



OFFICE OF INSPECTOR GENERAL

*Catalyst for Improving the Environment*

## **Audit Report**

# **Association of Metropolitan Sewerage Agencies - Costs Claimed Under EPA Cooperative Agreements X827577-01, X828302-01, and X829595-01**

**Report Number 2004-4-00038**

**August 31, 2004**

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

**Report Contributors:**

Keith Reichard  
Stephanie Oglesby

**Abbreviations**

CFR	Code of Federal Regulations
EPA	Environmental Protection Agency
OIG	Office of Inspector General
OMB	Office of Management and Budget
Recipient	Association of Metropolitan Sewerage Agencies



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

OFFICE OF  
INSPECTOR GENERAL

August 31, 2004

**MEMORANDUM**

SUBJECT: Report No. 2004-4-00038  
Association of Metropolitan Sewerage Agencies - Costs Claimed Under EPA  
Cooperative Agreements X827577-01, X828302-01, and X829595-01

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

TO: Richard Kuhlman  
Director, Grants Administration Division

We have examined the outlays reported by the Association of Metropolitan Sewerage Agencies (recipient) under cooperative agreements X827577-01, X828302-01, and X829595-01 with the Environmental Protection Agency (EPA). The cooperative agreements were authorized under Section 104 of the Clean Water Act.

We have questioned \$681,413 of unallowable reported outlays because the recipient could not demonstrate that it performed a sufficient analysis for the procurement of contractual services, as required under Title 40 CFR 30.45.

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

On April 26, 2004, we issued a draft report to the recipient for comment, and received comments on June 9, 2004. The recipient also submitted additional supporting documentation on June 28, 2004. As a result of the recipient's response and the additional documentation provided, all questioned outlays were resolved except for the questioned contractual outlays under cooperative agreement X829595-01. In addition, we modified the *Report of Non-Compliance*.

We have included a portion of the recipient's response to the draft report in Appendix B (we did not include the recipient's attachments or additional documentation but they are available upon

request). The response is also summarized after each finding with our comments. Because the final report was revised, some comments in the recipient's response pertain to issues that are no longer in the report.

### **Action Required**

In accordance with EPA Manual 2750, the action official is required to provide this office with a proposed management decision specifying the Agency's position on all findings and recommendations in this report. Separate recommendations are included in the *Independent Auditor's Report - Cooperative Agreement No. X829595-01* and the *Report of Non-Compliance*. The draft management decision is due within 120 days of the date of this transmittal memorandum.

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

Attachment

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## Summary Results of Audit

The Association of Metropolitan Sewerage Agencies' (recipient) financial management and procurement systems need to be improved to fully comply with the requirements of Title 40 Code of Federal Regulations (CFR) Part 30 and Office of Management and Budget (OMB) Circular A-122.

The recipient needs to: (1) prepare written accounting procedures to identify and allocate direct and indirect costs to projects, (2) ensure cash draws are limited to the actual and immediate need, (3) perform acceptable cost or pricing analyses for all procurement actions, (4) incorporate required contract provisions into all contracts, (5) submit financial and performance reports as required by regulation, and (6) submit an acceptable indirect cost proposal.

We questioned unallowable contract costs of \$681,413 because the recipient did not perform an adequate analysis to support that the price paid was reasonable. The questioned outlay is summarized below and detailed in the Independent Auditor's Reports.

Cooperative Agreement No.	Reported Outlays	Questioned Outlays	Report Page
X827577-01	\$107,067	\$0	5
X828302-01	\$293,416	\$0	7
X829595-01	\$759,033	\$681,413	9
Totals	\$1,159,516	\$681,413	





## Background

EPA awarded three cooperative agreements (agreements) to the Association of Metropolitan Sewerage Agencies (recipient) under Section 104 of the Clean Water Act. The following table provides some basic information about the authorized project period and the funds awarded under each of the agreements.

Cooperative Agreement No.	Award Date	EPA Share	Recipient Share	Total Awarded	Project Period
X827577-01	08/19/99	\$115,000*	\$0	\$115,000	09/01/99 - 01/02/02
X828302-01	08/09/00	\$300,000*	\$0	\$300,000	09/01/00 - 08/31/03
X829595-01	02/07/02	\$1,110,000	\$35,717**	\$1,145,717	11/30/01 - 09/30/06

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

\*\* The cooperative agreement included a 3-percent match from the recipient. Thus, the recipient's share should have been \$34,372 instead of \$35,717.

Cooperative Agreement No. X827577-01: This agreement was for the recipient to measure the effectiveness of using publicly owned treatment works' source control and pollution prevention programs to achieve compliance with anticipated mercury water quality standards and permit limits.

Cooperative Agreement No. X828302-01: This agreement was for the recipient to assist water and wastewater utilities in implementing asset management programs. The project involves the development and presentation of an industry best management practices handbook and associated checklist, training materials, and workshops. The purpose for the project was to develop a framework under which water and wastewater utilities can respond effectively to the sweeping changes found in the Governmental Accounting Standards Board Statement 34.

Cooperative Agreement No. X829595-01: This agreement was for the recipient to develop a vulnerability assessment tool for municipal wastewater treatment facilities. The tool would assist the wastewater treatment plant operators in assessing the vulnerability of their collection system and treatment facility and in determining what safeguards need to be implemented in order to protect the facilities from potential terrorist attacks. The tools developed under this project would be transferable to other municipal and private wastewater facilities.

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

**Reported Outlays:** Program expenses or disbursements identified by the recipient on the *Financial Status Report* (Standard Form 269) or the *Federal Cash Transactions Reports* (Standard Form 272A).

**Unallowable Costs:**

Outlays that are: (1) contrary to a provision of a law, regulation, agreement, or other documents governing the expenditure of funds; (2) not supported by adequate documentation; or (3) not approved by a responsible agency official.

