



OIG

OFFICE OF INSPECTOR GENERAL

Catalyst for Improving the Environment

Audit Report

Costs Claimed Under Construction Grant No. C530608-03 (Richmond Beach) Awarded to King County Department of Natural Resources, Seattle, Washington

Report No. 2003-2-00015

September 23, 2003

Report Contributors:

Robert Adachi
Lela Wong
Melinda Burks
Charles McCollum

Abbreviations

A&E	Architectural and engineering
CFR	Code of Federal Regulations
EPA	Environmental Protection Agency
grantee	King County Department of Natural Resources
Metro	Municipality of Metropolitan Seattle
OIG	Office of Inspector General
O&M	Operation and maintenance
Region	Environmental Protection Agency Region 10
State	Washington Department of Ecology



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

OFFICE OF
INSPECTOR GENERAL

September 23, 2003

MEMORANDUM

SUBJECT: Report No. 2003-2-00015
Costs Claimed Under Construction Grant No. C530608-03 (Richmond Beach)
Awarded to King County Department of Natural Resources, Seattle, Washington

FROM: /s/ *Robert K. Adachi* for
Michael A. Rickey
Director of Assistance Agreement Audits
Office of Audit

TO: L. John Iani
Regional Administrator
EPA Region 10

At your request, we performed an audit of the costs claimed by King County Department of Natural Resources for the Richmond Beach project under EPA Grant No. C530608-03. The project period was from September 30, 1988, to April 30, 1994.

The objectives of the audit were to determine whether:

- The costs claimed were eligible for Federal participation in accordance with the grant terms and conditions and consistent with 40 Code of Federal Regulations 35.2250;
- U.S. Environmental Protection Agency (EPA) program officials or their delegated State representatives, Washington Department of Ecology, have accepted the project as accomplishing the objectives of the grant; and
- The grantee adhered to the special conditions and fulfilled the material grant performance requirements.

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

Action Required

In accordance with EPA Manual 2750, you are required to provide a written response to this report within 120 calendar days of the date of this report. We have no objections to the further release of this report to the public. Please refer to the audit report number on all related correspondence. We will be pleased to provide additional accounting counsel and audit services which may be required in connection with this report and the implementation of our recommendations. For your convenience, this report will be available at <http://www.epa.gov/oigearth/erom.htm>.

If you or your staff have any questions regarding this report, please contact Robert Adachi at (415) 947-4537.

Table of Contents

Independent Auditor’s Report	1
Summary of Results	3
Recommendations	4
Grantee’s Preliminary Response	4
Background	4

Appendices

A	Construction Grant No. C530608-03 Richmond Beach Project Schedule of Costs Claimed and the Results of Audit For the Period September 30, 1988, to April 30, 1994	7
B	Scope and Methodology	17
C	Grantee Response	19
D	Distribution	23

Independent Auditor's Report

We have audited the final “*Outlay Report and Request for Reimbursement*”, dated March 13, 2000, submitted by the King County Department of Natural Resources (grantee) for the Richmond Beach project (project) under EPA Grant Number C530608-03 (grant). The preparation of the outlay report is the responsibility of the grantee’s management. Our responsibility is to express an opinion on the “*Outlay Report and Request for Reimbursement*” based on our audit.

We conducted our audit in accordance with Government Auditing Standards issued by the Comptroller General of the United States, and the United States generally accepted auditing standards for “*Special Reports*”. These standards require that we plan and perform our audit to obtain reasonable assurance that the costs claimed on the “*Outlay Report and Request for Reimbursement*” are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the “*Outlay Report and Request for Reimbursement*”. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall claim. We believe that our audit provides a reasonable basis for our opinion (see Appendix B for additional details on our Scope and Methodology).

The “*Outlay Report and Request for Reimbursement*”, was prepared by the grantee to report costs, and claim reimbursement under the grant. This claim is not intended to be a complete presentation of the grantee’s revenues and expenses.

In our opinion, except for the costs questioned in Appendix A, the “*Outlay Report and Request for Reimbursement*” referred to above present fairly, in all material respects, the eligible costs in accordance with the terms and conditions of the grant and the applicable Federal and EPA regulations. Details of our audit are included in the Summary of Results section and in Appendix A.

Robert K. Adachi /s/
Assignment Manager
Field Work End: January 15, 2003

Summary of Results

Category	Amount
Total Costs Claimed as Eligible (Note 1)	\$16,681,507
Less: Costs Questioned (see Appendix A)	
Ineligible	403,443
Unsupported	0
Total Questioned	\$403,443
Eligible Costs (Note 2)	\$16,278,064
EPA's Share of the Eligible Costs (55 percent) (Note 3)	8,952,935
Less: Cumulative Amount Paid to the Grantee	9,568,241
Amount Due EPA	\$615,306

Note 1: Total costs claimed represent the total amount the grantee claimed as eligible for grant participation on the final “*Outlay Report and Request for Reimbursement*” submitted to the Washington Department of Ecology (State) on March 13, 2000.

