OFFICE OF INSPECTOR GENERAL

Catalyst for Improving the Environment

Audit Report

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

Report No. 2004-4-00014

March 1, 2004

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

Report Contributors:

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Abbreviations

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

March 1, 2004

MEMORANDUM

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

/s/ *Michael A. Rickey*

FROM: Michael A. Rickey
Director, Assistance Agreement Audits

TO: Richard Kuhlman
Director, Grants Administration Division

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

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

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

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

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

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

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

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

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

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[3] See footnote 1

Action Required

In accordance with EPA Manual 2750, the action official is required to provide this office with a proposed management decision specifying the Agency's position on all findings and recommendations in this report. The draft management decision is due within 120 days of the date of this transmittal memorandum.

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

Attachment

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Independent Auditor's Report

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

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

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

The Foundation certified that the outlays reported on the *Financial Status Report*, Standard Form 269A, and *Federal Cash Transactions Report*, Standard Form 272A, were correct and for the purposes set forth in the agreements. The preparation and certification of each report was the responsibility of the Foundation. Our responsibility was to express an opinion on the reported outlays based on our examination.

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

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

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

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

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

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

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

Background

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

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

* The EPA share is 100% of total costs.

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

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

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

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

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

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

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

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

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

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

Results of Audit

Ineligible Recipient

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

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

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

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

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

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

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

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

Recipient's Comments

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

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

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

Auditor's Reply

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

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

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

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

Inadequate Financial Management System

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

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

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

Inadequate Accounting of Membership, Lobbying, and Public Outreach Activities

The recipient did not separately identify and accumulate all the costs associated with its membership, lobbying, and public outreach activities. Office of Management and Budget (OMB) Circular A-122, Attachment A, subparagraph B(4), provides that the costs of activities performed primarily as a service to members, clients, or the general public when significant and necessary to the organization's mission must be treated as direct costs whether or not allowable and be allocated an equitable share of indirect costs. Some examples of these types of activities include:

- Maintenance of membership rolls, subscriptions, publications, and related functions.

- Providing services and information to members, legislative or administrative bodies, or the public.

- Promotion, lobbying, or other forms of public relations.

- Meetings and conferences, except those held to conduct the general administration of the organization.

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

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

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

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

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

Recipient's Response

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

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

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

Auditor's Reply

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

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

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

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

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

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

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

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

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

Unsupported Labor Costs

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

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

- The reports must reflect an after-the-fact determination of the actual activity of each employee. Budget estimates (i.e., estimates determined before the services are performed) do not qualify as support for charges to awards.

- Each report must account for the total activity for which employees are compensated and which is required in fulfillment of their obligations to the organization.

- The reports must be prepared at least monthly and must coincide with one or more pay periods.

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

Recipient's Response

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

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

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

Auditor's Reply

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

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

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

Unreconcilable Reported Costs

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

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

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

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

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

Recipient's Response

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

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

Auditor's Reply

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

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

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

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

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

Unsupported Contract Costs

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

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

Recipient's Response

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

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

Auditor's Reply

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

Absence of Written Procedures

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

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

Recipient's Response

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

Auditor's Reply

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

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

Unsupported Indirect Cost Rates

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

OMB Circular A-122, Attachment A, subparagraph E(2), requires a nonprofit organization to submit an initial indirect cost proposal to the cognizant Federal agency no later than 3 months after the effective date of the award. The Circular also includes the requirement that organizations with previously negotiated indirect cost rates must submit a new indirect cost proposal to the cognizant agency within 6 months after the close of each fiscal year. Additionally, OMB Circular A-122, Attachment B, paragraph 25(c) requires that the recipient submit, as part of the annual indirect cost rate proposal, a certification that the recipient has complied with lobbying requirements and standards of paragraph 25.

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

Recipient's Response

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

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

Auditor's Reply

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

cost proposal to the cognizant Federal agency no later than 3 months after the effective date of the award. The Circular further states that organizations with previously negotiated indirect cost rates must submit a new indirect cost proposal to the cognizant agency within 6 months after the close of each fiscal year. EPA does not have the authority to omit this requirement from award recipients.

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

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

Improper Procurement Practices

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

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

For purchases over $100,000, Title 40 CFR 30.46 requires that procurement records and files shall include the following at a minimum: basis for contractor selection; justification for lack of competition when competitive bids or offers are not obtained; and basis for award cost or price. The recipient provided no justification for this lack of competition or the basis for the award cost or price in the procurement files.

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

In addition, under the provisions of Title 40 CFR 30.45, some form of cost or price analysis shall be made and documented in the procurement files in connection with every procurement action. The recipient did not always conduct the cost or pricing data supporting the purchases of goods and services for the cooperative agreements to demonstrate compliance with Title 40 CFR 30.45. Price analysis may be accomplished in various ways, including the comparison of price quotations submitted and market prices and similar indicia, together with discounts. Cost analysis is the review and evaluation of each element of cost to determine whether the proposed costs are reasonable and allowable. Without sufficient cost or pricing analyses, we cannot be assured that fair and reasonable prices were obtained.

Examples of the recipient's improper procurement practices follow:

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

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

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

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

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

Competition promotes obtaining the best goods and services at the best price. The lack of competition when procuring goods and services under a cooperative agreement can result in lower quality services and wasted funds. As a result of this lack of competition and cost or pricing analysis, there was no assurance that the contract costs paid under the cooperative agreements were reasonable. Therefore, these costs are not allowable under Federal rules.

Recipient's Response

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

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

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

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

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

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

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

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

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

Auditor's Reply

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

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

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

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

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

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

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

Sub-Award Costs Were Unsupported

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

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

Recipient's Response

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

Auditor's Reply

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

Performance Reports

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

Recipient's Response

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

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

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

Auditor's Reply

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

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

Recommendations

We recommend that EPA:

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

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

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

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

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

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

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

      (5) Include an adequate time distribution system that meets the requirements of OMB Circular A-122, Attachment B, paragraph 7. The system should account for total hours worked and leave taken, and identify the specific activities and final cost objectives that the employees work on during the pay period, including membership and lobbying activities. It should also serve as the basis for charging labor costs to Federal grants and cooperative agreements.

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

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

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

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

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

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

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

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

Scope and Methodology

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

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

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

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

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

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

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

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

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

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

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

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

Consumer Federation of America

BY E-MAIL AND FEDERAL EXPRESS

January 20, 2004

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

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

Dear Mr. Rickey:

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

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

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

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

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

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

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[1] Response, Parts 1, 3[A] and 3[B], and 4.

[2] Response, Part 2.

[3] Response, Parts 7[A], 7[C] and 7[D].

[4] Response, Parts 7[B], 7[C] and 7[E].

[5] Response, Part 6.

to recover: the Foundation has under-recovered approximately $600,000 in indirect costs from EPA.

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

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

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

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

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

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

Section prohibition.

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

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

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

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

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

Sincerely,

Stephen Brobeck
Executive Director

RESPONSE OF

CONSUMER FEDERATION OF AMERICA

TO AUDIT REPORT ON
CONSUMER FEDERATION OF AMERICA FOUNDATION

I. BACKGROUND

The Consumer Federation of America ("CFA"), established in 1967, is a consumer advocacy organization, working to advance pro-consumer policies on a variety of important issues before the U.S. Congress, the White House, Federal and State regulatory agencies, and the courts. It is also an educational organization, disseminating information on consumer issues to policymakers, the media and the public. In 1968, CFA was recognized by the Internal Revenue Service ("IRS") as an advocacy organization exempt from Federal taxation under Section 501(c)(4) of the Internal Revenue Code ("IRC"). CFA maintained 501(c)(4) status until January 2003, when it was recognized by the IRS as a charitable and educational organization, and the basis of its exemption was changed from IRC Section 501(c)(4) to IRC Section 501(c)(3).

CFA established the Consumer Federation of America Foundation (the "Foundation") in 1972 to serve as the CFA's research and education arm. The Foundation was known originally as The Paul H. Douglas Consumer Research Center, Inc. ("PHDCRC"); thereafter, its corporate name was changed twice - in March 1997, to the Consumer Research Council and, in March 1999, to the Consumer Federation of America Foundation. In 1972, the Foundation was recognized as a charitable and educational organization exempt from Federal taxation under IRC Section 501(c)(3). Thus, the Foundation has existed as a separate tax-exempt charitable organization without interruption for more than 30 years. During that period, the Foundation had its own board of directors, financial accounts, and funding, and conducted its own charitable and educational programs.

The Draft Audit Report ("DAR") prepared by the Office of Inspector General states that CFA established the Foundation in response to the enactment of the Lobbying Disclosure Act of 1995[1] ("LDA") in order "to receive the Federal funds"

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[1] Lobbying Disclosure Act of 1995, 2 USC 1601 et seq.

that CFA, a 501(c)(4) organization that engaged in lobbying, would no longer be eligible to receive under LDA Section 18.[2] This statement is misleading on two counts. **First**, the Foundation was not organized in response to the enactment of LDA Section 18; it was organized nearly twenty-five (25) years earlier. **Second**, CFA's purpose in establishing the Foundation was not - could not have been - to avoid the effects of LDA Section 18. This misrepresentation of the Foundation's history and corporate purpose is highly significant. The DAR relies on it, and on a distorted interpretation of LDA Section 18 and its legislative history,[3] to propose the disallowance of **all** of the $4.7 million in funding received by the Foundation from EPA during the period covered by the audit.

Prior to 1991, neither CFA nor the Foundation was a significant recipient of Federal funds. However, in that year, the U.S. Environmental Protection Agency ("EPA") asked CFA to undertake work on EPA's behalf to increase consumer awareness of radon contamination of indoor air. EPA approached CFA and asked for its assistance because of CFA's expertise on indoor air quality ("IAQ") issues and because of its unique network of state and local consumer groups. When CFA agreed, EPA awarded CFA a sole-source cooperative agreement ("CA") to perform the work.

In light of CFA's successful performance of the IAQ CA, over the next few years EPA significantly expanded the scope of the IAQ program, and the amount of program funding. It also asked CFA to undertake several other CAs, including, in 1993, a CA to manage a national public service campaign to educate consumers about the health risks of radon. In each case, the new award was initiated by EPA - that is, EPA determined the need for Federal action, defined the scope of the program, established the amount of available funding, and only then approached CFA to implement the program on its behalf. Each CA was awarded to CFA without competition. CFA never sought additional program responsibilities or responded to a competitive solicitation. During the same period, the Foundation received no Federal funds; its funding - about $110,000 per year between 1993 and 1995 - came

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[2] 2 USC 1611. Under Section 18, "[a]n organization described in section 501(c)(4) of title 26 [the Internal Revenue Code] which engages in lobbying activities shall not be eligible for the receipt of Federal funds constituting an award, grant, or loan."

[3] See Part II below, and the legal memorandum of Sonenthal & Overall P.C., submitted with this Response.

almost exclusively from private foundations.