## Independent Auditor's Report Cooperative Agreement No. X827577-01

We have examined the total outlays reported by the Association of Metropolitan Sewerage Agencies (recipient) under the EPA cooperative agreement, as shown below:

Cooperative Agreement No.	Financial Status Report		
	Date Submitted	Period Ending	Federal Share of Outlays Reported
X827577-01	5/30/02	1/2/02	\$107,067

The recipient certified that the outlays reported on the *Financial Status Report*, Standard Form 269A, were correct and for the purposes set forth in the agreement. Our responsibility was to express an opinion on the reported outlays based on our examination.

Our examination was conducted in accordance with the *Government Auditing Standards*, issued by the Comptroller General of the United States, and the attestation standards established for the United States by the American Institute of Certified Public Accountants. We examined, on a test basis, evidence supporting the reported outlays, and performed such other procedures as we considered necessary in the circumstances (see Appendix A for details). We believe that our examination provides a reasonable basis for our opinion.

In our opinion, the reported outlays on the *Financial Status Report* present fairly, in all material respects, the allowable outlays incurred in accordance with the criteria set forth in the agreements.

*Keith Reichard*  
Keith Reichard  
Assignment Manager  
Field Work End: February 27, 2004



## Independent Auditor's Report Cooperative Agreement No. X828302-01

We have examined the total outlays reported by the Association of Metropolitan Sewerage Agencies (recipient) under the EPA cooperative agreement (agreement), as shown below:

Cooperative Agreement No.	Financial Status Report		
	Date Submitted	Period Ending	Federal Share of Outlays Reported
X828302-01	11/12/03	8/31/03	\$293,416

The recipient certified that the outlays reported on the final *Financial Status Report*, Standard Form 269A, were correct and for the purposes set forth in the agreement. The preparation and certification of each report was the responsibility of the recipient. Our responsibility was to express an opinion on the reported outlays based on our examination.

Our examination was conducted in accordance with the *Government Auditing Standards*, issued by the Comptroller General of the United States, and the attestation standards established for the United States by the American Institute of Certified Public Accountants. We examined, on a test basis, evidence supporting the reported outlays, and performed such other procedures as we considered necessary in the circumstances (see Appendix A for details). We believe that our examination provides a reasonable basis for our opinion.

In our opinion, the reported outlays on the final *Financial Status Report* present fairly, in all material respects, the allowable outlays incurred in accordance with the criteria set forth in the agreements.

*Keith Reichard*  
Keith Reichard  
Assignment Manager  
Field Work End: February 27, 2004



## Independent Auditor's Report Cooperative Agreement No. X829595-01

We have examined the total outlays reported by the Association of Metropolitan Sewerage Agencies (recipient) under the EPA cooperative agreement, as shown below:

Cooperative Agreement No.	Federal Cash Transactions Reports		
	Date Submitted	Period Ending	Federal Share of Outlays Reported
X829595-01	7/22/02	6/30/02	\$184,396
	8/11/03	12/31/02	\$301,701
	8/11/03	6/30/03	\$272,936
<b>Total</b>			<b>\$759,033</b>

The recipient certified that the outlays reported on the *Federal Cash Transactions Reports*, Standard Form 272A, were correct and for the purposes set forth in the agreement. Our responsibility was to express an opinion on the reported outlays based on our examination.

Our examination was conducted in accordance with the *Government Auditing Standards*, issued by the Comptroller General of the United States, and the attestation standards established for the United States by the American Institute of Certified Public Accountants. We examined, on a test basis, evidence supporting the reported outlays, and performed such other procedures as we considered necessary in the circumstances (see Appendix A for details). We believe that our examination provides a reasonable basis for our opinion.

As discussed in the *Report of Non-Compliance*, the recipient did not fully comply with Federal requirements when procuring contractual services. As a result, we questioned unallowable reported outlays of \$681,413.

In our opinion, because of the effects of the matters discussed in the preceding paragraph, the reported outlays on the *Federal Cash Transactions Reports* do not present fairly, in all material respects, the allowable outlays incurred in accordance with the terms and conditions of the agreements and applicable EPA regulations. Details of our audit are included in the *Schedule of Reported Outlays and Results of Audit for Cooperative Agreement X829595-01* that follows.

*Keith Reichard*  
Keith Reichard  
Assignment Manager  
Field Work End: February 27, 2004

**Schedule of Reported Outlays and Results of Audit for  
Cooperative Agreement X829595-01 Awarded to the  
Association of Metropolitan Sewerage Agencies**

Cost Element	Reported Outlays	Questioned Outlays	Note
Personnel	\$34,136	\$0	
Travel	\$102	\$0	
Supplies	\$18,984	\$0	
Contractual	\$681,413	\$681,413	1
Other	\$24,398	\$0	
<b>Total</b>	<b>\$759,033</b>	<b>\$681,413</b>	<b>2</b>

Note 1: We questioned contract costs of \$681,413 because the recipient’s price analysis for this sole source contract was not sufficient to show that the contract costs paid were reasonable and allowable. Title 40 CFR 30.45 states:

*Some form of cost or price analysis shall be made and documented ... with every procurement action. Price analysis may be accomplished in various ways, including the comparison of price quotations submitted, market prices and other indicia, together with discounts. Cost analysis is the review and evaluation of each element of cost to determine reasonableness, allocability and allowability.*

The recipient compared the labor rates for PA Consulting with rates from similar consulting firms and concluded that the rates were reasonable. This analysis is both flawed and contrary to the requirements in the regulations for price analysis.

The recipient awarded the contract to PA Consulting without competition. None of the firms used for the comparison submitted price quotations. Therefore, it was not possible to compare price quotations. Further, the sole source justification stated that PA Consulting had unique experience and capabilities. It would be inconsistent to compare the PA Consulting’s rates to consultants that did not have similar experience and capabilities. Also, there was no evidence provided that the prices used for comparison were “market prices”<sup>1</sup>. Finally, the contract was a firm

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<sup>1</sup>EPA does not define “market prices” in 40 CFR Part 30. However, the Government defines “market prices” at 48 CFR 2.101(b) as current prices that are established in the course of ordinary trade between buyers and sellers free to bargain and that can be substantiated through competition or from sources independent of the offerors.



fixed price contract, not a labor hour type of contract. Reviewing labor rates without examining the quantity of hours proposed for each labor category would not give the total price needed for comparison purposes. In addition, the individual labor rates for PA Consulting were generally higher than the comparative rates shown for the other consultants. Without including the quantity of hours, the analysis is meaningless. According to recent EPA guidance, *Purchasing Supplies, Equipment, and Services Under EPA Grants* (available on the EPA website), noncompetitive proposals require cost reviews.