Note 2: The eligible costs represent the total expenditures determined to be eligible for grant participation (amount claimed by grantee minus amounts questioned by Office of Inspector General) in accordance with the grant terms and conditions, 40 Code of Federal Regulations (CFR) 35.2250, as well as determinations made by the State. Additional details are presented in Appendices A and B of this report.

Note 3: EPA’s share of the eligible costs is computed by applying EPA participation of 55 percent to the total OIG-determined eligible costs.

The State has accepted the project as accomplishing the objectives of the grant. The grantee, in general, adhered to the special conditions and fulfilled the material grant performance requirements, with the exception of the requirement of 40 CFR 35.2212, which requires the grantee to expeditiously initiate and complete the project. The grantee did not award some of the subagreements within 12 months of this grant award, which resulted in limitation on allowable costs. This limitation is referred to as construction lag penalty. The construction lag penalty on these contracts was calculated by the grantee and accepted by the State. The penalty was included in our computation of the grant eligible costs.

Recommendations

We recommend that the EPA Region 10 Administrator:

1. Advise the grantee that the costs questioned of \$403,443 are disallowed for grant participation.
2. Obtain recovery of the \$615,306 of Federal funds paid to the grantee in excess of the amounts determined to be allowable.

Grantee Response

We issued the grantee a draft report on April 24, 2003. The grantee provided a response on May 27, 2003. A copy of the grantee's response is included as Appendix C of this report. An exit conference was held with the grantee on June 19, 2003. The grantee's position is that \$389,450 of the questioned costs should be considered eligible. The grantee also believes that it is entitled to additional architectural and engineering (A&E) costs (see Appendix A, Note 6). The grantee's formal response to our draft report as well as the responses provided through meetings and correspondence, along with the OIG's comment, have been summarized in Appendix A.

Background

The grant was awarded on September 30, 1988, to provide Federal assistance of \$9,685,270 to Municipality of Metropolitan Seattle (Metro) for construction of a pump station and pipeline to transport sewage from Richmond Beach to the Edmonds treatment plant, and a pump station and pipeline to transport East Edmonds service area sewage to the West Point treatment plant collection system. The \$9,685,270 represents EPA's 55 percent participation of the eligible project costs. The grantee is responsible for the remaining costs for the project.

On January 1, 1994, Metro merged into King County. Metro became King County's Department of Natural Resources, Wastewater Treatment Division on January 1, 1996. The grantee submitted the final "*Outlay Report and Request for Reimbursement*" to the State on March 13,

2000. The grantee emphasized in the letter that it has not received all of the required approval letters from the State and that the final claim was prepared based on its analysis of the available documentation.

The State sent a request to EPA Region 10 (Region) for a final audit of the project on June 21, 2000. The State mentioned that the grantee did not provide supporting documentation (e.g., time cards, diaries, etc.) for costs claimed. The State was also concerned that the grantee revised its total costs and asserted misinterpretations numerous times. As a result, EPA OIG was requested to audit the final claim.

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

- | | |
|-------------------------|---|
| Costs Claimed | Program outlays identified by the grantee on the final “ <i>Outlay Report and Request for Reimbursement</i> ”. |
| Costs Questioned | Adjustments made by the OIG because the costs claimed are unsupported (not supported by adequate documentation) or ineligible (incurred and claimed contrary to a provision of law, regulation, or grant terms and conditions). |

Construction Grant No. C530608-03
Richmond Beach Project
Schedule of Costs Claimed and the Results of Audit
For the Period September 30, 1988, to April 30, 1994

Cost Category	Costs Claimed (Note 1)	Ineligible Costs	Reference
Construction Cost			
W/F40-91	\$235,335	\$26,384	Note 2
W/F8-90	5,227,282	(4,502)	Note 3
W/F9-90	9,713,775	(629,469)	Note 4
Excess Change Order	174,267	578,801	Note 5
Total Construction Costs	\$15,350,659	(\$28,786)	
A&E Construction Management	529,850	316,348	Note 6
O&M Manual	114,971	114,971	Note 7
Design Allowance	686,027	910	Note 8
Total Project Costs	\$16,681,507	\$403,443	

Note 1: Total costs claimed represents the total amount claimed by the grantee on the final “*Outlay Report and Request for Reimbursement*” submitted to the State on March 13, 2000.

