other costs is questioned for the following reasons:

- A. \$32,576 in facility maintenance costs is questioned because the costs were for AquaFuture’s hatchery at Turners Falls. As discussed in Note 4 above, NOAA specifically prohibited the reimbursement of any costs related to this hatchery.
- B. \$52,290 in other costs is questioned because AquaFuture did not provide sufficient information to determine cost allowability and allocability. OMB Circular A-110, Subpart C, Item 21(b)(7), states:

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“Recipients’ financial management systems shall provide for ... accounting records including cost accounting records that are supported by source documentation.”

1. \$14,000 in lease costs is questioned because AquaFuture did not have a lease for the Quonset Point property on which the hatchery was to be located.
2. \$3,895 in electricity and heating costs is questioned because AquaFuture could not support the costs. OMB Circular A-110, Subpart C, Item (b)(7), states:

“Recipients’ financial management systems shall provide for ... accounting records including cost accounting records that are supported by source documentation.”

We also are questioning these costs because they were for AquaFuture’s hatchery at Turners Falls. As discussed in Note 4 above, NOAA specifically prohibited the reimbursement of any costs related to this hatchery.

3. \$22,147 in final costs claimed is questioned because AquaFuture did not have documentation for the costs even though company officials certified in the final disbursement request that AquaFuture was entitled to the payment. OMB Circular A-110, Subpart C, Item (b)(7), states:

“Recipients’ financial management systems shall provide for ... accounting records including cost accounting records that are supported by source documentation.”

4. \$12,248 in total costs claimed is questioned because AquaFuture did not identify the costs to a specific approved budget item or include the costs in a specific funds disbursement request. 48 CFR Part 31.201-4 states:

“A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received ... ”

- C. \$1,540 in environment costs is questioned because the costs were for AquaFuture’s hatchery at Turners Falls. As discussed in Note 4 above, NOAA specifically prohibited the reimbursement of any costs related to this hatchery.

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Grantee Response

- A. Grantee officials stated that the costs were incurred before NOAA's June 1997 denial of AquaFuture's proposal to locate the project hatchery at Turners Falls.
- B.
 - 1. Grantee officials stated that the costs were for a down payment on the Quonset Point hatchery facility.
 - 2. Grantee officials stated that they would provide information on these costs later.
 - 3. Grantee officials stated that they would provide information on these costs later.
 - 4. Grantee officials stated that the costs were for personnel costs related to the grant closeout.
- C. Grantee officials stated that the costs were incurred before NOAA's June 1997 denial of AquaFuture's proposal to locate the project hatchery at Turners Falls.

OIG Comments

- A. We continue to question the \$32,576 because the grantee's response provides no evidence that the costs related to the Turners Falls hatchery are allowable and allocable in accordance with the terms of the NOAA grant award. The time that the facility maintenance expenses were incurred is not material to the allowability of the costs since the maintenance was for the Turners Falls hatchery and not for project purposes.
- B.
 - 1. We continue to question the \$14,000 because the NOAA grant award provided for the purchase of equipment to be used within hatchery and grow-out buildings, but did not authorize the actual construction of project facilities.
 - 2. We continue to question the \$3,895.
 - 3. We continue to question the \$22,147.
 - 4. We continue to question the \$12,248 because the grantee did not provide evidence that the costs are allowable and allocable to NOAA's award. See Note 1., OIG Comments.

APPENDIX I
Page 8 of 8

- C. We continue to question the \$1,540 because the grantee's response provides no evidence that the costs related to the Turners Falls hatchery are allowable and allocable in accordance with the terms of the NOAA grant award. The time that the environment expenses were incurred is not material to the allowability of the costs since the expenditure was for the Turners Falls hatchery and not for project purposes.

AquaFuture

Growing Food For A Healthy Future

4/30/99

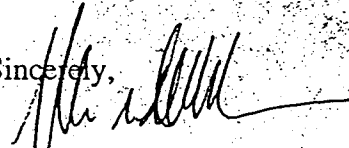
William R. Bedwell, Jr.
Regional Inspector General for Audits
Office of Inspector General
U.S. Department of Commerce
401 West Peachtree St., N.W. - Suite 2742
Atlanta, Georgia 30308

RE: Award No. NA56FK0112

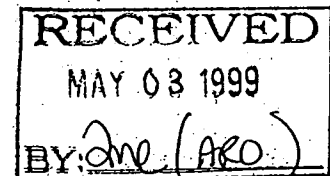
Dear Mr. Bedwell:

The Management of AquaFuture has review the audit report of the referenced award no. and has developed a response.