Note 2: The cooperative agreement required a 3-percent cost share. Since the recipient is not required to identify its 3-percent cost share on the *Federal Cash Transaction Reports*, the total reported is only the Federal share. In response to the draft report the recipient provided documentation to support in-kind matching costs exceeding the required match of \$23,475 [(\$759,033 ÷ 97%) - \$759,033].

### **Recipient's Comments**

For cooperative agreement X829595-01, the recipient also said that it performed an informal price analysis, and a detailed review of the contract's proposed contract costs to ensure that the costs were allocable and allowable. Based on the price/cost analysis the recipient believes that the contractor's proposed costs were reasonable.

### **Auditor's Response**

As stated in the finding, the price analysis performed was not sufficient to meet the requirement of Federal rules and did not support that the contract price was reasonable.

### **Recommendation Number 1**

We recommend that EPA recover the questioned Federal share of \$681,413.



## **Report of Non-Compliance (Association of Metropolitan Sewerage Agencies)**

In order to comply with the provisions of Title 40 CFR Part 30, the Association of Metropolitan Sewerage Agencies (recipient) needs to: (1) prepare written accounting procedures to identify and allocate direct and indirect costs to projects, (2) ensure cash draws are limited to the actual and immediate need, (3) perform acceptable cost or pricing analyses for all procurement actions, (4) incorporate required contract provisions into all contracts, (5) submit financial and performance reports as required by regulation, and (6) submit an acceptable indirect cost proposal.

### **Incomplete Written Accounting Procedures**

As required by Title 40 CFR 30.21, the recipient needs to draft written procedures for identifying direct and indirect costs, and the basis for allocating such costs to projects. These procedures would provide a consistent basis for the treatment of direct and indirect costs and serve as the basis for preparing an indirect cost proposal. The recipient also needs to develop written procedures to minimize the time elapsing between the transfer of funds to the recipient and the redemption of payment. The lack of written procedures contributed to the recipient drawing EPA funds in advance of actual cash needs as discussed below.

### **Recipient's Comments**

The recipient's Controller told us that procedures for identifying direct and indirect costs was being drafted and would be submitted to EPA along with the indirect cost proposal. The written procedure for drawing grant funds has already been completed.

### **Auditor's Response**

Except for the written procedures for identifying direct and indirect costs, the recipient has developed written accounting procedures that comply with the provisions of Title 40 CFR 30.21.

### **Recommendation Number 2**

We recommend that EPA ensure the recipient's indirect cost rate proposal includes information for identifying direct and indirect costs, and an explanation of how these costs are accounted for in the accounting system.

## **Inappropriate Cash Draws**

Contrary to Title 40 CFR 30.22 (b), the recipient withdrew EPA funds in advance of the actual cash needed. This practice occurred because the recipient lacked written procedures to minimize the time elapsing between the transfer of Federal funds and the redemption of payment. Drawing funds in excess of need could result in an Federal overpayment.

We reviewed 18 cash draws paid by EPA and found that the recipient did not disburse funds timely for 15 of those cash draws. The recipient generally disbursed funds anywhere from 9 to 43 days after the Federal funds were received. To comply with Federal regulations, the recipient needs to minimize the time elapsing between the draws and expenditure of the Federal funds.

## **Recipient's Comments**

The recipient has prepared written procedures to draw EPA funds on a reimbursement basis only. Request for reimbursement will be made on a monthly basis no later than 30 days after the end of the month. This will ensure that there are no excessive draws or overpayments made by the Federal government.

## **Auditor's Response**

If followed, the recipient's new procedures will eliminate the problem of drawing grant funds in excess of the actual cash needed.

## **Lack of Cost or Price Analysis**

The recipient's price analysis for a sole source contract was not sufficient to show that the contract costs paid were reasonable and allowable, as required by Title 40 CFR 30.45. Failure to fully comply with this regulation can result in excessive contract costs, and the disallowance of the costs under Federal agreements.

Refer to Note 1 - Schedule of Reported Outlays and Results of Audit for Cooperative Agreement X829595-01 on pages 10 and 11 for additional detail, the recipient's comments, and our recommendations.

## **Incomplete Contract Provisions**

The recipient did not ensure all contracts awarded under the cooperative agreements contained the required contract provisions cited in Title 40 CFR 30.48. For instance, none of the contracts awarded included the provisions of Title 40 CFR 30.48(d), which provides that the recipient, EPA, and the Comptroller General of the United States shall have access to any books, documents, papers, and records of the contractor that are directly pertinent to a specific program. The regulation also states that all contracts shall

contain the procurement provisions of OMB Circular A-110, Appendix A, as applicable. Further, none of the contracts we reviewed contained the (1) Equal Employment Opportunity provision; (2) Byrd Anti-Lobbying Amendment provision; and (3) Debarment and Suspension provision cited in the regulation. The recipient needs to amend the existing contracts to insert the required contract provisions, and include these required provisions when awarding any new contracts.

### **Recipient's Comments**

The recipient agreed with this finding. The contract under cooperative agreement X829595-01 is still active and has a contract addendum that amended the contract agreement to include all of the necessary contract provisions. In addition, the recipient has documented its procurement procedures in accordance with Federal requirements, and these procedures provide for the inclusion of the provisions.

### **Auditor's Response**

The recipient provided us the amended contract agreement under cooperative agreement X829595-01. The contract still did not contain all the required contract provisions specified in Title 40 CFR 30.48 and Appendix to Part 30.