Note 2: Ineligible costs of \$26,384 represent the difference between the amount claimed by the grantee of \$235,335 and the eligible amount of \$208,951 as determined under 40 CFR 35.2250. Under 40 CFR 35.2250, the EPA will determine the allowable project costs based upon the scope of the project, approved change orders, and the provisions of 40 CFR, Subpart I, Appendix A.

Based upon the State’s determination of September 24, 1999, and subsequent change order approvals, the eligible costs were determined to be \$208,951, consisting of base contract and change order amounts of \$204,790 and \$4,161, respectively. Details of our calculations are shown in the following table:

Description	Amount
Base Contract	
Cost Incurred Before Sales Tax	\$246,836
Less: Ineligible Plans & Specifications Addendum 1 and 2	(8,877)
Ineligible landscaping	(15,667)
Total Eligible Costs	\$222,292
<i>Eligible Costs Based on Design Flows (89.4 percent)</i>	198,729
Less: Construction Lag (95.24 percent) ¹	(9,459)
Add: Sales Tax (8.2 percent)	15,520
Total Allowable Base Contract Amount	\$204,790
Change Orders	
Cost Incurred Before Sales Tax	\$4,517
<i>Eligible Costs Based on Design Flows (89.4 percent)</i>	4,038
With Construction Lag (95.24 percent) ¹	3,846
Add: Sales Tax (8.2 percent)	315
Total Allowable Change Order Amount	\$4,161

Grantee Response

The grantee did not concur with the State's construction lag percent determination and believes that the construction lag should be 99.25 percent. The grantee stated that in September 1989, within the 12 month period after the grant was awarded, bids were received and subsequently rejected for the flow transfer line from Richmond Beach to the Edmonds Treatment Plant (Contract W/F 8-90) because the bids received were 15 percent over the project budget. The contract was re-bid excluding the Deer Creek Crossing section of the work. In order to complete the Deer Creek Crossing section of the pipeline, additional design and engineering was required. The grantee did not request reimbursement for the additional design and engineering since it was ineligible for grant participation. The new contract for Deer Creek Crossing (W/F 40-91) was then bid based on plans approved by the State in June 1991.

¹ The construction lag of 95.24 percent was computed by the grantee and submitted to the State on June 21, 1994. Based on the State's September 24, 1999, determination, the 95.24 percent was accepted.

Because the Deer Creek Crossing work was removed from the original pipeline contract and re-bid as a separate contract, the grantee disagrees with the State's construction lag of 95.24 percent against contract W/F 40-91. The grantee's position is based on the following:

- 1) 40 CFR Part 35, Subpart I, Appendix A, Section b(2)(e) - Determination of Allowable Costs. This regulation applies to a significant element of the project. The Deer Creek Crossing Project was not a significant element in the whole transfer project, but a small portion of the pipeline between the Richmond Beach Treatment Plant and the Edmonds Treatment Plant.
- 2) The completed sections of both the Pipeline Project (W/F 8-90) and the Deer Creek Crossing Project (W/F 40-91) were completed within the same month. This resulted in the completion of the Pipeline portion of the Flow Transfer system as if it was one contract as originally bid in September 1989.

The grantee believes Contract W/F 40-91 should have the same construction lag as Contract W/F 8-90 since the work was deleted from Contract W/F 8-90 and was subsequently completed within the same time frame as contract W/F 8-90. Contract W/F 40-91 was not a significant element of the whole transfer project.

Based on the 99.25 percent construction lag, the grantee believes the allowable amount would be \$217,750. The \$217,750 consists of base contract and change order amounts of \$213,413 and \$4,337, respectively. Details are shown in the following chart:

Description	Amount
Base Contract	
<i>Eligible Costs Based on 89.4 Percent Design Flows</i>	198,729
<i>With Construction Lag of 99.25 percent</i>	197,239
Add: Sales Tax (8.2 percent)	16,174
Total Allowable Base Contract Amount	\$213,413
Change Orders	
Eligible Costs Based on 89.4 Percent Design Flows	4,038
With Construction Lag of 99.25 percent	4,008
Add: Sales Tax (8.2 percent)	329
Total Allowable Change Order Amount	\$4,337

OIG Comment

The OIG's position remains unchanged. The 95.24 percent construction lag was calculated and provided by the grantee to the State on June 21, 1994. In their June 21, 1994, letter, the grantee stated that the calculation was computed "*In accordance with the federal regulations concerning project initiation*", and that the calculations would be used to determine allowable costs. Presumably, the calculations were made to comply with 40 CFR Part 35, Subpart I, Appendix A, Section b(2)(e). The 95.24 percent was subsequently approved by the State. No revision to the approval was made by the State or the Region.

