



OFFICE OF INSPECTOR GENERAL

Catalyst for Improving the Environment

Attestation Report

Association of State and Interstate Water Pollution Control Administrators Incurred Costs for Seven EPA Assistance Agreements

Report No. 2006-4-00122

July 31, 2006

Report Contributors:

Keith Reichard
Richard Valliere

Abbreviations

CFR	Code of Federal Regulations
EPA	U.S. Environmental Protection Agency
OIG	Office of Inspector General
OMB	Office of Management and Budget



At a Glance

Catalyst for Improving the Environment

Why We Did This Review

We conducted this examination to determine whether the total costs incurred for seven U.S. Environmental Protection Agency (EPA) assistance agreements were fairly presented, in all material respects, and the incurred costs were allowable in accordance with the terms and conditions of the agreements and applicable regulations.

Background

EPA awarded seven assistance agreements to the Association of State and Interstate Water Pollution Control Administrators (Association) to assist States, Tribes, and territories in complying with the Clean Water Act.

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/2006/20060731-2006-4-00122.pdf

Association of State and Interstate Water Pollution Control Administrators Incurred Costs for Seven EPA Assistance Agreements

What We Found

The Association did not comply with the financial and program management standards and the procurement standards promulgated in Title 40 Code of Federal Regulations (CFR), Subchapter B, Part 30. Specifically, the Association (1) could not provide support for any of its general journal entries; (2) included duplicate recorded costs in its accounting system; (3) could not always trace grant draws to the accounting records; (4) could not always support labor charged to the EPA grants; (5) could not support the recorded indirect costs; (6) did not record all of its program income; (7) did not have adequate written procedures for determining reasonable, allocable, and allowable costs; (8) drew EPA grant funds in excess of the funds needed; and (9) did not complete the required single audits for fiscal years ended June 30, 2004, and June 30, 2005.

The Association's procurement system did not comply with the procurement standards. The Association awarded contracts to the America's Clean Water Foundation, contrary to the requirements of Title 40 CFR 30.42 and 30.45. Because the Association did not adequately document its costs and did not comply with the EPA regulations, we questioned \$1,883,590 paid to the Association.

What We Recommend

We recommend that EPA (1) recover \$1,883,590 paid unless the Association is able to reconstruct its accounting records to meet the minimum financial management standards required in Title 40 CFR 30.21; (2) disallow contract costs procured in violation of Title 40 CFR 30.42 and 30.45; (3) rescind provisional indirect cost rates for the fiscal years ended June 30, 2005, and June 30, 2006; (4) stop work on all active grants and do not award any new grants until EPA has assurances that the Association meets minimum financial management requirements; (5) keep the Association on the reimbursement payment method until the Association meets minimum financial management requirements, settles current Federal liabilities, and repays all disallowed costs; and (6) require the Association to comply with single audit requirements for fiscal years ended June 30, 2004 and June 30, 2005. The Association stated many improvements have already been implemented and will continue to work to implement and address any remaining concerns.



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

OFFICE OF
INSPECTOR GENERAL

July 31, 2006

MEMORANDUM

SUBJECT: Association of State and Interstate Water Pollution Control Administrators
Incurred Costs for Seven EPA Assistance Agreements
Report No. 2006-4-00122

TO: Richard Kuhlman
Director, Grants Administration Division

This is our report on the subject audit conducted by the Office of Inspector General (OIG) of the U.S. Environmental Protection Agency (EPA). This report contains findings that describe the problems the OIG has identified and corrective actions the OIG recommends. This report represents the opinion of the OIG and does not necessarily represent the final EPA position. Final determination on matters in this report will be made by EPA managers in accordance with established audit resolution procedures.

On April 13, 2006, we issued a draft report to the Association of State and Interstate Water Pollution Control Administrators (Association) for comments. The Association responded and generally agreed with our findings, and outlined numerous corrective actions completed or underway. The Association's response and the OIG's comments are included in Appendix B.

The estimated cost of this report – calculated by multiplying the project's staff days by the applicable daily full cost billing rates in effect at the time – is \$88,404.

Action Required

In accordance with EPA Manual 2750, Chapter 3, Section 6(f), you are required to provide us your proposed management decision for resolution of the findings contained in this report before any formal resolution can be completed with the Association. Your proposed decision is due on November 28, 2006. To expedite the resolution process, please email an electronic version of your proposed management decision to reichard.keith@epa.gov.

We have no objections to the further release of this report to the public. For your convenience, this report will be available at <http://www.epa.gov/oig>. We want to express our appreciation for

the cooperation and support from your staff during our review. If you have any questions about this report, please contact Keith Reichard at (312) 886-3045.

Sincerely,

A handwritten signature in black ink, appearing to read "Bill A. Roderick". The signature is written in a cursive style with a prominent flourish at the end.

Bill A. Roderick
Acting Inspector General

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Background

The U.S. Environmental Protection Agency (EPA) awarded seven assistance agreements¹ (grants) to the Association of State and Interstate Water Pollution Control Administrators (Association) totaling \$2,020,696. The Association, which is located in Washington, DC, was formed in 1961, and is a Section 501(c) (3) not-for-profit organization (per Internal Revenue Code requirements). The following table provides some basic information about the authorized project periods and funds awarded under each of the seven grants:

Grant No.	Award Date	EPA Share *	EPA Payments	Payment Date	Project Period
X82919901	08/09/2001	\$125,000	\$125,000	07/28/2003	07/01/2001 – 10/01/2003
X82973401	05/02/2002	\$240,000	\$171,339	10/12/2005	04/01/2002 – 03/31/2006
X783105101	06/09/2003	\$360,000	\$360,000	05/24/2004	05/15/2003 – 05/14/2006
CP83106901	08/11/2003	\$200,000	\$200,000	05/05/2004	07/01/2003 – 06/30/2005
CP83107001	08/18/2003	\$440,000	\$440,000	05/12/2005	06/01/2003 – 05/30/2006
X783164601	03/24/2004	\$206,892	\$206,892	11/15/2004	02/19/2004 – 08/19/2005
X783173901	09/24/2004	\$448,804	\$380,359	11/01/2005	05/15/2004 – 05/14/2006
Total		\$2,020,696	\$1,883,590		

* The EPA share for all seven grants was 100 percent of allowable project cost.

