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

OFFICE OF
ADMINISTRATION
AND RESOURCES
MANAGEMENT

March 31, 2014

Kathleen Hill
P.O. Box 702
424 E. Elm Street
Chiloquin, OR 97624

RE: EPA Management Decision –Audit Report Number 12-4-0224--Examination of Costs Claimed Under Cooperative Agreement X7-8 3325501 Awarded to Kathleen S. Hill.

Dear Ms. Hill:

I am writing to advise you of EPA's determinations on the findings and recommendations that our Office of Inspector General (OIG) made in Audit Report Number 12-4-0224 ("the Audit Report"). The Agency has:

1. Allowed $46,940 of the $80,721 in costs the OIG questioned in the Audit Report and disallowed $33,781

2. Accepted the OIG's recommendation that EPA verify that you have a financial management system that complies with 2 CFR 215.21 (40 CFR 30.21) prior to making any future awards to you or to any organization you manage or otherwise control.

3. Accepted the OIG's recommendation that the Agency verify that your final financial status report for Cooperative Agreement X7-8 3325501("the CA") is adequately supported by accounting records. While EPA lacks the necessary resources to conduct a comprehensive review of your accounting records, EPA will verify that costs claimed on your final financial status report are reflected in your general ledger and correspond with the amount of your expenditures under the CA. The Agency will recover any excess payments.

The bases for these determinations are set forth in the attached Agency Decision (AD). In drawing these conclusions, EPA has carefully considered your August 26, 2011 response to the OIG's Draft Audit ("the August 2011 Response") and has addressed information and arguments that are relevant to the Agency's determinations in this Management Decision (MD).[1] EPA has also taken into account the information and arguments submitted in your January 2014 reply to our letter dated September 17, 2013, asking for clarification of your position regarding the 401(k) fringe benefit and "less than arms length lease" rental costs the OIG questioned in the Audit Report.

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[1] We have not addressed situations (e.g. not charging life insurance costs for yourself to the CA) in which your August 2011 Response convinced the OIG to change its preliminary findings in the final Audit Report. Additionally, the Agency has not responded to the assertions you made in the August 2011 Response that were not material to resolving the OIG's recommendations.

The Agency appreciates the OIG's determination that you fulfilled the overall purpose of the CA. (Audit Report p. 12). As a result, EPA is exercising its discretion to determine that certain violations of the regulations the OIG identified were not material to your performance of the CA. Additionally, it is noted that notwithstanding the OIG's questioning of the allowability of certain costs you incurred under the CA, the OIG did not allege that you embezzled any EPA funds.

Please mail a check in the amount of $33,781.70 to the Agency at the following address and ensure that the assistance agreement number X7-8 3325501_is indicated on the check.

U.S. Environmental Protection Agency
Las Vegas Finance Center
Box 979087
St. Louis, MO 63197-9000

You or your authorized representative may dispute the Agency Decision under 40 CFR § 30.63 and 40 CFR 31.72 as amended at 79 Fed. Reg. 4403-4407 (Volume 79, No. 18 January 28, 2014) by electronically filing an appeal within 30 calendar days of the date of this decision, unless an extension is granted. The appeal must be transmitted via email to EPA's Disputes Decision Official, Ms. Jill Young, at young.jill@epa.gov with a copy to me at holliday.kysha@epa.gov. Please note: you must electronically submit a request for an extension prior to the expiration of the 30 calendar day period for filing an appeal with a justification for your request.

Your appeal must include the following items:

(1) An electronic copy of the disputed Agency Decision.

(2) A detailed statement of the specific legal and factual grounds for the appeal including electronic copies of any supporting documents.

(3) The specific remedy or relief you are seeking under the appeal.

(4) The name and contact information, including email address, of your designated point of contact for the appeal.

Please feel free to contact me directly at (202) 564-1639 or holliday.kysha@epa.gov , or Mr. Joe Lucia at (202) 564-5378 or lucia.joseph@epa.gov if you have any questions.

Sincerely,

Kysha Carter Holliday,
Deputy Director
Office of Grants and Debarment
National Policy, Training and Compliance Division

Cc: Barbara Proctor, GIAMD
Jessica Durand, GIAMD
Jill Young, GIAMD
Jan Lister, OW
Elana Goldstein, OW
Macara Lousberg, OW
Michael Mason, OW
Lela Wong, OIG
Bob Adachi, OIG

AGENCY DECISION (AD) ONAUDIT REPORT NUMBER 12-4-0224--EXAMINATION OF COSTS CLAIMED UNDER COOPERATIVE AGREEMENT (CA) X7-8 3325501 AWARDED TO KATHLEEN S. HILL.

Background.

On January 20, 2006, EPA issued Announcement Number EPA-OW-IO-06-01 which sought competitive applications to establish and coordinate the activities of a Tribal Water Program Council (TWPC). Funding would be awarded under section 104(b)(3) of the Clean Water Act. The Announcement indicated that under this statute for profit organizations were not eligible to apply for funding.

You submitted an application dated March 9, 2006 that proposed to create and administer the TWPC that the Agency selected after considering seven competing applications. Based on this application and subsequent modifications, EPA awarded $800,000 in "incremental" funding to you on October 26, 2006, in your individual capacity as authorized by section 104(b)(3)(3) of the Clean Water Act. You agreed to comply with 40 CFR Part 30 as a condition of receiving EPA funds.[1]

On May 16, 2007, the tribal members of the TWPC adopted by laws which changed the name of the TWPC to the "National Tribal Water Council". We will refer to the project EPA funded under the CA as "the NTWC" in this AD.

The primary objective of the CA was to provide training and technical assistance to tribal leaders to raise awareness of water-related issues pertaining to the health of tribal communities and the quality of tribal aquatic resources and watersheds. You were to promote information exchange between EPA and tribal co-regulators and among tribal water programs to facilitate the adoption of best management practices for addressing water quality concerns, and encourage the enhancement of tribal water protection program development and implementation. The CA was for a four year project and budget period that commenced on October 15, 2006, and was to end on October 15, 2010.[2] EPA obligated $200,000 in initial funding for the CA and subsequent funding increments brought the Agency's investment up to the full $800,000 award level.

Substantial amounts of the $800,000 budget for the CA were for personnel and fringe benefit costs ($344,400) and travel ($245,280). You were the Project Manager for the CA and your husband, Dr. Joseph Dupris, was the Project Administrator. The Budget Detail for the CA indicated that both of you would charge the CA for 50% of each of your $70,000 annual salaries, that your fringe benefit rates would be 23% and that office rental and utilities would be $300 per month. EPA did not authorize you to charge any indirect costs to the CA.

[1] These regulations at 40 CFR 30.27 required you to comply with the "Cost Principles for Nonprofit Organizations" (formerly OMB Circular A-122) which are now codified at 2 CFR Part 230. We will cite the codified version of the Circular in this AD.

[2] Under 40 CFR 30.25(e)(1) and 40 CFR 30.28, EPA may agree to pay a recipient's pre-award costs.

While administering the CA, we learned that you had $56,854.38 in CA funds in the NTWC's bank account which indicated that you were receiving payments from EPA that exceeded your immediate cash disbursement requirements. This practice violated 40 CFR 30.22(b) and Administrative Condition 4a of the CA. By letter dated May 7, 2010, the Agency prohibited you from receiving further advances of EPA funding and placed you on "reimbursement" status until you could demonstrate that you could properly account for and document the expenditure of CA funds. The Agency also requested that EPA's Office of Inspector General (OIG) audit you. Audit Report at pp. 1 and 3.

On August 17, 2010, you requested a "no cost" extension of time until March 31, 2011 to complete work under the CA. EPA agreed to your request and amended the CA accordingly on September 30, 2010. However, the CA has not been closed out due to the pending resolution of the OIG's audit findings and recommendations.

