



United States Department of Agriculture  
Office of Inspector General  
Washington, D.C. 20250



DATE: January 19, 2011

AUDIT  
NUMBER: 08703-5-SF (4)

TO: Thomas L. Tidwell  
Chief  
Forest Service

ATTN: Donna M. Carmical  
Chief Financial Officer  
Forest Service

FROM: Gil H. Harden /s/ Rod DeSmet (for)  
Assistant Inspector General  
for Audit

SUBJECT: Grant Recipient Did Not Have an Approved Indirect Cost Rate - The Recovery Act – Forest Service (FS) Hazardous Fuels Reduction and Ecosystem Restoration on Non-Federal Lands (4)

The American Recovery and Reinvestment Act of 2009 (Recovery Act) provided the Department of Agriculture (USDA) with \$28 billion in funding.<sup>1</sup> Of this amount, \$1.15 billion was specifically allotted to the Forest Service (FS) to implement projects that directly accomplish its mission of sustaining the nation's forests and grasslands, creating jobs, and promoting U.S. economic recovery. Congress, in enacting the Recovery Act, emphasized the need for accountability and transparency in the expenditure of funds. Further, on February 18, 2009, the Office of Management and Budget (OMB) issued initial guidance that required Federal agencies to establish rigorous internal controls, oversight mechanisms, and other approaches to meet the accountability objectives of the Recovery Act.<sup>2</sup> OMB issued additional guidance on April 3, 2009, to clarify existing requirements and establish additional steps that must be taken to facilitate the accountability and transparency objectives of the Recovery Act. Moreover, OMB emphasized that, due to the unique implementation risks of the Recovery Act, agencies must take

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<sup>1</sup> Public Law 111-5, February 17, 2009.

<sup>2</sup> Office of Management and Budget Memorandum M-09-10.

steps, beyond standard practice, to initiate the additional oversight mechanisms.<sup>3</sup> The USDA's Office of Inspector General (OIG) was charged with the responsibility of overseeing FS and other agencies' activities in order to ensure Recovery Act funds are spent in a manner that minimizes the risk of improper use.

The Recovery Act included \$200 million<sup>4</sup> for FS to implement Wildland Fire Management (WFM) activities on State, county, and private lands.<sup>5</sup> From May through September 2009, FS' Washington Office approved 152 WFM projects on non-Federal lands. FS field staff at the regional and National Forest levels used grants to award the approved project funds to State, local and tribal governments, and non-profit organizations. These non-Federal entities applied for Recovery Act funds by submitting to FS grant proposals describing the anticipated project work and its estimated cost. Some of the non-Federal WFM-funded projects included both direct costs (e.g., personnel, travel, and equipment) and indirect costs (e.g., accounting services and facilities maintenance).

We reviewed non-Federal WFM Recovery Act-funded grants awarded to four grant recipients in FS' Pacific Southwest Region to determine whether claimed indirect costs were properly reviewed, approved, and supported in accordance with OMB requirements and Federal cost principles.<sup>6</sup> Of the four grant recipients reviewed, one claimed \$567,000 in indirect costs.<sup>7</sup> We determined that this grant recipient's indirect costs were not supported as required by OMB. We further determined that indirect costs claimed by the grant recipient for three other non-Recovery Act-related FS grants (totaling about \$2 million) were also not supported. This occurred because FS staff responsible for awarding the Recovery Act and non-Recovery Act-funded grants were not fully aware of OMB's indirect cost approval requirements. The grantee was therefore allowed to use an indirect cost rate that was never verified. Without a properly approved indirect cost rate, FS has no reasonable assurance that grant recipients are accurately claiming their indirect costs in compliance with OMB requirements. This report is one in a series of reports pertaining to Recovery Act-funded grants to non-Federal entities, and the issue discussed below, along with any others identified, will be compiled into a final report at the conclusion of our audit.

Non-Federal recipients of Federal grants are responsible for administering awarded funds in compliance with specific Federal cost standards developed by OMB. These standards identify

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<sup>3</sup> Office of Management and Budget Memorandum M-09-15.

<sup>4</sup> This amount excludes \$50 million designated for non-Federal wood to energy grants.

<sup>5</sup> These activities include hazardous fuels reduction, forest health, and ecosystem improvements.

<sup>6</sup> Title 2 CFR Part 230, *Cost Principles for Non-Profit Organizations*, August 31, 2005; Title 7 CFR Part 3019, *Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations*, January 1, 2003; OMB Circular A-122, *Cost Principles for Non-Profit Organizations*, May 10, 2004; and FS Handbook 1509.11, *Grants, Cooperative Agreements, and Other Agreements*, April 21, 1995.