In January 1996, the enactment of LDA Section 18 made 501(c)(4) organizations that engage in lobbying ineligible to receive Federal funds. CFA, which engaged in small amounts of lobbying on consumer issues, was swept up in the ban. But EPA wanted to maintain the programs that CFA was implementing on its behalf - including the public service campaign on radon pollution. Accordingly, EPA officials suggested that in the future, EPA funding would go, not to CFA, but to the Foundation. At the time they proposed this approach, it was clear that the responsible EPA officials knew about the relationship between CFA and the Foundation - in particular, they knew that the two organizations shared facilities and staff. In fact, the EPA officials required (and, on several occasions, specifically asked CFA to confirm) that the substitution of the Foundation as recipient would not mean a change in program staff - i.e., that the **CFA employees** who ran the program and the **CFA contractors** that provided services to the program would continue to do so under the new CA. At the same time, these EPA officials were clearly sensitive to the legal issues raised by program staff working for both CFA and the Foundation. For example, Mary Ellen R. Fise, then CFA's general counsel, was often asked to explain how key personnel (including Ms. Fise) could work on CA programs for the Foundation and, at the same time, appear before Congress and state legislatures as consumer advocates on behalf of CFA. In each case, Ms. Fise would explain that CFA and the Foundation shared staff and facilities, but that the organizations were legally separate and, moreover, took great care to assure that no CA funds received by the Foundation were used to support lobbying by CFA.[4]

In August 1996, EPA awarded the Foundation its first CA (CX 824939-01) covering work on radon and indoor air quality, including administration of the "Radon Fix It" program. In purpose and effect, this award replaced a CA between EPA and CFA that had expired in 1996, and was intended to transfer the IAQ program intact from CFA to the Foundation, where it continued to be managed and

[4] The relationship between CFA and the Foundation was also disclosed in CFA's OMB Circular A-133 audits for 1997 through 2002. The audit reports indicate that the Foundation paid no salaries, but each year made a payment for salaries and overhead to CFA. In addition, Note A to the each annual financial statements states clearly that CFA and the Foundation "share facilities and staff. Salaries and overhead expenses are reimbursed to CFA based on contractual agreements." For example: "Consumer Federation of America/Consumer Research Council: Audited Financial Statements, December 31, 1997" at 3, 7 (July 15, 1998) (Attachment #1).

implemented by the same personnel. In July 1997, EPA awarded the Foundation a second CA (CX 825612-01), with a five-year term, to conduct a public service campaign (including the production and distribution of public service announcements, or PSAs) on the health hazards of indoor radon pollution. In purpose and effect, this award replaced a CA between EPA and CFA that had expired in 1997, and was intended to transfer the program intact (including staff and contractors) to the new CA.[5] In September 1997, EPA awarded the Foundation a third CA (CX 825837-01), with a five-year term, to develop a public service campaign designed to alert the general public to the dangers of secondary smoke to children.

EPA made these awards to the Foundation even though the details of the CFA/Foundation relationship - in particular, their sharing of facilities and staff - were disclosed to EPA officials on numerous occasions. At no time did any EPA program official or grants-management official suggest that the CFA/Foundation relationship - including the sharing of facilities and staff - might transform the Foundation from a duly established 501(c)(3) organization eligible to receive Federal funds into a 501(c)(4) organization whose receipt of Federal funds was illegal. On the contrary, the message that EPA consistently delivered was that separate incorporation was sufficient to meet the requirements of LDA Section 18. For example, the standard terms and conditions set out in each of the Foundation's CAs contains the following provision, designed to determine eligibility for Federal funds under LDA Section 18:

> "Pursuant to Section 18 of the Lobbying Disclosure Act of 1995, PL. No. 105-65, 109 Stat. 691, the recipient affirms that:
>
> (1) it is not a non-profit organization described in Section 501(c)(4) of the Internal Revenue Code of 1986; or
>
> (2) it is a non-profit organization described in Section

[5] In its application for funding, the Foundation indicated that the advertising agency hired by CFA to work on the campaign for CFA - PlowShare Group - would continue to supply those services under the new CA. See Jack Gillis to Kristy Miller, EPA Indoor Environments Division (May 7, 1997) (Attachment #2).

> 501(c)(4) of the Internal Revenue Code of 1986 but does not and will not engage in lobbying activities as defined in Section 3 of the Lobbying Disclosure Act of 1995."[6]

There is nothing in this request for affirmation to suggest any basis for LDA Section 18 eligibility other than separate incorporation, no reference to laws, regulations or policies that would alert the recipient to the existence of a different standard of eligibility.[7]

Having disclosed the details of the CFA/Foundation relationship to EPA, and having received from EPA clear indications that it was an eligible recipient, the Foundation, in good faith, agreed to execute the CAs and, each year thereafter (through 2002), to execute CA amendments providing additional increments of funding for each program. Its performance during the period was outstanding. The public service campaigns, in particular, were recognized as highly effective (one of its PSA was awarded an Emmy); the competence and efficiency of its program administration were never questioned. In March 2002, however, the EPA Grants Management Office abruptly suspended all of the Foundation's CAs and, **for the first time**, expressed concern about the relationship between the Foundation and CFA, and about a number of the Foundation's financial management and procurement practices. The Foundation maintained (and continues to maintain - see Part II below) that, as a duly incorporated non-profit corporation exempt from Federal taxation under IRC Section 501(c)(3), it is fully eligible under LDA Section 18 to receive Federal funds. But, in deference to EPA concerns on that issue, it was agreed that CFA would change its tax-exempt status from 501(c)(4) to 501(c)(3),[8] and that the Foundation would then merge its operations into the reorganized CFA.

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[6] See, for example, Cooperative Agreement No. CX 825837-01-0 at 4-5 (September 22, 1997) Attachment #3.

[7] In fact, there was (and is) no standard for LDA Section 18 eligibility other than separate incorporation in the statute and its legislative history, or in any regulation, policy statement or program rule issued by the Federal government or the EPA. See Part III below, and the legal memorandum of Sonenthal & Overall submitted with this Response.

[8] Because the amount of CFA's lobbying activities was de minimus, it was easily able to satisfy the limitations on lobbying activities imposed on organizations exempt under Section 501(c)(3).

In addition, while not conceding any violations of law or regulation, it was agreed that CFA would take additional steps to assure the effectiveness and transparency of its financial systems and procurement practices, as detailed in its correspondence with EPA Grants Management. On that basis of these assurances, in May 2002, EPA lifted its suspension of the Foundation's CA activities. Since then, EPA has awarded the Foundation a new CA extending the ETS Campaign (XA 830590-01 in October 2002), and two new CAs for an energy efficiency program (XA 830875-01 in February 2003, and XA 831201-01 in October 2003), and increased funding for another (X 829178-01 in August 2002), and has awarded CFA a new CA for a radon indoor air quality program (in March 2003). Each award was made under a competitive solicitation.

II. THE LOBBYING DISCLOSURE ACT OF 1995.

The positions taken by OIG/EPA on the meaning of Section 18 and on the applicability of Section 18 to the Foundation, are untenable, for the following reasons. **First**, although its statement of the facts is generally accurate as far as it goes, the DAR misstates the historical relationship between the Federation and the Foundation and understates the actual "degree of separation" between the organizations. **Second**, the OIG/EPA's interpretation of Section 18 - that is, its **extension** of the Section 18 prohibition from the 501(c)(4) organizations identified in the statute to duly constituted 501(c)(3) organizations - is inconsistent with Section 18's plain and unambiguous terms, and has **no support** in the section's legislative history. To the contrary, the extension of Section 18 proposed by OIG/EPA crosses an important constitutional boundary that Congress, when it enacted the section, explicitly recognized and tried to avoid. Third, EPA does not have the authority to adopt the OIG interpretation of Section 18; and if EPA does adopt that interpretation, it should be vulnerable to legal challenge. **Finally**, even if EPA has the authority to adopt the OIG/EPA interpretation, under well-established legal precedent, it cannot apply that interpretation retroactively to the Foundation.

These arguments are discussed at length in a memorandum for our legal counsel, Sonenthal & Overall PC, submitted along with this response.

The OIG's interpretation of LDA Section 18 - that is, its **expansion** of the statutory disqualification beyond the 501(c)(4) organizations referred to in the statute - is incorrect as a matter of law, and unenforceable against the Foundation.

As a matter of law, a 501(c)(3) or a non-lobbying 501(c)(4) may share directors, facilities and staff — may be all but indistinguishable from the non-lobbying 501(c)(4) — without losing its eligibility under LDA Section 18, as long as the organizations respect their separate incorporation and maintain separate books of account. Our conclusion is based on the following considerations:

First, OIG's interpretation of LDA Section is inconsistent with the statute's plain and unambiguous terms.

Second, the legislative history of LDA Section 18, cited by OIG to support its expansion, appears instead to contradict its position — i.e., it appears to exclude separately incorporated 501(c)(3) organizations from the statute's coverage. The legislative history also suggests that Congress was concerned about the effect that LDA Section 18 would have on important First Amendment interests - interests which, in our view, could be chilled or compromised if eligibility for Federal funds were to depend on an undefined "degree of separation" between 501(c)(3) and 501(c)(4) organizations.

Third, EPA does not have the legal authority to adopt a broad interpretation of LDA Section 18. as it is not the only Federal agency charged with administering the statute, and it has no special expertise with respect thereto. If EPA does adopt that interpretation, its view would be entitled to no deference in a court of law, and should be vulnerable to legal challenge.

Fourth, even if EPA has the authority to adopt the OIG interpretation of LDA Section 18, under well established legal precedent, it cannot apply that interpretation retroactively to the Foundation.

III. FINANCIAL MANAGEMENT SYSTEM

According to the DAR, the Foundation's "financial management system was not adequate to account for the source and application of funds for Federally-sponsored activities as required by Title 40 CFR 30.21."

A. GENERAL RESPONSE

Many of the OIG allegations assume that CFA, not the Foundation, was the recipient of the EPA CAs. In fact, there is no legal basis for the OIG to ignore the

fact that CFA and the Foundation were separate corporations, with inter alia separate governing bodies, separate budgets, and separate financial accounting systems. The independent corporate status of the organizations was scrupulously observed. The fact that the Foundation obtained its administrative and technical support under contract from CFA does not negate this independent status, or make the Foundation a mere alter ego of CFA.

The DAR questions costs incurred by the Foundation, but then cites no basis for its questioning. To be allowable, costs charged to Federal awards must be allowable per OMB Circular A-122 and the Federal award, allocable to the Federal award, and reasonable. The DAR does not provide a basis for (unallowable, unallocable and/or unreasonable) or quantification of questioned costs. Instead, the DAR seems to take the view that perceived inadequacies in our financial management system are a sufficient basis for questioning all costs we incurred under the Federal awards subject to audit. We disagree with the underlying premise - that our systems were inadequate for audit and reporting on Federal awards - and we are perplexed that the contract files provided to OIG, which contained job cost accounting reports and the supporting documentation for each, and which had previously been audited under OMB Circular A-133, were not audited and reported upon by OIG for criteria of allowability, allocability, and reasonableness.

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

B. SPECIFIC RESPONSES

Set forth below are the OIG's specific allegations, followed by the detailed response of CFA management.

1. The Foundation did not structure its financial management system to "separately identify and

accumulate all of the direct costs associated with its membership, lobbying and public outreach activities" as required by subparagraph B(4) of OMB Circular A-122, Attachment A.

As noted, OMB Circular A-122 provides that the "costs of activities performed primarily as a service to members, clients, or the general public when significant and necessary to the organization's mission must be treated as direct costs whether or not allowable and be allocated an equitable share of indirect costs."[9] For that reason, the DAR asserts these costs must be "separately identif[ied] and accumulate[d]." The DAR fails to note, however, that Attachment A, subparagraph B(4) applies only when these costs are "significant." Attachment A, subparagraph B(2) reinforces this point, providing that

> "any direct cost of a minor amount may be treated as an indirect cost for reasons of practicality where the accounting treatment for such cost is consistently applied to all final cost objectives."

In fact, with one minor exception, neither the Foundation nor CFA incurred

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[9] According to the Circular, examples of these types of activities include:

> "a. Maintenance of membership rolls, subscriptions, publications, and related functions.
>
> b. Providing services and information to members, legislative or administrative bodies, or the public.
>
> c. Promotion, lobbying, and other forms of public relations.
>
> d. Meetings and conferences except those held to conduct the general administration of the organization.
>
> e. Maintenance, protection, and investment of special funds not used in operation of the organization.
>
> f. Administration of group benefits on behalf of members or clients, including life and hospital insurance, annuity or retirement plans, financial aid, etc."

any costs providing "services" within the meaning of Attachment A, subparagraph B(4). During the period covered by the audit, the Foundation had no members, no benefit or service programs, did not lobby or engage in public relations, and conducted no meetings and conferences. CFA did have members, but it did not recruit new members, had no benefit or service programs targeted primarily at members, did not lobby on behalf of members, and held no meetings or conferences primarily for the benefit of members (other than meetings held to conduct the general administration of the organization). It is true that CFA members could receive benefits from its programs - including publications, e-mailed information, technical assistance and conferences, as well as the small amount of consumer lobbying that CFA did each year - but they received these benefits primarily as members of the general public. CFA did not offer benefits to CFA members exclusively, or on terms or conditions different from those offered to non-members. Indeed, CFA functioned as a public-interest organization whose purpose was to serve the interests of consumers in general, not as a membership organization.

