



U.S. ENVIRONMENTAL PROTECTION AGENCY

OFFICE OF INSPECTOR GENERAL

Audits on EPA Recovery Act-Funded Diesel Emission Reduction Act Assistance Agreements Reported Programmatic and Management Challenges

Report No. 14-R-0355

September 15, 2014



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Report Contributors:

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Abbreviations

DERA	Diesel Emissions Reduction Act
EPA	U.S. Environmental Protection Agency
FY	Fiscal Year
OAR	Office of Air and Radiation
OIG	Office of Inspector General

Cover photos: The American Recovery and Reinvestment Act of 2009 logo (center); *(clockwise from top)*: a retrofitted school bus (EPA photo), old and new trailer refrigeration units (EPA OIG photo), a locomotive (EPA OIG photo), and an EPA-certified SmartWay tractor (EPA photo).

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At a Glance

Why We Did This Review

In 2005, Congress passed the Energy Policy Act, of which Title VII, Subtitle G, established a program commonly referred to as the Diesel Emissions Reduction Act (DERA) program. As part of our oversight of the U.S. Environmental Protection Agency's (EPA's) awarding of assistance agreements under the American Recovery and Reinvestment Act of 2009, we issued six separate reports on specific cooperative agreements involving the DERA program. The purpose of this new report is to summarize the findings in the previous reports and identify commonalities or overarching issues.

EPA awarded \$294 million in Recovery Act funds under the DERA program for 160 assistance agreements. The reported results are from our six previous reports, representing approximately \$26 million in federal expenditures.

This report addresses the following EPA goal or cross-agency strategy:

- *Addressing climate change and improving air quality.*

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The full report is at: www.epa.gov/oig/reports/2014/20140915-14-R-0355.pdf

Audits on EPA Recovery Act-Funded Diesel Emission Reduction Act Assistance Agreements Reported Programmatic and Management Challenges

What We Found

During the six previous audits on Recovery Act cooperative agreements awarded for DERA projects, we determined that:

- Four of the six recipients did not meet all objectives of grant awards.
- Five of the six recipients did not have financial management systems that met federal requirements.
- Four of the six recipients did not meet Recovery Act requirements.

EPA should consider the issues identified in our prior reports as it takes actions directed by the Office of Management and Budget to assess risk inherent in its programs.

As a result, we had questioned over 90 percent of the expenditures reviewed.

As part of the Office of Management and Budget's streamlining of federal assistance agreement requirements, emphasis has now been placed on agencies to assess recipient risk, and to focus on performance outcomes. The EPA should consider the issues identified as it takes such streamlining actions.

The six previous audits included recommendations for corrective actions. No new recommendations are included because the limited sample size of previous Office of Inspector General reports may not be representative of the entire population of EPA DERA awards. Examples of actions the EPA took to address issues identified in the prior audit reports include the following:

- In response to a recipient not requiring a subrecipient to scrap or remanufacture old engines taken from repowered locomotives in accordance with the cooperative agreement, action was taken to do so.
- The EPA was able to provide confirmation that every vehicle reported as retrofitted by a recipient under its cooperative agreement was completed.
- A recipient was not operating repowered locomotives in the area defined in the cooperative agreement, and the cooperative agreement was amended to have the grantee deliver environmental and health benefits to the required area.

The EPA's Office of Air and Radiation also made changes to DERA oversight to reduce risk in the future, including revised methodologies for emissions reporting, yearly project officer and grantee training, creation of technical guidance related to DERA-specific assistance agreement management, and continued baseline and advanced monitoring on the DERA program.



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

THE INSPECTOR GENERAL

September 15, 2014

MEMORANDUM

SUBJECT: Audits on EPA Recovery Act-Funded Diesel Emission Reduction Act Assistance Agreements Reported Programmatic and Management Challenges Report No. 14-R-0355

FROM: Arthur A. Elkins Jr.

A handwritten signature in black ink, appearing to read "Arthur A. Elkins Jr.", is written over the printed name.