<sup>7</sup> This amount was calculated by multiplying the grant recipient's \$3.78 million Recovery Act-funded grant by 15 percent, which was the indirect cost rate claimed by the grant recipient.

the types of direct and indirect costs for which grant recipients can claim reimbursement. Direct costs are those costs that can be specifically linked to a grant activity (i.e., the cost to purchase equipment or supplies needed to accomplish the project). Indirect costs are those costs that cannot be directly linked to a specific grant activity (i.e., building depreciation or centralized financial functions). Grant recipients seeking reimbursement for indirect costs are required to prepare an indirect cost rate proposal that includes financial documentation and analysis showing that the desired indirect cost rate is supported, accurate, and reasonable. In addition, this proposal must identify all activities carried out within the organization, classify those activities as direct or indirect, and subtract from indirect costs those costs that are ineligible, based on OMB guidance and agency regulations.<sup>8</sup> The grant recipient's indirect cost rate proposal should substantiate its indirect cost claims and provide the basis for a Federal agency's approval of the recipient's final indirect cost rate. The final approved rate is formalized in a written agreement and becomes the rate the recipient must use for every Federal grant it receives.

Formal review and approval of a grant recipient's proposed indirect cost rate is an important control function for the proper expenditure of Recovery Act-funded grants and other Federal funds. Past OIG audits have identified a number of problems relating to grant recipients' claimed indirect costs:<sup>9</sup>

- A large number of non-profit organizations did not have adequate documentation to support that claimed indirect costs were allowable and properly allocated.
- Organizations claimed indirect costs that included unallowable activities (e.g., fund-raising, lobbying, and bad debt expense).
- Indirect costs were not equitably allocated to Federal grants based on the relative benefits received.

FS staff are responsible for verifying that grant recipient's claimed indirect costs are supported in writing by an indirect cost rate determination and are legal to pay.<sup>10</sup> During our review of non-Federal WFM Recovery Act-funded grants in FS' Pacific Southwest Region, we found that FS had awarded a non-profit organization a Recovery Act grant in the amount of \$3.8 million and allowed it to claim indirect costs totaling about \$567,000 using a provisional (temporary) indirect cost rate. Provisional indirect cost rates are temporary rates that are typically used for new grant recipients that have not previously received Federal grants. Because the new recipient

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<sup>8</sup> Title 2 CFR Part 230, *Cost Principles for Non-Profit Organizations*, August 31, 2005.

<sup>9</sup> Department of Transportation OIG, Report No. ZA-2009-033, *Oversight of Design and Engineering Firms' Indirect Costs Claimed on Federal-Aid Grants*, February 2009; Department of Justice OIG, Audit Report 08-26, *Management of the Office of Justice Programs' Grant Programs for Trafficking Victims*, July 2008; Department of Health and Human Services OIG, Report No. A-04-02-08001, *Identification and Allocation of Indirect Costs at the Centers for Disease Control and Prevention*, December 2003; and Department of Agriculture OIG, Audit Report No. 27016-1-SF, *CACFP Audit Funds, California Department of Education*, April 2003.

<sup>10</sup> FS Handbook 1509.11, *Grants, Cooperative Agreements, and Other Agreements Handbook*, Chapter 20, October 20, 2009.

lacks documentation to support its actual indirect costs, it is allowed to use a provisional rate until its actual indirect costs are determined. The recipient is then expected to obtain a final approved indirect cost rate based on a subsequent audit of its actual indirect costs.

We determined that FS' approval of a provisional indirect cost rate for the grant recipient was inappropriate. We based our determination on the fact that the grant recipient had been operating for five years (since 2005) and, therefore, already had the historical information needed to support a formal indirect cost rate plan and a final audited rate. We further determined that the grant recipient had previously received three additional FS grants (non-Recovery Act-related) over that 5-year period and claimed about \$2 million in indirect costs for those grants, which had also never been reviewed and approved.<sup>11</sup> OMB circulars require non-profit organizations to submit an indirect cost rate proposal immediately after the organization is advised that a Federal award will be made or no later than 3 months after the effective date of the award.<sup>12</sup> This means that the grant recipient was required to submit its indirect cost rate plan to FS in 2005 when it received its first FS grant, which it never did. For the three previously awarded grants, FS, therefore, allowed the grant recipient to claim indirect costs without an approved indirect cost rate plan and final audited rate.