### **Recommendation Number 3**

We recommend that EPA require the recipient to include in all new contracts the provisions required by Title 40 CFR 30.48 and the Appendix to Title 40 CFR Part 30, and amend its existing contract under cooperative agreement X829595-01 to include all the required contract provisions, including:

- a. Conditions that allow for administrative, contractual, or legal remedies in instances in which a contractor violates or breaches the contract terms, and provide for such remedial actions as may be appropriate.
- b. Termination by the recipient, including the manner by which termination shall be effected and the basis for settlement. In addition, such contracts shall describe conditions under which the contract may be terminated for default as well as conditions where the contract may be terminated because of circumstances beyond the control of the contractor.
- c. Conditions to comply with all applicable standards, orders, or regulations issued pursuant to the Clean Air Act and the Federal Water Pollution Control Act.
- d. Conditions to comply with the Equal Employment Opportunity provisions.

## **Untimely Financial Reports**

For cooperative agreement X829595-01, the recipient did not submit any of its Report of Federal Cash Transactions (SF-272) within 15 calendar-days as required by Title 40 CFR 30.52. The SF-272 forms were submitted anywhere from 7 to 208 days late. As a result, EPA may not have sufficient information to make an informed assessment of whether the unexpended funds were adequate to complete all work.

### **Recipient's Comments**

In a July 26, 2004 discussion with the recipient, the recipient agreed that the financial reports were not always submitted timely, and will begin submitting timely financial reports for periods beginning in June 2004.

### **Recommendation Number 4**

We recommend that EPA ensure that the recipient submit financial reports timely and in accordance with EPA regulations. Should the recipient fail to submit timely financial reports, we recommend that EPA take action, including suspending payment under the agreements, until the financial reports are received.

## **Lack of Performance Reports**

The recipient did not submit all the required performance reports specified by the cooperative agreements. All three cooperative agreements required the recipient to submit quarterly performance reports. During the period covered by our audit, cooperative agreement X827577-01 required the recipient to submit nine performance reports, yet none were prepared. Under cooperative agreement X828302-01, the recipient was required to submit 11 performance reports, and 3 were provided to EPA. Finally, cooperative agreement X829595-01 required the recipient to submit six performance reports, and only two were provided to EPA. As illustrated, the recipient had only submitted 5 of the required 26 performance reports. Consequently, EPA may not have sufficient information to make an assessment of the recipient's performance in meeting the agreements' objectives, or determine whether the unexpended funds were adequate to complete all work required under the three cooperative agreements.

### **Recipient's Comments**

In a July 26, 2004, discussion with the recipient, the recipient stated that although formal performance reports were not always submitted, the EPA project officers were always provided timely information on the project via e-mail and telephone. Formal project reports meeting Federal requirements would be provided in the future.

## **Auditor's Response**

E-mail and telephone discussions do not meet the regulatory requirements for performance reports. Written performance reports require specific information and provide a permanent record of grant performance. Title 40 CFR 30.51 states that performance reports shall contain brief information on each of the following: (1) a comparison of actual accomplishments with the goals and objectives established for the period; (2) reasons why established goals were not met, if appropriate; and (3) other pertinent information, including analysis and explanation of cost overruns or high unit costs. A permanent record of this type of information ensures continuity in the event that the project officer is reassigned, retires, or leaves the Federal government. Informal information, such as e-mails and telephone conversations, may not cover all the necessary topics required by regulation and could easily be lost. The information required in performance reports may be needed to satisfy questions by senior EPA managers, Congress, or the public.

## **Recommendation Number 5**

We recommend that EPA require the recipient to submit performance reports for any current grant or cooperative agreement in accordance with EPA regulations and the terms and conditions of the award. Should the recipient fail to submit timely performance reports, we recommend that EPA take action, including suspending payment under the agreements, until the reports are received.

## **Unsupported Indirect Cost Rates**

EPA authorized indirect costs of \$20,433 under amendment number 3 to cooperative agreement X829595-01. Although authorized, the recipient has not submitted the required indirect cost rate proposal to EPA, and has not reported any outlays for indirect costs as of August 11, 2003.

In response to the draft report, the recipient provided the OIG a copy of an indirect cost proposal that it planned to submit to EPA no later than June 30, 2004. The proposal was based on 2003 audited costs. However, according to the recipient, the proposed indirect administrative labor costs included in the proposal were based on a conservative estimate of how much time each person spent on indirect activities. The actual indirect administrative labor costs could not be determined because employees did not identify indirect administrative time on their time sheets until May 2004. Consequently, prior to May 2004, the recipient's labor distribution system was not adequately structured to enable the recipient to develop an acceptable indirect cost rate proposal. The proposed indirect labor costs did not comply with the provisions of OMB Circular A-122, Attachment B, paragraph 7(m)(1), which requires the distribution of salaries and wages to awards be supported by personnel activity reports.

## **Recipient's Comments and Auditor's Response**

This finding has been revised based the recipient's comments to the draft report.

### **Recommendation Number 6**

We recommend that EPA rescind amendment 3 to cooperative agreement X829595-01, and not allow any indirect costs until the recipient can develop an acceptable indirect cost rate proposal based on actual labor costs instead of estimated costs.



## ***Scope and Methodology***

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

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

1. Is the recipient’s accounting system adequate to account for cooperative agreement funds in accordance with 40 CFR 30.21?
2. Does the recipient maintain an adequate labor distribution system that conforms to requirements of OMB Circular A-122?
3. Is the recipient properly drawing down cooperative agreement funds in accordance with the Cash Management Improvement Act?
4. Do the recipient’s procurement procedures for contractual services comply with 40 CFR 30.40 to 30.48?
5. Is the recipient complying with its reporting requirements under 40 CFR 30.51 and 30.52?
6. Are the costs reported under the cooperative agreements adequately supported and eligible for reimbursement under the terms and conditions of the cooperative agreements, OMB Circular A-122, and applicable regulations?
7. Did the recipient implement corrective actions in response to issues identified during a previous on-site review? If so, were they effective?

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

We reviewed management's internal controls and procedures specifically related to our objectives. Our examination included reviewing the recipient's compliance with OMB Circular A-122, 40 CFR Part 30, and the terms and conditions of the agreements. We also examined the reported costs on a test basis to determine whether the costs were adequately supported and eligible for reimbursement under the terms and conditions of the agreements and Federal regulations. We conducted our field work from October 7, 2003, through February 27, 2004.