All seven grants were awarded under the authority of the Clean Water Act. The scopes of work for the seven agreements are summarized as follows:

Agreement X82919901: Helped States improve monitoring programs required by the Clean Water Act for a full range of purposes including (1) improving the accuracy and completeness of impaired waters lists and comprehensive State water quality assessments reports, (2) streamlining the reporting requirements, and (3) enhancing public understanding and use of the reports.

Agreement X82973401: Provided a State/Federal work group to improve water quality standards development and implementation.

Agreement X783105101: This 3-year grant provided \$360,000 for technical support to assist States, Indian Tribes, and territories in complying with the total maximum daily load

¹ EPA's assistance to the Association was either a grant or cooperative agreement. For reporting purposes, all assistance will be referred to as a grant.

requirements. The scope of work is identical to Grant X783173901, listed below, and has an overlapping project period.

Agreement CP83106901: The purpose of this grant was to improve integrating point and nonpoint source control problems on a national scale through improved communications and coordination with State water quality agencies responsible for implementing water quality monitoring and assessment, and data management requirements.

Agreement CP83107001: Created State work groups for (1) permit program integrity and (2) prioritization and streamlining. The grant also provided a forum for national pollutant discharge elimination system managers to conference with EPA to address priority State concerns with point source-related water quality issues.

Agreement X783164601: Provided planning, support, and facilitation for three regional forums to create and enhance a multi-agency approach to implement nonpoint source pollution management measures at the watershed level.

Agreement X783173901: This 2-year grant provided \$448,804 for technical support to assist States, Indian Tribes, and territories in complying with the total maximum daily load requirements. This grant provided the same services and overlaps the project period for Grant X783105101 listed above.

Single Audit Activity

On September 12, 2005, our office issued the Association's single audit report for the year ended June 30, 2003. Nonfederal entities that expend \$300,000 (\$500,000 for fiscal years ending after December 31, 2003) or more in a year in Federal awards are required by Title 40 Code of Federal Regulations (CFR) 30.26 to have a single audit conducted in accordance with applicable requirements of the Office of Management and Budget (OMB) Circular A-133. The single audit report disclosed four findings that pertained to EPA grants:

1. The Association did not have adequate procedures in place to accurately track and record grant balances. The auditor required significant adjustments after the end of the fiscal year to properly report grant balances.
2. The Association's books of accounts were not accurately maintained on an accrual basis. The auditor required significant adjustments to accrue account balances in accordance with generally accepted accounting principles. As a result, the audited financial statements reflected results that were significantly different from internal management reports.
3. There were discrepancies in the net disbursements reported on the Financial Transaction Reports, SF-272, for several grants for the reporting periods ended December 31, 2002, and June 30, 2003. Cumulative disbursements reported for the same grants did not reconcile with the general ledger for these same periods.

4. The Association did not have adequate procedures to ensure that payments to hourly employees were correct and adequately supported. Timesheets for several off-site employees were not signed by either the employee or a supervisor with knowledge of the activities.

The single audit report disclosed that as of June 30, 2003, the Association drew advances from EPA in excess of expenditures resulting in a payable of \$141,289 due EPA.

Subsequent to the completion of the single audit for the fiscal year ended June 30, 2003, the Association hired Raffa & Associates to complete the Association's single audit for the year ended June 30, 2004. However, Raffa & Associates discontinued audit work after identifying accounting irregularities that might extend back to prior years, including the year ended June 30, 2003. Subsequently, the Association contracted with Raffa & Associates to provide accounting services and advice. After identifying the accounting irregularities, both the managing partner for Raffa & Associates and the Association's Executive Director met with EPA officials to report the accounting irregularities. On July 18, 2005, after being notified of the accounting irregularities, EPA temporarily placed the Association on the "reimbursement" method of payment as authorized by Title 40 CFR 30.14 and 30.22(h)(1). EPA took this action pending completion of corrective action to comply with Title 40 CFR Part 30.

Consequently, the single audit for the fiscal year ended June 30, 2003, remains unresolved, and the Association has not completed the single audits for the years ended June 30, 2004, and June 30, 2005.

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

Incurred Costs:	Expenses or outlays identified by the Association and recorded in the Association's accounting system.
Questioned Costs:	Costs that are (1) contrary to a provision of a law, regulation, agreement, or other documents governing the expenditures of funds; or (2) not supported by adequate documentation.

Independent Auditor's Report

We have examined the *Schedules of Budgeted & Reported Outlays by Assistance Agreement* prepared by the Association for each of the seven EPA grants: X82919901, X82973401, X783105101, CP83106901, CP83107001, X783164601, and X783173901. Preparing these schedules was the Association's responsibility. Our responsibility is to express an opinion on these schedules to determine the allowable costs incurred in accordance with the terms and conditions of the grants and applicable EPA regulations.

We conducted our examination 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 also followed the guidelines and procedures established in the *Office of Inspector General Project Management Handbook*, dated January 14, 2005. We examined, on a test basis, evidence supporting the costs incurred, and performed such other procedures as we considered necessary in the circumstances (see Appendix A for details). We believe that our examination provides a reasonable basis for our opinion.

In our opinion, because of the effects of the deficiencies discussed in the *Results of Examination*, the *Schedules of Budgeted & Reported Outlays by Assistance Agreement* do not present fairly, in all material respects, the allowable costs incurred in accordance with the terms and conditions of the grants and applicable EPA regulations. Accordingly, we questioned \$1,883,590 paid to the Association because the Association's financial management system was not adequate to account for grant funds in accordance with Title 40 CFR Part 30.