- OIG conducted field work for the Audit Report between January 11, 2011, and July 27, 2011. The steps the OIG took are specified on page 2 of the Audit Report. You provided detailed comments on the OIG's draft report in your August 26, 2011 Response ("the August 2011 Response") and EPA submitted comments in an August 29, 2011 memorandum ("the August 2011 EPA Memorandum").

- By letter dated September 17, 2013, EPA requested additional information from you regarding the 401(k) fringe benefits the OIG questioned in Note 1 of the Audit Report and the "less than arms length lease" rental costs the OIG questioned in Note 5 of the Audit Report. We sent the letter by U.S. Mail and electronically. The Agency asked for a response by October 18, 2013. When you did not provide a response, we followed up in December 2013 and you indicated that you had not received our September 17 letter.[3]

On December 15, 2013, you requested an extension of time until early February 2014 to provide the information we requested as well as documentation to support reimbursement for additional costs you incurred in performing the CA. We advised you on December 20, 2013, by email that you must provide a response to the September 17 letter by December 27, 2013 for us to consider it as part of this AD and that we would review your request for additional reimbursement as part of the process of closing out the CA.[4] You apparently did not receive our December 20 email in a timely manner due to a family emergency. As a matter of fairness, therefore, we will consider:

- The January 1, 2009, Northwest Retirement Plans, Inc. "Summary Plan Description for Kathleen S. Hill 401(k) Plan" you submitted on January 28, 2014 (the "Summary Plan Description")

- Your letter dated January 30, 2014 ("January 30 Letter")

[3] Our records do not include any information which indicates that the hard copy of the September 17, 2013, letter was returned as undeliverable or that the electronic version of the letter was sent to the wrong email address.
[4] A balance of $13,460.97 in CA funds remains available to pay you for unreimbursed costs you incurred in performing the CA that you can demonstrate are allowable.

- A document dated January 30, 2014 entitled Fringe Benefit Issues ("January 30 Fringe Benefit Submission")

A document dated January 31, 2014, entitled "Fringe Benefit Provisions of EPA and IRS" ("January 31 Fringe Benefit Submission")

The record in this matter is now complete for the purposes of the AD.

Agency Decisions.

Recommendation 1: Disallow and recover unallowable costs of $80,271.

Total Amount Questioned: $80,271

Total Amount Disallowed: $33,781

Total Amount Allowed: $46,940

Note 1—Fringe Benefits.

Amount Questioned: $60,339

Amount Disallowed: $30,169.50

Amount Allowed: $30,169.50

A. 401(k) Contributions.

(1) Audit Report Finding.

The OIG questioned the allowability of $32,943 in costs you charged to the CA for 401(k) contributions for you and your husband on the grounds that these costs were not supported by a written policy that included benefit amounts and computational methods. Audit Report at pp. 6, 19 and 40. According to the OIG, the financial management standards at 40 CFR 30.21(b)(6) and the documentation standards at 2 CFR Part 230, Appendix A, Section 2.g. require that your fringe benefit policy include these features to be acceptable under 2 CFR Part 230, Appendix B, Item 8.g. The Audit Report observes that you calculated the amount for 401(k) contributions based on the difference between other fringe benefits costs you charged to the CA and the 23% of personnel costs for fringe benefits in the EPA approved budget for the agreement. Audit Report at pp. 6 and 19. OIG's position is that the fringe benefit rate EPA agreed to in the CA is an estimate and "does not represent approved actual fringe benefit costs." Audit Report at p. 6. Additionally, the OIG

(2) Your Responses.

a. August 2011 Response and the Summary Plan Description. You contended that the OIG misapplied applicable laws, rules and regulations by questioning costs for fringe benefits on the basis of 2 CFR Part 230 and 40 CFR Part 30, which apply to nonprofit organizations, when you had to comply with federal IRS and state requirements as a small business owner providing 401(k) contributions as a fringe benefit. August 2011 Response at pp. 4, 8. In this regard, you provided evidence that in September of 2007 you informed EPA that you resolved "pension" and other fringe benefit related issues by restructuring your business from a sole proprietorship to a single member Limited Liability Corporation. Id. at pp. 4, 9, 10 and Attachment 9. You also provided evidence that the 401(k) contributions were a component of your personnel policies and developed by a financial professional with an eye towards compliance with IRS requirements. August 2011 Response at pp. 4, 9, 10 and Attachments 9, 10, and 18 through 21; Summary Plan Description. The Summary Plan Description states, in pertinent part:

> We are authorized under the Plan to make employer contributions on behalf of our employees. . . .
>
> Employer contributions will be contributed to your employer contribution account under the Plan at such time as we deem appropriate. Employer contributions may be contributed during the Plan Year or after the Plan Year ends. Any employer contributions we make during the year will be made in accordance with the following employer contribution formula.
>
> • **Discretionary employer contribution formula.** We will decide each year how much, if any, we will contribute to the Plan. Since this employer contribution is discretionary, we may decide not to make an employer contribution for a given year. We may decide to give a different contribution to each eligible participant under the Plan. The employer contribution may be determined as a percentage of compensation or as a dollar amount. We will inform you of the amount of your employer contribution once we determine how much we will be contributing for the year.

Summary Plan Description at p. 5.

Further, you provided evidence that EPA determined that the costs you proposed to incur under the EPA approved budget for the CA were reasonable. August 2011 Response, Attachment 14.

b .January 30 Letter. In response to our September 17, 2013 request for information regarding contributions to your and Dr. Dupris 401(k) plan from sources other than the CA you stated that your 401(k) plan "did not require contributions from other sources since the cooperative agreement was our primary source of income." January 30 letter at p. 2. You reiterated that the 401(k) contributions were included in the 23% fringe benefit rate EPA approved and your allocations for 401(k) contributions did not exceed that rate. January 30 Letter at p. 2.

c. January 30 Fringe Benefit Submission. Again, you noted that EPA's approval of the CA budget was "without exceptions for the fringe benefits" that the Agency's approval encompassed the 23% fringe benefit rate for you and Dr. Dupris. January 30 Fringe Benefit Submission at p.

1. You observed that "[I]t is also worth noting that if the salaried employees were full time, the fringe benefit, at 23%, would have been proportionally increased because the benefit would been proportionally increased." January 30, Fringe Benefit Submission at p. 2.

d. January 31 Fringe Benefit Submission. You argued based on a passage from Ted Nicholas's *The Complete Guide to Nonprofit Corporations* that "[T]he assertion that non-profit entities are not permitted to have self-insurance plans that reimburse employees for their health expenses appears to be in error." You further noted that the IRS regulates fringe benefit plans for both for-profit and nonprofit businesses and that these regulations apply to EPA grantees. On this basis you argued:

> The assertion that an EPA grantee cannot utilize favorable and permissible federal and state laws, or may put it in jeopardy by following those laws, appears to be unreasonable. . . . the Federal Fair Labor Standards Act, which provides for the regulation of hours, wages and benefits, also applies to EPA grantees. The salary status for the key personnel and their benefits eligibility are defined for the EPA grantee by the FFLSA and are enforceable under employment contracts, state, and federal law. . . The IRS standards are also part of employment law and are enforceable by the IRS. <u>If there is a conflict of law between the EPA regulations and other federal statutes, those conflicts are reasonable grounds for appeals and judicial determination.</u> . . . if there are conditions that require exemptions from the Part 230 provisions, then EPA can request exemptions from OMB for any unusual circumstances. It appears that EPA did not consider such a request given the current non-standard application of Part 230 to a for-profit business. . . <u>In addition, IRS regulations and the Fair Labor Standards Act apply to the EPA grantees and an arbitrary EPA negation of those rules and regulations is highly questionable.</u>

January 31 Fringe Benefit Submission at pp. 1 and 2. (Emphasis added).

