

**Statement of Melissa Heist
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U.S. Environmental Protection Agency
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Good afternoon Mr. Chairman and Members of the Committee. I am Melissa Heist, Assistant Inspector General for Audit at the U.S. Environmental Protection Agency (EPA) Office of Inspector General (OIG). I am pleased to be here today to discuss some of the challenges facing EPA in implementing the American Recovery and Reinvestment Act of 2009 (Recovery Act) and the OIG's plans to oversee EPA Recovery Act activities. The Recovery Act provided funding for a wide range of Federal programs intended to create jobs, stimulate economic recovery as quickly as possible, and invest in infrastructure. It also created a vital oversight role for Inspectors General within those agencies or departments that received Recovery Act funds to ensure that those funds are properly expended. The OIG has developed, and started to implement, an initial oversight plan designed to identify and prevent fraud, waste, abuse, or mismanagement of funds.

EPA Recovery Act Funding and Oversight Activities

The Recovery Act provided EPA with \$7.2 billion, roughly equal to its fiscal year (FY) 2009 appropriation, for the following six existing EPA programs:

- \$4 billion for the Clean Water State Revolving Fund (CWSRF) to provide funds for upgrading wastewater treatment systems.
- \$2 billion for the Drinking Water State Revolving Fund (DWSRF) to provide funds for drinking water infrastructure.
- \$600 million to the Hazardous Substance Superfund for site cleanup.
- \$300 million to the Diesel Emissions Reduction Act Program for projects that reduce diesel emissions.
- \$200 million to the Leaking Underground Storage Tank Trust Fund Program for cleanup activities of underground storage tank petroleum leaks.
- \$100 million to the Brownfields Program for grants to carry out revitalization projects.

Funds for these programs are available for obligation through September 2010. About \$90.5 million of this amount is specifically dedicated to management and oversight by EPA and is available through September 2011. The OIG received \$20 million for oversight of EPA Recovery Act activities that are available through September 2012.

EPA has begun to disperse some of its Recovery Act funds. As of April 17, 2009, EPA had awarded 66 grants worth nearly \$1.5 billion broken out as follows:

- 12 CWSRF grants totaling nearly \$1.1 billion;
- 10 DWSRF grants totaling over \$321 million; and
- 44 diesel emissions reduction grants totaling over \$76 million.

EPA has also awarded one Superfund contract worth \$20.55 million. EPA recently published a list of Superfund sites that will soon receive additional Recovery Act funds.

The Recovery Act contains specific provisions that EPA is required to meet regarding the use of its funds. These provisions include separately tracking the funds in the Agency's accounting system; the waiving of cost share and matching requirements; preference for quick-start activities; tribal set-asides for Indian Health Service; and appropriations for tribal grants. The Act also outlines specific reporting and accountability requirements for the use of Recovery Act funds.

EPA leadership is showing a strong commitment to ensuring Recovery Act funds are used for their intended purposes and to meeting the objectives of the Act. Early on they sought our advice on management and oversight issues. EPA has established several internal committees. These internal committees meet regularly to discuss Agency progress in meeting Recovery Act objectives. The OIG has been participating in an advisory role on all of these key committees. EPA is developing a stewardship plan to reinforce internal controls over the funds. This plan will address OMB's requirement for agencies to have risk mitigation strategies for Recovery Act funding. For the State Revolving Fund (SRF) programs, EPA issued guidance for awarding Recovery Act funding in March 2009. This guidance informed States of their application responsibilities and discussed the unique provisions in the Recovery Act. Under these programs, all 50 States and Puerto Rico maintain revolving loan funds that provide sources of low-cost financing for a wide range of water quality infrastructure projects. The amount of funds available to each State is based on established formulas.

Challenges Posed by the Recovery Act

EPA will face significant new financial and programmatic challenges as it awards and oversees Recovery Act funding. The Act provided additional funding for existing EPA programs, new requirements for award and implementation, and placed an emphasis on spending the funds quickly to help stimulate economic revitalization. EPA must meet its Recovery Act requirements while at the same time carrying out its ongoing environmental programs. Therefore, the OIG will be designating EPA management of stimulus funds as a new top management challenge for FY 2009.