/s/Keith Reichard

Office of Inspector General
U.S. Environmental Protection Agency
January 20, 2006

**Schedules of Reported Outlays by Assistance Agreement, Questioned Costs,
and Amounts Due EPA
Association of State and Interstate Water Pollution Control Agencies**

Description	Grant Number/Schedule Date							Total
	X82919901 01/10/2006	X82973401 01/10/2006	X783105101 01/09/2006	CP83106901 01/18/2006	CP83107001 01/18/2006	X83164601 01/18/2006	X83173901 01/10/2006	
Personnel	\$44,352	\$67,591	\$17,246	\$60,290	\$99,048	\$86,684	\$26,251	\$401,462
Fringe Benefits	\$47,149	\$23,726	\$15,786	\$26,779	\$33,378	\$23,480	\$5,459	\$175,757
Travel	\$5,568	\$56,927	\$4,106	\$52,456	\$139,507	\$115,023	\$827	\$374,414
Printing and Publications	\$0	\$5,312	\$0	\$0	\$0	\$0	\$0	\$5,312
Other	\$107	\$4,171	\$0	\$2,583	\$5,097	\$2,075	\$0	\$14,033
Supplies	\$0	\$0	\$1,853	\$0	\$0	\$0	\$6,956	\$8,809
Contractual	\$1,125	\$2,040	\$286,966	\$9,378	\$122,186	\$21,131	\$218,279	\$661,105
Indirect	\$36,264	\$57,509	\$36,690	\$61,643	\$99,649	\$27,711	\$94,870	\$414,336
Total Incurred Costs	\$134,565	\$217,276	\$362,647	\$213,129	\$498,865	\$276,104	\$352,642	\$2,055,228
Less: Program Income	\$0	\$0	\$0	(\$2,268)	(\$22,732)	(\$29,256)	\$0	(\$54,256)
Reported Outlays Note 1	\$134,565	\$217,276	\$362,647	\$210,861	\$476,133	\$246,848	\$352,642	\$2,000,972
Total Cost Questioned EPA Payments Note 2	\$134,565	\$217,276	\$362,647	\$210,861	\$476,133	\$246,848	\$352,642	\$2,000,972
Amount Due EPA	\$125,000	\$171,339	\$360,000	\$200,000	\$440,000	\$206,892	\$380,359	\$1,883,590

Notes:

1. The Association provided separate schedules of reported outlays for each grant as of the date specified in the schedule.
2. The source for the EPA payments was from EPA's Financial Data Warehouse.

Results of Examination

Financial and Program Management, and Procurement Systems Did Not Comply with Standards

The Association did not comply with the financial and program management standards and the procurement standards promulgated in Title 40 CFR, Subchapter B, Part 30. Because the Association did not to meet its fiduciary responsibilities under the regulations, the incurred costs are not allowable.

When applying for grant assistance, the Association certified that it had the institutional, managerial, and financial capability to ensure proper planning, management, and completion of the project described in the grant application, and that it would comply with all applicable requirements of all Federal laws, executive orders, regulations, and policies governing the grant. EPA's administrative grant regulations for nonprofit organizations are codified in Title 40 CFR, Subchapter B, Part 30. Under the provisions of Title 40 CFR Part 30, the Association was required to follow (1) the financial and program management standards codified in Title 40 CFR 30.21 through 30.28, and (2) the procurement standards codified in Title 40 CFR 30.41 through 30.48.

The Association's financial and program management system (1) could not provide support for any of its general journal entries; (2) included numerous duplicate recorded costs in its accounting system; (3) could not always trace grant draws to the accounting records; (4) could not always support labor charged to the EPA grants; (5) could not support the recorded indirect costs; (6) did not record all of its program income in the general ledger; (7) did not have adequate written procedures for determining reasonable, allocable, and allowable costs; (8) drew EPA grant funds in excess of the funds needed; and (9) did not complete the required single audits for fiscal years ended June 30, 2004, and June 30, 2005.

The Association's procurement system did not comply with the procurement standards. The Association awarded contracts to the America's Clean Water Foundation, a related organization, without competition or a cost analysis contrary to the requirements of Title 40 CFR 30.42 and 30.45.

The provisions of Title 40 CFR 30.62 provides that if a recipient does not comply with the terms and conditions of an award, whether stated in a Federal statute, regulation, assurance, application, or notice of award, EPA may disallow all or part of the cost of the activity or action not in compliance. Because the Association did not adequately document its costs and did not comply with the grant regulations, we questioned \$1,883,590 paid to the Association. Details on our findings follow.

Unsupported General Journal Entries

The Association did not provide any documentation to support and sufficiently explain any of its general journal entries for any grants as required by Title 40 CFR 30.21. The provisions of Title 40 CFR 30.21 (b) (7) require the Association's financial management system to have accounting records that are supported by source documentation. The Association used general journal entries to (1) record accruals such as payroll costs, (2) reverse posting entries, (3) correct errors made in recording cash receipts or expenditures, (4) allocate indirect costs, (5) record revenue, and (6) post transactions which were not recorded in the general ledger by other means. However, the Association could not provide supporting documentation to explain and support these general journal entries.

For the audit period from July 1, 2001, through November 30, 2005, the Association could not support or justify any general journal entries. For example, during the fiscal year ended June 30, 2005, the Association made a general journal entry to record almost \$255,000 in labor and fringe benefit costs incurred during a 5-month period beginning in January 2005. However, the Association could not provide the supporting documentation for the general journal entry. The Association's Executive Director indicated that the accounting was not done timely because the Association's Comptroller passed away during the first part of 2005. The Executive Director also could not explain why the supporting documentation for any of the general journal entries was not available. As a result, the Association did not have sufficient records to support the allowability of the incurred costs.

Duplicate Recorded Costs

During the fiscal year ended June 30, 2005, the Association used two different databases to record grant expenditures in the general ledger. Based on our review of these databases, we noted numerous duplicate recorded costs. The provisions of Title 40 CFR 30.21 require the Association to maintain a financial management system that is accurate, current, and complete, and provide for the effective control over and accountability for all funds. The Executive Director could not explain why the dual data bases were used, and why there were duplicate recorded costs. Because of the duplicate recorded costs, the Association's financial management system was not accurate, and the incurred costs were incorrect and overstated.