After gaining an understanding of the recipient's financial management system, we reconciled the reported costs for each cooperative agreement with the recipient's general ledger. For all other direct costs reported under each cooperative agreement, we tested transactions on a judgmental basis.

*President*  
William B. Schatz  
General Counsel  
Northeast Ohio Regional  
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Cleveland, OH

*Vice President*  
Donnie R. Wheeler  
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Hampton Roads Sanitation  
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Dick Champion, Jr.  
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City of Los Angeles  
Department of Public Works  
Los Angeles, CA

*Executive Director*  
Ken Kirk

June 9, 2004

Via Electronic Mail and Overnight Fedex

Keith Reichard  
Stephanie Oglesby  
EPA-OIG  
901 North Fifth Street  
Kansas City, KS 66101

RE: Draft Audit Report for Association of Metropolitan Sewerage Agencies –  
Costs Claimed Under EPA Cooperative Agreements X827577-01, X828302-01,  
and X829595-01

Dear Mr. Reichard and Ms. Oglesby:

Attached please find the Association of Metropolitan Sewerage Agencies (AMSA) response to the April 26, 2004 draft report prepared by the United States Environmental Protection Agency's Office of the Inspector General (OIG). *AMSA's Response to EPA Office of Inspector General (OIG) Draft Report* (attached) addresses the factual accuracy of the information in the OIG draft report.

I believe the attached documentation confirms that we have effectively responded to every item in the *Results of Audit, Recommendations, Independent Auditor's Report*, and *Report of Non-Compliance*. AMSA now has the procedures and systems in place to ensure our current and future compliance with all Federal regulations.

AMSA appreciates the opportunity to work collaboratively with the Federal Government on projects which are of critical importance to the clean water community. We are proud of the significant contributions we have made in executing each of the referenced agreements, and the important deliverables that have been produced.

June 9, 2004  
Page 2

I trust that the attached response will confirm AMSA's 100% compliance with every issue identified in the draft report. Should you have any questions, please do not hesitate to contact me.

Sincerely,

Ken Kirk  
Executive Director

Enclosure

ecc: Richard T. Kuhlman, EPA  
Curt Baranowski, EPA  
Betty Utterback, EPA  
Karen Bass, EPA  
Marguerite Pridgen, EPA  
Stephen Allbee, EPA  
Michael Mason, EPA  
Brian Frazer, EPA  
Michael A. Rickey, EPA

## Response to EPA Office of Inspector General (OIG) Draft Report

### Response to *Results of Audit/Report of Non-Compliance*:

**1. Inadequate Labor Distribution System: The recipient's financial management system was inadequate in that the recipient did not maintain an adequate labor distribution system required by OMB Circular A-122, and separate its personnel costs in the general ledger by project or grant.**

In January 2003, AMSA established a process that requires all employees to complete a personnel activity report/timesheet twice a month (the timesheet period coincides with AMSA's pay periods). The timesheet reflects the actual (after-the-fact) accounting of each employee's total activity for each pay period. Timesheets are signed consistent with the requirements of Circular A-122 and also account for total hours worked and leave taken. A copy of AMSA's timesheet is attached (see Attachment A, *AMSA Personnel Activity Report*). In February 2004, AMSA began separating out personnel costs in the general ledger by program (Grants, Technical Action Fund, etc.). Because timesheet procedures have been in place since January 2003, AMSA was able to go back to the beginning of fiscal year 2004 (October 2003) and do a journal entry to allocate personnel costs by program for the entire year. Currently, a journal entry is done monthly to record personnel costs in the general ledger based on the allocation of time to each program per the employee timesheets. This allows AMSA to properly record labor costs to cost objectives per the requirements of OMB Circular A-122, Attachment A, as required by 40 CFR 30.27 and to meet the requirements of an adequate financial management system per 40 CFR 30.21.

**2. Inadequate Accounting of Membership, Lobbying, and Public Outreach Activities: The recipient's financial management system was inadequate in that the recipient did not identify and accumulate the costs for all direct activities, such as membership support, lobbying, and public outreach required by Circular A-122.**

AMSA did identify and accumulate the costs for all direct activities as required by Circular A-122. At year end, AMSA allocated all costs as either Direct (AMSA Programs and Membership), or Administrative (indirect costs). Activities such as membership support, lobbying and public outreach were all classified as direct costs. This information is shown in AMSA's audited financial statements. AMSA's timesheet now includes additional programs to support the major functions of the organization (see Attachment A, *AMSA Personnel Activity Report*). These programs are: *Member Services* (includes all services and information to members such as member development and retention, marketing, maintenance of membership rolls, publications, web-site, and meetings and conferences); *Government Affairs* (includes all legislative and regulatory work and communications and public affairs); *Administrative* (includes accounting and building administration functions); *Grants* (each grant is listed separately – includes all project management activities); *Technical Action Fund (TAF) Projects* (includes all project management activities and lobbying costs); *Funding Task Force* (includes all project management activities); *Leadership Center* (includes all project management activities); *Water Infrastructure Network (WIN)* (includes all project management activities); and *National Biosolids Partnership* (includes all project management activities).

**3. Unsupported Indirect Cost Rates: The recipient's financial management system was inadequate in that the recipient did not prepare or submit indirect cost rate proposals required by OMB Circular A-122 and cooperative agreement X829595-01.**

AMSA's financial management structure is adequate to allow AMSA to develop an indirect cost rate proposal. AMSA's Controller has prepared an indirect cost rate proposal for the EPA. The indirect cost rate proposal summary page is attached (see Attachment B, *Indirect Cost Rate Proposal*). The documentation is being finalized and we anticipate that the proposal will be submitted to EPA no later than June 30, 2004. AMSA will notify the OIG when the indirect cost rate proposal is submitted to EPA.