The SRF programs are the largest share of EPA Recovery Act funding, totaling \$6 billion of the \$7.2 billion appropriated. The Congressional Budget Office has noted that historically, appropriations for the SRF programs are spent slowly with about half the funds spent over the first three years. Prior OIG work on EPA Border Programs, which

focus on developing infrastructure to treat wastewater and deliver safe drinking water along the U.S.-Mexico border, have shown similar problems. Since our audits the Agency has taken some corrective actions, but at the time of our work, these programs had unliquidated balances totaling over \$300 million that had accumulated over a 10-year period. By not deobligating these funds, EPA delayed much needed water improvements. EPA and its grantees will be challenged to spend the SRF Recovery Act funding in a timely manner, as required by the Act.

Most Recovery Act funds will be awarded through assistance agreements or contracts. EPA assistance agreements and contracts personnel will have to manage the stimulus-funded projects in addition to their normal workloads. Although EPA may set aside anywhere from 1 to 3.5 percent of Recovery Act funds for management and oversight purposes, EPA will be challenged to have sufficient, trained staff to award and monitor assistance agreements and contracts. If EPA does not assign sufficient staff to oversight, the Agency increases the risk of fraud, waste, and abuse of Federal funds. It will also increase the risk that EPA will award funds to entities that do not have adequate administrative and programmatic capabilities to efficiently and effectively carry out the work. EPA will also need to focus considerable attention on ensuring that Recovery Act funds produce their desired results and minimizing cost overruns and project delays.

The grants EPA awards with Recovery Act funding will contain new conditions that require additional monitoring and oversight. The Act states that grant funds should be awarded to recipients that will maximize job creation and economic benefits. The Act also requires each State to use at least 50 percent of the CWSRF and DWSRF loan amounts for forgiveness of principal, negative interest loans, or grants. The Act stipulates that to the extent that there are sufficient eligible projects, at least 20 percent of the SRF allotments are to fund projects to address green infrastructure, water or energy efficiency improvements, or other environmentally innovative activities. EPA also will need to more closely monitor Recovery Act funds because, unlike current programs, Recovery Act-funded grants do not require a match by the recipient and there are provisions for loan forgiveness, so not all funds will have to be repaid. These provisions increase the risk of fraud, waste, and abuse.

For most of the Recovery Act funding, EPA will rely heavily on State agencies as the primary fund recipients to properly manage their sub-recipients. For the SRFs, EPA provides funding to States that in turn award funding to a local government entity. The local government then awards contracts for water infrastructure construction. Given the significant economic problems many States face, they may not have the resources to properly oversee these funds. In addition, EPA may not have the information needed to identify fraud, waste, and abuse at the level where a majority of funds are expended. Currently, the Office of Management and Budget (OMB) is only requiring States to report information down to the sub-recipient level. If OMB does not develop a means and a requirement to collect data below the sub-recipient level, EPA will not have the information to identify potential fraud, waste, and abuse at the level where it is most likely to occur.

For the Superfund program, activities under the Recovery Act will generally be funded through contracts. With the emphasis on awarding funds and getting work started quickly, there is a risk that the contractors will not be ready and able to accept the additional work. This may result in greater reliance on subcontractors overseen by a contractor challenged to handle the additional work. While EPA plans on using existing contracts to obligate most of the Recovery Act funds, the additional funds may result in the contracts reaching cost ceilings earlier than expected and needing to be re-competed earlier than planned. These additional activities will strain the current acquisition workforce.

Remedial Action Contracts are a primary acquisition vehicle that the EPA Superfund program uses to conduct long-term clean-up and remediation support activities. A 2008 OIG report identified risks in managing such contracts. The process for determining contractor award fee amounts and whether they would be granted was burdensome. The complex contract award fee process resulted in excessive award fees to the contractor, and EPA viewed the award fees as more of an expectation for contractors rather than a factor to motivate excellence.

OIG Oversight Plan of EPA Recovery Act Funds

In March 2009, the OIG released its initial oversight plan of Recovery Act funds. Under our plan, the OIG will assess whether EPA is using its funds in accordance with applicable requirements and is meeting the accountability objectives defined by OMB. The objectives include whether:

- Funds are awarded and distributed in a prompt, fair, and reasonable manner.
- The recipients and uses of all funds are transparent to the public, and the public benefits of these funds are reported clearly, accurately, and in a timely manner.
- Funds are used for authorized purposes and instances of fraud, waste, error, and abuse are mitigated.
- Projects funded under this Act avoid unnecessary delays and cost overruns.
- Program goals are achieved, including specific program outcomes and improved results on broader economic indicators.