TO: Janet McCabe, Acting Assistant Administrator
Office of Air and Radiation

Nanci Gelb, Acting Assistant Administrator
Office of Administration and Resources Management

This is our report on the subject review conducted by the Office of the Inspector General (OIG) of the U.S. Environmental Protection Agency (EPA). As part of our oversight of the EPA's awarding of assistance agreements under the American Recovery and Reinvestment Act of 2009, we issued six separate reports on specific assistance agreements involving the Diesel Emission Reduction Act program. The purpose of this new report is to summarize the findings from the previous reports and identify commonalities or overarching issues. The six previous audits included recommendations for corrective actions. No new recommendations are included in this report because the limited sample size of the previous OIG reports may not be representative of the entire population of EPA Diesel Emission Reduction Act program awards. The report represents the opinion of the OIG and does not necessarily represent the final EPA position.

The Office of Air and Radiation's Office of Transportation and Air Quality and the Office of Administration and Resources Management's Office of Grants and Debarment can consider the issues identified in assessing the risks associated with recipients prior to award.

Action Required

Because this report contains no recommendations, you are not required to respond to this report. However, if you submit a response, it will be posted on the OIG's public website, along with our memorandum commenting on your response. Your response should be provided as an Adobe PDF file that complies with the accessibility requirements of Section 508 of the Rehabilitation Act of 1973, as amended. The final response should not contain data that you do not want released to the public. If your response contains such data, you should identify the data for redaction or removal, along with corresponding justification.

We will post this report to our website at <http://www.epa.gov/oig>.

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Introduction

Purpose

As part of our oversight of the U.S. Environmental Protection Agency's (EPA's) awarding of assistance agreements¹ under the American Recovery and Reinvestment Act of 2009, the EPA Office of Inspector General (OIG) issued six separate reports on specific assistance agreements involving EPA's Diesel Emission Reduction program. The purposes of this new report are to:

- Summarize the findings reported under the assistance agreement audit reports.
- Identify any commonalities or overarching issues that impacted the recipients' abilities to meet their grant objectives and comply with federal regulations.

Background

Diesel emissions account for 6.3 million tons of nitrogen oxide and 305,000 tons of particulate matter in the national mobile emissions inventory (2004). The emissions are from a variety of on-road and non-road vehicles, such as those used for freight, ports, transit, construction, agriculture and energy production.

According to the EPA, reducing emissions from diesel engines is one of the most important air-quality challenges facing the United States. These emissions contribute to serious public health problems, including asthma, lung cancer, and various other cardiac and respiratory diseases. These problems result in thousands of premature deaths, millions of lost workdays, and numerous other negative health and economic outcomes every year.

In 2005, Congress passed the Energy Policy Act, of which Title VII, Subtitle G established a program commonly referred to as the Diesel Emissions Reduction Act (DERA) program. Congress appropriated a total of \$219.1 million for the EPA under DERA for fiscal years (FYs) 2008 through 2011. The money enabled the EPA's Office of Air and Radiation (OAR) to fund programs managed by OAR's Office of Transportation and Air Quality to achieve significant reductions in diesel emissions (e.g., tons of pollution produced and diesel-emission exposures, particularly from fleets operating in areas designated by the agency as poor air quality areas). Of the authorized DERA amount, 70 percent is authorized

¹ An assistance agreement is the legal instrument EPA uses to transfer money, property, services, or anything of value to a recipient to accomplish a public purpose. It is either a grant or a cooperative agreement and will specify: budget and project periods; the Federal share of eligible project costs; a description of the work to be accomplished, and any terms and conditions/special conditions.

for competitive national assistance agreements and low-cost revolving loans, and the remaining 30 percent is for state assistance agreements and loan programs. The OAR continues to provide substantial DERA funding, with non-Recovery Act awards of over \$141 million to recipients to reduce diesel air emissions through FY 2017.

Congress appropriated an additional \$300 million to the EPA in FY 2009 for DERA assistance agreements under the Recovery Act. In addition to the DERA goal of reductions in diesel emissions, the assistance agreements awarded with Recovery Act funds were also intended to promote economic recovery and create or retain jobs. EPA was to consider these economic factors in awarding competitive grants and fund projects that could be undertaken quickly. The EPA reported that it awarded approximately \$294 million for 160 assistance agreements.

Responsible Offices

The OAR's Office of Transportation and Air Quality and the Office of Administration and Resources Management's Office of Grants and Debarment are the program offices responsible for the issues discussed in this report.