AMSA prepared an indirect cost rate proposal based on the Simplified Allocation Method discussed in EPA's guide, *Preparing Indirect Cost Rate Proposals for Grants and Contracts*. Since AMSA's major functions benefit from its indirect costs to approximately the same degree, it was possible to calculate an indirect cost rate based on separating the organizations costs for the base period as either direct or indirect. As discussed in EPA's guide, AMSA allocated salaries between direct and indirect costs based on budgeted amounts. AMSA will begin requesting indirect costs from the EPA based on this new rate. We were advised by EPA that we should use this new rate upon submittal due to the extended period of time that may be required to review and act on indirect cost rate proposals. The new rate would result in additional indirect costs for cooperative agreement X829595-01, however, AMSA will only submit for reimbursement of indirect costs per the amount budgeted in the award.

**4. Inadequate Written Accounting Procedures: The recipient's financial management system was inadequate in that the recipient did not maintain adequate written accounting procedures required by 40 CFR 30.21.**

AMSA has documented its accounting procedures in accordance with Federal requirements (40 CFR 30.21) to ensure that all costs are recorded accurately and on a timely basis. Please see Attachment C, *Accounting Procedures for Federal Awards*. These procedures document AMSA's responsibility to determine if costs are reasonable, allocable and allowable and ensure that accounting records are supported by adequate source documentation. AMSA's Accounting Procedures discuss identification of direct and indirect costs and include procedures to minimize the time elapsing between the transfer of funds to AMSA and the redemption of payment. The accounting procedures also require AMSA to provide an accurate, current and complete disclosure of the financial results of each Federally sponsored program. AMSA currently prepares a grant summary monthly on each Federal award. The referenced accounting procedures will be provided to the AMSA Board of Directors for approval at their next meeting in July 2004.

**5. Inappropriate Cash Draws: The recipient's financial management system was inadequate in that the recipient did not draw down on funds based on immediate cash need.**

AMSA has documented the process for draw down of funds in the *Accounting Procedures for Federal Awards* (see Attachment C). These procedures comply with Federal regulations and will minimize the time elapsing between the transfer of funds to AMSA and the redemption of payment. AMSA will draw down funds on a reimbursement basis only. Request for reimbursement of federal funds will be made

on a monthly basis no later than 30 days after the end of the month. This will ensure that there are no excessive draws and no overpayments made by the Federal government to AMSA.

**6. Improper Procurement Practices including Undocumented or Insufficient Competition and Lack of Cost or Pricing Analysis: For cooperative agreements X827577-01 and X829595-01, the recipient did not demonstrate that it: (1) procured contractual services competitively in accordance with the requirements of 40 CFR 30.43 and 40 CFR 30.46 and (2) performed cost or price analyses for the procurement of contractual services as required under 40 CFR 30.45**

AMSA has documented its procurement procedures in accordance with Federal requirements (40 CFR 30.40 through 40 CFR 30.48) to ensure that every procurement action is conducted in a manner to provide, to the maximum extent practical, open and free competition. AMSA will also perform and document cost and price analysis on every procurement action. Please see Attachment D, *Procurement Standards for Federal Awards*. AMSA will maintain all documentation (per the requirements of 40 CFR 30.46) to support the basis for contractor selection and include the provisions required by 40 CFR 30.48 and the Appendix to 40 CFR Part 30 in every contract.

**Cooperative Agreement X827577-01:**

For cooperative agreement X827577-01, AMSA did procure contractual services competitively in accordance with the requirements of 40 CFR 30.43 and 40 CFR 30.46. Also, AMSA did perform cost or price analyses for the procurement of contractual services as required under 40 CFR 30.45. Please see Attachment E, *Mercury Grant Documentation (X827577-01)*, for a detailed listing of the procurement procedures followed. This documentation shows: 1) how the request for proposal was advertised; 2) how many proposals were received; 3) the ranking criteria for evaluating the proposals; 4) the basis for award cost or price; and 5) the basis for contractor selection. Some of the original documentation to support the data above can not be located. However, AMSA reconstructed information and the individuals involved, Mark Hoeke, Margie Nellor, and Guy Aydlett, will attest that the above procedures were followed. The below excerpt from the *Mercury Grant Documentation* outlines the procurement procedures followed:

*May 26, 2000<sup>1</sup> – AMSA distributes Request for Proposals via e-mail to more than 40 firms and requests that proposals be submitted by June 30, 2000.*

*June 29, 2000 – AMSA receives two proposals for the project. Larry Walker and Associates and the Illinois Waste Management and Research Center/Board of Trustees of the University of Illinois at Urbana-Champaign.*

*June 30, 2000 – July 10, 2000<sup>2</sup> – AMSA representatives including Mark Hoeke, AMSA, Margie Nellor, Los Angeles County Sanitation District, and Guy Aydlett, Hampton Roads Sanitation District reviewed and scored the two proposals according to an RFP Evaluation Sheet. While AMSA does not have all of the completed review sheets, based on completed review sheets obtained from Margie Nellor (included as part of attachment E) and verbal communication with Mark Hoeke and Guy Aydlett, Larry Walker and Associates (the selected contractor) presented*

<sup>1</sup> Email from Mark Hoeke, AMSA dated May 26, 2000 to 43 firms with copy to project committees.

<sup>2</sup> AMSA obtained copies of completed evaluation sheets from one of the proposal reviewers.