There was one exception. During the period covered by the audit, it was CFA's practice to reimburse certain CFA member representatives for the travel expenses they incurred to attend CFA meetings and conferences. As a result, each year CFA paid the travel expenses for about 50 trips by member representatives to attend CFA meetings or conferences. The total amount of these reimbursements was approximately $16,000 per year. However, a significant portion of these reimbursements were for the "general administration of the organization" – e.g., trips by CFA directors to attend meetings of the CFA Board of Directors, and trips by CFA member representatives to CFA's policy subcommittee meetings and the CFA annual membership meeting. Thus, the total amount arguably covered by Attachment A was approximately $11,000 per year. Finally, nearly all of these travel reimbursements were treated on the organization's books as direct costs - i.e., they were charged by CFA to specific funds provided to the organization to cover such costs and not included in indirect costs. Thus, the total amount arguably covered by Attachment A, subparagraph B(4), if any, certainly qualified as a "minor amount" within the meaning of Attachment A, subparagraph B(2).

Accordingly, we believe that Attachment A, subparagraph B(4) did not require the Foundation (or CFA) to separately identify and accumulate the direct costs associated with its membership activities. Furthermore, CFA did treat those expenditures, such as they were, as direct costs, and did not include them in its indirect cost pool.

CFA accounted for its lobbying expenses. The individuals who engaged in lobbying activities on behalf of CFA submitted a record of the time spent on those activities twice a year. Lobbying expenses were excluded from the indirect expense pool and therefore not claimed for recovery under any federal award.

Therefore, because we properly accounted for costs under Attachment A, subparagraph B(4), this portion of the DAR, and any recommendations based thereon, should be regarded as resolved.

* * * *

2. The Foundation's time distribution system did not require all personnel to prepare timesheets, and used budget estimates, rather than after-the-fact activity determinations, to support claimed labor costs, and therefore did not meet the minimum requirements of OMB Circular A-122, Attachment B.

OMB Circular A-122, Attachment B, subparagraph 7(m) advises that the distribution of salaries and wages to awards must be supported by "personal activity reports," prepared at least monthly, reflecting an after-the-fact determination of the actual activity of each employee for the total activity for which the employee is compensated.

CFA has a complete set of personal activity reports ("PARs") meeting the requirements of Attachment B, subparagraph 7(m), for the three individuals whose time constituted approximately 70% of the labor hours charged to the CAs during the period covered by the audit. These PARs were made available to the OIG auditors during their visit to the CFA offices. In addition, at the request of the EPA Grants Management Office, the individuals who supplied almost all of the remaining labor hours charged to the CAs (approximately 30% of the total), prepared activity reports which record, activity by activity, the time they spent on activities that were charged to the CAs. This documentation can be used to make an accurate determination of the actual labor costs chargeable to each CA. If such a determination is required by EPA Grants Management Office, we expect that, given the amount of work performed by program staff, the labor costs chargeable to the CAs will be at or near

the labor costs actually charged.

We acknowledge, however, that we used budget estimates to support our claimed labor costs, rather than the personal activity reports and other after-the-fact documentation reference above. In March 2002, the EPA grants manager called our attention to the requirements of Attachment B, subparagraph 7(m). After discussions with the Grants Management Office, we instituted a revised time-keeping system covering all employees who charge their time, in whole or in part, to Federal awards. This new system - which includes a revised time-sheet, and is supported by specific instructions on time-keeping in the CFA Employee Manual - satisfies the requirements of Attachment B.[10] In addition, our internal procedures now require all invoicing for labor be based exclusively on these time-sheets and the record of time actually spent that it contains. Accordingly, this audit issue should be regarded as closed.

* * * *

3. [A] Prior to 2001, the Foundation's general ledger did not account for the various cost elements identified in the EPA Cooperative Agreements, preventing a comparison of outlays with budget amounts.

Section 30.21(b) of EPA's Uniform Administrative Requirements for Grants and Cooperative Agreements, 40 CFR §30.21(b), requires that a recipient's financial management system provide for "[c]omparison of outlays with budget amounts for each award." Although CFA acknowledges that prior to 2001, a "comparison of outlays with budgeted amounts" could not be made using the Foundation's general ledger only, nothing in 40 CFR §30.21(b) or OMB Circular A-110 requires that this comparison be made using the general ledger. During the period covered by the audit, the Foundation prepared Job Cost Activity Reports ("JCARs") on a consistent basis for each of its EPA CAs, and maintained those reports in the CA project file, and were provided to the OIG auditors for examination. These JCARs accurately reflect the amounts expended on each CA, allowing the required comparison of "outlays to budgeted amounts," and reconciling back to the OMB Circular A-133

[10] A copy of the CFA time sheet is attachment #4.

audit report. Accordingly, we believe that the Foundation fully complied with 40 CFR §30.21(b) for the period covered by the audit.

As a result of discussions with the EPA Grants Management, CFA has instituted additional internal controls that directly address the concerns raised in the DAR. The independent public accountant performing the OMB Circular A-133 audit will now conduct compliance testing during the fiscal year. Compliance testing will be conducted between the six and nine months of each fiscal year to assure that the JCARs reconcile to the general ledger at year end and the transactions comply the CA terms and conditions, and OMB Circular A-122.

[B] On the general ledgers, certain contractual costs were mis-classified, resulting in inaccurate cost element totals and making it impossible to accurately compare budgeted versus actual costs.

At the outset, we strongly object to the DAR questioning the classification of contractual costs on the Foundation's general ledger without specifying the nature of the alleged errors, or identifying specific examples of the contract costs in question. Under the circumstances, it is impossible for us to prepare an effective response on this point. Because of this failure to provide any specifics, we submit that this portion of the DAR, and any recommendations based thereon, should be stricken from the final report.

In addition, to the best of our knowledge, all contractual costs were properly classified on the general ledger. In fact, each year since 1997, our classification of costs was tested as part of an OMB Circular A-133 audit conducted by an independent auditor, and found to be satisfactory. Accordingly, it seems clear that the DAR's objection to our classification of costs amounts, at the very worst, to a disagreement about proper classification with our A-133 auditor, and not to a finding of non-compliance. For this reason as well, this portion of the DAR, and any recommendations based thereon, should be stricken from the final report.

* * * *

4. The Foundation was unable to provide

[A] a summary of costs incurred by contract and

reported under each CA, and [B] copies of some contracts and purchase orders awarded thereunder, and was therefore "unable to show that contract costs recorded in the accounting records were paid in accordance with the contract terms."

The DAR's allegations are untrue. With respect to 4[A], the Foundation's Job Cost Activity Reports (referred to in Part 3[A] above) contain a summary of costs incurred by contract and reported under each CA. These JCARs were provided to the OIG audit team during their visit to our offices.

With respect to 4[B], we strongly object to the DAR's allegation that "[t]he Foundation was unable to provide . . . copies of some contracts or and purchase orders awarded" under the CAs because the report gives no indication of **which** contracts and purchase orders are alleged to be missing. Without such information, it is impossible for us to prepare an effective response. Therefore, we submit that this portion of the DAR, and any recommendations based thereon, should be stricken from the final report.

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

* * * *

5. The Foundation failed to have "written accounting procedures [for] identifying direct and indirect costs and . . . allocating such costs to projects," which prevented proper evaluation of reported direct and indirect costs under the cooperative agreements.

Section 30.21(b)(6) of the EPA Uniform Regulation, 40 CFR §30.21, requires that a recipient's financial management system provide "written procedures for determining the reasonableness, allocability and allowability of costs in accordance with the provisions of the applicable Federal cost principles and the terms and conditions of the award." Significantly, the regulation does **not** require that the recipient have a formal "accounting manual" or similar document; it is sufficient for purposes of the regulation if there are "written procedures" that accomplish the same practical result.

In fact, during the period covered by the audit, the Foundation did have some written guidance on which the responsible officials relied "for determining the reasonableness, allocability and allowability of costs."[11] That guidance was supplemented by OMB Circular A-122. However, we agree in principle that more formal written procedures are preferable to the guidance on cost allowability that was used. In fact, when the EPA Grants Management Office called the requirements of 40 CFR §30.21 to our attention in March 2002, we promptly prepared and adopted a more detailed "Cost Policy Statement" covering the relevant cost accounting principles. The "Cost Policy Statement" merely formalized procedures that are well-established in the assistance management field, and that our financial management staff was already applying during the period covered by the audit.

The DAR suggests that the Foundation's alleged failure to have written accounting procedures "prevented proper evaluation of reported direct and indirect costs under the cooperative agreements." This comment is ambiguous. It may mean that, without "written accounting procedures," **OIG** was unable to evaluate reported direct and indirect costs. But it is difficult to understand how this could be the case. Our Circular A-133 auditor had no difficulty evaluating our direct and indirect costs. Moreover, the OIG has access to volumes of guidance on this point, and could easily have resolved any uncertainties by discussing them with us.

On the other hand, if the DAR is suggesting that, without "written accounting procedures," **the Foundation** was unable to "evaluat[e] reported direct and indirect costs," we strongly disagree. It does not follow that we failed to use consistent cost allocation practices. On the contrary, all our decisions on cost allocation were made by professionals with extensive experience in accounting, with the assistance (on

[11] An example of such guidance is the "Notes to Spreadsheet on Indirect Cost Rate" from the indirect cost rate proposal submitted to EPA in September 1994, included as Attachment #5.

indirect cost rate proposals) with experts in the field of Federal grants accounting and administration. Direct and indirect costs are supportable as such by examination of the invoice(s) from the vendor(s) that identifies the purpose of the expense. The propriety of direct costs can further be examined by tying the purpose of the expense to the program objective or workplan. Such information was provided to the OIG. Furthermore, one would expect that errors or inconsistencies in our practice, if any, would have been noted in our Circular A-133 audits between 1997 and 2002. But the independent auditor who conducted those audits and reviewed our allocation of direct and indirect costs found no reportable conditions or other problems.

We believe it would be unreasonable to conclude that direct and indirect costs were misallocated simply because of alleged shortcomings in our "written procedures."

* * * *

6. The Foundation-

[A] failed to prepare and submit indirect cost rate proposals for 1997 and 2002 as required by OMB Circular A-122;

The basis of the DAR's finding is OMB Circular A-122, Attachment A, subparagraph E(2), which requires a non-profit organization to submit an initial indirect cost proposal to its cognizant Federal agency not later than three months after the effective date of award, and organizations with a negotiated indirect cost rate to submit a new indirect cost rate proposal within six months of the close of each fiscal year. However, the standard terms and conditions in each of the Foundation's CAs specifically instructed the Foundation **not** to submit any indirect cost rate proposals to EPA. For example, the "Terms and Conditions" incorporated in CA CX 825837-01 provide that:

> "The recipient's authorized budget includes indirect costs in the amount of $36,854. The recipient agrees with 90 days of accepting this assistance agreement/amendment to prepare and maintain on file for review an indirect cost rate proposal based on [EPA] guidance."

Furthermore, when we prepared a formal indirect cost rate proposal based on 1998 cost data for an award from the U.S. Information Agency ("USIA"), and sought to submit it to EPA as well, we were told by Joan Clark, our EPA Grants Management officer, that "EPA does not accept indirect cost rate proposals from non-profit organizations." In light of the fact that EPA was the Foundation's "cognizant federal agency," the standard "Terms and Conditions," confirmed by the Grants Management Office, superseded the requirements of Attachment A, subparagraph E(2). Consequently, during the period covered by the audit, the Foundation was **not** required to prepare and submit an indirect cost rate proposal to EPA.

