



OFFICE OF INSPECTOR GENERAL

Catalyst for Improving the Environment

Quality Control Review Report

PricewaterhouseCoopers, LLP Single Audit of Natural Resources Defense Council, Inc., for Year Ended June 30, 2003

Report No. 2006-S-00002

May 25, 2006

Report Contributors:

Leah Nikaidoh
Lisa McCowan
Larry Gunn

Abbreviations

AICPA	American Institute of Certified Public Accountants
CFDA	Catalog of Federal Domestic Assistance
EPA	Environmental Protection Agency
NRDC	Natural Resources Defense Council
OIG	Office of Inspector General
OMB	Office of Management and Budget



At a Glance

Catalyst for Improving the Environment

Why We Did This Review

In a September 21, 2005 report on Environmental Protection Agency (EPA) assistance agreements issued to the Natural Resources Defense Council, Inc. (NRDC), we identified significant questioned costs due to inadequate support for cost claimed. Because of these issues we performed a quality control review of the single audit to determine whether it met single audit requirements.

Background

Under Office of Management and Budget Circular A-133, entities that expend Federal funds of \$300,000 in a year are required to have a single audit conducted. For the year ended June 30, 2003, PricewaterhouseCoopers, LLP conducted the NRDC audit. NRDC incurred \$608,099 in expenditures under EPA assistance agreements during this fiscal period.

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

To view the full report, click on the following link:
www.epa.gov/oig/reports/2006/20060525-2006-S-00002.pdf

Quality Control Review of PricewaterhouseCoopers, LLP Single Audit of Natural Resources Defense Council, Inc., for Year Ended June 30, 2003

What We Found

PricewaterhouseCoopers, LLP did not adequately test and document the auditee's compliance with Federal procurement regulations, and did not properly report the auditee's lack of compliance with indirect cost proposal requirements. These issues should have resulted in reported noncompliances in the single audit report. Because the Office of the Inspector General has already reported these matters to EPA for audit resolution, there will be no added benefit for PricewaterhouseCoopers, LLP to retract and reissue its single audit report.

We also identified two technical deficiencies. The single auditor did not correctly determine major and non-major programs, as required. Further, the single auditor did not adequately document its basis of materiality for compliance testing, in accordance with standards.

What We Recommend

We recommend that for future single audits, PricewaterhouseCoopers, LLP ensure that appropriate testing of procurements is performed and the results documented in its working papers. We also recommend that the single auditor sufficiently document its analysis and conclusions in future audits. For the technical deficiencies, we recommend that for future single audit work, the single auditor should ensure that appropriate steps are taken to address these deficiencies. The single auditor generally agreed with these recommendations.



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

OFFICE OF
INSPECTOR GENERAL

May 25, 2006

MEMORANDUM

SUBJECT: Quality Control Review of PricewaterhouseCoopers, LLP
Single Audit of Natural Resources Defense Council, Inc.,
for Year Ended June 30, 2003
Report No. 2006-S-00002

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

TO: Richard Kuhlman, Director
Grants Administration Division

This is our final report on the quality control review of the single audit of Natural Resources Defense Council, Inc. for year ended June 30, 2003, performed by PricewaterhouseCoopers, LLP. The report represents the opinion of the Office of Inspector General (OIG), and the findings contained in this report do not necessarily represent the final EPA position. The OIG has no objection to the release of this report.

On March 29, 2006, we issued a draft report to the single auditor for comment. The single auditor did not agree with all of the findings in our report. We have included an analysis of the single auditor's response in the appropriate sections of this report. The single auditor's entire response is included as Appendix B to our report.

Action Required

There are no findings or recommendations that require EPA action. Therefore, this report is being closed upon issuance. If you or your staff has any questions regarding this report, please contact me at (312) 886-3037 or Leah Nikaidoh at (513) 487-2365.

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Purpose

The purpose of the quality control review of a single audit is to determine whether the audit was conducted in accordance with generally accepted government auditing standards; the audit and reporting requirements of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, including its related Compliance Supplement; and other applicable audit guidance.

In a recent Environmental Protection Agency (EPA) Office of Inspector General (OIG) audit report,¹ we identified significant questioned costs at the Natural Resources Defense Council, Inc. (NRDC), due to insufficient documentation needed to support costs claimed. As part of that audit, we obtained PricewaterhouseCoopers, LLP (single auditor) working papers for review, and identified some potential issues with the quality and completeness of the single auditor's work. Therefore, we decided to perform a quality control review of the single auditor's working papers.