Scope and Methodology

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We identified six previous reports on Recovery Act DERA projects issued by the OIG for review, as listed in table 1.

Table 1: Summary of previously issued OIG audit reports

Report title	Report no.	Date issued
Examination of Costs Claimed Under EPA Cooperative Agreement 2A-83440701 Awarded Under the Recovery Act to Cascade Sierra Solutions, Eugene, Oregon	12-R-0749	September 4, 2012
Air Quality Objectives for the Baton Rouge Ozone Nonattainment Area Not Met Under EPA Agreement 2A-96694301 Awarded to the Railroad Research Foundation	13-R-0297	June 20, 2013
Projected Emission Reductions Overstated and Buy American Requirements Not Met Under EPA Award to the Tennessee Department of Transportation	13-R-0321	July 19, 2013
Examination of Costs Claimed Under EPA Cooperative Agreements 2A-96104501 and 2A-96107201 Awarded Under the Recovery Act to Chelsea Collaborative Inc., Chelsea, Massachusetts	13-R-0353	August 22, 2013
Examination of Costs Claimed Under American Recovery and Reinvestment Act Cooperative Agreement 2A-97706701 Awarded to Grace Hill Settlement House, St. Louis, Missouri	13-R-0367	August 30, 2013
Unless California Air Resources Board Fully Complies With Laws and Regulations, Emission Reductions and Human Health Benefits Are Unknown	14-R-0130	March 6, 2014

Source: OIG-issued reports

We analyzed the findings and recommendations to determine whether there were any issues common to more than one audit. We did not obtain any new information and did not conduct preliminary research. This report is intended to be informative in nature and provide lessons learned for future DERA awards. No recommendations are included because the limited sample size of the previous OIG reports issued may not be representative of the entire population of EPA DERA awards. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The seven assistance agreements included in these six reports represented \$26,737,810 of the approximately \$294 million of Recovery Act DERA money awarded by EPA. The six recipients included four non-profit organizations and two state agencies. Details on the assistance agreements are in table 2.

Table 2: Details on grants reviewed

Recipient	Recipient type	Grant no.	Project objective	Federal award amount	Project period
Cascade Sierra Solutions, Eugene, Oregon	Non-profit	2A-83440701	Create a national revolving loan program for heavy-duty trucks.	\$9,000,000	08/01/09 to 03/31/13
Railroad Research Foundation, Washington, D.C.	Non-profit	2A-96694301	Repower locomotives for Baton Rouge, Louisiana.	2,927,496	09/09/09 to 12/31/10
Tennessee Department of Transportation, Nashville, Tennessee	State	2A-95425709	Install a network of truck stop electrification facilities at highway truck stops.	2,000,000	06/01/09 to 11/30/11
Chelsea Collaborative Inc., Chelsea, Massachusetts	Non-profit	2A-96104501 and 2A-96107201	Provide 14 retrofits and four engines upgrades. Repower privately-owned stationary cold storage units.	1,921,426	05/01/09 to 09/30/11
Grace Hill Settlement House, St. Louis, Missouri	Non-profit	2A-97706701	Provide emission reduction technology for a variety of vehicles.	2,000,000	06/01/09 to 06/30/11
California Air Resources Board, Sacramento, California	State	2A-00T13801	Repower switch-yard locomotives within the South Coast Air Basin.	8,888,888	06/15/09 to 12/31/10
Total				\$26,737,810	

Source: EPA grants database.

What We Found

Our review of the six prior audits of specific cooperative agreements awarded under the Recovery Act involving DERA projects identified three common, overarching issues:

- Four of the six recipients did not meet all the objectives of the award.
- Five of the six recipients did not have a financial management systems that met federal requirements that applied to the grant award.
- Four of the six recipients did not meet Recovery Act requirements.

As a result, we questioned a total of \$23.8 million of the \$26.3 million claimed under the assistance agreements. We summarize the costs questioned by finding and recipient in tables 3 and 4, respectively.

Table 3: Costs questioned by finding

Finding	Costs questioned
Objectives of award not met	\$11,655,343
Federal requirements for financial management systems not met	10,538,263
Recovery Act requirements not met	1,623,049
Total	\$23,816,655

Source: OIG-issued reports.