Sincerely,


Joshua Goldman
President

CC: Michael Nelson, Chief, Grants Management Division



I. Summary of Grantee Response to Draft Audit

AquaFuture's NOAA's funded project *From fishing to farming* fostered a unique collaboration between four company's who participated in a effort to commercialize emerging technology in flounder aquaculture. The project was highly ambitious, requiring the permitting of three land-based aquaculture faculties, the scale-up of hatchery techniques and the development, selection engineering, manufacture and transfer of novel equipment and culture methods, many of which were without precedent in North America. In taking these critical first steps toward establishing a new industry in the region, all project participants took substantial business and financial risk and committed time, effort and funds well in excess of the original project workplan and budget.

In this response to the draft audit we will provide substantive contextual and supporting information which we believe has a material bearing on the *Findings and Recommendations* of the audit report. Specifically, we will show that:

- 1) NMFS Program Officers were informed of AquaFuture's intent to pursue the hatchery at the Turners Falls location and did not express any opposition to this occurring.

AquaFuture submitted a comprehensive information package to NMFS on April 29, 1997 which proposed to relocate the hatchery to Turners Falls MA for timing and budgetary reasons. NMFS denied the proposed change in location stating that it was unsupportable under the FIG program. Following this notification, on June 3, 1997, AquaFuture continued to pursue its plan for a hatchery in Quonset Point through June, 1997 when it became apparent that changes imposed by the State Building Inspector would make the project financially untenable. Between June and August of 1997 AquaFuture's Principal Investigator, Joshua Goldman, initiated a series of discussions with Harold Mears, Chief of the Programs Division for NMFS Northeast Region. In these discussions, Goldman requested Mears input on managing the project deliverables in lieu of NMFS denial of the change in hatchery location. During these discussions, and specifically on July 14, 1997, Mears suggested that the hatchery and the third batch of fingerlings be eliminated from the project workplan. Goldman accepted this suggestion and informed Mears that AquaFuture would like to pursue the hatchery in Turners Falls so that it might be able to supply the subcontractors with fingerlings in the future. Goldman stated that AquaFuture would not use *Federal* grant funds for hatchery activities on its site. Mears did not object to or otherwise advise against AquaFuture's stated intentions. AquaFuture's understanding of the arrangement was confirmed in a letter to Jean West dated August 8, 1997 and was reiterated in the project's final report.

- 2) No Federal Funds were used for the hatchery related activities after AquaFuture was notified of NMFS denial of its request for a location change in June of 1997.

However, in the 26 months that the grant was active prior to AquaFuture's receiving this notification, significant hatchery related spending (\$155,818) had occurred and was documented relating to functions in New Hampshire (GBA) and in preparation for activities at Quonset Point, RI (AquaFuture).

It is unreasonable to disallow all hatchery related spending when the majority of the spending occurred prior to any intent, request or notification of the denial of the requested change in location. After receiving this notification, AquaFuture submitted financial and progress reports *every two months* which clearly showed non-federal funds being allocated against the outstanding balance in various hatchery related budget lines. Again, there was no comment from the financial or program officers regarding what AquaFuture had understood to be an approved arrangement. In hindsight, it is apparent that AquaFuture misunderstood the requirement that no project funds (i.e. non-Federal) be used for activities at Turners Falls.

AquaFuture should have submitted a revised budget reflecting the smaller non-federal share which could logically have been developed from the revised workplan which resulted from discussions with H. Mears. Ironically, AquaFuture increased its non-Federal share of the budget in the Amendment to Financial Assistance Award, dated June 3, 1996. AquaFuture had the opportunity to modify the budget in accepting the Amendment to Financial Assistance Award but was reluctant to do so for fear that continuing delays in the Government review would cause serious financial harm to the fisherman subcontractors and negatively impact the ability to complete the project. At this point, NMFS had taken 12 months to review and approve the request for no-cost extension and the project subcontractors were continuing work to develop there facilities despite eight months without grant support.