Background

Under OMB Circular A-133, entities that expend Federal funds of \$300,000 in a given year are required to have a single audit conducted. Subpart D enables us to conduct a quality control review of such a single audit. PricewaterhouseCoopers, LLP conducted the single audit of NRDC for the year ended June 30, 2003. During this fiscal period, NRDC incurred \$608,099 in expenditures under EPA assistance agreements.

As part of performing a quality control review, the reviewer is to determine whether a noncompliance results in a substandard audit or a technically deficient audit. A substandard audit notes significant audit deficiencies that could potentially affect the audit results, thus making the report unusable for fulfilling one or more audit objectives. Technically deficient audits note deficiencies requiring corrective action that do not appear to affect the audit results.

Results of Review

PricewaterhouseCoopers, LLP did not adequately test and document the auditee's compliance with Federal procurement regulations, and did not properly report the auditee's lack of compliance with indirect cost proposal requirements, as required by OMB Circular A-133's Compliance Supplement. These issues should have resulted in reported noncompliances in the single audit report. Because the Office of the Inspector General has already reported these matters to EPA for audit resolution, there will be no added benefit for PricewaterhouseCoopers, LLP to retract and reissue its single audit report.

We also identified two technical deficiencies regarding the single audit's compliance with OMB Circular A-133, and auditing standards. The single auditor did not correctly determine major and non-major programs, and did not adequately document its basis for materiality for

¹ EPA OIG Report No. 2005-4-00120, *Natural Resources Defense Council Reported Outlays under EPA Cooperative Agreements CX82546101, CX82675101, and XA83033101*, issued September 21, 2005.

compliance testing. On May 23, 2006, we held an exit conference with the single auditor. The single auditor generally agreed with our final report recommendations.

Single Auditor Did Not Adequately Test and Document Auditee's Compliance with Procurement and Suspension and Debarment Regulations

The single auditor did not adequately test and document the auditee's compliance with the OMB Circular A-133, Compliance Supplement requirement, *Procurement and Suspension and Debarment*. As a result, the single auditor did not correctly conclude that the auditee was in noncompliance with applicable Federal procurement regulations.

During an OIG audit of costs claimed by NRDC under EPA cooperative agreements (Report No. 2005-4-00120), the auditors questioned \$131,835 under EPA Cooperative Agreement No. XA83033101. Of this amount, \$69,310 related to expenditures for the year ended June 30, 2003. The OIG questioned the \$131,835 because the auditee awarded a sole source contract to a consulting firm without competition, and had no justification to support this lack of competition. The OIG also determined that the auditee did not perform a cost or price analysis for the procurement as required by Title 40 Code of Federal Regulations 30.45.

When performing its single audit, the single auditor identified the following review steps for testing compliance with procurement and suspension and debarment: (1) select a sample of procurements; (2) review related contract files and verify that significant historical information is in the file, including method of procurement, contract type, and basis for contract price; (3) verify full and open competition; (4) if competition was limited, examine documentation to support rationale for limitation and if limitation was justified; and (5) verify that appropriate cost or pricing analysis was performed. These steps are the same ones recommended in OMB's Compliance Supplement.

In the single auditor's working papers for control review of direct costs related to general procurement standards, the single auditor noted in its "Results" section that NRDC had a letter to EPA justifying the sole source procurement because of the contractor's extensive track record with NRDC or expertise in the area. However, the single auditor's testing and reporting was inadequate. In the OIG's audit report of NRDC, the OIG found that NRDC did not have any cost or pricing analysis documentation to support the procurement. Therefore, the single auditor should also have found that NRDC did not have any cost or pricing analysis as part of the sole source contract procurement. Further, while the single auditor identified NRDC's rationale for sole source procurement, there is no evidence in the working papers that show that the single auditor determined that this limitation was justified. In its NRDC report, the OIG questioned NRDC's rationale because:

...the recipient did not provide any documentation to demonstrate that no other organization was capable of performing this work. An undocumented belief that an organization possesses unique qualifications does not justify making a noncompetitive award.