*a scope of work that was directly responsive to the RFP and demonstrated significant experience conducting similar projects. In comparison, the Illinois Waste Management and Research Center proposal provided no information on the expertise and experience of the principal investigator or other members of the project team. In addition, the proposed scope of work was limited to one treatment facility in Chicago and would not be representative of issues across the nation. For additional details, see attached, completed evaluation sheets (included as part of Attachment F). Please note that the evaluation sheets include a component evaluating the cost and budget of the project.*

*July 11, 2000 – AMSA notifies Betsy Elzufon of Larry Walker and Associates that they have been selected to conduct the work. Wm D. Morgan, University of Illinois is notified that the Illinois Waste Management and Research Center proposal was not selected due in large part to its limited scope.*

### **Cooperative Agreement X829595-01:**

For cooperative agreement X829595-01, due to the unique combination of industry knowledge and security/software experience required by the project tasks, AMSA awarded the contract on a sole-source basis. AMSA did perform cost or price analyses for the procurement of contractual services as required per 40 CFR 30.45. AMSA provided EPA with a sole source justification document (this document was given to Stephanie Oglesby by Paula Dannenfeldt during the OIG audit) explaining in detail why the contract was not competitively bid. AMSA has updated the sole-source justification document to include information on the cost-price analysis (see Attachment F, *Sole Source Justification for PA Consulting*). As noted, AMSA had previously informally prepared cost/price analysis but it was not included in the formal documentation sent to EPA. Please note that the contract that AMSA has with the contractor (PA Consulting Group) under this award is still active and AMSA has executed a contract addendum with PA Consulting Group amending the contract to include all of the necessary contract provisions as required under 40 CFR 30.48 (see Attachment G, *PA Consulting Group Amended Contract*). A copy of the fully executed contract was sent to Stephanie Oglesby via fedex to arrive on 6/10/04, see hardcopy Attachment 1, *PA Consulting Group Executed Contract*.

**7. Incomplete Contract Provisions: For cooperative agreements X827577-01, X828302-01, and X829595-01, the recipient did not ensure that all contracts were complete and contained the required contract provisions cited in 40 CFR 30.48.**

AMSA has documented its procurement procedures in accordance with Federal requirements (40 CFR 30.40 through 40 CFR 30.48). These procedures provide for the inclusion of the provisions required by 40 CFR 30.48 and the Appendix to 40 CFR Part 30 in every contract (see Attachment D, *Procurement Standards for Federal Awards*). The contracts AMSA had under cooperative agreements X827577-01 and X828302-01 did not contain all of the required contract provisions (please note that these cooperative agreements have concluded). The contract under X829595-01 is still active and as stated above, AMSA has executed a contract addendum with PA Consulting Group (the contractor under this award) amending the contract agreement to include all of the necessary contract provisions as required under 40 CFR 30.48 and the Appendix to Part 30 (see Attachment G, *PA Consulting Group Amended Contract*). As noted above, a copy of the fully executed contract was sent to Stephanie Oglesby via fedex to arrive on 6/10/04, see hardcopy Attachment 1.



**8. Reporting Requirements Not Met – Untimely Financial Reports: For cooperative agreements X827577-01, X828302-01, and X829595-01, the recipient did not comply with all reporting requirements of the cooperative agreements.**

AMSA has documented in its accounting procedures the Federal requirements per 40 CFR 30.52 to ensure that all reporting requirements are met. Please see Attachment C, *Accounting Procedures for Federal Awards*. These procedures document AMSA’s responsibility to file the Federal Cash Transactions report (SF-272) within 15 calendar days following the end of each reporting period. The procedures also require AMSA to file the final Financial Status Report (SF 269) no later than 90 days after the end of the budget period. AMSA has and will continue to submit all financial reports on time and in accordance with EPA regulations and the terms and conditions of the award.

**9. Reporting Requirements Not Met – Lack of Performance Reports: For cooperative agreements X827577-01, X828302-01, and X829595-01, the recipient did not comply with all reporting requirements of the cooperative agreements.**

AMSA communicated consistently with the EPA project officers on these cooperative agreements insuring that they were, at all times, aware of the on going status of the projects. Each of the EPA project officers will attest (Brian Frazer, Stephen Allbee and Curt Baranowski, respectively) to the fact that they were in constant communication with AMSA and that they had sufficient information to make an assessment of AMSA’s progress in meeting the agreements’ objectives and were able to determine whether the unexpended funds were adequate to complete all work required under the cooperative agreement. Please see Attachment E, *Mercury Grant Documentation (X827577-01)*, for a detailed listing of the project communications/reporting that occurred for cooperative agreement X827577-01. Please see Attachments H & I for a detailed listing of the project communications/reporting that occurred for cooperative agreements X828302-01 and X829595-01, respectively. AMSA has and will continue to submit all performance reports on time and in accordance with EPA regulations and the terms and conditions of the award.

**Independent Auditor’s Report – Cooperative Agreement No. X827577-01**

**Note 1: We questioned unsupported contractual costs of \$106,349 because the recipient did not procure the contractual services in accordance with procurement standards defined in 40 CFR 30.43; 40 CFR 30.45; and 40 CFR 30.46 (see Report of Non-Compliance).**

This question is addressed under #6 “Improper Procurement Practices” (see page 3). For cooperative agreement X827577-01, AMSA procured contractual services competitively in accordance with the requirements of 40 CFR 30.43 and 40 CFR 30.46. Also, AMSA performed cost or price analyses for the procurement of contractual services as required per 40 CFR 30.45. See Attachment E, *Mercury Grant Documentation (X827577-01)*, for a detailed listing of the procurement procedures followed. As a result, the \$106,349 should not be listed under “Questioned Outlays” and the OIG should not recommend that EPA recover these costs since we have demonstrated that they were properly incurred.

## **Independent Auditor's Report – Cooperative Agreement No. X829595-01**

**Note 1: We questioned personnel costs of \$34,136. The recipient's financial management and labor distribution systems were inadequate (see Report of Non-Compliance) to account for labor costs in accordance with Federal regulations.**

This question is addressed under #1 "Inadequate Labor Distribution System" (see page 1). In January 2003, AMSA established a new process that requires all employees to complete a personnel activity report/timesheet twice a month (the timesheet period coincides with AMSA's pay periods). The timesheet reflects the actual (after-the-fact) accounting of each employee's total activity for each pay period. Timesheets are signed consistent with the requirements of Circular A-122 and also account for total hours worked and leave taken. A copy of AMSA's timesheet is attached (see Attachment A, *AMSA Personnel Activity Report*). In February 2004, AMSA began separating out personnel costs in the general ledger by program (*Grants, Technical Action Fund, etc.*).