Unsupported Grant Draws

Contrary to the provisions of Title 40 CFR 30.21, the Association could not always show the receipt of Federal cash draws in the Association's accounting records. The provisions of Title 40 CFR 30.21 require that the Association's financial management system provide records that identify adequately the source and application of funds for federally-sponsored activities. For example, the Association could not show where almost \$378,804 of Federal grant funds drawn under EPA grant X783173901 were recorded in the Association's accounting records. The Executive Director could not explain the reason why grant draws were not properly recorded in the accounting system. Further, in

the fiscal year ended June 30, 2003,² the Association's single auditor reported as a material weakness that the Association did not have adequate procedures in place to accurately track and record grant balances.

Unsupported Labor Costs

The Association could not support some of its labor costs. From July through October 2004, the Association recorded labor charges twice in the accounting system. The duplicate labor transactions were caused by using two different databases to record grant expenditures in the general ledger.

We also noted that for a 5-month period from January through May 2005, all labor costs were recorded in the accounting system using a single general journal entry. As stated above in the section entitled "Unsupported General Journal Entries," the Association did not have any documentation to support and sufficiently explain the general journal entries for recorded labor.³ Further, in reviewing the labor charges, the Association could not provide all the required labor activity reports (timesheets). The provisions of Title 40 CFR 30.21 (b) (7) require the Association's financial management system to have accounting records that are supported by source documentation. The provisions of Title 40 CFR 30.21 also require the Association to maintain a financial management system that is accurate, current, and complete, and provide for the effective control over and accountability for all funds. Because the Association's accounting transactions were inaccurate and unsupported, the Association's financial management system does not comply with the provisions of Title 40 CFR 30.21.

While we cannot verify labor charges, the Association did require employees to prepare labor activity reports which met OMB labor documentation requirements. Therefore, if the Association is able to locate all of its timesheets, it may be able to reconstruct the allowable labor costs for each grant.

Unsupported Indirect Cost Rates

The Association could not support the recorded indirect costs. The Association recorded indirect costs in the general ledger using general journal entries. As discussed above in the section entitled "Unsupported General Journal Entries," the Association did not have any documentation to support and sufficiently explain its general journal entries for the indirect costs. Accordingly, the Association could not demonstrate how the indirect cost rate was calculated or what costs were included in the indirect rate.

The Association did not prepare,⁴ submit, or receive approved final indirect cost rates from EPA for the fiscal years ended June 30, 2001, through June 30, 2005, as required by the applicable regulations. The provisions of Title 40 CFR 30.27 require non-profit

² The single audit report was submitted by the Association to the Federal Audit Clearinghouse on January 19, 2005.

³ The journal entries also included fringe benefits such as FICA and Medicare.

⁴ On January 19, 2006, the Association emailed the OIG a worksheet of what appears to be the Association's fiscal year 2003 provisional indirect rate. No explanation was provided with the spreadsheet.

organizations to follow the provisions of OMB Circular A-122 for determining allowable costs. 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.

On behalf of EPA, the U.S. Department of the Interior's National Business Center (Center) negotiated provisional indirect rates for the years ended June 30, 2005, and June 30, 2006. However, the Center informed the Association that a final rate for 2005 would not be negotiated until the Association submitted a revised proposal containing actual costs, based on, and reconciled to, financial statements that meet the requirements of the Single Audit Act of 1984. To date, the Single Audit for 2005 has not been completed, and the Association has not submitted a revised final indirect cost rate proposal for 2005 to either EPA or the Center.

Under Reported Program Income

The Association underreported program income under EPA grants CP83107001, X783164601, and CP83106901. The Association held various summits, forums, and other conferences, and earned program income from holding these meetings. The Association recorded \$54,256 for program income under the three grants and reduced the grant costs by \$54,256. However, the Association provided reports which show that the Association earned program income of at least \$85,751 for the three grants. Thus, the Association's general ledger does not accurately identify all of the program income earned. The Association did not have sufficient controls to ensure all the program income was properly recorded. By not properly recording the program income, the Association's financial management system was not accurate, and the incurred costs may have been overstated for EPA grants CP83107001, X783164601, and CP83106901.

Written Accounting Procedures Did Not Meet Standards

The Association did not have adequate written accounting procedures for 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) (6) states that the Association'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.

In developing written procedures, the Association needs to address the requirements of OMB Circular A-122. Specifically, the Association needs to address (1) the allocability of costs (Attachment A, paragraph A.4), (2) the three allocation methods authorized for indirect costs (Attachment A, paragraph D), (3) definition of direct and indirect costs (Attachment A, paragraphs B and C), and (4) the negotiation and approval of indirect cost rates (Attachment A, paragraph E).

As discussed above in the section entitled “Unsupported Indirect Costs Rates,” the Association did prepare provisional indirect rates for fiscal years ended June 30, 2005, and June 30, 2006; however, the Association could not explain, and did not have written accounting procedures to identify, what costs were actually included in the indirect cost rate calculations. Consequently, the Association could not demonstrate that the proposed indirect costs were allowable in accordance with OMB Circular A-122.

For example, we noted that during the fiscal year ended June 30, 2005, the recipient accounted for membership services as an indirect cost in its accounting system. The provisions of 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. Since the Association could not explain to us what costs were included in the indirect cost rate calculation, we were unable to determine whether the Association correctly removed the membership services from the indirect cost pool and appropriately classified the membership services as direct costs. Without written policies and procedures to distinguish between direct and indirect expenses, the Association could not properly support either the direct or indirect costs reported for the EPA agreements.

Noncompliance with Cash Management Requirements

For the year ended June 30, 2003, the Association’s single auditor reported that the Association did not comply with the Federal cash management requirements. The single auditor disclosed that the Association received advances in excess of expenditures totaling \$141,289. The single auditor reported that the reason for the excess advances was that the Association did not properly record grant draws. In addition, cash receipts were incorrectly posted to the wrong grant in the accounting records, resulting in the balances of the grants being misstated.

The provisions of Title 40 CFR 30.22 provide that payment methods shall minimize the time elapsing between the transfer of funds from the United States Treasury and the issuance or redemption of checks, warrants, or payment by the recipient. Cash advances shall be limited to the minimum amounts needed and be timed to be in accordance with the actual, immediate cash requirements of the recipient organization in carrying out the purpose of the approved program or project.