- 3) AquaFuture's has substantial documentation which supports the consistency of all reported expenses with the project budget.

The auditors finding that AquaFuture did not maintain an adequate financial management system is principally based on: (i) the fact that accounting of salaried employees relied on percentage allocations, (ii) the non-allowance of all hatchery related expenses, and (iii) the non-allowance of one of the three subcontractor's (VG SeaFarms) expenses. In this submission we have supplied (i) payroll records by employee, (ii) employee activity sheets, and (iii) samples of work performed to document the effort and accomplishment of each employee involved in the project. The majority of hatchery expenses were incurred prior to June 1997. No Federal funds were used for hatchery expenses after between June and December 1997, after the hatchery objective was drooped from the project workplan. For the subcontractor, VG Seafarms, the quality of documentation presented to is similar to that presented for Trio and GBA (i.e. invoices for work performed and timesheets in accordance with the project budget). Further, because Trio and VG had identical budgets and workplans and succeeded in constructing similar facilities, management accepted VG's presentation of its expenses on the same basis as the other subcontractors.

- 4) This was a high-risk project experiential which succeeded in accomplishing the significant majority of its major objectives.

Despite the challenges noted above and described more fully in the project's Final Report, the project achieved virtually all of its major objectives. Only the second half of objective three ("demonstrate commercial grow-out") was not completed due to insufficient time, largely related to permitting delays. Completion of this objective would have taken an additional 12 to 18 months to complete. The auditors have incorrectly placed various details of the project's tactical implementation — many of which could not have been predicted at the project's outset — above the accomplishment of the project's major objectives. These objectives were structured to provide a flexible means of addressing real-world constraints to commercializing emerging aquaculture technology while facilitating tangible assessment of project results. Indeed, this project should be regarded as highly successful as evidenced by the emergence of the founder industry in the Northeastern U.S., led in large measure by the participants in this project.

II. Project Background and Response to Audit Findings and Recommendations

A. Project Background

The *From Fishing to Farming* project resulted in the siting, permitting, financing, and construction of two aquaculture facilities owned and operated by individuals involved in the commercial fishing industry. The project helped these company's address siting and permitting issues and documented the challenges and costs associated with permitting land-based marine aquaculture facilities in Massachusetts and Rhode Island. Permitting was found to require a significant investment of time and energy under the current regulatory structure. For each project participant (AquaFuture, GreatBay AquaFarms, Trio Argarvio and V&G SeaFarms) the total time and cost involved in entering this emerging sector of the aquaculture business significantly exceeded the more limited subset of activities defined under the project's budget and workplan.

This project addressed four barriers to making the transition from fishing to farming that were identified in the project workplan:

- It helped the two companies in the fishing industry addresses permitting and siting issues, and educated regulators so that it will be easier for other commercial fishers to enter aquaculture in the future;
- Two environmentally controlled recirculating flounder grow-out facilities were designed and specialized equipment was developed and fabricated according to the project budget. The fishing-industry owners of these faciites were provided with training in land-based grow-out of flounder;
- It provided these companies with investment capital to reduce the risk of starting an aquaculture businesses based on emerging technology; and
- It stimulated the development of two hatcheries in the region using predominantly private funds that are capable of supplying juvenile fish to the subcontractors and future start-up businesses.

All project deliverables and reporting was completed in a timely manner, including, (i) over 60 pages of quarterly and bi-monthly reports, (ii) a financial model was prepared for the grow-out farms, and (iii) a draft grow-out manual for intensive summer flounder aquaculture was produced and submitted to NMFS personnel fore review, and (iv) a comprehensive final report completed describing the projects accomplishments, challenges and findings was produced at the project's completion.

While the project stimulated private investment and generated alternative economic activity for people in the fishing industry, permitting related delays in conjunction with the two year grow-out time for flounder did not allow for completion of the grow-out trials. As a result, it is still too early to assess whether the project will result in the establishment of successful aquaculture business run by commercial fishermen.

B. Response to Specific Findings & Recommendations

Finding 1: AquaFuture Failed to meet the basic requirements of constructing a coastal hatchery.