You once again argued that because the Agency approved your salary and fringe benefit proposals in the CA budget, "For EPA to arbitrarily negate that approval after the fact is unreasonable." January 31 Fringe Benefit Submission at p. 2.You then provided excerpts from EPA's guidance for calculating fringe benefits contained in the Agency's "Sample Indirect Cost Proposal Format For Nonprofit Organizations" and from "IRS Publication 15B Employers Tax Guide to Fringe Benefits" and noted that EPA's guidance document "does not negate the IRS rules and regulations." January 31 Fringe Benefit Submission at p. 2 (quote) and pp. 2 -4 (excerpts).

(3) EPA Determination:

The Agency has allowed $16,471.50 of the $32,943 in questioned 401(k) costs and disallowed $16,471.50. The amounts of the allowance/disallowance reflects the fact that you and Dr. Dupris earned fifty percent of your annual salaries performing the CA and you did not provide any information to contradict the OIG's finding that the CA bore 100% of the 401(k) contribution costs.

We have noted your contention that the OIG and the Agency failed to take into account your status as a small business owner. This argument is without merit. For profit organizations are not eligible for grants and cooperative agreements under section 104(b)(3) of the Clean Water Act. The Agency made specific inquiries regarding whether you would receive the CA as an individual or as a business owner and you advised that you were applying for funding in the former capacity. August 2011 Response, Attachment 6. You expressly agreed to abide by federal regulations applicable to nonprofit organizations when you accepted the CA. Audit Report at p. 18. Nonetheless, EPA does not agree fully with the OIG's Audit Report Finding which questioned the allowability of all of the $32,943 in 401(k) costs you charged to the CA.

As indicated in the August 2011 EPA Memorandum, the Agency's position is that there is no explicit requirement under 2 CFR Part 230, Appendix B, Item 8.g. that fringe benefit plans include benefit amounts and computational methods. Rather, the regulation requires that fringe benefits be ". . . granted in accordance with established written organization policies. . . [and] . . . distributed to particular awards and other activities in a manner consistent with the pattern of benefits accruing to the individuals or group of employees whose salaries and wages are chargeable to such awards and other activities." (Emphasis added).

The Agency agrees with the OIG that 40 CFR 30.21(b)(6) does require that recipients have written procedures for determining reasonableness, allocability and allowability of costs. However, the OIG has not questioned whether the amount of 401(k) contributions you charged to the cooperative agreement were reasonable, allowable under the Cost Principles, and within the ceiling for fringe benefits in the CA budget EPA approved. Audit Report at pp. 6, 19 and 30. Our disposition of the fringe benefit costs the OIG questioned takes the absence of an adequate system for determining allocability into account by partially disallowing costs to ensure that the CA bore its fair portion of the charges for these items.

It is also true that 2 CFR Part 230, Appendix A, Section 2.g. requires that costs be adequately documented but that provision does not go into detail regarding what documentation is adequate. Moreover, the standard for disallowance of costs is whether the recipient has materially violated regulations applicable to the CA. 40 CFR 30.62(a)(2). The regulations do not define the term "material" but under Generally Accepted Accounting Principles the "materiality principle" provides that noncompliance with a requirement must have an effect or make a difference to be a reportable violation of an applicable requirement. Consistent with EPA's determinations in other audits, we are reluctant to disallow otherwise allowable costs a recipient incurs solely on the grounds that the contemporaneous documentation is imperfect.[5]

In your case, the Summary Plan Description establishes that the 401(k) contributions at issue were granted in accordance with a written fringe benefit policy which meets the minimum requirement at 2 CFR Part 230, Appendix B, Item 8 g. (2). EPA determined that your budgeted amount for fringe benefits (23% of personnel costs) was reasonable. You used a consistent, albeit flawed, methodology for calculating 401(k) contributions chargeable to the CA that ensured that fringe benefit costs remained within the CA budget.

[5] The complete absence of documentation to support charges to an assistance agreement or documentation that does not meet an express regulatory standard, such as using budget estimates to support labor costs in violation of 2 CFR Part 230, Appendix B, Item 8 m.(1)(a), may warrant disallowance.

The Summary Plan Description did not contain a precise calculation methodology that would provide regular amounts for 401(k) contributions. Rather, it left the method for calculating the amount of the contributions to your discretion. Whatever deficiencies this methodology may have, they do not rise to the level of a material violation of the above cited regulations that warrants disallowance of the entire $32,943 in 401(k) contribution costs you charged to the CA. Whether all of these 401(k) costs are allowable, however, is another matter.

In the August 2011 EPA Memorandum, we indicated that the Agency was concerned that not all of your fringe benefit costs were allocable to the CA. However, the OIG did not believe allocability applied to the 401(k) contributions because the costs were based on the maximum fringe benefit amount allowable under the EPA approved budget rather than employment status and recommended that the Agency disallow all of the 401(k) costs. Audit Report at p. 19. We disagree with the OIG on this point. The applicable regulations focus on ensuring that costs generally, and fringe benefit costs in particular, are distributed in proportion to the benefits received by the CA.

With regard to EPA approval of the 23 % fringe rate in the CA budget, the Agency did authorize you to charge the CA for fringe benefits costs that did not exceed that rate when EPA awarded the CA. We agree with the OIG, however, that fringe benefit amounts in the budget are estimates and that actual charges must be for fringe benefit costs that comply with 2 CFR Part 230, Appendix B, Item 8.g. and be allocable to the agreement as required by 2 CFR Part 230, Appendix A, Section 2. a. c. d., and Section A. 4. Further, we note that fringe benefit charges, like salaries, are a form of personnel compensation. They are linked to actual services performed that benefit the CA. Under 2 CFR Part 230, Appendix B, Item 8.m. (2)(a) budget estimates "do not qualify as support for [salary] charges [to the CA]". EPA's approval of your 23% fringe benefit rate in your budget did not relieve you of responsibility for ensuring that the actual charges for 401(k) contributions complied with the applicable regulations.

To be allowable under the CA, the fringe benefit charges for the 401(k) contributions must take into account the fact that you and Dr. Dupris worked on the CA on a part time basis and that you did not make any other 401(k) employer contributions from other sources. Even if the CA turned out to be your and Dr. Dupris' primary source of income that circumstance does not make all of the fringe benefit costs allocable to the CA. You and Dr. Dupris presumably received, or could have received, compensation from other sources as well. You were free to perform work for the consulting firm you and he owned, Quail Plume Enterprises since the CA did not require you and he to devote all of your working hours to its performance.[6] Further, your argument in the January 30 Fringe Benefit Submission that had you and Dr. Dupris worked full time on the CA that your benefits would have increased proportionally misses the point. Neither of you were authorized to charge 100% of your salaries nor attendant fringe benefits to the CA.

[6] You advised EPA in June 2006 that Quail Plume Enterprises is a commercial consulting firm you and Dr. Dupris own. August 2011 Response, Attachment 6. The resumes for you and Dr. Dupris that were attached to your March 2006 proposal for the CA indicate that both of you provide consulting services to the Klamath Tribes through this firm.

With regard to the IRS fringe benefit rules, the FFLSA, and state employment laws, there is no conflict between these requirements and the provisions of 2 CFR Part 230 cited above. The purpose of the OMB Cost Principles is to determine whether, and to what extent, a federal financial assistance agreement should absorb the costs of fringe benefits. Compliance with the IRS rules for fringe benefit payments and the FFLSA for compensating employees are independent legal requirements that further different public policies than those reflected in federal grant regulations. That you ensured that your fringe benefit arrangements were consistent with federal and state law is laudable but does not require that the CA bear the entire cost of the fringe benefits you paid to yourself and Dr. Dupris.

The relevance of the material from EPA's "Sample Indirect Cost Proposal Format For Nonprofit Organizations" is not clear. While we agree with you that this guidance does not negate IRS rules, the terms of the CA provided you were not authorized to charge any indirect costs to the agreement. All of your costs fell under the rules for the allowability of direct costs. The applicable regulations do not allow you to charge the CA for fringe benefits in amounts that are not proportional to your and Dr. Dupris part time status.