Single Audits Not Completed

The Association did not obtain single audits for the fiscal years ended June 30, 2004, and June 30, 2005, as required by Title 40 CFR 30.26. Title 40 CFR 30.26 provides that nonprofit organizations are subject to the audit requirements of OMB Circular A-133. OMB Circular A-133, Subpart B, requires nonfederal entities that expend \$300,000 (\$500,000 for fiscal years ending after December 31, 2003) or more in a year in Federal awards to have a single audit conducted in accordance with applicable requirements of the Circular. The certified public accountant firm contracted to conduct the Association's single audit for the fiscal years ended June 30, 2004, discontinued work after finding accounting irregularities. On July 18, 2005, after being notified of the accounting irregularities, EPA temporarily placed the Association on the "reimbursement" method of payment, as authorized by Title 40 CFR 30.14 and 30.22(h)(1). EPA took this action pending completion of corrective action to comply with Title 40 CFR Part 30.

Improper Procurement

Under Grants X783105101 and X783173901, the Association awarded two sole source fixed price contracts to the America's Clean Water Foundation, a related nonprofit organization.⁵ These contracts required the Foundation to provide "Circuit Rider" services to the Association. The first contract, under grant number X783105101, was for \$284,514.⁶ The second contract, under grant X783173901, was for \$368,524.⁷ Federal regulations (Title 40 CFR 30.42) provide 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. There was a conflict of interest since both the Association's Executive Director and Deputy Director were paid employees of both organizations--the Association and the America's Clean Water Foundation--and they both signed the contracts. In addition, the Association did not conduct a cost analysis of the two contracts in violation of Title 40 CFR 30.45. Without competition and the required cost analysis, there is no assurance that the prices paid were reasonable.

The Association also entered into shared service agreements for financial and administrative support services. These agreements were fixed price and identified as "indirect expenses for ASWIPCA." The value of these service agreements for a 2-year period ending June 30, 2005, was \$152,099. These agreements also violate Title 40 CFR 30.42 and 30.45.

⁵ The two nonprofit organizations are related through common management, and share office space, the telephone system, and office equipment.

⁶ The Association's *Schedule of Budgeted & Reported Outlays by Assistance Agreement* reported \$308,224 for this contract.

⁷ The Association's *Schedule of Budgeted & Reported Outlays by Assistance Agreement* reported \$245,682 for this contract.

Recommendations

We recommend that the Director for the Grants Administration Division:

1. Recover \$1,883,590 unless the Association is able to:
 - Reconstruct its accounting records and exclude all duplicate recorded costs from its accounting records.
 - Provide explanations and support for all general journal entries.
 - Identify and record all grant draws and program income in its accounting system.
 - Ensure that all transactions are supported by adequate source documentation including labor activity reports.
 - Prepare and submit fringe and indirect cost rate proposals for fiscal years 2001 through 2005 in accordance with OMB Circular A-122.
 - Develop written procedures to determine reasonable, allowable, and allocable costs in accordance with OMB Circular A-122.
 - Submit interim or final financial status reports for all seven grants included in this report. When submitting these status reports, include a schedule of reported outlays for each grant similar to those included in this report.
2. Disallow contract costs procured in violation of Title 40 CFR 30.42 and 30.45.
3. Rescind provisional indirect cost rates for fiscal years ended June 30, 2005, and June 30, 2006.
4. Stop work on all active grants and do not award any new grants until EPA has assurances that the Association meets minimum financial management requirements.
5. Keep the Association on the reimbursement payment method until the Association meets minimum financial management requirements, settles current Federal liabilities, and repays all disallowed costs.
6. Require the Association to comply with single audit requirements for fiscal years ended June 30, 2004, and June 30, 2005.

Status of Recommendations and Potential Monetary Benefits

RECOMMENDATIONS						POTENTIAL MONETARY BENEFITS (in \$000s)	
Rec. No.	Page No.	Subject	Status ¹	Action Official	Planned Completion Date	Incurred Amount	Agreed To Amount
1	12	Recover \$1,883,590 unless the Association is able to (a) reconstruct its accounting records and exclude duplicate recorded costs, (b) provide explanation and support for all general journal entries, (c) identify and record all grant draws and program income in its accounting system, (d) ensure that all transactions are supported by adequate documentation including labor activity reports, (e) prepare and submit fringe and indirect cost rate proposals for fiscal years 2001 - 2005 in accordance with OMB Circular A-122, (f) develop written procedures to determine reasonable, allowable, and allocable costs in accordance with OMB Circular A-122, and (g) submit interim and final financial status reports, including a schedule of reported outlays for each grant similar to those included in this report.	U	Director, Grants Administration Division		\$1,884	
2	12	Disallow contract costs procured in violation of 40 CFR 30.42 and 30.45.	U	Director, Grants Administration Division		(a)	
3	12	Rescind provisional indirect cost rates for fiscal years ended June 30, 2005, and June 30, 2006.	U	Director, Grants Administration Division		(a)	
4	12	Stop work on all active grants and do not award any new grants until EPA has assurances that the Association meets minimum financial management requirements.	U	Director, Grants Administration Division			
5	12	Keep the Association on the reimbursement payment method until the Association meets minimum financial management requirements, settles current Federal liabilities, and repays all disallowed costs.	U	Director, Grants Administration Division			
6	12	Require the Association to comply with single audit requirements for fiscal years ended June 30, 2004, and June 30, 2005.	U	Director, Grants Administration Division			

(a) The values for the questioned contract and indirect costs are \$661,105 and \$89,515, respectively, and are included in recommendation 1 to recover \$1,883,590.