Response: The original project workplan described a relationship between AquaFuture and GreatBay Aquafarms ("GBA") whereby the parties would cooperate to develop a hatchery and produce juvenile flounder for use by the subcontractors. Under the original plan, this relationship was structured to enable: (i) AquaFuture to provide GBA with technical/engineering expertise, (ii) for GBA to supply the fishing industry subcontractors with juvenile fish and in so doing establish long-term customers for its product, and (iii) for the subcontractors to receive a sufficient number of juveniles to aid their start-up process. The GBA facility was to be located in Newington New Hampshire, which is neither a coastal nor a fishing community. In fact, the hatchery facility is located at a utility owned power plant.

The approved project workplan clearly segments the *technology, training and hatchery* functions from the *fishing industry* functions. These functions, to be undertaken by the fisherman, were limited to the *grow-out* portion of the process. Only the grow-out activities were to take place in coastal communities in order to stimulate alternative employment for fisherman and make use of underutilized processing facilities for aquaculture. Page 1 of the approved grant makes this clear in stating the major goal of the project:

... to transfer flatfish culture technology to fisherman in order to demonstrate the viability of commercial fish farming as alternative employment. Commercial scale, land-based growout of summer flounder will be undertaken by existing fishermen. . ."

Despite a change in the relationship between AquaFuture and GreatBay, the hatchery facility was built as described in the project workplan, based in-part on the promise of selling fingerlings to the fishing industry subcontractors and the technical assistance provided by AquaFuture. AquaFuture provided GBA with over 1,400 man hours of technical assistance (as evidenced by sample documents included in section 3). However, instead of receiving funds (Federal + Non-Federal) for equipment (\$281,641), supplies (\$54,910) and other costs (\$69,910) according to the original budget to undertake the production of a target of 120,000 juvenile fish, they received \$29,183 in equipment and were paid \$105,000 for 60,000 fingerlings. Therefore, the cost to the program per delivered fingerling was actually more favorable than originally budgeted.

	<u>Funds to GBA</u>	<u>No. Fingerlings</u>	<u>Cost/Fingering</u>
Original	\$406,461	120,000	\$3.38
Revised/Actual	\$134,183	60,000	\$2.23

It could also be argued that this approach involved less risk since GBA was only paid for fish delivered to the subcontractors. Reducing the funds paid to GBA enabled the project to accomplish its objectives in accordance with the budget given the significant increase in time and effort that was required to support and implement other aspects of the project. To summarize, while the

specific details of the relationship and budget between the AquaFuture and GBA changed over the course of the project, the major project objective of *mass producing summer flounder juveniles* and the specific goal of developing a hatchery to supply juveniles for the fishing industry cooperators occurred as described in the approved project workplan. Additionally, NMFS program personal were apprised of and approved all changes in the relationship between AquaFuture and GBA, as evidenced by the project documentation.

Finding 1(a): The Company did not diligently pursue constructing a hatchery at the alternative coastal site approved by NOAA and instead and equipped a hatchery at its own inland location

Response: AquaFuture put enormous effort into permitting the facility at the Quonset Point location. We can provide approximately 500 pages of permitting related documentation showing our efforts to permit and construct the hatchery facility at the Quonset Point location. A representative sample of the available documentation is enclosed in Section 4. AquaFuture was the first Company to attempt to permit a *newly constructed* land-based aquaculture facility in the Rhode Island. This forced us to confront a poorly defined regulatory framework which imposed severe challenges on completion of the hatchery facility within the allowable timeframe a project budget. An overview of the permitting process is presented below.

Overview of Hatchery Permitting Process

AquaFuture's flounder project coordinator, Zack Gund, was engaged in permitting and site development activities on a full time basis from October 1995 through July 1997. AquaFuture submitted a proposal for its hatchery to the RI Coastal Resources Management Council in November, 1995. The agency rejected the application in January, 1996, and requested a meeting with AquaFuture. At the meeting, held in February, it was determined that AquaFuture would need to submit two applications: one for the building and site plan, the other for permission to drill a sub-surface well to check water quality and availability. The sub-surface well point was selected as a low cost way to obtain naturally filtered sea water.