Costs must be allocable and be consistent with policies that apply uniformly to both federally financed and other activities the recipient performed to be allowable under the CA. 2 CFR Part 230, Appendix A, Section 2. a. c. d., and Section A. 4. Further, as indicated above 2 CFR Part 230, Appendix B, Item 8.g. requires that fringe benefit costs must be distributed "consistent with the pattern of benefits accruing to the individuals . . . whose salaries and wages are chargeable to [the CA] and other activities." (Emphasis added). Your failure to charge 401(k) costs to the CA in compliance with these regulatory provisions led to the CA bearing disproportionate share of the 401(k) contributions and constitutes a material violation of these regulations. It would be unfair, however, to disallow all of the costs you incurred for 401(k) contributions because the methodology you used to calculate charges to the CA was noncompliant when the proper methodology is readily apparent.

Both you and Dr. Dupris worked only 50% of your time on the CA. However, the record shows that 100% of both of your 401(k) contributions during the period of time covered by the CA were charged to the agreement. We have, therefore, disallowed $16, 471.50 which represents 50% of the costs you incurred for 401(k) contributions and allowed an equal amount as authorized by 40 CFR 30.62(a)(2).

B. Life Insurance and Medical Costs.

(1) Audit Report Finding.

The OIG questioned $4,901 in life insurance costs for the Dr. Dupris' life insurance to the CA as well as $22,495 in family medical costs that were also charged to the CA. Family medical costs were comprised of the employee's share of a family health insurance policy provided by the California Public Employees Retirement System and all medical out of pocket medical and dental expenses for you, Dr. Dupris and your two children. The OIG found that even though both you and Dr. Dupris worked only 50% of your time performing duties related to the CA, you charged 100% of the life insurance costs and family medical costs to the CA. Consequently, the

OIG asserted that these costs were not properly allocated to the CA in proportion to the benefits accruing from the fringe benefit expenditures as required by 2 CFR Part 230, Appendix A, Section A. 4. Audit Report at pp. 7, 19, 38, 40, 42 and 43.

(2) August 2011 Response.

The arguments you raised regarding the allowability of the entire cost of Dr. Dupris's life insurance policy are substantially the same as those described in Item 1.a. (2) regarding above the 401(k) costs. August 2011 Response at pp. 4, and 8-10. Your arguments, however, did not address allocability of the life insurance costs because the OIG did not assert allocability as grounds for questioning the life insurance costs in the Draft Audit Report. The OIG raised allocability as an issue in response to comments we made in the August 2011 EPA Memorandum. Audit Report at p. 19. Nonetheless, you apparently do not take issue with the OIG's factual finding that you charged all of the costs of Dr. Dupris's life insurance premiums to the CA. August 2011 Response at p. 9. You also raised robust objections to the OIG's position that all of the family medical costs were not allocable to the CA which seem to apply with equal force to whether all of Dr. Dupris's life insurance costs were allowable charges to the CA.

First, you contended that the OIG erred by not taking into account the fact that, as salaried employees, you and Dr. Dupris were exempt from requirements under federal and Oregon laws for being paid by the hour. You argued that CA received sufficient benefits from all of the family medical costs for 100% of them to be properly allocable under 2 CFR Part 230, Appendix A, Section A. 4. Your position is that you and Dr. Dupris were not paid for all hours worked on NTWC business and paying the employee share of the CALPERS policy obviated the need to charge the higher cost of a separate health insurance policy to the CA. August 2011 Response at pp. 10 and 11.

Second, relying on the definition of "Prior approval" at 2 CFR 230.25(b), you argued that EPA approved your practice of charging 100% of the family medical costs to the CA when the Agency agreed to fund your budget for the CA that specified that fringe benefits would be funded at a rate of 23% of your and Dr. Dupris salary. August 2011 Response at p. 11. The regulatory provision states:

> (b) Prior approval means securing the awarding agency's permission in advance to incur cost for those items that are designated as requiring prior approval by the part and its Appendices. Generally this permission will be in writing. Where an item of cost requiring prior approval is specified in the budget of an award, approval of the budget constitutes approval of that cost.

Third, you argued that under 2 CFR Part 230, Appendix A, Section A. 6., even if you did not have an advance understanding with EPA to charge 100% of the family medical costs to the CA, as a small business owner who received the preponderance of your support from the CA the costs were allocable. Essentially, you contend that as a small business owner you had more limited access to the funds in the CA budget to pay for your and Dr. Dupris fringe benefits because he and you were not employees of a nonprofit organization. EPA's Project Officer apparently authorized you to seek professional assistance to develop a fringe benefit plan that complied with

IRS Rules (a "Section 105 Medical Care and Insurance Reimbursement Plan") for small business owners who employ their spouses. The plan you adopted enabled your family to be insured under Dr. Dupris's CALPERs health insurance policy without exceeding the 23% fringe benefit rate in the CA budget. August 2011 Response at pp. 11 and 12.

Fourth, you asserted that charging 100% of the family medical costs to the CA complied with 2 CFR Part 230, Appendix B, Item 8.g. (quoted in Note 1 a. (3), above). This argument is based on the fact that you had a written organizational policy that authorized you to reimburse Dr. Dupris for medical care and insurance costs. August 2011 Response at p. 12.

Finally, you opined that the cost of the medical plan you charged the CA for were reasonable and did not utilize an excessive amount of the EPA approved fringe benefit budget. On this basis you argued that it would be unreasonable to require that you repay the $22,495 in family medical costs the OIG questioned. August 2011 Response at p. 12.

(3) Agency Determination.

We agree with the OIG that the $4,901 in health insurance costs for the NTWC's Project Administrator's health insurance to the CA as well as $22,495 in family medical costs were not properly allocable to the CA. However, we do not agree with the OIG that all of the costs should be disallowed and have allowed $2450.50 in health insurance costs and $11,247.50 in family medical costs while disallowing equal amounts in both categories. These amounts represent 50% of the charges to the CA for life insurance and family medical costs that the OIG questioned. Our determination reflects the fact that Dr. Dupris only earned one half of his salary performing the CA and we have applied the applicable regulations accordingly. We have explained the Agency's positions on the arguments you made in favor of allowing all of the family medical costs (and by implication all of the 401(k) and life insurance costs) below.

Your first contention that because you and Dr. Dupris were compensated with fixed salaries rather than as hourly employees the CA received sufficient benefit from your work to charge 100% of the family medical costs to the CA was not persuasive. As the OIG pointed out, the terms of the CA called for you and Dr. Dupris to charge one half of your annual compensation to the CA and the benefits accrued to the CA accordingly. Audit Report at p. 42. To be allowable, fringe benefits must be distributed "consistent with the pattern of benefits accruing to the individuals . . . whose salaries and wages are chargeable to [the CA] and other activities." 2 CFR Part 230, Appendix B, Item 8.g. Any purported savings to the CA by paying for Dr. Dupris' CALPERS health insurance policy premiums are not determinative of compliance with this provision or with the allocability requirements of 2 CFR Part 230, Appendix A, Section A. 4. You paid for the entire amount of these premiums as well as all of your family's out of pocket medical costs with CA funds. Audit Report at p. 7. Other activities you and Dr. Dupris performed, or could have performed, to earn the other half of your $70,000 per year salaries, such as consulting work for Quail Plume Enterprises should have borne an equal share of the family medical costs.