- ¹ O = recommendation is open with agreed-to corrective actions pending;
 C = recommendation is closed with all agreed-to actions completed;
 U = recommendation is undecided with resolution efforts in progress

Schedule 1
Comparison of Grant Payments with
Incurred Costs

Description	Cash Payments by Grant							Total
	X82919901	X82973401	X783105101	CP83106901	CP83107001	X83164601	X83173901	
Reported Outlays ⁸	\$134,565	\$217,276	\$362,647	\$210,861	\$476,133	\$246,848	\$352,642	\$2,000,972
EPA Grant Amount	\$125,000	\$240,000	\$360,000	\$200,000	\$440,000	\$206,892	\$448,804	\$2,020,696
EPA Cash Payments ⁹	\$125,000	\$171,339	\$360,000	\$200,000	\$440,000	\$206,892	\$380,359	\$1,883,590
Date of Last Payment	07/28/2003	10/12/2005	05/24/2004	05/05/2004	05/12/2005	11/15/2004	11/01/2005	
Excess Cash Payments ¹⁰	\$0	\$0	\$0	\$0	\$0	\$0	\$27,717	\$27,717
Cost Overruns ¹¹	\$9,565	\$0	\$2,647	\$10,861	\$36,133	\$39,956	\$0	\$99,162
Funds Not Yet Draw ¹²	\$0	\$68,661	\$0	\$0	\$0	\$0	\$68,445	\$137,106
Grant Period	07/01/2001 to 10/01/2003	04/01/2002 to 03/31/2006	05/15/2003 to 05/14/2006	07/01/2003 to 06/30/2005	06/01/2003 to 05/30/2006	02/19/2004 to 08/19/2005	05/15/2004 to 05/14/2006	

⁸ The Association provided separate schedules of reported outlays for each grant as summarized on page 5.

⁹ Source: EPA's Financial Data Warehouse.

¹⁰ The difference between the reported outlays and the EPA cash payments.

¹¹ The difference between reported outlays and the EPA grant amount.

¹² Amount of funds remaining per EPA's Financial Data Warehouse.

Scope and Methodology

We performed our examination in accordance with the *Government Auditing Standards*, issued by the Comptroller General of the United States, and the attestation standards established 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 January 14, 2005.

We conducted this examination to express an opinion on the incurred costs, and determine whether the recipient complied with all applicable laws and regulations, as well as any special requirements under the agreement. We conducted our field work from January 9, 2006, through January 20, 2006.

In conducting our examination, we performed the following procedures:

- We reviewed grant and project files to obtain background information on the Association and the agreement.
- We interviewed recipient personnel to understand the accounting system and the applicable internal controls as they relate to the reported outlays.
- We reviewed the most recent single audit reports to identify issues which may impact our examination.
- We reviewed the recipient's internal controls specifically related to our objectives.
- We performed tests of the internal controls to determine whether they were in place and operating effectively.

We examined the incurred 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 and cost principles.

Recipient Response and OIG Comments

June 29, 2006

Mr. Michael A. Rickey
Director, Assistance Agreement Audits
U.S. Environmental Protection Agency
Office of the Inspector General
77 West Jackson Blvd
Chicago, IL 60604-3507

Re: ASIWPCA Response to Office of Inspector General Draft Attestation Report
Draft Attestation Report on EPA Grants X82919901, X82973401, X783105101,
CP83106901, CP83107001, X783164601, and X783173901
Report No. 2006-00620

Dear Mr. Rickey:

The Association of State and Interstate Water Pollution Control Administrators (ASIWPCA) appreciates the opportunity to respond to the Office of Inspector General's (OIG) draft audit report entitled, *Association of State and Interstate Water Pollution Control Administrators Incurred Costs For Seven EPA Assistance Agreements* (draft report) dated April 13, 2006.

Please find our detailed response attached which addresses and clarifies the information in OIG's draft report. Although we understand that not all of the issues raised in the draft report will be resolved before becoming final, the ASIWPCA Board asks that the OIG will reconsider aspects of its opinion based on the response provided.

Specifically, the Association is requesting that incurred costs identified as questioned costs by OIG in the draft report be deemed **unresolved**, until such time as GAD has been given the chance to review the entire record. The Association also requests that the final report be tempered with an acknowledgement of the limitations of a general ledger for financial analysis when embezzlement has occurred.

For those areas where OIG has identified weaknesses, ASIWPCA has revised its procedures and systems to ensure current and future compliance with Federal regulations. These have also been identified in the attached detailed response. Again, thank you for the opportunity to reply to these findings.

Sincerely,

A handwritten signature in black ink, appearing to read "Karen Gautreaux". The signature is written in a cursive style and is positioned to the left of a vertical red line.

Karen Gautreaux
ASIWPCA President and
Deputy Secretary, Louisiana DEQ

cc: ASIWPCA Board of Directors
Linda Eichmiller, ASIWPCA
Luis Luna, EPA
Howard Corcoran, EPA
Richard Kuhlman, EPA
Michael Mason, EPA
Bill Roderick, EPA
Mark Bialek, EPA
Melissa Heist, EPA
Eileen McMahon, EPA
John Manibusan, EPA
Ben Grumbles, EPA
James Hanlon, EPA

Enclosure

ASIWPCA RESPONSE

*Draft Attestation Report:
Association of State & Interstate Water Pollution Control Administrators
Incurred Costs for Seven USEPA Assistant Grants*

Summary

The Association of State & Interstate Water Pollution Control Administrators (Association) is hopeful that the Office of Inspector General (OIG) will revise its recommendation to recover the entire amount of grant monies utilized by the Association to complete the work on seven grants. OIG has identified several areas where the Association can improve its processes and procedures. Many improvements have already been implemented and we will continue to work with the Office of Grants & Disbarment (GAD) to implement and address any remaining concerns.

We have made great strides in mitigating the damage caused by the bookkeeper who embezzled Association funds. We are well along in our effort to rebuild all direct expenses for USEPA grants with backup that provides much greater detail than the general journal entries. We have removed the duplicate entries caused by the use of two data systems. We are working to identify and record all grant draws and other program income. All of our program activity reports (timesheets) back to 2002 have been consolidated and the data entered into spreadsheets. We are working with GAD to determine the most cost effective way to deal with the final indirect cost rate proposals. Once our financial rebuild is completed we will be able to provide final financial status reports for all seven grants.

The Association recognizes the report raises many legitimate issues and would like to work with the Agency to put into place and implement a corrective action plan. Since discovering the embezzlement, the Association has:

- Hired an accounting firm with a strong background in nonprofit organizations and USEPA grants
- Reorganized fiscal paper files which the bookkeeper intentionally put into disarray
- Secured provisional indirect cost rates for FY2005 and FY2006
- Started preparations for final indirect cost rate for 05/06
- Continued to rebuild the Association's electronic accounting system
- Rebuilt the Payroll records for FY2002-2006
- Organized all fiscal supporting documentation for the original 4 grants identified by OIG as subject to review. The scope will be expanded to include all 7 grants reviewed in this report.