AquaFuture's application for the test pump was approved in March 1996, and the company installed a well point at the mean low water line to test the water. The experiment revealed significant contamination by grease solvents, probably related to the sites history as a military base. As a result of this finding, AquaFuture revised its plans to obtain water directly from the Bay. New drawings were submitted to CRMC showing the revised intake system.

During this time, the issue of whether AquaFuture could separate the application for the hatchery building from the water sourcing system re-emerged, and took several months to resolve. In May, 1996, CRMC again agreed that the applications could be separated, and AquaFuture submitted a third application for the building along with a \$1,500 review fee. The application was accepted in June, but CRMC declined to approve several elements of the facility, including minor pads for oxygen and propane tanks, in the absence of engineer-stamped drawings. A permit for the water intake and discharge system was issued in September, 1996.

AquaFuture obtained a RIPDES permit in three months — a substantial reduction in the timeframe experienced by Huba or Trio. After the RIPDES permit was issued, the Company applied for a permit from Army Corps of Engineers granted for construction of an intake and discharge system. The Company applied for and received an aquaculture permit RI Department of Fish and Wildlife. In June, 1996, AquaFuture paid \$14,000 in project funds to Morton Buildings, Inc. as a deposit on the hatchery building which was booked under the "Site lease/Site development" line. This payment was necessary to secure building plans which comprised an integral component of submissions to various planning and oversight agencies. Approvals from the North Kingstown Town Council, the North Kingston Building Inspector, the Rhode Island Port Authority and the Federal Aviation Administration (FAA) were also obtained over the course of 1996. Two engineering firms (Dowdell Engineering, Whitman) and a landscape architecture firm assisted in preparing materials in support of the permitting process.

AquaFuture's proposed hatchery was to be located on State property, which brought the construction under the jurisdiction of the Rhode Island State building inspector. The State specifically targeted the area of the former Quonset point naval facility for aquaculture. AquaFuture applied for a State Building Permit in the Second Quarter of 1996. In the fourth quarter of 1996, despite the State's designation, the State raised concerns about wind loading associated with the coastal site and about potential damage to the facility and related to flooding and wave velocity during storms. The State Inspector required that the entire building be elevated (requiring substantial fill), the structure's foundation be reinforced, and that specialized drains to equalize water pressure during flooding conditions be installed. Most significantly, the Building Inspector and Fire Marshall Office required that all electrical equipment be elevated above the 100-year flood level — a requirement which forced a major redesign of facility because the majority of the filtration and pumping equipment relies on gravity to bring the water to the lowest point in the system.

The auditors are correct in stating that AquaFuture did not actively push to complete certain local permits during the fourth quarter of 1996. This was a sound decision since completing these permits would have triggered the requirement to begin making lease payments in advance of receipt of the State Building Permit; which required significant additional time and effort to complete. The Original project submission anticipated these problems, and had as one of its principal objectives the documentation of these challenges:

Aquaculture presents a number of very real impediments for the owner operator who attempts to site an operation in a bay, estuary or wetland. Competing uses of the water resource area, particularly recreation, add additional time and cost to the permitting process. Many a would be aquaculturist have had their dreams smashed by the daunting permits, fees, hearings, engineering and time required to site an operation . . . Fishermen turning to aquaculture will not rid themselves of the increasing regulatory oversight that penetrates the commercial harvesting sector. In fact, they may find themselves in another sort of regulatory maze when investigating the siting of an operation requiring diversion of water for both influent and effluent.

Delays in NOAA responses were a significant Factor in Timing, Project Progress & Decision Making

As the impact of these permitting related delays was mounting, AquaFuture responded by submitting a request for a 12 month no-cost extension on June 14, 1996. It took the NMFS until February 1997 — a full eight months — to respond to AquaFuture's request. At this time, NMFS requested a meeting with all project participants in order to gather more information on the status of the project. This was due in part to the fact that the original program officer (Bob Klake) had been reassigned. After the meeting, AquaFuture was asked to provide a revised request for no-cost extension. This was submitted as part of a comprehensive 48 page project update which was submitted to NOAA on April 29, 1997. In this document, AquaFuture reiterated its request for a 12 month extension (through December 31, 1997) and requested permission to relocate the hatchery to Turners Falls where the permitting issues would enable the company to deliver the final batch of fingerlings in the limited amount of time remaining.