Staff at the non-profit organization receiving the grant stated they were familiar with the OMB requirements and that they knew they were required to have an approved indirect cost rate. They also noted that the non-profit organization was subject to a review by the FS' Pacific Southwest Regional office in 2007. During the review, this indirect cost rate requirement was reiterated and the non-profit organization was directed to submit an indirect cost rate plan to FS for review and approval. The staff at the non-profit organization further stated they did not comply with FS' direction because obtaining an approved indirect cost rate was a low priority and they knew FS staff would never have followed up to ensure the final rate was obtained. FS staff we spoke with did not know why the grant recipient's indirect cost rate had never been officially reviewed and approved by FS, but suggested that the approval "fell through the cracks." FS staff stated that they knew this non-profit organization did not have an approved indirect cost rate when they awarded it Recovery Act funds in August 2009. They believed they adequately addressed this shortfall by approving the non-profit organization's use of a provisional indirect cost rate in its Recovery Act-funded grant and by requiring the non-profit organization to annually submit its actual Recovery Act indirect costs to a FS project manager.

While we recognize that FS took some action to address the non-profit organization's unverified indirect costs when it awarded the Recovery Act-funded grant, we do not agree that these actions were sufficient. When the grant recipient received its first FS grant in 2005, OMB circulars required the grant recipient to submit to FS support for its indirect costs. The grant review performed by FS in 2007 reiterated this requirement by specifically directing the grant recipient

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<sup>11</sup> The grant recipient received three FS grants since 2005 with budgeted expenditures totaling approximately \$13 million. In each grant, the recipient included indirect costs totaling \$1.9 million, approximately 15 percent of total grant funds.

<sup>12</sup> Title 2 CFR Part 230, *Cost Principles for Non-Profit Organizations*, Appendix A, August 31, 2005.

to take the necessary steps to obtain an approved rate. Despite that direction, the grant recipient took no action to comply with the indirect cost rate requirements. Rather than approving the grant recipient's use of a provisional rate for its Recovery Act-funded grant, FS should have deferred the Recovery Act-funded award until the grant recipient provided evidence that it had developed and submitted a formal indirect cost rate plan to the agency for review and approval. Even though FS staff knew the grant recipient was claiming indirect costs in three other FS grants previously received, and that those grants contained no formal indirect cost rate plan, FS staff did not modify the grants to address this deficiency.

When this issue was brought to the attention of FS staff responsible for overseeing the grant recipient's Recovery Act-funded grant, they promptly directed the grant recipient to submit an indirect cost rate plan and supporting documentation to the agency's financial service center to facilitate the approval of a final, verified indirect cost rate. According to FS, the grant recipient has since submitted for review and approval the required indirect cost documentation to establish an indirect cost rate for future indirect cost claims. However, FS staff did not obtain and review the grant recipient's previously claimed indirect costs to ensure they were supported and allowable. In addition, FS did not modify the provisions of the grant recipient's three previously awarded FS grants to require the use of the final indirect cost rate once approved.

To ensure consistent and sufficient accountability over Recovery Act-funded grants and other awarded Federal funds, FS needs to ensure that its grant recipients are using indirect cost rates that have been developed and approved in accordance with OMB regulations. FS should instruct its staff to review all existing Recovery Act and non-Recovery Act-funded grants to ensure that grant recipients claiming indirect costs have the required approvals and supporting documentation. For those grants where FS determines grant recipients' indirect cost rates have not been properly approved, FS should direct recipients to immediately submit for its approval indirect cost rate plans and supporting financial documentation. In the interim, FS should not allow grant recipients to claim indirect costs until FS approves their indirect cost rates. Finally, FS should review indirect costs previously claimed by grant recipients lacking approved rates and disallow any indirect costs FS determines to be ineligible, inaccurate, or unsupported.

We discussed our concerns with FS Washington Office officials, who generally agreed with our finding and recommendations. While FS agreed with the need to review non-Federal WFM Recovery Act and non-Recovery Act-funded grants to ensure indirect cost rates had been properly developed and approved, it suggested randomly sampling the grants rather than having to review all of them. We do not agree with FS' recommendation to select only a random sample of the grants to review, particularly those grants funded through the Recovery Act, since the accountability and transparency objectives of the Recovery Act require FS to ensure all non-Federal WFM Recovery Act-funded grant recipients claim indirect costs in compliance with Federal cost principles and OMB direction.

We recommend that FS:

1. Instruct FS grant managers to review all existing non-Federal WFM Recovery Act and non-Recovery Act-funded grants to ensure that grant recipients claiming indirect costs have the OMB required approvals and supporting documentation.
2. For those grants where FS determines recipients' indirect cost rates have not been formally reviewed and approved, direct grant recipients to prepare and submit to FS' financial service center an indirect cost rate plan for FS review and approval. In the interim, FS should not allow grant recipients to claim indirect costs until FS approves their indirect cost rates.
3. Review indirect costs previously claimed by grant recipients lacking approved rates and disallow any indirect costs FS determines to be ineligible, inaccurate, or unsupported.