- Updated the Association's personnel and fiscal operation manuals as requested by USEPA
- Confirmed with USEPA that all prior year Single Audit issues have been resolved.
- Documented and summarized all program income for each grant

The accounting system and the related software have been "real time" for an entire year since July 1, 2005. Accruals are made when they occur, receipts are processed as they are received, and checks are written within the system. Grant expenditures are tracked against the grant or cooperative agreement and against the remaining grant balance to ensure propriety and timeliness of incurring the costs and billing the cost to the Federal government. The books are closed within 10 days of the subsequent month with a reconciliation prepared for the cash and other major accounts and the subsidiary ledgers. Checks and balances are maintained between bookkeeping staff and the on-site out sourced accounting firm that provide oversight.

The Association understands the difficulty that the OIG Inspectors had in reviewing the financial status of the organization. The general ledger (GL) had numerous errors, poorly supported general journal entries, and for a short time period contained redundant transactions. As such, it is clearly within the purview of the Office of Inspector General to recommend disallowance of all incurred costs in situations where a grantee does not comply with financial, program management and procurement standards as outlined in the federal regulations.

The Association is instead requesting that these costs be deemed **unresolved**, until such time as GAD has been given the chance to review the entire record. The Association also requests that the final report and analysis be tempered with an acknowledgement of the limited utility of the general ledger available at the time of review.

OIG Comment: Deeming the questioned costs as unresolved would be inconsistent with the OIG's long-standing reporting practice and the *Inspector General Act of 1978*. The OIG's opinion is based on the condition of the records, observations and results of analysis at the time field work was conducted. This basis is consistent with the requirements of the *Government Auditing Standards*.

Questioned costs are defined in the report as costs that are (1) contrary to a provision of a law, regulation, agreement, or other documents governing the expenditures of funds, or (2) not supported by adequate documentation. The action official for this report will resolve the report's findings in accordance with *EPA's Audit Management Process*. If the action official decides to provide a supplementary analysis of the findings and recommendations, the action official will inform the recipient of the specific information or documentation that will be needed in support of the findings. Any disputes with the action official's decision will be resolved in accordance with Title 40 CFR 30.63.

We agree that the general ledger had limited utility at the time of our review. However, the limited use of the general ledger did not relieve the Association of its responsibility for maintaining an adequate financial management system as required by Title 40 CFR 30.21.

1. Unsupported General Journal Entries

The Association recognizes this was a problem with general journal entries which made it difficult to use the general ledger (GL) and validate the entries with supporting documentation. However, we are concerned that the scope of this issue was mischaracterized by stating that the Association “could not provide support for any of its general journal entries” [emphasis added]. This supporting documentation was available but because the investigators did not request these materials, we did not think to offer them at that time. For example, support for FY2005 general journal entries were all kept in a single binder in the bookkeeping office and to our knowledge this was not requested by the investigators during the review process.

The specific example provided in the draft report represents another instance where supporting documentation was actually available during the review. The \$255,000.00 general journal entry for labor and fringe benefit costs incurred during a 5-month period had supporting documentation behind it. Our new accounting firm, Raffa & Associates was responsible for this particular general journal entry and did maintain the appropriate materials as supporting documentation. (See Appendix 1¹³) Behind these spreadsheet schedules were all of the individual timesheets, payroll documents, and fringe benefit vendor files. Due to the chaos caused by the former bookkeeper and the need to deal with the embezzlement, the journal entry was believed by Raffa to be the best approach under the circumstances.

For many general journal entries in the GL the documentation is available. However, we recognize general journal entries can be a potential vulnerability in an accounting system. As we rebuild our financial records, the use of general journal entries will be limited, and proper source documentation will be scrupulously retained.

OIG Comment: According to notes in our audit work papers, the auditors (not investigators) made several requests to the Association’s Executive Director, and the accounting firm’s personnel for the documentation needed to support all the general journal entries. The supporting documentation was not provided, including the \$255,000 general journal entry prepared by the accounting firm.

The support for the journal entries will be necessary to support the reconstruction and revised claims to EPA.

¹³ The appendices are available from the OIG upon request.

2. Duplicated Recorded Costs

During our in-house review, the Inspector was given a ledger for FY2004 which continued past June 30 and ran to the first week of November. The Inspector was also given the FY2005 ledger which started July 1, 2004. The net effect was that from July 2004 to November 2004 there were two data systems or ledgers tracking our financial status. Although our accountants did not know at that time which of the two systems more accurately represented those months, they did explain to the Inspector our intent to rebuild our financial records using the more accurate of the two sets of data.

Since that time, we have initiated action to go back and document all direct expenditures for each grant and put them in spreadsheet schedules, which will eliminate all issues with duplicate entries per OIG's recommendation.

OIG Comment: The Association will need to revise its *Schedules of Budgeted & Reported Outlays by Assistance Agreement* that were incorrect and overstated due to the duplicate recorded costs. The Association will also need to revise the outlays reported on the Financial Status Reports.

3. Unsupported Grant Draws

The Association recognizes that this was an issue for our grants. Although we have not yet determined whether this was an artifact of the embezzlement or not, we do understand the importance of properly tracking this information. As part of the rebuild, Federal cash draws are now and will be appropriately documented in the future to comply with Title 40 CFR 30.21. This issue is also addressed in the revised ASIWPCA Accounting Policies Manual.

4. Unsupported Labor Costs

As was noted in the duplicate transaction section, there were two databases tracking our income and expenses during the time period of July 2004 to November 2004. This was fully disclosed to the Inspectors at the time of the review. A decision had not been made by our accountants as to which database represented the correct information. The Inspectors were informed that as part of the rebuild this could be determined and all redundant entries for those months would be eliminated.

Also noted in general journal entry section above, recorded in the GL is general journal entry for \$255,000.00 representing 5 months of labor and fringe. Backup support documentation was available at the time and has been provided as apart of this response. The organization's bookkeeper passed away in March of 2005, after having been hospitalized off and on for the three months prior. In June of

2005 it was discovered that the labor costs for the prior months had not been entered into the financial system and the new accounting firm determined that a general journal entry was appropriate under the circumstances.