The OIG is surely aware of EPA's policy of refusing new indirect cost rate proposals from non-profits, and of the basis for that policy - namely, that EPA has a significant backlog of indirect cost rate proposals from non-profit organizations submitted but not yet reviewed. In fact, CFA submitted an indirect cost rate proposal to EPA in **1994**; ten years later, that proposal has not yet been reviewed or approved.

We acknowledge, however, that the standard "Terms and Conditions" did require the Foundation to **prepare** an indirect cost rate proposal for 1997, and to maintain that proposal in its files. We did not prepare such a proposal until 1999, in connection with our award from US Information Agency. Nevertheless, we believe this to be, at worst, a technical violation of our agreements that caused no prejudice to EPA, considering the fact that the proposal would have remained locked in our files, and that a comprehensive review of our indirect cost rates, and the establishment of final rates, will take place as part of CA close-out. If the final rates show that, over the life of the CAs, we recovered more in indirect costs than we were entitled to recover, EPA will, of course, be entitled to a refund.

In that connection, we note that we have already prepared an indirect cost rate proposal for 1997, which was shown to the OIG audit team, and are in the process of completing a proposal for 2003 (based on 2002 data), which we will submit once the OIG audit process is completed. In addition, we have reviewed our final cost data for the other years covered by the audit. Our preliminary analysis indicates that, for the period covered by the audit, we recovered **significantly less** in indirect costs than we were entitled to recover, and that the Foundation has under-recovered approximately $600 thousand in indirect costs. We will present our findings on this point to EPA as soon as they are completed.

[B] calculated its indirect cost rates for 1999 through 2001 incorrectly, using indirect costs rather than direct labor as the allocation base.

We acknowledge that our indirect cost rates for 1999 through 2001 were miscalculated; it appears that, in the fraction used to calculate the rate, the numerator and denominator were inadvertently reversed. That error was identified and corrected during the review and analysis referenced in Part 6[A].

As noted above, we expect this correction, along with other appropriate corrections and revisions, will lead to a **significant increase** in the indirect costs payable to the Foundation under the CAs.

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7. The Foundation did not always follow proper procurement practices for contracts awarded under its CAs, and therefore the reasonableness of contract costs could not be adequately assessed. In particular-

[A] Contracts over the $100,000 small purchase threshold were awarded without competition, and without justification to support the lack of competition.

Section 30.43 of the EPA Uniform Regulation, 40 CFR §30.43, provides that "all procurement transactions" under a cooperative agreement "shall be conducted in a manner to provide, to the maximum extent practical, open and free competition." In addition, for each procurement transaction in excess of the small purchase threshold ($100,000), the recipient must maintain "procurement records and files" that include, at a minimum, "the basis for contractor selection; justification for lack of competition when competitive bids or offers are not obtained; and basis for award cost and price." 40 CFR §30.46. On request, these records and files must be made available for EPA review. 40 CFR §30.44(e).

During the five-year period covered by the audit, the Foundation had only two (2) procurement contracts in excess of the $100,000 small purchase threshold.

The first contract (the "Radon PSA Contract") was awarded just after the execution of CA CX825612-01 in July 1997 to PlowShare Group ("PlowShare") of Stamford, Connecticut, an advertising firm specializing in public service campaigns for non-profit organizations. The contract called for the development and delivery of public service announcements ("PSAs") for a public service campaign to increase consumer awareness about the health hazards of radon, and to encourage consumers to test their homes for the presence of radon. From 1998 through 2002, as EPA amended CA CX825612-01 to provide annual increments in funding for the Radon PSA campaign, the Foundation extended the Radon PSA Contract as well. Each annual extension increased the total contract amount by more than the $100,000. So although there was only a single procurement **contract** under CA CX825612-01, there were a total of five (5) procurement **transactions** under that CA in excess of the $100,000 small purchase threshold.

The second procurement contract (the "ETS Contract") was awarded in October 1997 under CA CX825837-01, also to PlowShare. The contract called for the development and delivery of PSAs for a public service campaign - the ETS campaign - to alert the general public to the dangers of secondhand smoke to children. From 1998 through 2002, as EPA amended CA CX825837-01 to provide annual increments in funding for the ETS campaign, the ETS Contract was extended as well. Each annual extension except the last (in 2002) increased the total contract amount by more than the $100,000. So although there was only a single procurement **contract** under CA X825837-01, there were a total of four (4) procurement **transactions** under that CA in excess of the $100,000 small purchase threshold.

These nine (9) procurement transactions - five (5) under CA 825612-01, and four (4) under CA X825837-01 - were the **only** procurement transactions in excess of the $100,000 small purchase threshold under the Foundation's CAs during the period covered by the audit.

The DAR alleges that these contracts, and the extensions thereto, were awarded without competition, and without justification to support the lack of competition. On this point, the DAR is incorrect.

The **Radon PSA Contract** was awarded to PlowShare after the CA for Radon PSA campaign expired, and the program was transferred from CFA to the Foundation. As noted above, EPA wanted the existing Radon PSA campaign

transferred into the new CA without change - i.e., it wanted the same scope of work, performed by the same program staff and program contractors. Because PlowShare was already engaged under the expired CA to produce and distribute the Radon PSA, the Foundation notified EPA in its application for funds that it intended to continue using PlowShare for those services under the new CA. After EPA approved the application, the Foundation entered into a contract with PlowShare as indicated in the application. Under the circumstances, there were at least two well-recognized sole-source justifications available to the Foundation to support its award to PlowShare. **First**, because of EPA's desire to transfer the Radon PSA campaign intact, PlowShare was, in effect, EPA's **designated contractor** for production and distribution, requiring the Foundation to contract with PlowShare without competition.[12] **Second**, to the extent, if any, that the Foundation had discretion in the choice of a contractor for PSA production and distribution, the sole-source selection of PlowShare was justified as a follow-on to the work PlowShare was performing under the expired CA. Indeed, given the nature of the services that PlowShare was providing to the Radon PSA campaign, and the contractor's special expertise in public service campaigns (in particular, those involving radon), this justification is particularly compelling.[13]

The **ETS Contract** was awarded on the basis of a competitive procurement, conducted from August to October 1997, in which four (4) competing offers were received and evaluated.[14] PlowShare's offer was one of the two lowest in price, and included more services and more distribution options than the other offers submitted.[15] Furthermore, in negotiations, we were able to obtain additional price

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[12] EPA was also instrumental in the selection of PlowShare as a contractor under the expired CA. After the unacceptable performance by a large "Madison Avenue" agency (Bates) on PSAs on indoor air quality, EPA concluded that a small, specialized agency would offer lower costs and better results. Around that time, PlowShare's president, who had managed a radon PSA campaign while at the Ad Council, contacted EPA, and EPA in turn suggested that PlowShare be engaged to produce and distribute the Radon PSA.

[13] This point is discussed in greater depth in connection with contract extensions on page 18 below.

[14] Mary Ellen Fise to Files, "Advertising Agency Selection for ETS Campaign" (October 3, 1997)(Attachment #6).

[15] Id.

concessions from PlowShare, further reducing its already low competitive price.[16] As a result, PlowShare was awarded the contract as the offeror whose proposal was deemed most advantageous, price, quality and other factors considered. See 40 CFR §30.43.

Each subsequent contract extension in excess of the $100,000 small-purchase threshold had a well-recognized sole-source justification - namely, to permit the incumbent to continue the work that it had started during the initial term. Given the nature of the services, this sole-source justification is particularly compelling. **First**, it takes years of focused effort to build a successful public awareness campaign whose message "burns through" public ignorance (or indifference) - especially where there are conflicting messages in the marketplace (for example, regarding the health impact of secondary smoke). For both campaigns, a consistent creative approach was indispensable. A change in advertising agency would have lead, almost inevitably, to a change in creative approach. Such a change might have made sense if the existing campaigns were unsuccessful, but they were not. PlowShare's work was extremely well received and effective. One of its public service announcements won an Emmy. **Second**, the specialized nature of the services required for the campaigns meant that a replacement agency would take considerable time - perhaps months - to become familiar with the scientific and policy issues. This would amount to a substantial duplication of cost, which was unlikely to be recovered by competition, and would have cause unacceptable delays in the production and distribution of PSAs. Therefore, once the Radon PSA and ETS Contracts were in place and their respective campaigns successfully launched, a change of advertising agency would almost certainly have disrupted the campaigns and diminished their effectiveness, and would have imposed significant costs on the Government for no compensating benefit.

With respect to documentation: When the ETS Contract was awarded in October 1997, a memorandum was placed in the Foundation files describing the procurement process, the evaluation of offers and the basis for award.[17] However, when the Radon PSA Contract was awarded, the Foundation did not place in its

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[16] PlowShare's initial proposal set a total contract price of $285,300; after negotiation, PlowShare reduced the price to $257,357.

[17] Mary Ellen Fise to Files, "Advertising Agency Selection for ETS Campaign" (October 3, 1997)(Attachment #6).

procurement files a formal explanation of the basis of contractor selection, or a justification for its use of less than "open and full competition." Nor were such explanations placed in the procurement file when the contracts were extended on the basis of EPA incremental funding of the corresponding CA. These omissions have been (or will soon be) corrected, bringing the Foundation into compliance with 40 CFR §§30.44(e)(2) and 30.46 with respect to all procurement transactions in excess of the $100,000 small purchase threshold. In addition, in order to ensure that, in the future, procurement decisions (including sole-source awards) are appropriately documented, we have adopted a manual on "Procurement Procedures for Federal Funds," which provides clear guidance on "competitive bidding for contracts" and requiring that documentation complying with 40 CFR §30.46 be prepared for each procurement and placed in the procurement file at the time of award.

The Foundation's failure to comply in a timely manner with the documentation requirements of 40 CFR §§30.44(e)(2) and 30.46 should not be a basis for any disallowance of costs. For each procurement transaction in excess of the $100,000 small purchase threshold, the Foundation either made the award using "open and free competition," or can demonstrate a well-recognized justification for making a sole source award. Our untimely compliance does not alter the fact that, in each instance, the Foundation, acting on behalf of EPA, received high quality services from a responsible contractor at a competitive price.

[B] The Foundation failed to make and document cost or price analyses in connection with every procurement action.

Section 30.45 of the EPA financial assistance regulation, 40 CFR §30.45, provides that

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

In addition, 40 CFR §30.46 requires that, for purchases in excess of $100.000, the recipient's "procurement records and files" include an explanation of the "basis for award cost or price."

The DAR alleges that the "Foundation failed to make . . . cost or price analyses in connection with every procurement action." This allegation is untrue. **First**, with respect to the Radon PSA Contract awarded to PlowShare in 1997, the Foundation compared the prices offered by PlowShare with prices for similar services that were paid to advertising agencies under CA CX 822244-01 between 1994 and 1996 - including such agencies as Bates USA, Campbell Mithun Esty (CMA), Pia Promotions, Commercial Works and PlowShare - before negotiating price with PlowShare.[18] **Second**, with respect to the ETS Contract, as noted above, the Foundation conducted a competitive procurement from August to October 1997. It received and evaluated four competing offers. The price of PlowShare initial proposal was one of the two lowest; in addition, the Foundation was able to negotiate additional price concessions, further reducing PlowShare's already low competitive price. From that time forward, the competitive price information gathered from the ETS competitive procurement, PlowShare's low competitive bid, and the even lower prices included in the contract after negotiations with PlowShare, served as a benchmark for price negotiations when the two contracts with PlowShare came up for extension.

In addition, it was the Foundation's standard practice each time an extension to the Radon PSA or ETS Contracts was negotiated with PlowShare, to require that PlowShare submit a written contract proposal, broken down into specific contract tasks. With the contract proposal in hand, the responsible Foundation officials analyzed the proposed prices for each activity against the baseline established by the original ETS procurement and subsequent price adjustments, if any. They then conducted a careful line-by-line negotiation with PlowShare in a concerted effort to limit price increases over the baseline established in previous years. The Foundation was able [i] to obtain, on a regular basis, significant price reductions from the initial PlowShare proposal, [ii] to limit year-to-year price increases, and [iii] on occasion, to obtain year-to-year price reductions. For example, after PlowShare submitted its initial contract proposal for the 2001-02 extension of the Radon PSA Contract, the

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[18] See Mary Ellen R. Fise and Jack Gillis to Kristy Miller, "Closeout Report" (December 30, 1997) (Attachment #7)

Foundation required the PlowShare to resubmit the proposal three times before the prices were deemed acceptable. As a result, PlowShare reduced its agency production fees from 17.65% in the initial proposal to 15.00% in the final proposal, and its creative fees by a total of $10,073.