The single auditor should have made a determination that NRDC had a major program noncompliance regarding procurement of its sole source contract. Because the single auditor's materiality threshold was \$10,000, this noncompliance would have been material, since NRDC incurred \$69,310 in expenditures associated with the contract (approximately 11 percent of total Federal expenditures) for the year ended June 30, 2003.

We also noted that the single auditor's working paper documentation is insufficient because the single auditor did not ascertain if the justification for the sole procurement was reasonable. According to Government Auditing Standards, 4.24:

Audit documentation serves to (1) provide the principal support for the auditors' report, (2) aid auditors in conducting and supervising the audit, and (3) allow for the review of audit quality. The preparation of audit documentation should be appropriately detailed to provide a clear understanding of its purpose, and source and the conclusions the auditors reached, and it should be appropriately organized to provide a clear link to the findings, conclusions, and recommendations contained in the audit report.

Therefore, the single auditor did not meet government auditing standards for working paper documentation for its review of procurement compliance.

Single Auditor Response and OIG Evaluation

The single auditor agreed with our observation that it relied upon the letter of NRDC's project manager to EPA, justifying the sole source procurement because of the credentials and experience in this area by the consultant. The single auditor said that it understood that NRDC's project manager and its lead scientist for the market transformation project had a sound working knowledge of consultant qualifications and the range of hourly rates charged in the marketplace. In addition, NRDC noted, in its responses to the OIG cost audit, that the consultant had been working with NRDC since the inception of the award.

The single auditor said that it was important to note that when the single audit report was issued, NRDC had solicited and received competitive bids. The results of this effort indicated that the sole source contractor was "more cost competitive" than the competing consulting firm. Because the results of the competitive bidding process revealed that the consultant's fees were the most competitive, the single auditor did not believe there were any questioned costs to report under the single audit. NRDC's use of this consultant in 2003, even though NRDC did not utilize competitive bidding initially, had no effect on the expenditure of Federal dollars from the Market Transformation Grant in 2003. The single auditor believed that no recommendation would be needed because corrective action had been taken. As a consequence, there was no material noncompliance. Therefore, the single auditor disagreed with our initial recommendation that the single audit report should be revised to include a finding of material noncompliance. The single auditor did agree that it could have documented better in its working papers the decision not to include a finding in the single audit report.

We continue to maintain our position that the single auditor should have reported that NRDC did not adequately justify its sole source procurement. Regardless of the outcome of subsequent procurements that NRDC conducted in a competitive manner, NRDC did not perform adequate price analysis for the sole source procurement. However, the questionable contract costs identified in our report have already been questioned under the previously cited OIG report, and EPA is in process of resolving this matter. Therefore, requiring the single auditor to reissue the single audit report would not affect EPA's actions.

Recommendation

1. Due to the fact that EPA is already in the process of resolving this finding under a separate report, we will not require PricewaterhouseCoopers, LLP to perform any additional audit work. We recommend that the single auditor perform and document the necessary compliance testing steps for procurement under future single audits.

Single Auditor Did Not Report that NRDC Did Not Comply with EPA Policy for Indirect Cost Rate Proposals

The single auditor did not properly disclose that NRDC did not meet EPA requirements to prepare and maintain indirect cost and fringe benefit rate proposals. While the single auditor noted in the financial statement portion of its audit that a 1995 indirect cost rate agreement was being used, the auditor did not properly report that NRDC was in noncompliance with EPA Policy No. GPI-96-01, *Policy on Indirect Cost Rate Proposals for Non-Profit Organizations*. This policy provided that non-profit grant recipients were not required to submit a rate proposal to EPA if indirect costs were “35% or less of total direct project cost and represent less than \$200,000.” The policy also stated that “...grantees must prepare an indirect cost rate proposal within 90 days from the grant award date and retain it in their files, subject to audit.” Although the single auditor identified this noncompliance in its working papers, it did not report this noncompliance in the single audit report. Therefore, the single auditor did not meet Compliance Supplement requirements for reporting this noncompliance.

In the Compliance Supplement, under *Audit Objectives for Non-Profit Organizations*, the auditor has to determine whether the organization complied with provisions of the OMB Circular A-122 cost principles for direct and indirect costs and related Federal requirements. Given that NRDC had not prepared indirect cost rate proposals for EPA since 1995, the single auditor should have found that NRDC was in noncompliance with EPA's indirect cost rate policy in effect at the time of the audit.