The Agency has already addressed your second argument that by approving the CA budget EPA agreed to pay for any fringe benefit costs that did not exceed 23% of your and Dr. Dupris'

salaries. In addition to the reasons set forth in Note 1, a. (3), above, the record does not contain evidence that you disclosed to EPA your intention to charge 100% of the family medical costs (or Dr. Dupris' life insurance premiums) to the CA when you submitted the budget or afterwards. The "prior approval" through budget acceptance contemplated by 2 CFR 230.25(b) is predicated on disclosure of sufficient information regarding the item of cost for EPA to be aware of the recipient's intentions. We also note that technically fringe benefits are not one of the items of cost in Appendix B of 2 CFR Part 230 that require the prior written approvals covered by 2 CFR 230.25(b).

Your third argument based on your status as a small business owner who was unable to pay herself and her employees' fringe benefits under the same terms as those available to nonprofit organizations despite receiving a preponderance of support from the CA is also unpersuasive.

We do not agree that you should have been able to allocate all of your family's medical costs to the CA because you adopted a Section 105 Medical Care and Insurance Reimbursement Plan even if that plan allowed you to stay within the CA budget for fringe benefits. You chose to apply for the CA as an individual. Even if you had formed a nonprofit organization the general allocability principles (2 CFR Part 230, Appendix A, Section 2. a. c. d., and Section A. 4.) as well as the specific requirement at 2 CFR Part 230, Appendix B, Item 8.g. that fringe benefit costs be distributed proportionally among all of the activities an employee carries out for an organization would have applied. As discussed in detail above, the 23% fringe benefit rate EPA approved in the CA budget did not relieve you of the responsibility to comply with these regulations when charging the CA for family medical costs.

The "advance understanding" coverage at 2 CFR Part 230, Appendix A, Section A. 6. does not require that we determine that all of your family medical costs are allocable to the CA. Determining the allocability of family medical costs is not difficult when there is only one assistance agreement at issue and the terms of that agreement provided that you and Dr. Dupris would receive only 50% of your support from the CA. Further, in addition to the passages from the regulation you quoted in your August 2011 Response, the Cost Principles state "[I]n order to avoid subsequent disallowance or dispute based on unreasonableness or nonallocability, it is often desirable to seek a written agreement with the . . . awarding agency in advance of the incurrence of special or unusual costs." We accept your statement (see Note 4, below) that you received informal authorization from EPA's Project Officer to obtain professional assistance in developing a Section 105 Medical Care and Insurance Reimbursement Plan. However, there is nothing in the record that demonstrates that EPA provided written or oral approval for you to allocate 100% of your family medical costs to the CA.

Your fourth argument, which stresses the existence of a written organizational policy (the Medical Care and Insurance Reimbursement Plan for Dr. Dupris) is also based on a partial quotation of the applicable regulatory coverage. Our decision to allow only 50% of the family medical costs is not based on any defects in your organizational policy for fringe benefits. As we determined in Note 1 a. (3), above, the documentation you provided was adequate for the purposes of satisfying the requirement for an "established written organizational polic[y]" on fringe benefits for the purposes of 2 CFR Part 230, Appendix B, Item 8.g. Rather, our disallowance of $2450.50 in insurance costs and $11,247.50 in family medical costs is predicated

on your material noncompliance with the requirement in that regulation that fringe benefits be distributed "consistent with the pattern of benefits accruing to the individuals . . . whose salaries and wages are chargeable to [the CA] and other activities." 2 CFR Part 230, Appendix B, Item 8.g. (emphasis added) and be allocable as required by2 CFR Part 230, Appendix A, Section 2. a. c. d., and Section A. 4.

We do agree, at least in part, with your final argument in favor of allowing you to charge the CA for the health insurance and family medical costs. There is no indication in the record that the medical benefits you granted Dr. Dupris were unreasonable and you kept the charges within the 23% rate that EPA approved in the CA budget. It would be inappropriate under these circumstances to require that you repay the entire $4901 in health insurance costs and $22,495 in family medical costs the OIG questioned in the Audit Report. We have, therefore, disallowed only 50% of the questioned costs---$2450.50 for health insurance and $11,247.50 for family medical costs. That is the proportion of the health insurance and family medical costs that should have been allocated to other activities for which Dr. Dupris performed or could have performed for Quail Plume Enterprises or for you to receive his $70,000 annual salary.

Note 2. Travel and Per Diem Costs[7]

Amount Questioned: $1,916

Amount Disallowed: $1,728.71

Amount Allowed: $188

(1) Audit Report Finding.

The OIG questioned $1,728.71 travel costs you paid for with CA funds on the grounds that you received a refund in this amount that you did not credit to the CA as required by 2 CFR Part 230, Appendix A, Section A. 5.a. According to the OIG, there were no accounting records in your General Ledger (GL) to document that the refund was credited to the CA. The OIG also questioned $188 in cell phone charges on the grounds that the charges were miscoded as travel and per diem. Audit Report at pp. 7 and 8. Additionally, as discussed in detail in Note 5 of the Audit Report, the OIG questioned all of the cell phone costs you charged to the CA on the grounds that these costs were not properly allocated.

(2) Your Response

August 2011 Response. You disputed the OIG's finding on the grounds that the $1,728.71 "refund" was allocated to the CA and was properly recorded in your files. You essentially contended that the spreadsheet you provided to the OIG coupled with payment records for the NTWC Credit card demonstrated that rather than charging the CA for $8,768.10 in allowable travel costs relating to the NTWC meeting that were billed to the NTWC Credit Card you only charged $7,039.39 ($8,768.10 - $1,728.71) to offset the refund. August 2011 Response at pp. 12

[7] We have also addressed the allowability of cell phone charges in the Agency's decision on Note 5.

and 13;Attachments 24 through 28. Further, although you acknowledged that the offset for the "refund" was not recorded in the GL, you argued that due to the fact that the OIG audit took place prior to the closeout of the CA you had not had an opportunity to conduct the due diligence necessary to ensure that the GL was up to date. August 2011 Response at pp. 7, 12 and 13; Attachments 24 through 28.

With regard to the $188 in cell phone costs the OIG questioned due to miscoding, you argued that you properly and accurately reported the charges in your documentation for CA expenses. You noted again that because the OIG audit took place before the CA was closed out you did not have an opportunity to conduct the due diligence necessary to ensure that all accounting records were accurate. Finally, you contended that it would be unreasonable for EPA to disallow costs due to a simple miscoding error during the course of performing the CA. August 2011 Response at p. 14.

(3) Agency Determination.

Based on the information currently available to us, we have disallowed the $1,728.71 in travel costs the OIG questioned in the Audit Report. Our decision is based on the apparent absence of accounting records from your GL or otherwise which support your contention that you offset the $1,728.71 refund of lodging expenses against allowable costs you incurred but did not charge to the CA.

EPA will not disallow the $188 in cell phone costs the OIG questioned due to miscoding of the charges as travel and per diem. We agree with you that it would be unreasonable to conclude that this error rises to the level of a material violation of the financial management requirements of 40 CFR 30.21(b). However, as indicated in our decision on Note 5 the Agency shares the OIG's concerns that you did not properly allocate cell phone costs to the CA and has disallowed a substantial amount of cell phone charges on those grounds.

Our decision to disallow $1,728.71 is based on OIG's finding that your accounting system did not adequately verify that the offset in this amount you depicted in the Attachment 24 spreadsheet reflects a credit to the CA under within the meaning of 2 CFR Part 230, Appendix A, Section A. 5.a. That regulation provides:

> The term applicable credits refers to those receipts, or reduction of expenditures which operate to offset or reduce expense items that are allocable to awards as direct or indirect costs. Typical examples of such transactions are. . . .adjustments of overpayments or erroneous charges. To the extent that such credits accruing or received by the organization relate to allowable cost, they shall be credited to the Federal Government either as a cost reduction or cash refund, as appropriate. (Emphasis added)

Further, under 40 CFR 30.21(b)(2) recipients' records must adequately account for how income from refunds of are applied and 40 CFR 30.22(g) requires that refunds be expended for allowable costs before requesting additional cash payments from EPA. The absence of accounting records in the GL or otherwise documenting the $1,728.71 offset you described actually took place would materially violate the applicable regulations.