Note 3: The grantee claimed \$5,227,282, or \$4,502 less than the eligible amount of \$5,231,784. The eligible amount of \$5,231,784 was computed based upon the State's eligibility determination and subsequent change order approvals. Details of our calculations are shown in the following table:

Description	Amount
Base Contract Amount	\$6,212,971
Less: Ineligible Base Contract Amount	(1,137,594)
Subtotal	\$5,075,377
Add: Change Order Amount	321,198
Less: Ineligible Change Order Amount	(164,791)
Total Allowable Construction Costs	\$5,231,784

Grantee Response

The grantee concurred with the results shown above.

Note 4: The grantee claimed \$9,713,775, or \$629,469 less than the eligible amount of \$10,343,244. The eligible amount of \$10,343,244 was computed based upon the State's eligibility determination and subsequent change order approvals. Details of our calculations are shown in the following table:

Description	Amount
Base Contract Amount	\$12,246,066
Less: Ineligible Base Contract Amount (a)	(2,890,115)
Subtotal	\$9,355,951
Add: Change Order Amount	1,528,102
Less: Ineligible Change Order Amount (b)	(540,809)
Total Allowable Construction Costs	\$10,343,244

- (a) Ineligible base contract amount of \$2,890,115 includes the following items determined by the State on February 22, 1996, and September 24, 1999, to be ineligible for grant participation:

Description	Amount
Schedule I (Richmond Beach Pump Station)	
Ineligible Amount Based on Design Flows	\$750,626
Schedule II (Lake Ballinger Pump Station)	
Ineligible demolition	85,500
Ineligible landscaping	139,685
Ineligible Amount Based on Design Flows	1,520,839
Construction Lag	174,683
Subtotal Before Tax	\$2,671,333
Add: Sales Tax (8.19 percent)	218,782
Ineligible Base Contract Amount	\$2,890,115

- (b) Ineligible change order amount of \$540,809 included a computer credit of \$1,383 (\$1,278 plus sales tax of 8.19 percent) questioned under change order number one.

Grantee Response

The grantee did not concur with the costs questioned. The grantee believes the credit of \$1,278 was already included in the ineligible base contract amount of \$2,890,115 determined by the State, therefore, it should not be deducted again in change order number one. The grantee concurs that the computer equipment is ineligible for grant participation, and therefore, is not questioning the eligibility of the costs, only the duplication for the reduction in the price of the computer.

OIG Comment

The OIG’s position remains unchanged. The ineligible base contract amount of \$2,890,115 includes only the ineligible demolition and landscaping work, plus the applicable design flow percentages and the construction lag penalty. The State’s February 22, 1996 letter detailing the items being disallowed did not include any computer-related costs. The computer credit was only taken out from change order number one as an ineligible cost.

Note 5: Ineligible costs of \$578,801 represent the sum of \$174,267 of excess change order costs claimed by the grantee, plus the \$404,534 in excess of the maximum allowable amount under 40 CFR 35.2205(a)(2) calculated in this note .

According to 40 CFR 35.2205(a)(2), the maximum allowable project costs would be:

- The allowable cost of the following:
 - a. The initial award amount of all project subagreements between the grantee and its contractors;
 - b. The initial amounts approved for force account work to be performed on the project;
 - c. The purchase price of eligible real property;
 - d. The initial amount for project costs not included in a. through d., excluding any amounts approved for an allowance under 40 CFR 35.2025 (i.e., design allowance under this project) and for contingencies; and
- Five percent of the sum of the amounts included above.

Based on 40 CFR 35.2205(a)(2), the five percent represents the maximum allowable change order amount, which is determined to be \$743,327. Details of our computation are shown in the following table:

Construction Contract	Eligible Base Contract Amount	Total Eligible Change Orders
Deer Creek Crossing: W/F40-91	\$204,790	\$4,161
Pipeline: W/F8-90	5,075,377	156,407
Pump Stations: W/F9-90	9,355,951	987,293
Total Construction Costs	\$14,636,118	\$1,147,861
A/E Construction Management	230,422	

Construction Contract	Eligible Base Contract Amount	Total Eligible Change Orders
Approved O&M Manual	0	
Total Project Costs	14,886,540	
Limitation Per 40 CFR 35.2205(a)(2)	5 percent	
Maximum Allowable Change Orders Per 40 CFR 35.2205(a)(2)	\$ 743,327	\$ 743,327
Amount in Excess of Allowable Change Orders Per 40 CFR 35.2205(a)(2)		\$ 404,534

Total change order amount determined to be eligible before the five percent consideration is \$1,147,861, as shown above. Since the maximum allowable change order amount under the grant is \$743,327, the total eligible change order amount of \$1,147,861 exceeded the allowable amount by \$404,534. As a result, total allowable costs should be reduced by \$404,534 and not increased by \$174,267.