Table 4: Funds audited and costs questioned by recipient

Recipient	Federal funds audited	Costs questioned
Cascade Sierra Solutions	\$9,000,000	\$9,000,000
Railroad Research Foundation	2,904,578	2,904,578
Tennessee Department of Transportation	1,623,049	1,623,049
Chelsea Collaborative Inc.	1,921,426	0
Grace Hill Settlement House	1,985,679	1,423,028
California Air Resources Board	8,866,000	8,866,000
Total	\$26,300,732	\$23,816,655

Source: OIG-issued reports and assistance agreement award documents.

Cooperative agreements require substantial involvement in the form of technical assistance, development of outputs and oversight. Substantial involvement takes the form of monitoring the project by the EPA, participation and collaboration between the EPA and the recipient in program content, review of project progress, and quantification and reporting of results. Greater involvement, especially in the

early stages of the project, could prevent confusion over requirements and the later need for corrective actions at the end of the project.

Recipients Did Not Meet Award Objectives

Four of six recipients did not meet the award objectives. Details on our findings are in table 5.

Table 5: Details on recipients not meeting award objectives

Recipient	Objective	Findings
Cascade Sierra Solutions	The cooperative agreement allows for funding of pre-2007 model year highway vehicles so long as verified emission control technologies have been installed.	Recipient did not install verified emission control technologies on pre-2007 model year trucks; therefore, trucks did not meet emission requirements.
Railroad Research Foundation	The cooperative agreement states that the foundation requested funds to repower locomotives in the city of Baton Rouge, Louisiana, which is currently designated as a nonattainment area for ozone.	Repowered locomotives were not operating in the Baton Rouge nonattainment area as provided for in proposal. As a result, the inhabitants of Baton Rouge were not receiving the benefits of the lower diesel emissions expected by the EPA.
Tennessee Department of Transportation	The cooperative agreement states that the final project report will include a summary of the project or activity, and actual results (outputs and outcomes, and costs). The agreement also says the final report will include the actual emissions benefit calculations.	Recipient overestimated emission reduction projections because it used estimated hours rather than actual usage.
California Air Resources Board	<ul style="list-style-type: none"> The cooperative agreement requires the recipient to agree to scrap or remanufacture replaced equipment. The cooperative agreement states that the project will achieve significant reductions in diesel emissions. 	<ul style="list-style-type: none"> Recipient did not scrap or remanufacture replaced locomotive engines. Emission reductions calculations were based on estimates of fuel usage because actual fuel usage data was not available. As a result, the board does not have reasonable assurance of achieving projected emission reductions and human-health benefits.

Source: OIG-issued reports and assistance agreement award documents.

Our audits reported that, in some cases, recipients misunderstood requirements of the cooperative agreement awards; or, in the haste of completing projects within the Recovery Act deadlines, guidance was not adequately communicated or documented to the recipient. We noted that one recipient did not seek guidance from the EPA on a timely basis, and did not disclose the issue in the quarterly

reports. Further, the audits disclosed issues with emission reduction calculations similar to those reported in a previous OIG report to the OAR (see later section, *Additional Prior Report Noted Similar Issues*). Ultimately, the final reports submitted by recipients did not demonstrate that Recovery Act DERA projects achieved the desired emissions reductions.

Recipients Did Not Seek or Document EPA Guidance

Although the Railroad Research Foundation's award required repowering five locomotives in Baton Rouge—an ozone nonattainment area—we found that the locomotives were not operating in Baton Rouge. The foundation's subrecipient did not believe that it was required to operate the repowered locomotives in the Baton Rouge area after the project period expired. This conclusion was based on a response to a hypothetical question that the railroad obtained from the National Clean Diesel Campaign Helpline. If the subrecipient had questions regarding its obligations under the agreement with the foundation, it should have addressed those concerns directly with the foundation.