The refund at issue was credited to the "NTWC Credit Card" that you used to pay an Embassy Suites property advance for lodging for a May 2010 NTWC meeting in Washington D.C. Apparently not all of the rooms you reserved were needed by NTWC members.[8] August 2011 Response, Attachments 24 and 26. Although you provided the OIG with a spreadsheet summarizing how you offset the $1,728 credit against other allowable costs, the OIG could not verify that the credit was properly applied through your accounting system. [9] You apparently could not provide the OIG with entries in your GL to support the offset when the OIG requested that you do so. Audit Report at pp. 7 and 8; August 2011 Response at p.1.

In making the $1, 728.71 disallowance, we have carefully considered the probative value of the documentation you provided in Attachment 27 of the August 2011 Response which establishes that on July 23, 2010, you made a payment on the balance for the NTWC Credit card in the amount of $7,039.39. The amount of this payment may corroborate your contention that you offset the $1, 728.71 refund against the $8,768.10 in charges to the NTWC credit card for the May 2010 NTWC meeting that remained unpaid as of July 21, 2010. August 2011 Response, Attachment 24. Nonetheless, at the time of the OIG Audit the absence of entries in your GL or other documentation establishing that you only charged the CA $7,039.39 is significant. On this basis, we are unable to conclude at this time that you properly offset the $1,728.71 credit as required by 2 CFR Part 230, Appendix A, Section A. 5.a. and 40 CFR 30.21(b)(2).

Note 3---Supplies

Amount Questioned: $170

Amount Disallowed: $0

Amount Allowed: $170

(1) Audit Report Finding.

The OIG questioned whether $170 in cell phone costs on the grounds that the charges were miscoded as supplies. Audit Report at p. 9. Additionally, as discussed in detail in Note 5 of the Audit Report, the OIG questioned all of the cell phone costs you charged to the CA on the grounds that these costs were not properly allocated.

(2) Your Response.

As with the other cell phone costs the OIG questioned due to miscoding, you argued that you properly and accurately reported the $170 in cell phone charges coded as supplies in your documentation for CA expenses. You also noted again that because the OIG audit took place before the CA was closed out you did not have an opportunity to conduct the due diligence necessary to ensure that all accounting records were accurate.

[8] The refund was credited to the NTWC credit card account on May 22, 2010.
[9] Under 40 CFR 30.22(g), recipients must disburse funds they receive from refunds of financial assistance agreement expenditures before requesting additional federal funds.

(3) Agency Determination.

EPA will not disallow the $170 in cell phone costs the OIG questioned due to miscoding of the charges as supplies. This error does not materially violate the financial management requirements of 40 CFR 30.21(b). However, as indicated in our decision on Note 5 the Agency agrees with the OIG's finding that you did not properly allocate cell phone costs to the CA and has disallowed a substantial amount of the cell phone charges on those grounds.

Note 4 Contractual Costs

Amount Questioned: $3,375

Amount Disallowed: $0

Amount Allowed: $3,375

(1) Audit Report Finding.

The OIG questioned the allowability of $3,375 in costs you incurred for professional advice in setting up your 401(k) plan, medical plan and employee agreements on the grounds that you did not obtain prior EPA approval for these organizational costs as required by 2 CFR Part 230, Appendix B, Item 31. Audit Report at p. 8. Information you provided indicating that EPA's Project Officer approved the organizational costs did not persuade the OIG that you met the applicable requirement. Among other things, the OIG contended that you did not inform the Project Officer that you intended to obtain professional services and discounted the significance of the information you provided in a quarterly report regarding organizational costs because this was an after-the-fact description of project activities. Audit Report at pp. 8, 9 and 48. The OIG, however, did not question the reasonableness or allocability of the costs at issue.

(2) Your Response.

You argued that EPA did in fact approve the organization costs including the requisite professional services. August 2011 Response at p. 4. In this regard you contended that you and Dr. Dupris made concerted efforts in July and August of 2007 to obtain formal EPA approval for a budget modification to cover the organizational costs and received oral approval for the costs from EPA's then Project Officer.[10] August 2011 Response at pp. 15 and 16. You provided emails documenting that you communicated with both the EPA Project Officer and Grant Specialist assigned to the CA at that time regarding the budget modification, a proposed budget modification, as well as a quarterly report to the Agency which disclosed that you obtained professional services for organizational costs. August 2011 Response, Attachments 9, 10, 11, 12, 30, 31, 32 and 33.

[10] You also noted that EPA did not establish regulations governing the award of CWA 104 grants to individuals but this is irrelevant since you agreed to comply with regulations applicable to nonprofit organizations.

(3) Agency Determination.

We have allowed the $3,375 in questioned organizational costs by granting a waiver from the 2 CFR Part 230, Appendix B, Item 31 prior approval requirement as authorized by 40 CFR 30.25(e). Our decision is based on the evidence in the record which indicates that EPA implicitly approved your request.

Under 2 CFR 230.25(b) the term "prior approval" means:

> . . . securing the awarding agency's permission in advance to incur cost for those items that are designated as requiring prior approval by the part and its Appendices. Generally this permission will be in writing. Where an item of cost requiring prior approval is specified in the budget of an award, approval of the budget constitutes approval of that cost. (Emphasis added).

The CA budget that EPA approved for the contractual line item in October 2006 did not include professional services for structuring your fringe benefit plan. August 2011 Response, Attachment 15. The record does indicate, however, that in July and August 2007 you and Dr. Dupris attempted to discuss a proposed budget modification for the organizational costs with Agency personnel but were unsuccessful in arranging a telephone conference. August 2011 Response, Attachments 9, 11, 12, 30 and 33. Moreover, on August 8, 2007 EPA's Project Officer provided written approval for "a shift in line item amounts" that you requested. Attachment 12.

A "Revised Budget" dated "7/31/07" states that you intended to modify the CA budget by shifting $3,000 in funding from the "Other" category to "Supplies" for costs relating to "start up as sole proprietor".[11] This document also indicates that you anticipated a variance in the contractual line item due to "IRS Rules". August 2011 Response, Attachment 11. Your August 6, 2007 email to EPA's P.O. regarding your inability to contact EPA's Grant Specialist to discuss the budget modification refers to a change for the "Supplies" line item. August 2011 Response, Attachments 12 and 33.

In requesting this budget modification you apparently mischaracterized costs for acquiring professional services for organizational costs as "supplies". Supplies are tangible items of personal property that have a per item acquisition cost of $5000 or less. 40 CFR 30.2(h). It is unlikely that you would have incurred $3,000 in additional costs for supplies in order to organize a sole proprietorship; that task would have required the assistance of legal and financial advisors. Further, the $3,000 budget modification depicted in the "7/31/07 Revised Budget" roughly corresponds to the $3,375 in organizational costs for professional services the OIG questioned in the contractual category.

Your Year 1 3rd Quarterly Report for the period from April 1, 2007, through June 30, 2007, which was submitted on July 31, 2007, advised EPA that work was ongoing on issues relating to fringe benefits and IRS rules and noted that "[F]urther work will be in progress for several

[11] It is not clear from the record that this document was formally submitted to EPA. However, given that on August 8, 2007, EPA's Project Officer approved the $3,000 "shift" in funding from the "Other" budget line item to "Supplies" we will presume that she received a copy of your proposed budget modification.

quarters to resolve these issues." August 2011 Response, Attachment 11. Although it is true that your Year 1 3rd Quarterly Report describes activities that had already taken place the report was also submitted the same day that Dr. Dupris advised EPA's P.O. and Grant Specialist that you needed a budget modification that would take into account unanticipated issues relating to federal and state taxes. August 2011 Response, Attachment s 30 and 31. The context of the information you provided regarding organizational costs in the Year 1 3rd Quarterly Report indicates that EPA's Project Officer was on notice that you had incurred organizational costs and intended to do so in the future when she approved your budget modification. [12] Consequently, we disagree with the OIG's position that the information you provided the Agency regarding the organizational costs in your quarterly reports should not be considered in determining allowability.