According to the single auditor's working papers on compliance testing, NRDC informed the single auditor that EPA had a policy that stated EPA would no longer give written confirmation of indirect cost rates as long as the rate was below the EPA threshold of 35 percent. NRDC indicated that it was told by EPA that as long as it continued to use a 22.29 percent indirect cost rate that was included in the EPA cooperative agreement, the calculation of a new rate was not necessary. The single auditor did note that NRDC was not completely correct and that NRDC should prepare proposals and maintain them in its files, subject to audit. The single auditor indicated that it advised NRDC of this requirement, and commented that in the future some

limited testing should be performed to ensure that the 35 percent threshold and \$200,000 limit have not been exceeded.

Although the single auditor identified in its working papers that NRDC was in noncompliance with the EPA policy, the single auditor provided no explanation in its working papers why it did not report this noncompliance in the single audit report. Given NRDC's continued noncompliance with this EPA policy, as well as the magnitude of expended indirect costs, this noncompliance should have been reported as a reportable condition in the single auditor's report on major program compliance.

Single Auditor Response and OIG Evaluation

The single auditor stated that we were correct in reporting that the single auditor noted in the audit working papers that NRDC was not in compliance with the EPA policy to annually prepare indirect cost proposals and maintain them in its files subject to audit. The single auditor reiterated that NRDC was not required to submit indirect cost proposals to EPA, so long as NRDC stayed under the 35 percent threshold.

Based on calculations made by NRDC in 2006 of the actual indirect costs rates for the eight fiscal years ended June 30, 2004, the amount actually overbilled using the 1995 provisional rate was approximately \$63,000 for the entire period. Although the single audit would consider reporting this matter as a finding, they would not have considered this matter to be material, given the \$63,000 is applicable to eight years of awards, totally approximately \$4 million. Furthermore, the amount in question for 2003, approximately \$17,000, was less than the materiality threshold for that year of \$19,200. Although not documented in the audit working papers for 2003 (as discussed below), the single auditor considered materiality for major programs to be 5 percent of total expenditures for each major program. In this case, materiality would be 5 percent of \$384,772 total expenditures for the Market Transformation projects, or \$19,200. As a result, the single auditor did not agree that the magnitude was large enough to warrant reporting this as a major program material weakness. The single auditor did agree that they could have documented this matter better in its working papers.

Although NRDC finally submitted indirect cost rates in 2006, the fact that it did not have indirect cost rates for 8 years prior to then should have resulted in a reportable condition. As we discussed above, NRDC's failure to properly prepare and submit indirect cost rate proposals has been reported upon in the above mentioned OIG audit report, and EPA is in the process of resolving this matter. As such, reissuing the 2003 single audit report would duplicate resolution efforts already underway by EPA.

Recommendation

2. Due to the fact that EPA is already in the process of resolving this finding under a separate report, we will not recommend that PricewaterhouseCoopers, LLP reissue its single audit report. We recommend that the single auditor ensure that it properly documents its analyses and conclusions in future audits.

Single Auditor Did Not Determine Major Federal Programs

The single auditor did not correctly determine major and non-major programs, as required by OMB Circular A-133. By not performing this determination correctly, the single auditor risks not performing sufficient compliance testing for major programs, making the audit incomplete.

OMB Circular A-133 requires the use of a risk-based approach to determine which Federal programs are major programs. The auditor must identify larger Federal programs as Type A (i.e., major) programs using the percentages and thresholds outlined in §_520 of the Circular. As required by OMB Circular A-133, any Federal program that had Federal expenditures of more than \$300,000 is considered a major program. Based on the results of the single auditor's determination, the single auditor will perform compliance testing on major programs identified, covering at least 50 percent of the amount of Federal expenditures for that year.

Upon reviewing the single auditor's working papers and related conclusions, the single auditor did not correctly determine the major Federal program based on the dollar thresholds identified in OMB Circular A-133 §_520(b) and label it as a Type A program. Instead of grouping Federal expenditures by Catalog of Federal Domestic Assistance (CFDA) numbers to determine the threshold level for major programs, the single auditor determined major Federal programs by award number only. Therefore, the single auditor incorrectly concluded that there were no major Federal programs. However, the single auditor did correctly identify and report on major programs in its single audit report. We discussed this inconsistency with the single auditor, and the single auditor agreed the working paper was wrong in stating there were no major programs. The single auditor agreed that there was one major program – the EPA Market Transformation project (CFDA 66.034) – with total expenditures of \$384,769.