As EPA awards Recovery Act funds, the OIG is taking a number of actions to alert Agency managers of risks and cost effective controls to help prevent fraud, waste, and abuse; and ensure program goals are achieved and stimulus funds are accurately tracked and reported. As our auditors and evaluators identify risks, they will provide flash reports to Agency managers with recommendations for ways to mitigate these risks. We have been meeting with EPA managers to increase our understanding of how stimulus funds will be used and to provide technical assistance based on past experience in auditing and investigating EPA programs. We are also reviewing prior audits in program areas covered by the Recovery Act to determine whether corrective actions have been completed. Finally, after EPA awards stimulus funds, we will review EPA

management of Recovery Act programs, how funds are being used, and the accuracy of the information being reported.

From an investigative perspective, we will undertake a proactive approach to prevent fraud, waste, and abuse of funds by educating EPA and State employees, contractors, and grant recipients on identifying fraud indicators and reporting suspicious activities and conditions to the OIG. This includes the development and distribution of brochures, pamphlets, and other training materials. Plans are also currently underway for our investigators, in conjunction with the EPA Office of Water, to conduct fraud prevention training via webcast to States and other stakeholders. We will conduct outreach with law enforcement at the Federal, State, and local levels in an effort to gather information on potential fraudulent activity involving EPA funds. This outreach will also include contacting the top SRF recipients to facilitate ongoing communications regarding funds distributed to local authorities. We will use various investigative tools and techniques such as data mining, forensic auditing, and the development of fraud investigative teams to further detect fraudulent activity. These teams — composed of OIG investigators, auditors, and evaluators — will analyze fraud indicators among the top State recipients of funds to determine those that are at high risk for fraudulent activity. Finally, we will review, as appropriate, concerns raised by the public about specific allegations of fraud, waste, or abuse of Recovery Act funds received via our OIG Hotline.

The following are some of the specific areas the OIG plans to audit and investigate.

Performance Audits

- Evaluate the process for awarding funds, particularly competitive awards.
- Evaluate the process States will use to award Recovery Act SRF funds.
- Determine whether funds are being awarded and spent timely.
- Determine whether the Agency has sufficient staff with the skills and knowledge needed to manage the grants and contracts awarded with Recovery Act funds.
- Evaluate how the Agency is monitoring the use of the funds.
- Assess how performance is being measured and the process used for computing jobs saved and created.
- Review the quality of data systems and information EPA uses for reporting Recovery Act's requirements.

Financial Audits

- Conduct interim and final financial audits of Recovery Act fund recipients to determine whether:
 - costs incurred met federal requirements;
 - funds were used as intended; and
 - funds were free of fraud, waste, abuse, and mismanagement.

- Work with EPA to update the Single Audit Compliance Supplements for the Clean Water and Drinking Water State Revolving Funds.
- Review Single Audit reports on Recovery Act funds and ensure that corrective action is taken.
- As part of the annual audit of EPA’s overall consolidated financial statements:
 - assess internal controls over the financial reporting of Recovery Act funds;
 - examine transactions to determine whether they are properly authorized, recorded, and reported; and
 - examine compliance with Recovery Act provisions that could have a material or direct effect on the financial statements.

Investigations

- Investigate allegations raised by the public and others of fraud, waste, and abuse committed against EPA involving Recovery Act funds.
- Contact State recipients to facilitate ongoing communications regarding EPA Recovery Act funds distributed to local authorities.
- Through the review of EPA and State audits and evaluations, identify fraud indicators, program weaknesses, and potential problems.
- Outreach and educate recipients of Recovery Act funds on potential fraud indicators.
- Gather information on potential instances of fraud being perpetrated with EPA Recovery Act funds from law enforcement officials, auditors, contractors, suppliers, and vendors at the federal, State, and local levels.

Currently, we have 12 staff working on Recovery Act activities. Our plan is to increase our staffing to have between 35-45 staff assigned to this work. The number will fluctuate based on the time it takes to recruit staff and the amount of funds that have been awarded and spent.