The OIG's argument that you had a duty to disclose your intention to acquire professional services in order for the organizational costs to be allowable is not persuasive. There is no such requirement in either 2 CFR 230.25(b) or 2 CFR Part 230, Appendix B, Item 31. The circumstances surrounding your request for a budget modification have convinced us that EPA's Project Officer intended to approve your incurring organizational costs. Nonetheless, her approval of the budget modification did not meet the requirements of 2 CFR 230.25(b) and 2 CFR Part 230, Appendix B, Item 31. First, you may have incurred some organizational costs prior to receiving the P.O.'s approval on August 8, 2007.[13] Second, the Project Officer lacked authority to approve organizational costs as under 40 CFR 30.25(b) and (c)(iii), only EPA's Award Official could grant the approval.

As stated above, we are reluctant to disallow otherwise allowable costs on technical grounds particularly when, as here, you sought EPA's approval for a budget modification for the organizational costs in good faith. EPA's Award Official has exercised his discretion under 40 CFR 30.25(e) to waive the prior approval requirement for organizational costs specified in 2 CFR Part 230, Appendix B, Item 31. Therefore, the $3,375 in organizational costs the OIG questioned is allowed.

Note 5 Other Costs.

Amount Questioned: $13,085

Amount Disallowed: $1883.40

Amount Allowed: $11,201.60

A. Less Than Arms Length Rental Costs.

[12] In your Year 1 4th Quarterly Report for the period of July 1, 2007, through September 30, 2007, you provided an update on the progress in resolving fringe benefit, tax and organizational structure issues and advised the Agency that "[F]urther work with the accountants, attorney and fringe benefit specialist should be on a limited basis in the future." August 2011 Response, Attachment 9.

[13] The Audit Report does not specify when the questioned organizational costs were incurred.

(1) Audit Report Finding.

The OIG questioned $8,800 in costs you incurred under the CA for renting office space in a mobile home that was initially owned by your daughter and that you subsequently purchased. They contended that the $200 per month you charged to the CA was arbitrary and not properly calculated under the standards for less than arms length rental transactions under 2 CFR Part 230, Appendix B, Item 43 b. and .c. Audit Report at pp. 9 and 49. According to the Audit Report:

> . . . less than-arms-length leases include, but are not limited to, those between divisions of a non-profit organization and the key employee of the nonprofit organization or his or her immediate family. Rental costs of buildings under less-than-arms-length leases are allowable only up to the amount that would be allowed had title to the property vested in the nonprofit organization. The allowable costs, according to 2 CFR 230, Appendix B, Section 43.b, include actual costs of ownership, expenses such as depreciation or use allowance, maintenance, taxes, and insurance.

Audit Report at p. 9

In response to the OIG's Draft Audit Report, you provided a "use allocation" methodology that you apparently believed to comply with the applicable regulations that yielded a monthly rental rate of $211.91 per month. August 2011 Response at p. 17. The use allocation methodology you described in your August 2011 Response was based on a formula ((Cost-Residual Value)/Estimated Life in Units = Depreciation per Unit Depreciation, Multiplied Rate per Unit times the Number of Units) which indicated that the base cost of the mobile home was $18,000. However, the OIG faulted your methodology because it did not provide a basis for allocating your entire $20,000 cost for acquiring the office space between the depreciable portion (the mobile home) and the non-depreciable portion (the parcel of land). Further, the OIG contended that your methodology did not include a cost of ownership calculation for the period of time your daughter owned the office space and received rental payments from you. Audit Report at pp. 9 and 49.

(2) Your Response.

August 2011 Response and your January 13, 2014 letter. In addition to the "use allocation" methodology (discussed above) you provided to demonstrate that your $200 per month rental charge was reasonable you disagreed with the OIG's characterization of your $200 per month rental charge as "arbitrary". August 2011 Response at p. 17 You also argued that EPA approved those costs under the 2 CFR 230.25 "prior approval" provision (quoted above) when the Agency agreed to your proposed budget for the CA which included a $300 per month line item for "Office Space Rental and Utilities" that you discussed with EPA's P.O. August 2011 Response at p. 17 and Attachment 15.

Our September 17, 2013 letter asked you to revise your methodology for calculating the less than arms length lease charges to respond to the shortcomings the OIG identified. Your January 30, 2014 letter does not provide a revised methodology. Rather, you indicated that you allocated $18,000 of the purchase price in the transaction to the mobile home and $2,000 to the land on

which it sits because . . . we were interested in the office space, not the land. . .". January 30, 2014 Letter at p. 3. You again did not address the rental cost charges to the CA for the period of time your daughter owned the trailer and the land. However, you did provide some useful background information regarding your decision to rent an office trailer from your daughter and real estate market conditions in the sparsely populated area of Oregon where your office was located. January 30, 2014 Letter at pp. 2 and 3. You also provided two price comparisons for model of mobile home you used for an office (a 1966 Fleetwood) to support your contention that an $18,000 valuation for the office space is appropriate. January 30, 2014 Letter at p. 3.

(3) EPA Determination.

We have allowed all of the $8,800 in rental costs the OIG questioned on the grounds that amount you charged the CA for office space was reasonable such that any technical deficiencies in your method for calculating the less than arms length lease charges did not materially violate 2 CFR Part 230, Appendix B, Item 43 b. and .c.

Notwithstanding our decision to allow the rental costs, we do not agree with your position that Agency approval of a line item in the CA budget for $300 per month in rental and utility costs makes a $200 per month rental rate allowable. Less than arms length leases do not require prior EPA approval. EPA's approval, therefore, of the line item in the CA budget for rent and utilities does not implicate 2 CFR 230.25. Moreover, the OIG has not questioned whether the rental costs were allowable under the CA due to the absence of EPA approval. Audit Report at p. 49. Rather, what properly concerned the OIG is whether your formula for calculating the amount of rental costs to be charged to the CA meets the applicable regulatory standards.

As indicated in our September 17, 2013 letter, the Agency agrees with the OIG's findings that you obtained office space to perform the CA under less than arms length leases and that the "use allocation" formula you provided in your August 2011 Response did not technically meet the requirements 2 CFR Part 230, Appendix B, Item 43 b. and .c. EPA shares the OIG's concern that you did not present a basis for allocating your cost for acquiring the office space between the depreciable and non-depreciable portions of the property by providing tax records or an independent appraisal to support your assertion that the value of the land was $2,000 and the mobile home was $18,000. You also again neglected to include a cost of ownership calculation for the period of time your daughter owned the office space and rented it to you. Nonetheless, we are also mindful that the policy behind the "less than arms length lease" coverage in 2 CFR Part 230 is to prevent recipients from charging federal financial assistance agreements for unreasonably high rents.

The Agency has decided to give you the benefit of the doubt and allow the $8,800 in rental costs you charged to the CA. The information you provided with your January 30, 2014 letter has convinced us that the $200 per month rental charges did not materially violate the requirements in 2 CFR Part 230, Appendix B, Item 43 b. and .c. for the allowability of than arms length rental charges. A rental rate of $200 per month appears to compare favorably with charges for office space in the area in which you lived based on the market research you described in the January 30, 2014 letter. Additionally, your valuation of the mobile home at $18,000 for the purposes of a use allocation formula seems to be reasonable given that two identical units have recently been

advertised for $34,900 and 24,900 at two California locations. January 30, 2014 Letter at p. 3. Under these unique circumstances, we believe that the technical deficiencies in the use allocation formula you provided in the August 2012 response are not material to the allowability of the rental costs you charged to the CA.