Since the maximum allowable change order amount is five percent of the eligible base construction contract amounts plus all other eligible costs under the grant, the allowable amount is subject to adjustment in the event the final costs questioned during audit resolution varies from those recommended by the OIG.

Grantee Response

The grantee does not concur with the amount of eligible project costs used to calculate the maximum allowable change order amount. The grantee believes that the O&M manual costs of \$114,971 and the additional A&E expenses claimed should be added to our calculation. See Notes 6 and 7 for details.

OIG Comment

The OIG has changed its position since the draft report to incorporate the grantee's responses. The results explained in this note represent the revised position of the OIG. Since the O&M manual costs and additional A&E expenses the grantee want to include in our calculation are being questioned in this report, we can not include them in the calculation of maximum allowable change order amount. However, the maximum allowable change order amount is subject to change pending the State and EPA's final determination on the allowability of those costs claimed.

Note 6: Ineligible costs of \$316,348 for the A&E construction management fee represent the difference between the amount claimed by the grantee of \$529,850 and the eligible amount of \$213,502. The eligible amount of \$213,502 was computed

based on actual costs incurred by the grantee and the State's September 29, 1999, eligibility determination. Details of our computation are shown in the following table:

Description	Amount
Total Amount Spent on Amendment 4 (a)	\$420,803
Less: Ineligible Tasks 612, 613 and Part of Task 614 (a)	(142,407)
Total Eligible Costs	\$278,396
Percent Allocable to Eligible Portion of Project (b)	76.69 Percent
Total Allowable A&E Costs	\$213,502

- The A&E costs shown above represent amounts the grantee paid to the A&E firm under Amendment 4 of the contract. The contract between the grantee and the A&E firm consists of the basic contract plus seven amendments. The State determined that only amendment four of the A&E firm contract was eligible for grant participation. The State also determined that tasks 612, 613, and part of task 614 were not eligible.
- (b) The maximum allowable A&E percent represents the ratio of eligible construction costs to the total construction costs incurred in accordance with 40 CFR, Part 35, Subpart I, Appendix A.H.2.h. Under 40 CFR, Part 35, Subpart I, Appendix A.H.2.h, the allowable A&E cost is limited to the amount allocable to the eligible portion of the construction costs under the project.

Grantee Response

The grantee does not concur with the State's determination provided at the time of grant close out. The grantee's review and reevaluation of Amendments 6 and 7 revealed that the majority of the costs were for services during construction. Costs associated with services during construction should be eligible for grant participation. Page 4 of the State's letter dated July 2, 2000, stated that "... Previous staff had determined the work ineligible, based on regulatory requirements, and Ecology concurred." To date the grantee has not found any written documentation from the State regarding ineligibility of Amendments 6 and 7.

The grantee is requesting that Amendment 6 and 7 for A&E services during construction be reevaluated to determine eligibility for grant reimbursement.

OIG Comment

OIG's position remains unchanged. The State determined that only Amendment 4 of the contract was eligible for grant participation. No other amendments to the

A&E contract have been approved by the State for grant participation. Any redetermination of eligibility would need to be made by the State.

Note 7: Ineligible costs of \$114,971 for an O&M manual consist of the following:

- (a) Costs of \$60,538 claimed in excess of the budgeted amount of \$54,433. The State approved the grantee's O&M manual on August 16, 1994. However, the dollar amount for the O&M manual was not mentioned in the approval letter. Therefore, we assumed the budgeted amount of \$54,433 shown in the grant award document was the approved amount.
- (b) Costs of \$54,433 recorded in the grantee's accounting system as "non-grant eligible" costs. In the draft report, the costs were questioned as unsupported because the grantee could not locate the source documentation to support the costs claimed. Subsequently, the grantee provided documentation to verify the amount claimed to the accounting system. However, the grantee identified the costs as "non-grant eligible" in their accounting system. The amount is questioned to be consistent with the classification of the costs in the grantee's accounting records.

Grantee Response

The grantee's position is that the entire \$114,971 claimed should be eligible. The grantee did not believe that any limitation was set on the allowable costs for the O&M manual since the approval letter did not specify an amount.

The grantee also did not concur with the OIG's interpretation that the costs coded as non-grant eligible in its accounting system would be ineligible for grant participation. The grantee explained that during the project period, its procedures were to code expenditures as grant eligible only when an approval letter was received from the State. Since the grantee had not received the necessary approval letter during the project construction, the expenditures remained coded as non-grant eligible expenditures. The grantee said that as documented by the State's approval letters, many approval letters were received well after project construction was completed. The grantee further stated that it had requested reconsideration for these costs during grant close out and was unable to resolve the issue.