We consider this finding to be a technical deficiency, since the discrepancy had no effect on the reported results or auditor's opinions.

Single Auditor Response and OIG Evaluation

The single auditor agreed that within the audit working papers, the single auditor did not group the programs by CFDA number to identify the Type A program that was over \$300,000. However, the single auditor correctly audited CFDA 66.034 as a major program and correctly identified it and reported on it as a major program in the single audit report. The single auditor also agreed that this was a technical deficiency that had no impact on the audit. However, the single auditor indicated that the caption on this finding overstated the matter. The single auditor stated that it clearly determined major Federal programs because the report did indicate the major program. The single auditor

said that this deficiency was simply an inadvertent error on one working paper, and requested that we reconsider the need to include this finding in the report at all.

We continue to consider this a technical deficiency. While the technical deficiency did not impact the ultimate results of this audit, if there had been more grants under a variety of programs, we have no assurance that the single auditor would have made the appropriate major Federal program determination. Therefore, no changes will be made to this finding.

Recommendation

3. We recommend that PricewaterhouseCoopers, LLP ensure that the determination for Major Federal Programs is correctly prepared for future single audits by properly grouping Federal grant expenditures by corresponding CFDA numbers, in accordance with OMB Circular A-133.

Single Auditor Did Not Document Initial Basis of Materiality

When designing its audit, the single auditor did not adequately document its initial basis of materiality for compliance testing, in accordance with American Institute of Certified Public Accountants (AICPA) standards. The single auditor, as part of its planning process, establishes materiality limits that will later be used to assess the overall materiality of instances of noncompliance. While the single auditor determined there were no changes in its assessment of materiality based on the results of its work, the single auditor's working papers did not include information showing the basis for materiality decisions.

The AICPA Audit Guide, *Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards*, Section 6.14, states that, in designing audit tests and developing an opinion on the auditee's compliance with compliance requirements, the auditor should apply the concept of materiality to each major program taken as a whole.

The single auditor's working paper section for assessing overall materiality for compliance testing had the following guidance:

- a. Make a final assessment of the quantitative and qualitative measures of materiality to be used solely for the purpose of compliance testing, compare this with earlier materiality decisions, and draw a final conclusion on whether the aggregate of findings that have been identified during the audit is material.
- b. Document the measures used for materiality in the Comments section.
- c. Determine whether additional substantive tests are required.

The single auditor concluded in this working paper that, "No changes in our assessment of materiality were noted based on the results of our audit work." However, we did not find in any of the single auditor's working papers that the initial materiality assessment was performed. We asked the single auditor if this earlier assessment was performed, and the single auditor could not produce any such assessment. The single auditor said it appeared that the auditors performing the work used \$10,000 for questioned costs as the basis for determining materiality. Therefore,

we conclude that the single auditor did not adequately document its basis for materiality for major program compliance testing.

We consider this issue to be a technical deficiency, since there were no compliance issues reported upon in the single audit report.

Single Auditor Response and OIG Evaluation

The single auditor agreed that materiality was not documented in its working papers. The single auditor stated that it considered materiality for major programs to be 5 percent of total expenditures for each major program. In this case, materiality would have been 5 percent of \$384,772 total expenditures for the Market Transformation project, CFDA 66.034, or \$19,200. In reporting findings, the single auditor stated that it also considered the materiality threshold for questioned costs of \$10,000 specified in Section .510 of OMB Circular A-133.

Recommendation

4. We recommend that PricewaterhouseCoopers, LLP ensure that the basis for materiality determination for major Federal programs is properly documented in its working papers for future single audits, in accordance with AICPA standards.

Scope and Methodology and Prior Audit Coverage

Scope and Methodology

We conducted a quality control review of the PricewaterhouseCoopers, LLP audit of NRDC for the year ended June 30, 2003, and the resulting reporting package that was submitted to the Federal Audit Clearinghouse, dated March 16, 2004. We performed the review using the 1999 edition of the *Uniform Quality Control Guide for the A-133 Audits*, issued by the President's Council on Integrity and Efficiency. This guide applies to any single audit subject to OMB Circular A-133 and the approved checklist of the President's Council on Integrity and Efficiency for performing the quality control reviews.