Both Cascade Sierra Solutions and California Air Resources Board made decisions on grant activities that did not meet the award objective because they believed they had EPA concurrence, but they did not have documentation. Specifically:

- The Cascade Sierra Solutions award allowed the purchase of pre-2007 model-year trucks as long as verified emission control technologies were installed. Cascade purchased the trucks but did not retrofit them as required by the award. Cascade said the EPA project officer approved the purchase of the pre-2007 model-year trucks without retrofits on the condition that they be retrofitted at a later date. However, the communication cited by Cascade does not provide the project officer's approval for the purchase; it only acknowledges the purchase of the trucks and that Cascade planned to retrofit the trucks in the fall of 2010. In addition, the quarterly reports submitted by Cascade do not mention the pre-2007 model-year trucks until the fourth quarter of 2010. As of the report date of September 4, 2012, Cascade had yet to retrofit the pre-2007 model-year trucks.
- The California Air Resources Board said it did not require the BNSF Railway Company to scrap or remanufacture the old engines in accordance with the award and Energy Policy Act requirements. The locomotives with the old engines would be banned from operation within California, which is consistent with the board's other funding programs using incentives. The board said that the ban option was part of discussions with the EPA, and the board believed it had approval from the EPA. The EPA acknowledged that the period during project approvals was a chaotic time, but was not aware of any approval. In response to the audit, the board and BNSF signed a written agreement to scrap or remanufacture the old engines, and this agreement is supported by EPA headquarters and Region 9.

Recipients' Final Report Did Not Demonstrate Achievement of Emission Reduction

The Tennessee Department of Transportation overstated its project results by using significantly overestimated usage assumptions in its projections rather than using actual usage data. As a result, Tennessee did not have reasonable assurance that the truck stop electrification project will achieve its projected emissions reductions and, ultimately, expected environmental and human health benefits. Further, the DERA program results may be overstated. In response to the report, EPA Region 4 said it is working with Tennessee to update emissions reduction information, and Tennessee said it was willing to work with the EPA to modify project results based on actual usage.

The California Air Resources Board calculated potential emissions reductions for the repowered locomotives based on estimates of fuel usage because actual fuel-usage data for individual locomotives was not available. The board provided a range of emissions reductions based on estimated fuel usage, but the estimates varied significantly and the project may not achieve the emissions reduction targets. Unless the board can provide actual fuel usage, the EPA does not have reasonable assurance that the project will achieve projected emission reductions or expected environmental results and human health benefits.

Recipients' Financial Management Systems Did Not Meet Federal Requirements

We questioned \$10,538,263 because the financial management systems for five of six recipients did not meet federal requirements that apply under the assistance agreement award. Of the five recipients, four are non-profit organizations and one is a state agency. Specific instances of noncompliance included:

- A financial management system that was unable to provide timely financial information and reporting.
- A formal revolving fund not being established to support the revolving loan fund program.
- Project costs that were not fully supported.
- Progress reports that did not accurately identify expenditures by funding source, the number of projects, and the total cost of projects.
- Equipment procurements not meeting competition or cost and price analysis requirements.
- A contractor billing costs in excess of the recipient's share of total costs.
- Lack of segregation of unallowable costs.
- Cash draws exceeding immediate cash needs.

The amount of questioned costs by recipient are presented in table 6.

Table 6: Financial management system questioned costs

Recipient	Recipient Type	Questioned Costs
Cascade Sierra Solutions	Non-profit	\$9,000,000
Railroad Research Foundation	Non-profit	21,126
Chelsea Collaborative Inc.	Non-profit	0
Grace Hill Settlement House	Non-profit	1,423,028
California Air Resources Board	State	94,109
Total		\$10,538,263

Source: OIG-issued reports and EPA grants database.

Because four of the six recipients audited were non-profit organizations, we reviewed EPA policies and procedures to determine whether the EPA had any specific guidance regarding the award of assistance agreements to non-profit organizations. EPA Order 5700.8, *EPA Policy on Assessing Capabilities of Non-Profit Applicants for Managing Assistance Awards*, establishes internal controls for determining whether the administrative and programmatic capability of non-profit organizations apply for assistance agreements. It also establishes uniform post-award procedures for addressing a material failure to comply by non-profit recipients. As part of our audit work, we did not assess the EPA’s pre-award process for compliance with this order. However, given the significant financial management issues identified in our reports, EPA may need to reassess the effectiveness of this policy for future DERA awards.