We have traditionally been very diligent about tracking our time in labor activity reports. In the past, both the employee and supervisor were required to sign off on the paper copies. Almost every single signed paper copy for the last 5 years has been found to reconstruct our financial records and all data from these labor activity reports have been entered into spreadsheet schedules which have been shared with GAD through the reimbursement process. (See Appendix 2)

OIG Comment: The supporting documentation for the \$255,000 journal entry is not sufficient to fully support the entry. The assumptions and methodology used to determine the labor allocation and associated costs are not clear. Further, the hours on the schedules supporting the journal entry vary somewhat from the hours shown in Appendix 2 of the Association's response.

5. Unsupported Indirect Cost Rates

As was noted in the section above, in the future, the Association will avoid using general journal entries for direct or indirect expenses unless absolutely necessary and will retain all appropriate supporting documentation.

The Association has made a good faith effort to properly document indirect cost rates in compliance with the USEPA policy. There appeared to be some inconsistencies between the USEPA policy and the Office of Management and Budget (OMB) circulars regarding indirect cost documentation. Subsequently, the USEPA and OMB policies were amended to reconcile these apparent inconsistencies. Because the Association relied on and complied with the original USEPA policy, any failure to submit annual indirect cost rate proposals to USEPA was unintended. Thus, the Association should not be penalized for the previously-submitted documentation.

The Association acknowledges an understanding of the OMB Circular A-122, which requires the recipient to submit new indirect cost proposals to the cognizant agency within six months after the close of each fiscal year. The Association further understands USEPA cannot accept the reported outlays for indirect costs until we resubmit final indirect cost rate proposals for all appropriate prior years. Our efforts to do so are now underway with GAD to get final rates for FY2005 and FY2006.

OIG Comment: EPA's policy to allow the recipient to retain the indirect cost rate proposal(s) on file did not comply with OMB Circular A-122, Attachment A, subparagraph E (2) and has been rescinded. Nevertheless, both EPA and OMB policies required the Association to

prepare an indirect cost rate proposal. The Association did not provide any evidence that it prepared or maintained such documents. Accordingly, all indirect costs remain unsupported until the Association submits and receives approved indirect rates for all years beginning with the fiscal year ended June 30, 2001.

6. Underreported Program Income

The Association agrees that this was an issue with the GL. However, it should be noted that ASIWPCA's program staff tracked and documented this information in detail on spreadsheets (by event, participant and payment method). The methodology was explained to the investigators and those records were available for review. To the extent the GL differs from those records, we recognize changes must be made as part of the rebuild.

OIG Comments: The Association may have more program income than is supported by supplemental records. In reviewing the general ledger we identified program income from the CAFO roundtables/summits meeting; however, there were no Regonline¹⁴ reports provided for that meeting. Therefore, the program income may be greater than the amount identified in the supplemental records. By not properly recording and reconciling the program income, the Association's financial management system was not accurate, and the incurred costs may have been overstated for EPA grants CP83107001, X783164601, and CP83106901.

7. Inadequate Written Accounting Procedures

The Association agrees there were deficiencies in our written accounting procedures. Further, where there may not have been written deficiencies, there were areas of concern relating to implementation.

We request that the OIG review the Association's *Accounting Policies Manual*, dated August 2005, prepared for us by Raffa & Associates. If upon further review, more details must be provided, the Association is very willing as part of a corrective action plan, to provide more information in those areas. Several layers of checks and balances have been instituted to ensure implementation.

As part of our provisional indirect cost rate application, the Association now provides detailed descriptions of any and all assumptions made to develop the rate. Although in the past our provisional rate calculations included member services, for all current and future applications these costs will be treated as direct costs. The Association will further ensure that EPA is provided all relevant materials to support rate calculations and that appropriate written procedures are

¹⁴ Online event registration software and services for meetings, conferences, training classes, and other corporate functions.

in place to provide explanation to EPA regarding our treatment of direct and indirect expenses.

OIG Comment: The Association did not provide us with the *Accounting Policies Manual* either during our field work or in response to this report. Accordingly, we cannot comment on the adequacy of the procedures.

8. Noncompliance with Federal Cash Management Requirements

The Association agrees that this was an ongoing problem that comes up in the A-133 Single Audits Reports. Although no Federal funds have been identified as having been stolen, the report provides insight into the methodology of the embezzler to use different funds to back pay other expenses. Procedures with checks and balances have been put into place to assure this will not be a problem in the future.

9. Single Audits Not Completed

As was noted above, the FY2003 Single Audit Report was not finalized until June 24, 2004. In an attempt to go forward with the FY2004 Single Audit, Raffa & Associates discovered the embezzlement and the Association agreed that the audit should be put on hold until we could place confidence in our financial records. The Association is aware that under OMB Circular A-133, nonfederal entities that expend \$300,000 (*\$500,000 for fiscal years ending after December 31, 2003*) or more in a year in Federal awards must have a Single Audit conducted. We are currently rebuilding our records and will work with our accountants and the Office of Grants to determine the appropriate timing and solution for this issue.

The OIG draft report indicates that issues identified in the FY2003 Single Audit have not been addressed and resolved. ASIWPCA has since submitted to the agency a summary of actions that have been completed to resolve the issues identified in that audit (See Appendix 3). Those measures are in place and operational.

10. Improper Procurement

It is agreed that in situations where two organizations are related through common management, share office space, the telephone system, office equipment, etc., that greater scrutiny must exist to avoid a conflict of interest for decisions to spend Federal grant dollars on contractual services inter-organizationally. The specific issues raised in the OIG draft report focused on the TMDL Circuit Rider Grants and the Shared Services Agreement with America's Clean Water Foundation (ACWF) as well as several other smaller contracts.

The Association believes that these issues can be worked out with USEPA upon further discussion and review of ASIWPCA records. For instance we believe that information can be provided and presented by ASIWPCA that the rates from most work were at or below market rates and that the work was effectively completed. We look forward to discussing this further with USEPA.

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