In this context, we believe that the benchmark provided by the competitive information gathered in the first ETS procurement, the requirement of a detailed breakdown of prices by activity, the review and analysis of those prices conducted by the Foundation officials, and, finally, the intensive negotiation of final contract prices with PlowShare on a line-by-line basis - all this, taken together, amount to substantial compliance with the "price or cost analysis" requirement of 40 CFR §30.45.

The DAR also alleges that the "Foundation failed to . . . document cost or price analyses in connection with every procurement action." With respect to the award of the initial ETS contract in October 1997, the allegation is demonstrably untrue. The memorandum prepared by Foundation counsel at the time sets forth the "basis of the award in cost or price" - i.e., the evaluation of proposals in connection with the competitive solicitation. For the remaining procurement actions - that is, the extensions of the Radon PSA and ETS Contracts - we believe that the detailed proposals submitted by PlowShare, the spreadsheet analyses that the Foundation's officials used to conduct price negotiations, and the resulting contract budgets, considered in light of the benchmark provided by the 1997 competitive solicitation, qualify as contemporaneous documentation of the "basis for award cost or price" within the meaning of 40 CFR §§30.45 and 30.46. Thus, we believe that the Foundation substantially complied with those provisions.

To be sure, Foundation officials did not prepare a formal memorandum or other formal written materials explicitly designed to record their price analysis. This omission has now been corrected, bringing the Foundation into compliance with the documentation requirements of 40 CFR §§30.45 and 30.46. Furthermore, the preparation of a contemporaneous price/cost analysis is now required for each procurement by the CFA manual on "Procurement Procedures for Federal Funds," and has become standard organizational practice.

In any event, the Foundation's failure, if any, to comply in a timely manner with the documentation requirements of 40 CFR §§30.45 and 30.46 should not be the basis of a disallowance of costs. For each of its contracts, the Foundation analyzed

prices against a low competitive benchmark, negotiated successfully to keep year-to-year prices increases to a minimum (and even achieved year-to-year reductions), and in the end contracted for and received high quality services at a competitive price.

[C] A contract to develop and distribute PSAs for indoor radon pollution, awarded prior to the execution of CA CX825612-01, was awarded without competition and the required cost or pricing analysis; the contract did not include a price, and was not amended to include additional work as and when the CA was amended.

The referenced "contract to develop and distribute PSAs for indoor radon pollution, awarded prior to the execution of CA CX825612-01" was awarded under a different CA by a different recipient. This award is clearly outside the scope of this audit, and any alleged defect in the procurement process for that contract cannot be the responsibility of the Foundation under of CA CX 825612-01.

If however DAR's reference is to the Radon PSA Contract awarded by the Federation to PlowShare after the execution of CA CX 825612-01, the initial award and subsequent extension of that contract is discussed at length in Parts 7[A] and [B]. With respect to the DAR's specific allegations:

[1] The Radon PSA Contract was awarded without open an free competition; but the decision to do so was fully justifiable. See Part 7[A]

[2] The Foundation conducted the required cost/price analysis by comparing the price offered by PlowShare to the prices charged by other advertising agencies for PSAs recently produced and distributed for the EPA under other CAs. See Part 7[B].

[3] The contract documents for the Radon PSA Contract, including without limitation a written offer (price proposal) submitted by PlowShare and accepted by the Foundation, did include specific prices covering all the activities to be performed by PlowShare under the contract.

[4] In tandem with each amendment of CA CX825612-01, the Foundation negotiated an extension of the Radon PSA Contract, evidenced in each instance by a

detailed PlowShare offer (price proposal), negotiation spreadsheets, and a final PlowShare offer (price proposal) that was accepted by the Foundation.

[D] Under CA CX825837-01, the recipient had no support to demonstrate how it selected the contractor for a research contract to determine the number of people who smoke inside the home.

The Foundation did not select the above-referenced contractor, nor was it a party to the above-referenced contract. The parties to the contract were PlowShare and Bruskin Research of Edison, New Jersey. Thus, the fact that the Foundation has nothing in its files to demonstrate how the contractor was selected, if true, is certainly not surprising.

To the best of our knowledge, PlowShare engaged Bruskin Research on EPA's instructions to undertake urgently needed research on an expedited basis. Based on contemporaneous experience with similar research contracts (at the time, we awarded three or four such contracts each year, paid for out of non-Federal funds), the cost of the research was reasonable.

[E] The recipient did not perform the required cost or price analysis when selecting consultants for legal and consulting services, and paid its attorneys and consultants in excess of the maximum daily rate prescribe for Level 4 of the Executive Service (i.e., $62.50 per hour).

The Foundation did, in fact, perform a cost or price analysis when contracting for the legal and accounting services in question, and as a result received expert professional services at a reasonable cost - in the case of legal services, at a cost considerably below the rates charged by attorneys of similar background and seniority.

In March 2002, when EPA temporarily suspended the Foundation's CAs, the Foundation's Executive Director contacted one of its outside counsel - Gail Harmon of Harmon, Curran, Spielberg & Eisenberg, LLP, the most prominent law firm in Washington DC serving nonprofit organizations. Mr. Brobeck and Ms. Harmon discussed the Foundation's options at length - large law firms, pro bono services, and

specialized boutiques, such as Sonenthal & Overall, with experience in the award and administration of Federal grants and cooperative agreements.[19] Based on her knowledge of local firms, Ms. Harmon recommended Sonenthal & Overall. Mr. Brobeck also consulted Mary Ellen Fise, the Foundation's general counsel for additional recommendations. After contacting a number of firms, Mr. Brobeck settled on Sonenthal & Overall as the best combination of expertise and competence, at a moderate cost.[20]

Subsequently, Mr. Sonenthal advised us that a significant portion of the work on the EPA suspension could be done, with equal effectiveness and at considerably lower cost, by a non-lawyer - e.g., an accountant with experience in the administration of Federal cooperative agreements. He recommended that we contact RSM McGladrey LLP regarding the services of Stephen Kroll, formerly head of the Contract Audit Management at the U.S. Agency for International Development. RSM McGladrey offered Mr. Kroll's services at an hourly rate of $180.00. Mr. Brobeck determined that these rates were reasonable based on Mr. Kroll's special expertise, and on Mr. Brobeck's knowledge of the hourly rates charged by accounting firms for similar work, and considering in addition the benefits (e.g., in quality control) of engaging a recognized international accounting firm such as RSM McGladrey.

In light of the foregoing, we believe that the price/cost analysis conducted by Foundation in connection with its engagement of Sonenthal & Overall and RSM McGladrey met the requirements set forth in 40 CFR §30.46. To be sure, the Foundation did not prepare a contemporaneous memoranda or other formal written materials explicitly designed to record its cost or price analysis. This omission has been (or will soon be) corrected, placing the Foundation in compliance with 40 CFR §§30.45 and 30.46 with respect to these engagements. Furthermore, the preparation of a contemporaneous price/cost analysis memorandum is now required by the CFA procurement manual and has become standard organizational practice.

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[19] A copy of the firm's brochure - "Introduction to Sonenthal and Overall" - and the resume of Robert Sonenthal, the Foundation's principal counsel, are attached as Attachment #8.

[20] Mr. Sonenthal's hourly rate of $265.00 per hour is approximately 10-15% below his normal billing rates, which in turn is considerably below the going rate in Washington DC for an attorney of his education and experience.

Even if the Foundation failed to comply with the documentation requirements of 40 CFR §§30.45 and 30.46 in a timely manner, its tardiness should not be the basis of a disallowance of costs. For its engagement of Sonenthal & Overall and RSM McGladrey, the Foundation sought competitive quotations, analyzed prices and costs, and on that basis contracted for and received high quality services at reasonable prices.

With respect to the DAR allegation that the Foundation "paid its attorneys and consultants in excess of the maximum daily rate prescribe for Level 4 of the Executive Service (i.e., $62.50 per hour)": The EPA regulation on which the DAR relies - 40 CFR §30.27(b) - applies only to "salar[ies] (excluding overhead) paid to individual consultants retained by a recipient's contractors or subcontractors." The limitation is **not** applicable to "contracts with firms." The Foundation did not retain "individual consultants" to provide legal and accounting services; it retained a law firm (Sonenthal & Overall) and an accounting firm (RSM McGladrey). It is obvious therefore that the salary limitation set forth in 40 CFR §30.27 does not apply to those engagements. In terms of cost allowability, the only question is whether the costs incurred by the Foundation for legal and accounting services were reasonable, allocable to the CAs and allowable under OMB Circular A-122. As discussion above clearly demonstrates, the hourly rates paid by the Foundation to Sonenthal & Overall and RSM McGladrey were reasonable. The DAR suggests no other basis on which these costs can be questioned.

[F] The Foundation failed to ensure that contracts under the cooperative agreements included all provisions required under 40 CFR §30.48.

The Foundation admits that not all of its contracts under the CAs contained all the standard contract clauses required under Section 30.48 of the EPA Uniform Regulation, 40 CFR §30.48. However, we note that [i] EPA was not prejudiced in any manner by these omissions, and [ii] our new manual on "Procurement Procedures for Federal Funds" requires that henceforth the standard contract clauses be included in all our procurement contracts.

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IV. SUBAWARDS

8. The Foundation did not always require CA sub-recipients to submit the final financial status reports required under 40 CFR Parts 30 and 31, preventing a determination of actual costs for the sub-awards.

Given the size of the typical subaward, and the basis for payment, the final program report and request for disbursement submitted by the sub-recipient was the substantial equivalent of a final financial status report, and that a separate "final financial status report" labeled as such would have been a needless additional burden and expense, and would provide the recipient no additional information.

The typical subaward under the EPA CAs was between $2,000 and $5,000, made to a CFA state or local affiliate. Each subaward was intended to finance a discrete activity, with easily measurable results, whose total cost could be established at the outset with reasonable certainty. To establish total cost, we reviewed the proposed budget in detail prior to the commitment of funds in order to verify that the proposed costs were reasonable and that there was little risk of subsequent change. After an initial payment, further payment was contingent on the successful completion of the activity and submission of the final program report. If the activity was not completed as contemplated, no further payment was made - even if the sub-recipient had incurred "allowable costs."

Based on these three key elements - a discrete activity with fixed costs and easily measurable programmatic results; a detailed up-front budget analysis; and payment upon completion of easily established milestones - these small subawards are **fixed-obligation subawards**, rather than cost reimbursable subawards. As fixed-obligation subawards, from an audit standpoint, **it is unnecessary - indeed wasteful - to require the sub-recipient to track and report its actual subaward costs** - as would be the case with a fixed-price procurement contract. Accordingly, we believe that, with respect to these fixed obligation subawards, the requirement that sub-recipients submit a "final financial report" is inapplicable.

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9. [A] The Foundation did not competitively solicit and award sub-agreements.

As demonstrated in the legal memorandum prepared by Sonenthal & Overall PC, and submitted with this response, there is no requirement in the EPA Uniform Regulation, in the any of the CAs, or in official EPA policies or procedures, that require a recipient to "competitively solicit and award sub-agreements."

On the contrary, the Uniform Regulation actually **prohibits** EPA from applying the requirement to the Foundation. It provides that EPA may not, by policy or by contract, impose requirements on its recipients that are not set forth in the Uniform Regulation, or are inconsistent with its provisions, without obtaining a special deviation from the agency (for case-by-case deviations) or from the Office of Management and Budget (for class deviations), or unless specifically required by Federal statute or Executive Order. We are not aware that any deviation regarding competition for subawards applicable to the Foundation has been approved by either EPA or OMB, and the DAR provides no reference to any such deviation. If no such deviation exists, EPA enforcement of a sub-award competition requirement against the Foundation would be **a violation of EPA's own regulations**.