OIG Comment

OIG's position remains unchanged. Our results were based on the available documentation and is consistent with the grantee's accounting records. The State has not provided additional information on the approved costs of the O&M manual. Absent any specific approval by the State or the Region listing the eligible O&M manual costs, the amount listed in the grant award document represent the total eligible amount. The State has also not stated whether they

accepted the grantee's explanation for coding expenditures in their accounting system and whether the costs claimed of \$54,433 were eligible. As a result, the balance of the O&M manual costs are being questioned.

Note 8: Ineligible costs of \$910 relating to design allowance represent the difference between the amount claimed by the grantee of \$686,027 and the eligible amount of \$685,117 as determined under 40 CFR 35.2025. Under 40 CFR 35.2025, the allowance for facilities design of the project is to be determined in accordance with 40 CFR Part 35, Subpart I, Appendix B. Appendix B.3 states that the allowance is not intended to reimburse the grantee for costs actually incurred for facilities design. Rather, the allowance is intended to assist in defraying those costs. Appendix B.4 states that the estimated and final allowance will be determined in accordance with Tables 1 and 2 of the appendix. Table 2 is to be used in the event that the grantee received a grant for facilities planning. Since the grantee received a grant for facilities planning (grant number C530608-01 awarded on June 1, 1976), Table 2 was used in our computations. Appendix B.7 further states "the final allowance will be determined one time only for each project, based on the initial allowable building costs, and will not be adjusted for subsequent cost increases or decreases."

Based on 40 CFR 30.2025 and 40 CFR Part 35, Subpart I, Appendix B, the design allowance was determined to be \$685,117.

Grantee Response

The grantee concurred with the OIG's methodology for determining the design allowance amount.

Scope and Methodology

The audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and auditing standards established by the American Institute of Certified Public Accountants for “*Special Reports*” (SAS 62). These standards require that we plan and perform our audit to provide reasonable assurance about whether the “*Outlay Report and Request for Reimbursement*” is free of material misstatement. This requires examining, on a test basis, evidence supporting the costs claimed. We also obtained a sufficient understanding of the grantee’s internal control structure to determine the nature, timing, and extent of tests to be performed to reach an opinion on the costs claimed. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall claim. We believe that our audit provides a reasonable basis for our opinion.

The audit field work was performed between March 1, 2002 and January 15, 2003. We did not perform any followup of prior audit reports. The following steps were performed to determine whether costs incurred were eligible for grant participation:

- We first reviewed the grant files at EPA Region 10 and the State.
- Eligibility was determined using the supporting documentation obtained from the State’s grant files:
 - ▶ King County’s construction lag calculations dated June 21, 1994.
 - ▶ The State’s various eligibility determination letters.
 - ▶ State letters describing approval of contract change orders.
 - ▶ Bid approval for each of the construction contracts.
- We also visited King County and obtained the following supporting documents:
 - ▶ Final progress payment for each of the construction contracts.
 - ▶ Original claim, along with supporting spreadsheet, King County submitted to the State on March 13, 2000.
- We reconciled the grantee’s original claim, along with the spreadsheet supporting the claim, to Metro’s accounting system reports. This accounting system was eliminated when Metro merged with the grantee. Since we were unable to test the controls in the system, we assumed maximum control risk.
- We verified all progress payments against the payment vouchers and copies of the check to confirm actual payment to the contractors. We also verified that no costs were incurred prior to the Notice to Proceed date and that all retention amounts were released

to the contractors prior to the final claim.

- The eligible percentages computed by the State based on design flows were applied to the eligible base contract and change order amounts. These percentages represent the ratio of costs based on design flows and the costs based on existing flows.
- The construction lag percentages were then applied to the eligible base contract and change order amounts.
- Sales tax was added to come up with totals for the contract. The sales tax represents the actual average tax rate paid to the contractors. The State of Washington does not have sales tax exemption for Government contractors.
- The eligible costs for A&E construction management and an O&M manual were then computed and added to the total eligible amount for the project.
- The design allowance was computed in accordance with 40 CFR, Part 35, Subpart I, Appendix B, and added to the final eligible project total.

Control Risks and Criteria

In planning and performing our audit, we considered relevant aspects of the internal control structure to determine our auditing procedures. For these internal controls, we obtained an understanding of the relevant policies and procedures during the period of the project.

We did not examine the accounting system because the system utilized during the project is no longer in existence. Reports generated from the accounting system were used in the verification of transactions, but no tests of the adequacy of the system were performed. As a result, we assumed maximum control risk and tested all transactions for verification of payments.