We conducted our review in November 2005 in accordance with applicable *Government Auditing Standards*, issued by the Comptroller General of the United States. We assessed the following areas:

- Qualification of Auditors
- Independence
- Due Professional Care
- Quality Control
- Planning and Supervision
- Federal Receivables and Payables
- Other Standards Affecting Federal Awards
- Determination of Major Programs
- Schedule of Expenditures of Federal Awards
- Audit Followup
- Reporting
- Data Collection Form
- Materiality
- Internal Controls
- Compliance Testing

We reviewed the audit documentation prepared by the single auditor, and discussed the audit results with single auditor representatives. We also interviewed the EPA grant specialist responsible for grants awarded to NRDC.

Prior Audit Coverage

EPA OIG Report, *Natural Resources Defense Council Reported Outlays under EPA Cooperative Agreements CX82546101, CX82675101, and XA83033101* (Report No. 2005-4-00120, issued September 21, 2005): The auditors questioned \$1,419,548 of reported outlays because the recipient did not maintain the necessary documentation to fully support the reported costs, as required by Federal regulations. Specifically, the recipient did not obtain required Federal approval for indirect and fringe benefit costs, and did not perform required cost or price reviews to support the reasonableness for contract costs.

Department of Defense OIG Report, *Report on Quality Control Review of the PricewaterhouseCoopers LLP and the Defense Contract Audit Agency Office of Management and Budget Circular A-133 Audit Report of the RAND Corporation, Fiscal Year Ended September 29, 2002* (Report No. D-2006-6-002, issued December 16, 2005): The Department of Defense OIG, in conducting a quality control review of PricewaterhouseCoopers, LLP, identified the following two issues that are relevant to our quality control review: (1) the single auditor did not adequately document the compliance testing for the procurement aspect of the Procurement, Suspension and Debarment compliance requirement; and (2) the single auditor did not properly calculate the dollar threshold amounts to distinguish between major and non-major programs for the audit.

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April 28, 2006

Ms. Leah Nikaidoh
Office of Inspector General
United States Environmental Protection Agency
Washington, D.C. 20460

Subject: Quality Control Review of PricewaterhouseCoopers, LLP Single Audit of
Natural Resources Defense Council, Inc. for the year ended June 30, 2003

Dear Ms. Nikaidoh,

We received the letter dated March 29, 2006 from Michael A. Rickey, Director, Assistance Agreement Audits, and I am responding to you at his request regarding our comments to the findings and recommendations reflected in the draft report. We appreciate the opportunity to respond before the report becomes final. As described below, we do not believe that any of the four matters discussed in your report are material non-compliance or material weaknesses in internal control on NRDC's part, and therefore, we believe there is no basis to reissue the audit report for fiscal 2003 or consider our audit to be substandard.

Our comments with regard to the four findings and recommendations are as follows:

1. Single auditor did not adequately test and document auditee's compliance with procurement and suspension and debarment regulations.

Regarding the \$69,310 sole source contract to a consulting firm without competition in fiscal 2003 for the Market Transformation Grant # 20741, you are correct that we relied on a letter of NRDC's project manager to Peter Banwell at the EPA dated April 30, 2002 justifying the sole source procurement because of the credentials and experience in this area of ECOS Consulting, the contractor, and NRDC's experience in dealing with ECOS. We understood that NRDC's project manager and their lead scientist for the market transformation project had a sound working knowledge of consultant qualifications and the range of hourly rates charged in the marketplace. In addition, as discussed in NRDC management's responses to the EPA OIG Report, dated August 22, 2005 and March 17, 2006, ECOS Consulting had been working with NRDC since the inception of the award.

It is important to note, however, that at the time our 2003 A-133 report was issued, NRDC had solicited and received competitive bids. The results of this effort indicated that ECOS Consulting was more cost competitive than the competing consulting firm.