Furthermore, even if there were a formal EPA "policy" requiring competition of sub-awards, and that policy did not violate the EPA Uniform Regulation (i.e., OMB had approved a class deviation as required by 40 CFR §§30.1 and 30.4) that "policy" could not be binding against the Foundation, because it was not incorporated into (or even referenced) in any of the Foundation's CAs, and the Foundation did not otherwise agree to abide by its terms. In fact, the Foundation had no notice of the existence of the "policy" or of its alleged applicability to the CAs. Therefore, to enforce the "policy" against the Foundation would be a denial of due process of law, especially if that enforcement were to result in a disallowance of costs.

Finally, one of the principal reasons that EPA solicited CFA's (and, later, the Foundation's) participation in the IAQ, Radon PSA and ETS campaigns was the relationship between CFA (and, later, the Foundation) and CFA's many state and local members and affiliates. In fact, it is clear that EPA expected the Foundation to implement certain CA programs primarily through its members and affiliates. Under the circumstances, it is fair to say that the Foundation was authorized by the CAs to make sub-awards to its members and affiliates. The "full and fair competition" of sub-awards that (according to the DAR) is required by EPA "policy," would have been as inconsistent with EPA's expectations as it would have been with the requirements of the EPA Uniform Regulation.

[B] In soliciting only dues-paying members for sub-awards as a general rule, the Foundation did not comply with EPA policy requiring full and fair competition in the award of cooperative agreements.[21]

As noted in our response in Part 9[A], there is no provision in the EPA Uniform Requirements mandating of "full and fair competition" in the award of sub-awards. Therefore, as noted above, any EPA "policy" purporting to require such competition would amount to an "additional requirement" in violation of the Uniform Regulation, unless a class deviation endorsing that "policy" has been approved by the Office of Management and Budget. To our knowledge, no such class deviation has been approved. Furthermore, to our knowledge, the EPA "policy" was never publicly announced or otherwise communicated to the Foundation - in particular, there is no mention of it in any of the CAs. Accordingly, even if the "policy" exists and (notwithstanding the limitation impose by 40 CFR §30.1) it is legally enforceable, it cannot be enforced against the Foundation.

Also as noted, EPA expected the Foundation to direct sub-awards primarily to its members and affiliates. Thus, "full and fair competition" of sub-awards would have been inconsistent with EPA's expectations and with the explicit requirements of the CAs.

* * * *

V. PERFORMANCE REPORTS

10. The Foundation did not submit all required performance reports, preventing the EPA from assessing progress in meeting the CAs' objectives or determining whether the unexpended funds were adequate to complete the required work.

The DAR does not accurately reflect the number and frequency of

[21] The DAR never quotes, or provides any citation to, the alleged EPA "policy" requiring competition of sub-awards.

performance reports provided to EPA project officers. In fact, the Foundation exceeded the reporting requirements in many respects by submitting more frequent reports than were mandated by the specific CAs.

The nature of the Foundation's relationship with EPA project officers meant that we were in regular contact with the project officers. We communicated regularly through day-to-day e-mails, phone calls, and specialized reports provided upon request. Project officers were well-informed of our progress through this regular communication and, at least monthly, could see that we drawing down funds to pay for our efforts on a reimbursement basis. At no point during the Foundation's work on any cooperative agreement, has an EPA project officer ever indicated that the Foundation failed to produce reporting documents in violation of the terms of a CA.

Each project officer received, on a monthly basis, a copy of the Job Cost Activity Report that summarized the budget versus actual financial activity under each CA, in addition to frequent phone calls and emails providing updates of the Foundation's work on particular projects. The Job Cost Activity Reports showed that activity had taken place and showed when and how it had been paid for (on a reimbursement basis). They also showed under which line item the activity had taken place. Samples are attached.

Copies of written performance reports issued for each cooperative agreement are included in the attachments:

X824939-01 Radon IAQ (requiring Annual Reports and a Final Report)

The project officer received a monthly report on the activity of the Radon Fix-It Program. Copies of these monthly reports for the five-year project period are attached. The Foundation also submitted annual reports for the Radon Fix-It Program for the project period.

The Foundation submitted reports on the state and local outreach component of this agreement. Mid-term reports are available for 1996-1997 and 1997-1998. Annual reports on the state and local outreach results were submitted for each year of the project period. Copies are attached as Attachment #12.

The Foundation provided a written summary of the other types of national

outreach executed under this cooperative agreement for 1998-1999, 1999-2000, and 2000-2001. Copies of these performance reports are in Attachment #12.

Finally, the Foundation submitted final financial and technical reports for this CA and copies of these are in Attachment #13.

X829178-01 Radon IAQ2 (requiring quarterly, mid-year, annual, and final reports)

The Foundation submitted monthly Radon Fix-It program reports from the beginning of the project period until September 2003, when the program was shifted to the National Safety Council. Annual Reports for the Radon Fix-It Program are available for the two years the program was operative under this CA. Copies of these reports are included as Attachment #14.

The Foundation submitted semiannual and annual performance reports on the state and local outreach program for the year in which state and local outreach was executed. An annual report also summarized the results of the Foundation's national outreach. Copies of these reports are included in Attachment #15.

A final technical and financial report is not due for this agreement until November 2004.

X825837-01 ETS Public Service Advertising (requiring quarterly and final reports)

The Foundation customized reports for this project officer upon request on several occasions. Examples of these reports are included as Attachment #16.

The project officer also received at least quarterly (and sometimes more often upon request) copies of media usage reports. These reports indicate where the advertisements aired, frequency of airings and donated media value - the key indicators used to measure the effectiveness of the advertising. The project officer also received periodic cumulative media usage reports. Examples of these reports are included in Attachment #17.

The Foundation submitted the final financial and technical reports for this CA. Copies are included as Attachment #18.

X825612-01 Radon Public Service Advertising (requiring quarterly and final reports)

For each of the five media campaigns developed and distributed under this CA, media usage reports were submitted to the project officer on a quarterly basis. Frequently, the project officer requested weekly reports. The project officer also received cumulative media usage reports. Examples of these reports are included as Attachment #19.

The Foundation submitted the final financial and technical reports for this CA. Copies are included as Attachment #20.

X28814-01 Energy Efficiency (requiring quarterly and final reports)

The Foundation submitted annual reports for 2001-2002 and 2002-2003, the project period covered by this agreement. The Foundation has also submitted the final financial and technical report for this agreement. Copies of these reports are included as Attachments #21 and #22.

VI. CONCLUSION

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

In addition, the DAR ignores the fact that the programs were undertaken by CFA **at EPA's specific request**, and were later transferred intact from CFA to the Foundation **at EPA's specific request**. It ignores five years of successful program performance by the Foundation, and the considerable benefits for public health and education that flowed from those programs. Finally, it ignores the fact that Foundation acted, at all times and in all matters, in the utmost good faith.

SONENTHAL AND OVERALL P.C.
1120 Nineteenth Street, N.W.
Suite 600
Washington, D.C. 20036

January 20, 2004

MEMORANDUM

TO: Stephen Brobeck
Executive Director
Consumer Federation of America

FROM: Sonenthal & Overall P.C.

SUBJECT: [1] Section 18 of the Lobbying Disclosure Act of 1995; and [2] Competition of SubAwards under EPA Cooperative Agreements,

I. INTRODUCTION

At your request, we have reviewed the draft audit report ("DAR") dated November 21, 2003, prepared by the Office of Inspector General, U.S. Environmental Protection Agency ("OIG/EPA"), and submitted to the Consumer Federation of America ("CFA") for comment.[1] The DAR covers costs claimed by the Consumer Federation of America Foundation (the "Foundation") under five cooperative agreements ("CAs") administered by the Foundation on EPA's behalf between 1997 and 2002, and makes a series of recommendations to EPA regarding, among other things, the allowability of costs claimed. In particular, you asked that we express our views on two significant legal questions raised in the DAR:

A. Whether from the time the first CA was awarded through the end of 2002, CFA was ineligible to receive Federal funds under Section 18 of the Lobbying Disclosure Act of 1995, as amended, 2 U.S.C. §1611 ("LDA"), and whether EPA can require CFA, the Foundation's successor in interest, to return all of the funds received by the Foundation from EPA to implement the CAs (approximately $4.7 million).

[1] Office of Inspector General, "Audit Report: Consumer Federation of America Foundation - Costs Claimed under EPA Cooperative Agreements," Report No. 2004-x-xxxxx (November 21, 2003)(draft - not for public distribution).

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B. Whether the Foundation was required, by EPA regulation, policy or otherwise, to award the assistance subawards authorized under three of its CAs on a competitive basis.

This memorandum sets forth our preliminary analysis and conclusions on these two questions. It is based on information made available to us by CFA staff, and research regarding the LDA, its legislative history, and the cases and materials relating to agency enforcement of Federal law. If the questions discussed in this memorandum become the subject of a court proceeding, further research and analysis is likely to be required.

II. SUMMARY OF CONCLUSIONS

A. In our view, the OIG's interpretation of LDA Section 18 - that is, its **expansion** of the statutory disqualification beyond the 501(c)(4) organizations referred to in the statute - is incorrect as a matter of law, and unenforceable against the Foundation. We believe that, as a matter of law, a 501(c)(3) or a non-lobbying 501(c)(4) may share directors, facilities and staff — may be all but indistinguishable from the non-lobbying 501(c)(4) — without losing its eligibility under LDA Section 18, as long as the organizations respect their separate incorporation and maintain separate books of account. Our conclusion is based on the following considerations:

First, OIG's interpretation of LDA Section 18 is inconsistent with the statute's plain and unambiguous terms.

Second, the legislative history of LDA Section 18, cited by OIG to support its expansion, appears instead to contradict its position — i.e., it appears to exclude separately incorporated 501(c)(3) organizations from the statute's coverage. The legislative history also suggests that Congress was concerned about the effect that LDA Section 18 would have on important First Amendment interests - interests which, in our view, could be chilled or compromised if eligibility for Federal funds were to depend on an undefined "degree of separation" between 501(c)(3) and 501(c)(4) organizations.

Third, we question whether EPA has the legal authority to adopt a broad interpretation of LDA Section 18, as EPA is not the only Federal agency charged with administering the statute, and it has no special expertise with respect thereto. If EPA does adopt that interpretation, its view would be entitled to no deference in a court of law, and should be vulnerable to legal challenge.

Fourth, even if EPA has the authority to adopt the OIG interpretation of LDA Section 18, under well established legal precedent, it cannot apply that interpretation retroactively to the Foundation.

B. With respect to the alleged obligation of an EPA recipient to compete subawards: There is no requirement in the EPA Uniform Regulation, in the any of the CAs, or in official EPA policies or procedures, that require a recipient to "competitively solicit and award sub-agreements." EPA regulations actually prohibit the agency from imposing requirements on its recipients, by policy or by contract, that are not already set forth in the regulations, or are inconsistent with their provisions, without obtaining a special deviation from the agency (for case-by-case deviations) or from the Office of Management and Budget (for class deviations), or unless specifically required by Federal statute or Executive Order. To our knowledge, no deviation, statute or Executive Order authorizes EPA to require competition of subaward.

II. THE LOBBYING DISCLOSURE ACT.

1. OIG's Interpretation of LDA Section 18

LDA Section 18, as amended, provides that "[a]n organization described in section 501(c)(4) of the Internal Revenue Code of 1986 which engages in lobbying activities shall not be eligible for the receipt of Federal funds constituting an award, grant or loan." In the DAR, OIG acknowledges that, at all relevant times, the Foundation was not "an organization described in section 501(c)(4) of the Internal Revenue Code of 1986"; it was, instead, a organization described in IRC Section 501(c)(3) — a charitable and educational organization. OIG maintains, however, that the Foundation was ineligible to receive Federal funds because of its close relationship with CFA. According to OIG, "[t]here was no discernible separation between [CFA] and the Foundation other than having separate general ledgers for each organization."