For cooperative agreement X829595-01, AMSA tracked employee time allocated to this cooperative agreement for fiscal year 2002. Employees tracked their time on calendars which were collected and recorded in a spreadsheet which was used to calculate the amount to be charged to the EPA. AMSA has an accurate listing of employees hours for 2002 to support the amount charged (\$34,136) to the EPA. AMSA has taken the employee calendars and transferred the data to AMSA timesheets (copies of the timesheets supporting the \$34,136 were sent to Stephanie Oglesby via fedex to arrive on 6/10/04, see hardcopy Attachment 2, *AMSA 2002 Timesheets*). As a result, the \$34,136 should not be listed under the "Questioned Outlays" and EPA OIG should not recommend that EPA recover these costs since AMSA has demonstrated compliance with Federal regulations.

**Note 2: We questioned \$4,219 in supply costs as unallowable. The recipient's reported outlays included and \$899 transaction that was not supported or recorded in the general ledger. In addition, the recipient's reported outlays included a \$3,320 transaction that was claimed twice in error.**

AMSA does have support for the \$4,219 of supply costs listed as "unallowable". The \$899 transaction is for an invoice that was paid to Guernsey Office Products for the purchase of 33 boxes of padded envelopes which were used for the mailing of the VSAT™ software developed under cooperative agreement X829595-01. AMSA has a copy of this invoice which was paid on 2/12/03 (a copy of this invoice was sent to Stephanie Oglesby via fedex to arrive on 6/10/04, see hardcopy Attachment 3); however, this transaction was incorrectly recorded in the general ledger to the "general" supplies account, rather than to the VSAT™ cooperative agreement. This error has been corrected in the general ledger.

AMSA did request reimbursement for a \$3,320 transaction twice in error on 4/23/03 (request #46). The transaction was for the reproduction of VSAT™ software purchased from Triple Disc. AMSA was aware of this error and it was corrected when the \$3,320 was subtracted out of the amount requested on 10/17/03 (request #47). A copy of request #47 with supporting backup was sent to Stephanie Oglesby via fedex to arrive on 6/10/04, see hardcopy Attachment 4. Therefore, AMSA does not owe EPA for this amount since the funds have already been returned to EPA. As a result, the \$4,219 of supply costs

should not be listed under “Questioned Outlays” and the OIG should not recommend that EPA recover these costs.

**Note 3: We questioned unallowable contractual costs of \$681,413. As discussed in the Report of Non-Compliance, the recipient did not comply with the requirements of 40 CFR 30.43; 40 CFR 30.45; and 40 CFR 30.46 in procuring contractual services.**

This question is addressed under #6 “Improper Procurement Practices” (see page 4). For cooperative agreement X829595-01, AMSA awarded the contract on a sole-source basis. AMSA provided EPA with a sole source justification document (this document was given to Stephanie Oglesby by Paula Dannenfeldt during the OIG audit) explaining in detail why the contract was not competitively bid. AMSA did perform cost or price analyses for the procurement of contractual services as required per 40 CFR 30.45 at that time; however, this information was not documented in the justification. AMSA has since updated this sole-source justification document to include information on cost-price analysis (see Attachment F, *Sole Source Justification for PA Consulting*). As a result, the \$681,413 of contractual costs should not be listed under “Questioned Outlays” and the OIG should not recommend that EPA recover these costs since we have demonstrated that they were properly incurred.

**Note 4: We questioned \$1,693 of other costs as unallowable. The recipient’s reported outlays included four postage transactions that totaled \$1,693, yet they were not supported or recorded in the general ledger.**

AMSA does have support for the other costs totaling \$1,693. These transactions are for postage charges for VSAT CD mailings. The amounts were calculated based on postage logs kept by AMSA which detail these costs. The information from the postage logs are compiled monthly and the amounts are given to accounting to record the charges. The below information supports the questioned postage costs:

7/25/02 – 276 CDs at \$1.29 each = \$356.04  
8/2/02 – Outreach announcing VSAT software availability to public utilities = \$1,153.26  
8/6/02 – Outreach announcing VSAT software availability to public utilities = \$102.49  
8/9/02 – 63 CDs at \$1.29 each = \$81.27  
TOTAL = \$1693.06

AMSA incorrectly recorded these postage costs in the general ledger to the “general” postage account, rather than to the VSAT™ cooperative agreement X829595-01. This error has been corrected in the general ledger. As a result, the \$1,693 of other costs should not be listed under “Questioned Outlays” and the OIG should not recommend that EPA recover these costs since AMSA has demonstrated that they are allowable costs.

**Note 6: EPA overpaid the cooperative agreement by \$22,771. The overpayment represents the recipient’s share of the reported costs. The cooperative agreement specified that the recipient’s match was 3 percent of allowable project costs. The recipient did not provide us with any documentation to demonstrate that it met the required cost share under the agreement. Further, the recipient claimed cumulative project costs of \$759,033 in its Federal Cash Transactions Report dated August 11, 2003, and EPA reimbursed the recipient for the entire \$759,033. Consequently, EPA overpaid the agreement by \$22,771 ( $759,033 \times 3\%$ ), and we have questioned the costs.**

AMSA met the 3% matching requirement on cooperative agreement X-829595-01 through volunteer services. These volunteers provided a high level of in-kind service by attending meetings, participating in conference calls and/or reviewing and commenting on key documents related to the project. At a conservatively averaged hourly rate of \$85/hour (inclusive of benefits, but no other overhead), in-kind services are valued at \$46,240. Detailed information documenting the in-kind services is included in Attachment J, *In-Kind Volunteer Services for X829595-01*. Volunteer time was tracked and recorded in a spreadsheet which was used to calculate the amount to be allocated to the EPA. All future volunteer time used for matching will be tracked on AMSA's timesheet. AMSA has an accurate listing of volunteer hours to support the full amount of the required match (\$35,717).

AMSA incorrectly completed the Federal Cash Transactions Report dated August 11, 2003, and did not include the match amount of \$46,240 on this report in error. AMSA will correct this error and send a revised Federal Cash Transactions report with the report that is due on July 15, 2004. As a result, the \$22,771 was not overpaid by EPA and should not be listed under the "Questioned Outlays". EPA OIG should not recommend that these costs be recovered since AMSA has demonstrated compliance with Federal regulations.

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