In reporting findings in the Schedule of Findings and Questioned Costs the auditors should include their conclusions as well as make appropriate recommendations and discuss, among other matters:

- Cause
- Condition
- Criteria
- Effect

Because the results of the competitive bidding process revealed that ECOS's fees were indeed the most competitive, we do not believe there were any questioned costs to report for fiscal 2003. NRDC's use of ECOS in fiscal 2003, even though NRDC did not utilize competitive bidding initially, had no effect on their expenditure of federal dollars from the Market Transformation Grant in fiscal 2003. No recommendation would be needed because corrective action had been taken. As a consequence, there was no material noncompliance and therefore we disagree with your statement that our report should be revised to include a finding of material noncompliance. We do agree, however, that we could have documented better in our workpapers our decision not to include a finding.

2. Single auditor did not report that NRDC did not comply with EPA policy for indirect cost rate proposals.

You are correct that PwC noted in the audit work papers for fiscal 2003 that NRDC was not in compliance with the EPA policy to annually prepare indirect cost proposals and maintain them in their files subject to audit. (The fact that NRDC did not submit indirect cost proposals to EPA each year was acceptable since indirect costs did not exceed 35% of direct costs and did not meet the \$200,000 limit requiring formal approval of an indirect cost rate.) NRDC continued to use the 1995 provisional rate of 22.29% through fiscal 2003 because the EPA had informed them that the calculation of a new rate was not necessary.

Based on calculations made by NRDC in 2006 of the actual indirect cost rates for the eight fiscal years ended June 30, 2004, the amount actually over billed using the 1995 provisional rate for these eight years was approximately \$63,000 for the entire 8-year period. Although we would consider reporting this matter as a finding, (we understood EPA did not require an actual calculation of the indirect cost rate) we would not have considered this matter to be material noncompliance given the \$63,000 is applicable to eight years of awards totaling approximately \$4,000,000. Furthermore, the amount in question for 2003, approximately \$17,000, was less than the materiality threshold for

that year of \$19,200. Although not documented in the audit work papers for fiscal 2003, we considered materiality for major programs to be 5% of total expenditures for each major program. In this case, materiality would have been 5% of \$384,772 total expenditures for the market transformation projects, CFDA #66.034, or \$19,200. As a result we do not agree with your statement that the magnitude of expended indirect costs was large enough to warrant reporting this matter as a major program material weakness. We do agree, however, that we could have documented this matter better in our workpapers.

3. Single auditor did not determine major federal programs.

We agree with you that within the audit work papers, the PwC auditor did not group the programs by CFDA # to identify the Type A program that was over \$300,000. However, the PwC auditor correctly audited CFDA #66.034 as a major program and correctly identified it and reported on it as a major program in our A-133 report. We agree with you that this technical deficiency had no impact on the A-133 audit. However, we believe the sub-caption and related discussion on page 4 of your draft report entitled "Single Auditor Did Not Determine Major Federal Programs" is an overstatement of this matter. We clearly did determine major Federal programs because our report did indeed indicate the major program. We believe that this matter is simply an inadvertent error on one work paper, and we request that you reconsider the need to include this in your report at all.

4. Single auditor did not document initial basis of materiality.

Although not documented in the audit work papers for fiscal 2003, we considered materiality for major programs to be 5% of total expenditures for each major program. In this case, materiality would have been 5% of \$384,772 total expenditures for the market transformation projects, CFDA #66.034, or \$19,200. In reporting findings, we also consider the materiality threshold for questioned costs of \$10,000 specified in Section .510 of OMB Circular A-133. Note that our substantive tests covered approximately 90% of the federal expenditures of \$384,772 for this major program and approximately 62% of total federal expenditures for fiscal 2003. We agree with you that this technical deficiency. It is our policy to document materiality for major programs.

We appreciate the thorough review performed by the EPA auditors. We always strive to improve the quality of our audits and will surely learn from the results of this audit. However, we absolutely disagree that the findings noted rise to a level that makes this a substandard audit. We also do not believe that our report needs to be reissued because we believe that in hindsight with the facts as they are presently known, our report would not have included material findings related to these matters. We would appreciate the opportunity to discuss our response with you before you finalize your report. I can be reached at 646-471-1022.

Very truly yours,

/s/

Jerry A. O'Neil
Engagement Partner

Distribution

EPA

Director, Grants Administration Division
Audit Followup Coordinator, Grants Administration Division
Agency Audit Followup Coordinator
Director, Office of Grants and Debarment
Acting Inspector General

External

Partner, PricewaterhouseCoopers, LLP, New York, New York