For all transactions tested, we examined the source documents and performed other audit procedures we considered necessary to gain an understanding of the grantee's financial management and contract administration controls. As criteria, we used 40 CFR, Parts 30 and 35; and Office of Management and Budget Circulars A-87 (Cost Principles for State, Local and Indian Tribal Governments) and A-102 (Grants and Cooperative Agreements With State and Local Governments). Our review did not disclose any material weaknesses in the grantee's financial management or contract administration systems.

Grantee Response



King County

Wastewater Treatment Division

Department of Natural Resources and Parks
King Street Center
201 South Jackson Street
Seattle, WA 98104-3855

*Shari
Lindahl
206-684-1030
5/27/03*

May 27, 2003

Ms. Armina K. Nolan OMP-145
U. S. Environmental Protection Agency—Region 10
1200 Sixth Avenue
Seattle, WA 98101

Re: Response to Draft Audit Report
 Final Audit Costs Claimed For Grant No. C530608-03
 Richmond Beach Transfer Project

Dear Ms. Nolan:

Thank you for the opportunity to respond to the draft audit report for EPA Grant No. C530608-03 dated April 24, 2003. King County Wastewater Treatment Division (WTD) received a copy of the draft audit report on April 25, 2003.

Enclosed is WTD's response to the findings in the draft audit report. As discussed in the response, the majority of the findings are related to eligibility.

WTD is requesting an exit conference to discuss the report on:

Date: June 19, 2003
Time 10:30 – 12:30
Location: Wastewater Treatment Division
 201 South Jackson Street
 Seattle, Washington 98104
Conference Room: 5-F (Fifth Floor)

We are looking forward to resolving these issues. If you have any questions, please contact Linda Biarum, Grants Administrator, at 206-684-1030.

Sincerely,

Robert N. Hirsch
Government Relations Administrator

Enclosure

cc: Linda Biarum, King County Wastewater Treatment Division



CLEAN WATER – A SOUND INVESTMENT

**King County Wastewater Treatment Division
Response to Draft Audit Report Dated April 24, 2003
Richmond Beach
EPA Grant No. C530608-03**

On April 25, 2003, King County Wastewater Treatment Division (WTD) received a copy of the above named draft audit report dated April 24, 2003. WTD has reviewed the draft audit report and is submitting this response as requested.

Listed below is WTD's response to the individual findings.

Contract W/F 40-91 Audit Report Note 2

In September 1989, within the 12 month period after the grant was awarded, bids were received and subsequently rejected for the flow transfer line from Richmond Beach to the Edmonds Treatment Plant (Contract W/F 8-90) because the bids received were 15 percent over the project budget. The contract was re-bid excluding the Deer Creek Crossing section of the work. In order to complete the Deer Creek Crossing section of the pipeline additional design and engineering was required. The grantee did not request reimbursement for the additional design and engineering since it was ineligible for grant participation. The new contract for Deer Creek Crossing (W/F 40-91) was then bid based on plans approved by Ecology in June 1991.

Because the Deer Creek Crossing work was removed from the original pipeline contract and re-bid as a separate contract, the grantee disagrees with Ecology's construction lag of 95.24 percent against contract W/F 40-91. Grantee's position is based on the following:

- 1) 40 CRF Pt. 35, Subpart I, Appendix A (b)(2) (e) – Determination of Allowable Costs – This regulation applies to a significant element of the project. The Deer Creek Crossing Project was not a significant element in the whole transfer project, but a small portion of the pipeline between the Richmond Beach Treatment Plant and the Edmonds Treatment Plant.
- 2) The completed sections of both the Pipeline Project (W/F 8-90) and the Deer Creek Crossing Project (W/F 40-91) were completed within the same month. This resulted in the completion of the Pipeline portion of the Flow Transfer system as if it was one contract as originally bid in September 1989.

The grantee believes Contract W/F 40-91 should have the same construction lag as Contract W/F 8-90 since the work was deleted from Contract W/F 8-90 and was subsequently completed within the same time frame as contract W/F 8-90. Contract W/F 40-91 was not a significant element of the whole transfer project.

Contract W/F 8-90 Audit Report Note 3

Grantee concurs with the results in the draft audit report dated April 24, 2003.

Contract W/F 9-90 Audit Report Note 4

Included in the bid was \$6,700 for two computers. Ecology's approval letter for this contract had disallowed computer cost of \$6,700 in its original eligibility determination. Ecology's eligibility determination letter, September 24, 1999, noted that landscaping, irrigation and computers were not eligible for grant reimbursement. Change Order No. 1 revised the computer requirements to one computer at a reduced price of \$5,422, a bid reduction of \$1,278. Therefore, the original bid eligibility had deducted \$6,700, and when Change Order No. 1-PWC 2 was processed, it increased the ineligibility of the computer by another \$1,278 for a total ineligible cost of \$7,978 for the computer.