Please provide a written response within 5 days outlining your proposed corrective action for this issue. If you have any questions, please contact me at (202) 720-6945, or have a member of your staff contact Steve Rickrode, Director, Rural Development and Natural Resources Division, at (202) 690-4483.

cc:

Jennifer McGuire, Director of Audit and Assurance, Forest Service  
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**Agency's Response**

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**USDA'S**

**FOREST SERVICE'S**

**RESPONSE TO AUDIT REPORT**



**File Code:** 1430

**Date:** February 4, 2011

**Subject:** Response to Audit Report No. 08703-5-SF(4) “Grant Recipient Did Not Have an Approved Indirect Cost Rate – The Recovery Act – Forest Service (FS) Hazardous Fuels Reduction and Ecosystem Restoration on Non-Federal Lands (4)”

**To:** Gil H. Harden, Assistant Inspector General for Audit

This letter is in response to Audit Report No. 08703-5-SF (4) “Grant Recipient Did Not Have an Approved Indirect Cost Rate – The Recovery Act – Forest Service Hazardous Fuels Reduction and Ecosystem Restoration on Non-Federal Lands (4)” dated January 19, 2011 from the US Department of Agriculture Office of the Inspector General. We appreciate the opportunity to respond to your audit. The response for each recommendation follows:

**OIG Recommendation #1:** Instruct Forest Service (FS) grant managers to review all existing non-Federal Wildland Fire Management (WFM) Recovery Act and non-Recovery Act-funded grants to ensure that grant recipients claiming indirect costs have the OMB required approvals and supporting documentation.

**Forest Service Response:** The FS agrees with this recommendation. One hundred percent of Recovery Act WFM grants have been reviewed and appropriate follow-up is being conducted on the results. In order to expedite the non-Recovery Act grant’s review, the FS will look at each recipient’s indirect cost rate documentation. Guidance will be provided to all FS Grant Officials by March 4, 2011, requiring review of WFM non-Recovery Act funded grants by recipient to ensure approved indirect cost rates are in place.

**OIG Recommendation #2:** For those grants where FS determines recipients indirect cost rates have not been formally reviewed and approved, direct grant recipients to prepare and submit to FS financial service center an indirect cost rate plan for FS review and approval. In the interim, FS should not allow grant recipients to claim indirect costs until FS approves their indirect cost rates.

**Forest Service Response:** The FS cannot concur with this recommendation as it is written. For those grantees without approved indirect cost rates, the FS will direct those recipients to prepare and submit indirect cost rate proposals to their cognizant agency for review and approval. If the FS is determined to be the cognizant agency, we will request the cognizant agency auditor to conduct the appropriate audits.

The FS is precluded from holding reimbursement for indirect costs as requested by the recommendation. So until an audit can be conducted, the FS proposes to negotiate reasonable indirect cost rates with grantees and reimburse accordingly throughout the grant until the final rate can be determined. Currently, the FS does not have authority delegated to them to conduct indirect cost audits.





**OIG Recommendation #3:** Review indirect costs previously claimed by grant recipients lacking approved rates and disallow any indirect costs FS determines to be ineligible, inaccurate, or unsupported.

**Forest Service Response:** The FS cannot concur with this recommendation as it is written. FS is implementing processes for program managers to negotiate lower indirect cost rates than what their audited statements would allow. This is done to lower and control indirect costs paid by FS and improve delivery of services. FS is questioning the reasonableness of indirect costs as we rely on the determination of an external auditor on whether the costs are supportable. Pursuant to OMB Circular A-133, grantees with federal funding \$500,000 and above are required to have a Single Audit. The FS can use the information contained in these reports from these grantees to determine an appropriate indirect cost rate after completion of the audit, however, reviews of these computed rates versus the negotiated rates often indicate that the negotiated rate is lower than what the audited rate would result in.

For those grantees with less than \$500,000 in federal funding, there is no requirement for an audit. Consequently, FS would be required to conduct an audit to form the basis for disallowance of costs which would result in additional cost to the Agency. We propose that FS conduct a regular evaluation of grants which meet these criteria and have indirect costs to determine the relative risk of exposure for overpayment of indirect costs as not all grants have indirect costs.

If you have any additional questions, please contact Donna Carmical, Chief Financial Officer, (202) 205-1321, [dcarmical@fs.fed.us](mailto:dcarmical@fs.fed.us).

*/s/ Donna M. Carmical*  
DONNA M. CARMICAL  
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