As NMFS sought to gather more information, grant funding was suspended from December 1995 through June, 1996 — a critical month period in which little progress was achievable. In addition, the 12 month delay between AquaFuture's request for the no-cost extension and NMFS approval represented over 1/3rd of the project time-frame — a factor which introduced significant uncertainty and hindered the efforts of all project participants. AquaFuture's April-May, 1997 report states:

"There was relatively little progress to report on during the April-May timeframe. This was principally due to the fact that NMFS funding was suspended from December, 1996 through July 1997, leaving the co-investigators with no new funding for equipment purchase or installation. This situation was compounded by general uncertainty concerning the current and future status of the project related to the expiration of the original project."

Finding 2(c): It is apparent that AquaFuture's inability to construct the hatchery was caused by the Company's failure to diligently pursue permits. AquaFuture officials presumably did the to justify changing the hatchery location to the Turners Falls facility.

Response: After NMFS denied AquaFuture's request to relocate the hatchery in June 1997, the company reinvigorated its efforts to complete the permitting for the Quonset Point facility. Harry Gaines, AquaFuture's Engineer, developed a 31 section report containing over 300 pages to respond to the Inspector requirements relating to the conditions at the coastal site. When the engineering report was completed in July 1997, it became clear that cost to address the State Building and Fire requirements would add more than \$100,000 to the project — making the already tight budget non-viable. In light of the limited time and funds available to complete the project, AquaFuture's Principal, Joshua Goldman, initiated a series of discussions with Harold Mears, Chief of the Programs Division for NMFS Northeast Region. In these discussions, Goldman requested Mears input on managing the project deliverables in lieu of NMFS denial of the change in hatchery location.

During these discussions, which occurred on June 3rd and July 14, 1997, Mears suggested that the hatchery and the third batch of fingerlings be eliminated from the project workplan. Goldman accepted this suggestion. By this point, the \$155,818 of hatchery related funds had been expended in connection to GBA and in preparation for the development at Quonset Point. Goldman informed Mears that AquaFuture would like to pursue the hatchery in Turners Falls out of a sense of obligation to the subcontractors and the desire to advance the emerging founder industry. While there was no way to directly recover these funds within the available budget and timeframe, Goldman stated that AquaFuture was considering pursuing the Hatchery outside of the context of the grant and would not require or use any Federal grant funds for hatchery activities on its site. Mears did not object to or otherwise advise against AquaFuture's stated intentions (See section 5). AquaFuture's understanding of the arrangement was confirmed in a letter to Jean West dated August 8, 1997 and was reiterated in the project's final report.

Because of timing of the approval of the no-cost extension and the denial of AquaFuture's request to move the hatchery to Turners Falls, it is no longer possible to produce or deliver the third batch of fingerlings within the project timeframe. This conclusion was arrived at after several discussions with Harry Mears. After the conclusion of the project, AquaFuture anticipates working to secure additional fingerlings for the co-investigators, but as previously communicated, no guarantee can be made with respect to this delivery.

It is apparent that AquaFuture misunderstood the requirement that no project funds (i.e. non-Federal) be used for hatchery activities at Turners Falls. However, it is unreasonable to disallow hatchery related spending when the vast majority of the activity occurred in accordance with approved budget prior to any intent or request by AquaFuture or notification by NOAA of the denial of the location change. AquaFuture clearly should have submitted a revised budget reflecting the smaller non-federal share which could logically have been developed from the revised workplan which resulted from discussions with H. Mears. Ironically, AquaFuture actually increased its non-Federal share of the budget in the Amendment to Financial Assistance Award, dated June 3, 1996 to provide additional funds to purchase additional fingerlings and pursue the Turners Falls.