**King County Wastewater Treatment Division
Response to Draft Audit Report Dated April 24, 2003
Richmond Beach
EPA Grant No. C530608-03**

The grantee believes the credit (\$1,278) was already included in the ineligible base contract amount \$2,890,115 as determined by Ecology. Therefore it should not be deducted again in Change Order No. 1. The grantee concurs that the computer equipment is ineligible for grant participation, and therefore, is not questioning the eligibility of the costs, only the ineligibility /disallowance duplication for the reduction in the price of the computer.

Excess Change Order Calculation Audit Report Note 5

The grantee does not concur with the methodology used to calculate the maximum allowable project costs. Based on 40 CFR 35.2205 (a)(1) allowable maximum costs are calculated based on the four elements listed below, whereas Ecology only allowed five percent for change orders on approved construction contracts awarded. The elements are:

- 1) the initial award amounts of all project sub-agreements between the grantee and its contractors,
- 2) the initial amount approved for force account work to be performed on the project,
- 3) the purchase price of eligible real property, and
- 4) the initial amount approved for project costs not included under paragraphs (a)(1)(i) through (a)(1)(iii) of this section, excluding amounts for an allowance under 32.2025

40 CFR35.2205 (a)(2) states that five percent of the sum of the amounts included in 40 CFR35.2205 (a)(1) are project allowable costs.

Force account work was approved in the grant agreement as documented by the application submitted to EPA that included work to be completed by Metro staff for inspection services, administrative services and O&M Manuals. 40 CFR 35.936-14 states

“A grantee must secure the project officer’s prior written approval for use of force account method for: ... 3) any step 3 work in excess of \$25,000; unless the grant agreement stipulates the force account method.” (emphasis added)

Since the force account work was approved in the grant award, prior written approval for the force account work was not a requirement. 40 CFR 35.2205 (a)(1) states “The allowable costs of the following: ... (ii) The initial award amounts approved for force account work to be performed on the project; ...” Therefore, even though all force account work related to the project was not charged to the grant for reimbursement, the amount initially approved is eligible for determining the maximum allowable project costs.

In addition, the amount initially awarded for A&E Services During Construction was excluded from the calculation of maximum allowable project costs. Services During Construction was awarded to an A&E firm and are eligible project costs for calculating the maximum allowable project costs. 40 CFR 35.2205 (a)(1) states “The allowable costs of the following: ... (i) The initial award amount of all project subagreements between the grantee and its contractors; ...”. Therefore, the initial amount of each amendment awarded to the consultant (contractor) is eligible for determining the maximum allowable project costs.

The grantee is requesting that the maximum allowable project costs be recalculated in compliance with 40 CFR 35.2205.

**King County Wastewater Treatment Division
Response to Draft Audit Report Dated April 24, 2003
Richmond Beach
EPA Grant No. C530608-03**

A&E Construction Management Audit Report Note 6

The grantee does not concur with Ecology's determination provided at the time of grant close out. The grantee believes that costs in Amendments 6 and 7 for Services During Construction are eligible for grant participation. A&E Services During Construction is an allowable costs for this project.

The grantee's review and reevaluation of Amendments 6 and 7 determined that the majority of the costs were for Services During Construction. Costs associated with Services During Construction should be eligible for grant participation. In Ecology's letter dated July 2, 2000, Page 4, it was stated that "... Previous staff had determined the work ineligible, based on regulatory requirements, and Ecology concurred." To date the grantee has not found any written documentation from Ecology regarding ineligibility of Amendments 6 and 7.

The grantee is requesting that Amendment 6 and 7 for A&E Services During Construction be reevaluated to determine eligibility for grant reimbursement.

O&M Manual Audit Report Note 7

The auditor will review these records prior to finalizing the draft audit report.

Design Allowance Audit Report Note 8

The grantee concurs with the OIG's methodology for determining the design allowance amount.

Distribution

EPA Region 10

Office of Management Programs, Grants Administration Unit
Office of Water, Standards and Planning Unit
Audit Followup Coordinator
Office of Communication, Education and Change

Headquarters Office

Director, Grants Administration Division (3903R)
Agency Audit Followup Coordinator (2724A)
Associate Administrator for Congressional and Intergovernmental Relations (1301A)
Associate Administrator for Communications, Education, and Media Relations (1101A)

Office of Inspector General

Inspector General

Auditee

King County Department of Natural Resources, Wastewater Treatment Division