Reports on our findings not related to ongoing criminal investigations will be posted on our “EPA OIG Recovery Act Efforts” page of our Website when published. Our work is being closely coordinated with the Recovery Accountability and Transparency Board, as well as other audit and law enforcement organizations at the Federal, State, and local levels. This includes the Council of Inspectors General on Integrity and Efficiency, which represents the Federal Inspector General community. Specifically, the Council’s Recovery Funds Workgroup serves as a point of communication and coordination on Recovery Act matters that affect the Board and other OIGs.

Completed OIG Recovery Act Work

The OIG has started to issue reports on our Recovery Act oversight activities. Earlier this month, we issued a report that reviewed open recommendations from prior OIG audit reports that could impact EPA Recovery Act activities. Open

recommendations are those for which EPA has not completed corrective actions. We identified five open recommendations from three audit reports that pertain to grants, contracts, and interagency agreements. In response to a 2008 report, EPA agreed to implement our recommendation to distribute revised terms and conditions to regions in June 2009 for spending brownfields grant funds more timely. EPA told us these terms and conditions would be in place before EPA awarded any Recovery Act grants. A 2008 report found that EPA had no assurance that use of Cost-Plus-Award-Fee contracts facilitated a higher level of performance than other types of contracts, and contractors were given award fees without sufficient support. To address these issues, the EPA Office of Acquisition Management completed revisions to the Contracts Management Manual and will have the information published by late April. We also noted EPA Region 5 paid award fees in excess of limits, and corrective action is still pending. A 2007 report found that EPA often entered into interagency contracts without conducting cost reasonableness assessments or identifying alternatives, such as whether EPA in-house staff should acquire the services or products. EPA is not planning to conduct its comprehensive review of interagency contracts to verify implementation of the corrective action until September 2010. EPA needs to ensure other corrective actions related to cost reasonableness assessments and considerations of alternatives to interagency contracts are implemented for Recovery Act interagency contracts. We recommended that the Agency expedite corrective actions for the open recommendations as they pertain to Recovery Act funds. EPA is required to respond to our report in May 2009 describing how it has addressed, or plans to address, these recommendations.

In March, the OIG reviewed OMB's updated guidance for the Recovery Act and provided several comments for OMB's consideration in a special report. Overall, we found that the guidance is prescriptive for agencies to make funding available in a transparent, need-driven way on an agency-by-agency basis. However, there does not appear to be a process described for cross-agency coordination of grantee and other fund recipient review to ensure that recipients are not obtaining funds from multiple sources for the same project. We also believe cross-agency checks should be required, beyond the current process, to ensure that a grantee, contractor, or recipient does not have outstanding Federal obligations and has performed satisfactorily in the past. Further, because States will be primary recipients of Recovery Act funds, we think more clarity is needed regarding what obligations State auditors have to review and report on the propriety of, accounting for, and use of the Recovery Act funds, as well as the recipient's accuracy in the reporting of results.

In addition, we made comments on specific sections of the guidance. These involved such issues as seeking more information on subprime contractors, identifying expected savings, assessing risk associated with any decision for providing funds to each grantee, and having a third party arbitrating disputes between the Agency contract officer and the auditor.

Additional Recovery Act reports will be issued in the weeks and months to come as our work is completed. For example, we are currently reviewing open recommendations from prior OIG financial reports on assistance agreement and contract

recipients. We have an audit ongoing that is assessing EPA's use of contractors' past performance evaluations and responsibility determinations in awarding Recovery Act funds. We have also initiated work on an evaluation to assess some concerns expressed by public interest groups about the portion of funding set aside for green infrastructure, water or energy efficiency, and environmentally innovative projects under the Recovery Act.

Conclusion

The purpose of the Recovery Act as it applies to EPA is to preserve and create jobs, promote economic recovery, and invest in environmental protection and other infrastructure that will provide long-term economic benefits. EPA must manage Recovery Act funds to achieve these purposes while commencing expenditures and activities as quickly as possible, consistent with prudent management. The OIG's role is to assess whether EPA is meeting its responsibilities and to hold EPA accountable for the funds it expends. While we have developed a plan to oversee EPA Recovery Act activities, we anticipate that our plans and activities will evolve. We will revise and update our oversight plans as necessary to ensure that fraud, waste, abuse, and mismanagement is identified and addressed.

Thank you for the opportunity to testify before you today. I would be pleased to answer any questions the Committee may have.