AquaFuture had the opportunity to modify the budget in accepting the Amendment to Financial Assistance Award and should have done so. AquaFuture's reluctance to submit a revised budget stemmed from fear that further delays in NOAA's response would cause serious financial harm to the fisherman subcontractors and negatively impact the ability to complete the project. In no way did AquaFuture seek to conceal its hatchery activities at Turners Falls, since it had already told the Senior program manager (H. Mears) of its intentions. Further, AquaFuture submitted financial and progress reports every two months which clearly showed non-federal funds being allocated against the outstanding balance in various hatchery related budget categories as did the project's Final Report. Again, there was no comment from the financial or program officers regarding what AquaFuture had discussed with them and understood to be an approved arrangement to meet the project objectives in the very limited time remaining.

Finding 2: AquaFuture failed to produce any flounder juveniles and instead purchased 60,000 juveniles to provide the grow out farms (half the projects required number).

Response: Under the original project workplan, the two grow-out subcontractors each would each have received 60,000 fingerlings during the 18-month grant period. These fingerlings were to be produced by GBA, a subcontractor to AquaFuture, in their to-be-constructed hatchery in Newington, NH. On September 1, 1995, AquaFuture requested a change in the relationship between AquaFuture and GBA. In explaining the requested change to NOAA, AquaFuture was asked to address the impact of the change on fishing Communities, responding:

"The targeted impact to fishers and fishing communities was through the fisher operated grow-out sites. This aspect of the project remains unchanged."

NOAA approved the requested change in relationship with GBA on November 24, 1995 indicating acceptance of AquaFuture's stated rationale regarding the modification's impact on target fishing communities.

On June 14, 1996, as GBA's hatchery was becoming operational, AquaFuture informed NOAA that it would purchase 20,000 fingerlings from GBA to ensure that the subcontractors had adequate fingerlings to begin the grow-out trial. This information was reiterated in a written communication to NOAA on December 23, 1996. On February 7, 1997 at a meeting of the project participants at NOAA's offices in Gloucester MA, AquaFuture agreed to increase the number of fingerlings to be purchased to 60,000 in order to increase the subcontractors supply to a level adequate to start-up their businesses. This request was formally approved by NOAA on June 3, 1997.

According to the project workplan, the 60,000 fingerlings to be supplied to each grow-out facility would fill 100% of their facilities expected capacity, forcing the subcontractors to immediately commit additional capital to expand their operations while they were still in very early stages of learning to operate. As the implications of this ambitious 60,000 fish/system target were becoming apparent, it was clear that the two year production cycle for summer flounder prior to the commencement of sales would require a commitment of post-grant capital that subjected the subcontractors to a high level of financial risk. AquaFuture's role in supplying aquaculture technical and business expertise to the project participants required us to advise that we felt that the operating risks were too great under this scenario. Specifically, pushing a biological system to 100% of design capacity too early creates an unacceptable risk. For these reasons, AquaFuture strongly suggested to NMFS and the subcontractors that a more gradual development scenario using a smaller number of fingerlings be adopted. This revised approach was approved verbally by Harry Mears on July 14, 1997 and confirmed in writing on August 8, 1997 and as part of an Extension to the Fingerling Supply Agreement which was executed by AquaFuture, GBA, V&G and Trio between 12/3 and 12/15, 1997.

Given the experimental nature of the project, Section 8 of the grant proposal lists: "Number of juveniles produced — variance from target" and "Number of Juveniles Reared by Demonstration Grow-out Farms" among the projects

evaluation criteria. Our inclusion of these factors as evaluation criteria reflects our anticipation of that there could be significant variance in the achievement of these targets. As a demonstration project seeking the first ever scale-up of an emerging biological technology, it was always clear to the NOAA program managers and the project participants that it was not possible to guarantee a set number of fingerlings be supplied.

Finding 3: AquaFuture did not engage any independent auditors either before or after receiving the grant award (per OMB circular A-133).

Response: The requirement to obtain an independent audit per OMB circular A-133 was not part of the original conditions of the Award. This requirement was added to the proposed Amendment to the Financial Assistance Award which became active August 1, 1997. The Inspector General Audit took place within one year of this date, fulfilling the projects audit requirement.

Finding 4: AquaFuture failed to maintain an adequate financial management system.

Response: Management disagrees with the finding and suggests that adequate support is available to support the costs claimed. The following section details our response to the findings presented in the audit reference notes. Supporting documentation is provided in the appendix and is referenced under each response.