> "The Foundation had no employees, space or overhead expenses separate from [CFA]. All personnel proposed in the assistance agreement applications and used under the agreements were [CFA] employees. The overhead costs claimed under the agreements were based on [CFA]'s overhead costs. Consequently, [CFA] and the Foundation did not have the

> **required degree of separation** between Federal grant money and the private lobbying effort by the Federation."[2]

Because the Foundation and CFA did not have the "required degree of separation," OIG concludes that [i] the Foundation and CFA must be treated as a single organization; [ii] CFA was therefore the effective recipient of all CA funds; [iii] because CFA was a 501(c)(4) organization that engaged each year in a small amount of lobbying,, CFA's receipt of Federal fund was a violation of LDA Section 18, and, as a result [iv] "all the costs claimed [by the Foundation] and paid under the [CAs] are statutorily unallowable."[3]

2. Statement of Facts.

At the outset, we note that the DAR misstates the historical relationship between the Foundation and CFA, and understates the actual "degree of separation" between the two organizations. As noted, OIG acknowledges that the Foundation was a duly established 501(c)(3) charitable organization. It acknowledges, as well, that the Foundation and CFA kept separate books of account, but it passes quickly over this point and focuses instead on the fact that [i] the Foundation was housed in CFA space, and [ii] the Foundation relied almost exclusively on CFA personnel, working under a contract between the Foundation and CFA, for its administrative and technical support.[4] But OIG ignores other significant evidence of legal and practical separation between the two organizations. For example, it fails to note that each organization had its own Board of Directors, and that during a portion of the relevant period, a majority of the Foundation's Board were directors with no affiliation to CFA. In addition, the OIG's statement that "all personnel proposed and used under the CAs were Federation employees" is not accurate.[5] While the Foundation had no permanent employees, we understand that, under several of the Foundation's CAs, a

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[2] DAR at 6 (emphasis added).

[3] DAR at 6.

[4] In this respect, the Foundation was no different from many small 501(c)(3) and 501(c)(6) organizations whose Boards economize — personnel costs (salary and benefits) and space in particular — obtaining administrative and technical support from a management services company.

[5] DAR at 6.

portion of the program work was done by consultants engaged directly by the Foundation.

Furthermore, as noted in the CFA's Response to the DAR,[6] OIG misstates the historic relationship between the CFA and the Foundation. According to OIG, CFA established the Foundation "to receive federal funds, while CFA retained its rights to lobby as a 501(c)(4) organization." This statement implies that the Foundation was a CFA front, created in response to the enactment of LDA Section 18 in order to keep EPA funds flowing to CFA. The implication is incorrect. The Foundation was not formed by CFA "to receive Federal funds" on its behalf. In fact, the Foundation was incorporated in 1972. It was recognized by the IRS as a tax-exempt charitable organization in August 1972.[7] From the date of its incorporation, the Foundation conducted its activities separately from CFA, under its own Board of Directors, its own accounting system, and its own budget.[8] Until 1996, the Foundation operated substantially without Federal funds.[9] That changed, according to the Response, in 1996 and 1997 when the EPA awarded the Foundation three separate CAs. In each case, the award was initiated by EPA, and was intended by EPA to transfer CAs previously administered by CFA on EPA's behalf, from CFA, a 501(c)(4) organization precluded by LDA Section 18 from receiving Federal funds, to the Foundation, an eligible 501(c)(3) recipient.

Although OIG's description of the Foundation's history and its relationship to CFA, is inaccurate and misleading, we do not agree that the "degree of separation" between the organizations has any effect, one or the other, on the Foundation's eligibility for Federal funds under LDA Section 18. In fact, we believe that, as a matter of law, a 501(c)(3) or a non-lobbying 501(c)(4) may share directors, facilities and staff — may be all but indistinguishable from the non-lobbying 501(c)(4) in all material respects — without losing its eligibility under LDA Section 18, as long as the organizations respect their

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[6] Response of the Consumer Federation of America to Draft Audit Report on the Consumer Federation of America Foundation at 1-2 (January 20, 2004) ("Response").

[7] The Foundation's original corporate name was the "Paul H. Douglas Consumer Research Center, Inc." In March 25, 1997, its name was changed to the "Consumer Research Council," and then, in March 1999, to the "Consumer Federation of America Foundation." See Response at 1.

[8] See Response at 1.

[9] See Response at 2-3.

separate corporate status and maintain separate books of account. our conclusion is based on the text of LDA Section 28, its somewhat meager but instructive legislative history, and the statutes underlying purposes and policies.

3. Statutory Interpretation.

LDA Section 18 prohibits Federal financial assistance to a 501(c)(4) organization that engages in lobbying activities — specifically, to "[a]n organization described in section 501(c)(4) of the Internal Revenue Code of 1986." By it terms, therefore, the coverage of LDA Section 18 is predicated, in the first instance, on tax-exempt status. Organizations described in section 501(c)(4) are covered by the section if they lobby; organizations described in IRC section 501(c)(4) that do not lobby, organizations described in IRC 501(c)(3), and others organizations are not. There is nothing ambiguous in the text - that is, there are no words or phrases in the text whose meaning or reference is unclear. As a result, the text cannot be interpreted to provide that close affiliation with a lobbying 501(c)(4) organization brings a 501(c)(3) organization within the ambit of the section. Support for OIG's broad interpretation of LDA Section 18, if it exists at all, must come from outside the statutory text.

4. Legislative History

OIG appears to concede that its interpretation of LDA Section 18 finds no support in the statutory text. It offers no argument on this point, but turns immediately to the section's legislative history. One might question whether resort to legislative history is permissible where the statutory text is plain and unambiguous. Furthermore, one of the sources of legislative history on which OIG relies - a report on the LDA first prepared by the Congressional Research Service ("CRS") in 1996, after the statute was enacted — does not, strictly speaking, qualify as legislative history. Still, the excerpts offered by OIG in support of its interpretation are instructive, as much for what they omit as for what they quote.

First, OIG cites an excerpt from H.R. 104-339, a report of the House Committee on the Judiciary:

> "This Section [Section 18] provides that organizations described in Section 504(c)(4) of the Internal Revenue Code which engage

> in lobbying activities shall not be eligible for the receipt of Federal funds constituting an award, grant, loan or other form. Under this provision, 501(c)(4) organizations may form affiliate organizations in which to carry on their lobbying activities with non-federal funds'""[10]

The **second excerpt** is from the CRS Report. As quoted by OIG, it reads as follows:

> "[T]he legislative history of [Section 18] clearly indicates that a 501(c)(4) organization may separately incorporate an affiliated 501(c)(4), which would not receive any federal funds, and which could engage in unlimited lobbying. The method of separately incorporating an affiliate to lobby . . . was apparently intended to place a degree of separation between federal grant money and private lobbying, while permitting an organization to have a voice through which to exercise its protected First Amendment rights of speech, expression and petition."[11]

It is immediately obvious that neither the House Report nor the CRS report contain any statement directly supporting the extension LDA Section 18 coverage beyond 501(c)(4) organizations that lobby. The CRS excerpt notes that one purpose of LDA Section 18 was to place a "degree of separation between federal grant money and private lobbying." But, significantly, the required "degree of separation" appears to be satisfied by "separately incorporating." There is no suggestion that a 501(c)(3) organization, "separately incorporated" from a 501(c)(4) affiliate, would be subject to any further test regarding the precise "degree of separation" needed to qualify for Federal funding under LDA Section 18.

This reading is supported by the first sentence of the quoted text — i.e., "The legislative history of the provision clearly indicates that a 501(c)(4) organization may separately incorporate an affiliated 501(c)(4), which would not receive any federal funds, and which could engage in unlimited lobbying." A 501(c)(4) organization created by a 501(c)(4) parent for the sole purpose of receiving Federal funds will likely — will almost

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[10] DAR at 5n.2.

[11] DAR at 6.

certainly — share directors, facilities, and staff with its parent, but that fact would not seem to affect the eligibility of the new 501(c)(4) for Federal funds under LDA Section 18. Indeed, the issue is not even mentioned. Separate incorporation alone appears sufficient.

This reading is clearly confirmed when the text that OIG deleted from the quoted paragraph is replaced. This deleted text is crucial because it reports real "legislative history" — statements made by the Congressional sponsors of LDA Section 18 — and because it bears directly on the validity of OIG's interpretation. When the paragraph is read in its entirety, it is clear that the sponsors intended that separate incorporation, by itself, was enough to shelter the affiliates of a lobbying 501(c)(4) from disqualification under LDA Section 18. The text deleted from the paragraph by OIG is underlined:

> "The legislative history of the provision clearly indicates that a 501(c)(4) organization may separately incorporate an affiliated 501(c)(4), which would not receive any federal funds, and which could engage in unlimited lobbying. The method of separately incorporating an affiliate to lobby, **which was described by the amendment's sponsor as "splitting,"** was apparently intended to place a degree of separation between federal grant money and private lobbying, while permitting an organization to have a voice through which to exercise its protected First Amendment rights of speech, expression and petition.) **As stated by Senator Simpson: "If they decided to split into two separate 501(c)(4)'s, they could have one organization which could both receive funds and lobby without limits."**[12]

According to Senator Simpson, when a 501(c)(4) organization "splits" into two separately incorporated 501(c)(4) affiliates, but remains "one organization," the non-lobbying 501(c)(4) is treated as independent for purposes of LDA Section 18, and is therefore eligible to receive Federal funds. On the same basis, where a 501(c)(3) and a lobbying 501(c)(4) are "one organization," the 501(c)(3) should also be treated as independent for purposes of LDA Section 18, and should therefore be eligible to receive Federal funds. Separate incorporation is sufficient. When the language deleted by OIG is included, the

[12] Congressional Research Service, Report No. 96-809, Lobbying Regulations on Non-Profit Organizations" (updated May 19, 1998), available on-line at http://www.ncseonline.org/NLE/CRSreports/Risk/rsk-53.cfm

"legislative history" on which OIG relies to support its interpretation of LDA Section 18 turns out to contradict that interpretation.

5. Statutory Purpose/Public Policy

It is not difficult to see why the text of LDA Section 18 defines its coverage solely in terms of tax-exempt status, and the legislative history, both authoritative and non-authoritative, speaks in terms of "separate incorporation." **First**, separate incorporation is sufficient to serve the basic purposes of the statute. Separate incorporation means separate books of account. This, in turn, allows greater transparency in the use of Federal funds, and provides the Government additional assurance that its funds are not being used for lobbying. No similar benefit appears to flow from prohibiting separately incorporated organizations from sharing facilities and staff.

Second, separate incorporation is an objective fact. Using separate incorporation as a benchmark, an organization affiliated to a lobbying 501(c)(4) can determine its eligibility to receive Federal funds under LDA Section 18 with reasonable certainty. In contrast, the test proposed by OIG — i.e., the "degree of separation" between the two organizations - is neither easy to apply nor certain of result. What precisely is the "degree of separation" required by LDA Section 18? Does it demand different directors, different personnel, or both? And how different? In the absence of detailed guidance,[13] any organization - 501(c)(3), or 501(c)(4) or otherwise - with a lobbying 501(c)(4) affiliate would be unsure of its status. A board resignation, a secondment of personnel or something equally trivial could erase the required "degree of separation," and make it ineligible to receive Federal funds.

Similarly, a recipient of Federal funds with a lobbying 501(c)(4) affiliate may discover only **after the fact** that the "degree of separation" between the two organizations was somehow insufficient for purposes of LDA Section, and that it was, without knowing it, ineligible to receive Federal funds. The Foundation, of course, is in precisely that situation. Relying on recognized tax exempt status and separate incorporation, the

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[13] It is highly unlikely that such detailed guidance could be written, given the variety of integration that can exist between organizations. Such guidance would also seem to interfere unacceptably with the freedom of non-profit organizations to structure their internal affairs, and might make it difficult for small non-profits to achieve economies of affiliation.