Recipients Did Not Meet Recovery Act Requirements

To receive Recovery Act funding, recipients had to comply with various requirements. As part of our audits, we reported that recipients did not fully comply with Recovery Act requirements related to job reporting and Buy American. The fact that Recovery Act requirements such as Buy American and job reporting were challenging for both the EPA and the recipients to interpret and implement contributed to the issues noted.

Four of the six recipients did not calculate the number of jobs created or retained in accordance with Office of Management and Budget guidance for Section 1512 of the Recovery Act. Three recipients calculated jobs created or retained by including labor hours that were not funded through the Recovery Act. The recipients either agreed with the finding or expressed willingness to work with EPA on resolving the finding. One recipient was unable to provide supporting documentation for the number of jobs reported as created or retained, and the recipient disagreed with the finding. EPA has not provided a response and the finding is still unresolved.

One recipient—the Tennessee Department of Transportation—did not comply with the Recovery Act’s Buy American requirements for all of its contract awardees. This occurred because, subsequent to the contract awards, the EPA incorrectly determined that the requirements did not apply to the project. Consequently, there was no assurance that all iron, steel or manufactured goods incorporated into the project were manufactured or substantially transformed in the United States, as required by Section 1605 of the Recovery Act. As a result, we questioned \$1,623,049 as unsupported. Tennessee disagreed with the finding and recommendation. EPA Region 4 said that Tennessee has information that demonstrated Buy American compliance, but the finding is still unresolved.

Additional Prior Report Noted Similar Issues

In addition to the six audits noted, the OIG had conducted an evaluation to determine whether selected Recovery Act awards were effective in obtaining diesel retrofits and intended diesel emission reductions. That evaluation, *EPA Should Improve Guidance and Oversight to Ensure Effective Recovery Act-Funded Diesel Emissions Reduction Act Activities* (Report No. 11-R-0141), was issued March 1, 2011.

The OIG had reviewed National Clean Diesel Funding Assistance Program and State Clean Diesel Program assistance agreements. The report found that documentation of grant activities was not always sufficient to demonstrate that funded work met the specific requirements needed to achieve the desired emissions reductions. As a result, the EPA could overestimate emissions reductions for grant activities. Additionally, EPA funds were used to replace vehicles that would have been replaced anyway due to normal attrition.

The report concluded that EPA should issue additional guidance and improve oversight to ensure that completed activities achieve planned emissions reductions and that the activities are reported accurately. Additional EPA guidance was needed to clarify when replacements were considered normal attrition and not eligible for DERA funding. OAR had concurred with the findings and conclusions and agreed to implement all of the report’s recommendations.

Update On Actions Taken by EPA

OAR provided additional information on the DERA program’s activities since the grants were awarded in 2009. OAR said it has strengthened the DERA program over the past 5 years and addressed many of the issues identified in the prior audits.

OAR acknowledged the issues with Recovery Act requirements but noted these were unique requirements and had not been required for non-Recovery Act

DERA projects. OAR believed it worked hard to balance the need to meet the mission of Recovery Act funding to complete “shovel ready projects” as fast as possible while interpreting and implementing Recovery Act requirements.

OAR said significant effort has been made to resolve the issues in the prior audit reports. OAR and the regions have worked with grantees to complete projects as intended. Specific actions included:

- Closing out the agreement between the California Air Resources Board and BNSF to scrap locomotive engines.
- Confirming with the Grace Hill Settlement House that every vehicle retrofitted under the grant was completed.
- Amending the agreement between the Railroad Research Foundation and the Kansas City Southern Railway Company regarding the operation of five repowered locomotives.
- Recovering \$1.8 million of funds from Cascade Sierra Solutions; the funds were returned to the DERA program to fund emissions projects in priority areas with poor air quality.

In addition, OAR has made changes to DERA program oversight and implementation to reduce the risk of issues in the future, including:

- Updating DERA’s request for proposal.
- Revising reporting templates and methodologies for emissions reporting.
- Revising assistance agreement terms and conditions to clarify “early replacement.”
- Initiating yearly project officer and grantee training.
- Creating a technical guidance document emphasizing important points related to DERA-specific grants management and emission reduction technologies.
- Continuing to conduct baseline and advanced monitoring on the DERA program.

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