Finding 4(a): Personnel; \$261,170 in salaries and fringes is questioned because;

A. \$227,352; AquaFuture didn't provide sufficient information to determine cost allowabilty and allocability

Response: In this submission we have supplied (i) payroll records by employee, (ii) employee activity sheets summarizing the role, time commitment and accomplishment of each project employee, and (iii) samples of work performed to support the effort and accomplishment of each project employee. Time sheets to record hours were not used because the professional nature of the responsibilities and the fact that all project employees were salaried. Two employees (Gund & Baker) were hired specifically for the project and 100% of their time was devoted to project activities. Employee agreements have been supplied for these individuals. The enclosed document support the allowance of the cost for personnel. See Appendix A- F.

B. \$33,818; The amount exceeds the approved budget line

Response: The budget guidelines provides for a 10% change between line item without approval. This amount is within the allowable percentage.

Finding 4(b): Sub recipient; \$173,275 in subrecipients cost for V&G Seafarms is questioned because the company didn't provide sufficient information to determine cost allowability and allocability.

Response: Cost is supported by documents and or invoices provided by V&G and reviewed by AquaFuture. Management visited the subrecipient's site and assisted in the work at least twice per month throughout the project, thereby

giving us the opportunity to verify the activity related to the personnel time and all other costs submitted. The VG site at Quonset Point presently is fully operational giving sound physical evidence of the project cost's incurred. The sub recipient being a fisherman, organized the business as a proprietorship and ran the operation as a one to two man operation with little clerical support. The enclosed documents provides the support for the cost. See Section 6.

Finding 4(c): Other \$86,406 of other cost is questioned because;

A. \$32,576; Facility maintenance costs were for the AquaFuture's hatchery which NOAA prohibited.

Response: The funds were disbursed prior to NOAA's June 1997 notification. See Budget Comparison in Section 7.

B: \$52,290; AquaFuture didn't provide sufficient information to determine cost allowability and allocability.

Finding 4(d): lease cost; \$14,000 because AquaFuture did not have lease at Quonset Point property. See Section 8.

Response: This category was revised to reflect lease/site development activities. The fund were paid to Morton Builders as a down payment on the facility which was needed to receive stamped engineering drawings which were then submitted to various agencies in connection with the permitting of the Quonset Point hatchery facility.

Finding 4(e): Electricity; \$3,895 because AquaFuture did not maintain adequate documentation support.

Response: See section 8 for documentation.

Finding 4(f): final cost; \$22,147 because AquaFuture did not maintain adequate documentation support.

Response: See section 8 for documentation.

Finding 4(g): total cost claimed; \$12,147 in because AquaFuture didn't identify the costs to a specific approved budget item .

Response: Closeout costs relate to personeal; see section A - F.

Finding 4(h): Consulting; \$2,000 questioned because AquaFuture did not maintain adequate documentation support.

Response: See Section 8.

Finding 4(i): Travel; \$1,393 questioned because AquaFuture did not maintain adequate documentation support

Response: See Section 8.

Finding 4(j): Equipment; \$148,18 questioned for AquaFuture's hatchery which NOAA prohibited.

Response: As described above, these funds) were used for activities occurring before NOAA's June 1997 notification to AquaFuture of the denial of the location change. No Federal funds were used for hatchery expenses a between June and December 1997, after the hatchery objective was drooped from the project workplan.

Finding 4(k): Supplies; \$9,236 questioned for AquaFuture's hatchery which NOAA prohibited.

Response: The funds were disbursed prior to NOAA's June 1997 notification. See Budget Comparison in Section 7.

Finding 4(l): Environmental; \$1,540 questioned for AquaFuture's hatchery which NOAA prohibited.

Response: The funds were disbursed prior to NOAA's June 1997 notification. See Budget Comparison in Section 7.

To: Robert Hoy@OCAD@OIG
From: Jennifer Bryan@COUNSEL@OIG
Cc: Annie Holmes@OA@OIG, Jessica Rickenbach@IG@OIG, Kevin
OMalley@OCAD@OIG
Subject: Public Release-Redacted Report
Attachment:
Date: 7/27/1999 3:35 PM

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**Jennifer Bryan
U.S. Department of Commerce
Office of Inspector General**