Foundation received Federal funds for five years on five different cooperative agreements. Now, well after the fact, in circumstances in which the Foundation can take no remedial action, OIG announces that, for five years, the "degree of separation" between the Foundation and CFA was "inadequate," making the Foundation's receipt of Federal funds during that entire period illegal. OIG does not indicate on what basis, or by applying what standard, it determined that the "degree of separation" was inadequate; it does not suggest when or how the Foundation could have discovered that standard in advance, and adjusted its conduct accordingly.

In brief, it is unreasonable to read LDA Section 18 as OIG suggests. To do so would produce an unending succession of unprincipled ex post facto disallowances, limited only by the definition of "degree of separation" adopted by the Government from time to time. Congress could not have intended that result.

Third, important First Amendment concerns also argue for a narrow construction of LDA Section 18 and against the broad and unprincipled interpretation offered by OIG. As Congress recognized, the prohibition imposed on lobbying 501(c)(4)s affects their First Amendment interests by, in effect, imposing the penalty of ineligibility on organizations that exercise their right to petition the Government. As a result, Congress had an interest in making the statute clear, precise and easily enforceable, and in allowing the broadest possible freedom for lobbying 501(c)(4)s to organize or affiliate with organizations that are eligible to receive Federal funds. The legislative history of Section 18 clearly shows that Congress encouraged such affiliations — precisely in order to assure that the LDA Section 18 prohibition would not unduly restrict the First Amendment rights of 501(c)(4) members. A broad, unprincipled reading of LDA Section 18 such as OIG proposes could significantly restrict those First Amendment rights. Statutes which impinge on fundamental rights must be narrowly construed. Woodward v. Rogers, 344 F.Supp. 974 (D.D.C.), aff'd, 486 F.2d 1313 (D.C. Cir.)(1974).

5. **Other Sources of Law**.

OIG cites no other sources, in law, regulation, case law or commentary, to justify its reading of LDA Section 18. Accordingly, in light of clear statutory language, the legislative history, the underlying statutory purposes and policies, the unacceptable consequences of unprincipled ex post fact enforcement, and the possible chilling affect on First Amendment rights — LDA Section 18 should be read narrowly to exclude all

separately incorporated lobbying 501(c)(4) affiliates. OIG's broad reading of the statute should be rejected.

6. **OIG's Interpretation of LDA Section 18 Is Not Authoritative**

Even if the meaning of LDA Section 18 were not plain and unambiguous, and underscored by the statutes legislative history, if EPA adopted OIG's interpretation of the statute, that interpretation would be entitled to little or no deference in a court of law. The Supreme Court and various Federal Circuit Courts have made clear that deference is to be accorded to an administrative agency's interpretation of a statute only if such agency has been specifically and exclusively charged with the administration of that statute.[14] The Courts reason that it is appropriate to "pay particular attention to the views of an expert agency where they represent 'specialized expertise.'"[15] Conversely, where an agency has not been specifically charged with the administration of a particular statute, no deference to the agency's statutory interpretation is called for. LDA Section 18, by its very nature, is applied by all federal agencies that make grants to non-governmental entities. As far as we are aware, EPA has not been specifically or exclusively charged with its administration. The Federal courts have consistently declined to defer to any one agency's construction of a statute that is designed to be implemented by multiple agencies.[16]

Finally, deference is normally accorded to agency interpretations of law when those interpretations have been applied on a consistent basis over time. As noted below, EPA adoption of the OIG interpretation of LDA Section 18 would be an abrupt departure from what appears to be EPA's current position.

Therefore, EPA's authority to adopt OIG's interpretation of LDA Section 18 is

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[14] See, e.g., Hoffman Plastic Compounds v. NLRB, 122 S.Ct. 1275 (2002) (extending the reasoning of the Chevron decision on the degree of deference due to statutory construction by administrative agencies)

[15] See Martin v. Occupational Safety and Health Review Commission, 499 U.S. 144 (1991).

[16] See, e.g., Saleh v. Chrisotpher, 85 F. 3d 689 (D.C. Cir. 1996); Rapoport v. Department of Treasury, 59 F. 3d 212 (D.C. Cir. 1995); Avenue of the Americas Associates v. RTC, 22 F. 3d 494 (2d Cir. 1994).

questionable in three respects: [i] the interpretation departs from the plain and unambiguous meaning of the statute; [ii] EPA does not have LDA enforcement authority, or any special expertise that would require the courts to accord any special consideration to its views; and [iii] the OIG interpretation is not well-established at EPA; on the contrary, it reverses a position that EPA took with respect to LDA Section 18 in 1996 and 1997 and again, as recently as late 2002.

7. <u>Retroactive Enforcement</u>

In this section, we assume, for the sake of argument, that a federal court has approved OIG's proposed interpretation of LDA Section 18, has identified and adopted a legal standard defining the "degree of separation" between 501(c)(3) recipients and their 501(c)(4) affiliates required by LDA Section 18, and has determined that, under the adopted standard, that the Foundation and CFA did not have the required "degree of separation." Even in these circumstances, however, a court is likely find a disallowance based on the OIG interpretation of the section to be "arbitrary, capricious and contrary to law" because [i] the expansion of Section 18 to 501(c)(3) recipients would be a departure from EPA's established practice; [ii] the Foundation relied on that established practice each time it agreed, at EPA's specific request, to perform services for EPA under a cooperative agreement; [iii] retroactive application of an expanded Section 18 would impose a serious financial penalty on the Foundation U.S. Court of Appeals set aside a National Labor Relations Board ("NLRB") decision applying retroactively a new rule that was contrary to a "well settled" rule on which the respondent employer had relied. The issue before the court was whether retroactive application was "arbitrary, capricious or contrary to law."

> "Among the considerations that enter into a resolution of the problem [of retroactivity] are (1) whether the particular case is one of first impression, (2) whether the new rule represents an abrupt departure from well established practice or merely attempts to fill a void in an unsettled area of law, (3) the extent to which the party against whom the new rule is applied relied on the former rule, (4) the degree of burden which a retroactive order imposed on a party, and (5) the statutory interest in applying the new rule despite the reliance of a party on the old standard." 466 F.2d at 390.

The application of LDA Section 18 to the Foundation is **not** a case of first impression, at least not for EPA. In fact, as recounted in the Response, at the time EPA transferred CFA's programs to the Foundation (1996/1997), it appears that EPA [i] clearly understood the nature of the relationship between the Foundation and CFA — including the specific facts and circumstances on which OIG bases its claim that the Foundation is ineligible under LDA Section 18; [ii] considered the implications of that relationship for the Foundation's eligibility under LDA Section 18; and [iii] determined that the relationship did not render the Foundation ineligible to receive Federal funds.[17]

EPA confirmed that initial determination repeatedly thereafter - each time it awarded a new CA, added funding to an existing CA, or simply disbursed funds to the Foundation thereunder. More recently, in 2002, EPA suspended performance of all five of the Foundation's CAs pending clarification of certain legal and regulatory compliance issues. One of those issues was the relationship on-going relationship between the Foundation and CFA. In May 2002, after full disclosure and discussion, but without any change in the Foundation/CFA relationship, EPA lifted the suspension and began once again to make disbursements under each of the five CAs. EPA would not have restarted its disbursements to the Foundation and continued those disbursements through the end of 2002 if it had not made a determination that the Foundation was an eligible recipient under LDA Section 18. (Indeed, if the OIG interpretation of LDA Section 18 is correct, all EPA's disbursements to the Foundation in 2002 were illegal.)

Accordingly, if EPA adopts the OIG's interpretation of LDA Section 18, and applies that interpretation to the Foundation, the result would qualify as "an abrupt departure" by EPA from its established interpretation of LDA Section 18, the interpretation under which it had, on numerous occasions, determined the Foundation to be an eligible CA recipient. The change is not likely to qualify as an "attempt to fill a void in an unsettled area of law" - e.g., the clarification of ambiguous language in the statute. See Retail, Wholesale and Department Store Union v. NLRB, supra, 466 F.2d at 391. As noted above, the statute is not unclear or ambiguous, and the proposed OIG interpretation reaches organizations that the plan and unambiguous terms of the statute do not cover.

With respect to reliance and injury: There can be no question that the Foundation specifically relied on EPA's determination that the Foundation was an eligible recipient under Section 18 when it agreed to accept the CAs transferred to it from CFA at EPA's

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[17] See Response at 3.

behest. It relied as well on EPA's implicit confirmation of its eligibility each time EPA approached the Foundation to take on a new CA, or to accept additional funding under an existing CA. Similarly, the extraordinary burden that a change in EPA policy with respect to LDA Section 18 would impose on the Foundation — namely, a $4.7 million disallowance and refund — is too obvious to require comment.

Finally, it is difficult to see what statutory purpose would be served by apply the OIG interpretation retroactively, and many equitable arguments to the contrary. On the contrary, it is fair to say that the Foundation acted in good faith and in the absence of any guidance in law, regulation or precedent suggesting that its relationship with CFA might make it ineligible for Federal funding. Under the circumstances, retroactive enforcement of the OIG interpretation would not vindicate any public interest, penalize the misuse of Federal funds for lobbying activities, or lead to the recovery any funds for which the Government, and the general public, did not receive full value. As noted in Retail, Wholesale and Department Store Union v. NLRB, "[a] distinction must . . . be made between the purpose of the statute and the necessity of a particular remedy to effectuate that purpose." 466 F.2d at 392. Here, it does not appear that the "particular remedy" sought by OIG -– a $4.7 million forfeiture — is reasonably necessary to support the purposes of the statute.

The Foundation does not contest EPA's right to change its policies, and to insist that its recipients conform to those policies **prospectively**. Indeed, when the EPA Grants Management Office first raised the question of the Foundation's LDA Section 18 eligibility in March 2002, the Foundation and CFA hastened to arrange a corporate reorganization to respond to EPA's concerns. However, EPA would not have the authority to enforce that new policy retroactively against a party that relied in good faith on the old policy, now discarded, and would suffer extreme hardship if the policy were enforced.

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B. **COMPETITION of SUBAWARDS**..

In the DAR, OIG criticizes the Foundation for its failure to use the competitive procedures required by 40 CFR Part 30 to award subagreements under three of its CAs.[18] According to IOG-

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[18] DAR at 2, 13.

> "It is EPA policy to promote competition in the award of cooperative agreements to the maximum extent practicable. Further, it is EPA policy that the competitive process be fair and open and that no applicants receive an unfair competitive advantage. Soliciting only dues paying members does not promote competition and is not fair and open."[19]

The first sentence in the quote above may well be an accurate statement of EPA policy with respect to "the award of cooperative agreements." However, we are aware of no regulation, policy or practice that requires the recipient of a cooperative agreement to compete - "to the maximum extent practicable" or otherwise - in the award of sub-agreements.

OIG supports the sub-award competition requirement by citing Section 30.5 of the EPA financial assistance regulation, 40 CFR 30.5. By its terms, Section 30.5 makes the provisions of OMB Circular A-110 applicable to certain "subrecipients performing work under awards." It does not speak to the obligations of recipients, either in general, or with reference to the award of subagreements.

40 CFR Part 30 is EPA's version of the OMB common rule for administration of cooperative agreements and grants to institutions or higher education, hospitals and other non-profit organizations. The requirements of the regulation rule are uniform across agencies and therefore difficult to change. For example, under the common rule agencies "may not impose additional or inconsistent requirements" on their recipients and grantee without obtaining a deviation from the agency (case-by-case deviations) or from OMB (class deviations), or unless specifically required by Federal statute or Executive Order. These provision of the common rule are incorporated in 40 CFR 30.1 and 30.4.

Consequently, absent a provision in 40 CFR Part 30 requiring the use of competitive procedures to award subagreements, or a formal deviation from 40 CFR Part 30 imposing such an obligation, EPA is not required to do so. Furthermore, to impose that requirement as a matter of EPA policy, as suggested by OIG would be a violation of EPA's own regulations — i.e., 40 CFR 30.1, cited above.

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[19] Id. at 13.

Appendix C

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