B. Cell Phone Costs

(1) Audit Report Finding.

The OIG questioned $4,285 in cell phone costs you charged to the CA on the grounds that these costs were not properly allocated to the CA in relation to the benefits the CA received as required by 2 CFR Part 230, Appendix A, section A.4. Their position is based on a finding that the four cell phone plans you used while performing the CA were family plans that included your two children as well as Dr. Dupris and that you charged the CA for either 100% of the costs for cell phone service or an arbitrary amount. The OIG also found that the cell phones were used for both business and personal calls. Audit Report at p. 10.

In response to the OIG's Draft Audit Report, you proposed a revised allocation methodology. August 11 Response at pp. 18, 19, 20 and Attachment 34. The OIG did not accept this methodology. According to the OIG the methodology did not comply with the applicable regulations because it did not take into account the fact that there were four family members using the cell phone service and that you and Dr. Dupris only worked part time on the CA. They found that that your revised methodology would have resulted in approximately 75% of the monthly plan costs being charged to the CA. Audit Report at pp. 10, 11, 52 and 53.

(2) Your August 2011 Response.

You contended that the OIG auditors were confused. First, you asserted that you calculated the amount of reimbursement for cell phone costs you received from the CA in a financially conservative manner consistent with IRS rules. Second, you argued although they examined cell phone bills for family plans that were paid with CA funds the amount of reimbursement you obtained from the CA did not cover your children's cell phone expenses. August 2011 Response at p. 18.

In support of your revised allocation methodology, you provided a narrative explanation for why you switched cell phone plans during the CA performance period.[14] August 2011 Response at pp. 18, 19, and 20. Essentially, you contended that you sought plans that would minimize cell phone costs for the CA. You also indicated that it was necessary for you to obtain a "smart phone" in order to have access to the internet and emails from NTWC members and EPA while traveling. In addition to providing a description of how you allocated charges to the CA under all four plans, you developed a spread sheet which provided financial data to support your

[14] You also noted that you made late payment charges on behalf of the CA "during the closeout process" and that other late payment charges or fees had been identified for reimbursement pending the outcome of the audit resolution process. August 2011 Response at p. 18. It is unlikely that EPA would agree that fees you incurred for making late payments on your cell phone bills would be an allowable cost under the CA.

contention that you incurred $1,992.21 in allowable cell phone costs over and above the $4,285 the OIG questioned. August 2011 Response at p. 20 and Attachment 34.

(3) EPA Determination.

We have disallowed $1,883.90 of the $4,285 in cell phone costs the OIG questioned and allowed $2401.10.

We agree with the OIG that the cell phone cost allocation methodology you proposed in your August 2011 Response would charge the CA for costs that are attributable to use of the cell phones by you and your family for purposes other than carrying out the CA. This would be a material violation of the requirement in 2 CFR Part 230, Appendix A, section A.4 that costs be charged to the CA in relation to the benefits received by the EPA funded project. Our rationale for this decision, and the basis for our calculation of the amount of allowable cell phone costs, is set forth below.

(a) October 15, 2006 through May 18, 2007--- the original cell phone service.

(i) You proposed to charge the CA $34.98 per month for 50% of the $69.95 monthly base fees for the cell phone service you received for the October 15, 2006 through May 18, 2007 period. August 2011 Response pp. 18, 19 and Attachment 34. We have determined that only 25% of the monthly base fees ($17.49 or a prorated portion of this amount if appropriate) are allowable. The base fee pays for services for four cell phone users and two of the cell phone users (you and Dr. Dupris) charged 50% of their salaries to the CA for part time work. Therefore, only 25% of the monthly base fees are allocable to services which benefited the CA.

(ii). You proposed to allocate to the CA $29.67 which is 50% of a $59.34 credit to your monthly base fee for the original service that you received on May 18, 2007. We have determined that only 25% of this credit ($14.84) serves as an offset to cell phone costs you charged to the CA. As with charges to the CA, under 2 CFR Part 230, Appendix A, Section A 5.a. the amount of any credits you give to the CA must be allocable to the agreement. Because 25% of the monthly base fee is a cost that is allocable to the CA, you need only credit the CA with 25% of any refunds, fee rebates, promotional discounts or other reductions in the base fees for cell phone services.

(iii) We have accepted all of the other proposed charges and credits to the CA for cell phone costs for the period of October 15, 2006 through May 18, 2007 depicted on the spread sheet you provided as Attachment 34 to your August 2011 Response.

(b) Late May 2007 through October 18, 2007--- the second cell phone plan.

(i) You proposed to charge the CA $135.01 per month for the cost of the second cell phone plan's monthly base fee. This is the amount over and above 50% of the monthly base fee for the original service for the October 15, 2006 through May 18, 2007 period. August 2011 Response p. 19 and Attachment 34. We have determined that 25% of the $169.99 monthly base fees ($42.50 or a prorated portion of this amount if appropriate) for the second cell phone plan are

allowable for the reasons set forth in Note 5 b. (3)(a)(i) above. The cost of the original service is not relevant in determining the amount of allocable charges during the periods covered by subsequent cell phone plans.

(ii) You proposed to charge the CA for 50% of the $14.00 charge under the second cell phone plan for unlimited incoming calls. We have determined that only 25% of this charge is an allowable cost under the CA. As with the monthly base fee for the original and second cell phone plans, all four users of the cell phones benefited from the unlimited incoming calls feature and only you and Dr. Dupris earned 50% of your salaries from work related to the CA. Consequently, only 25% of the monthly charge for unlimited incoming calls is allocable to services which benefited the CA.

(iii) We have accepted all of the other proposed charges to the CA for cell phone costs for the period from late May 2007 through October 18, 2007 depicted on the spread sheet you provided as Attachment 34 to your August 2011 Response.

(c) Late October 2007 through May 18, 2009—the third cell phone plan.

(i) You proposed to charge the CA $95.01 for the cost of the third cell phone plan's monthly base fee. This is the amount over and above 50% of the monthly base fee for the original service for the October 15, 2006 through May 18, 2007 period. August 2011 Response p. 19, 20 and Attachment 34. We have determined that 25% of the $129.99 monthly base fees ($32.50 or a prorated portion of this amount if appropriate in a given month) for the third cell phone plan are allowable for the reasons set forth in Note 5 b. (3)(a)(i) above. The cost of the original service is not relevant in determining the amount of allocable charges during the periods covered by subsequent cell phone plans.

(ii) You proposed to charge the CA for 50% of the $14.00 charge under the third cell phone plan for unlimited incoming calls. August 2011 Response p. 19, 20 and Attachment 34.We have determined that only 25% of this charge is an allowable cost under the CA for the reasons set forth in Note 5 b. (3)(b)(ii) above.

(iii) You proposed to charge the CA for $24.95 for the full monthly cost of "smart phone" services that you contend were "acquired specifically for the [CA]". August 2011 Response at p. 20 and Attachment 34. We have determined that only 50% of these costs ($12.48 or a prorated amount if appropriate) are allowable under the CA. While we agree that you having access to emails from EPA and NTWC members while traveling benefited the CA, you could also use the smart phone for personal communication and your consulting business. The CA, therefore, was not the exclusive beneficiary of the smart phone feature on the third cell phone plan.

You worked part time as the NTWC Project Administrator and received 50% of your annual salary for duties relating to performing the CA. Consequently, only 50% of the costs for the smart phone services were allocable to the CA.

(iv) We have accepted all of the other proposed charges to the CA for cell phone costs for the period from late October 2007 through May 18, 2009 depicted on the spread sheet you provided as Attachment 34 to your August 2011 Response.

(d) Late May 2009 through March 31, 2011—the fourth cell phone plan.

(i) You proposed to charge the CA $95.01 for the cost of the fourth cell phone plan's monthly base fee over and above 50% of the monthly base fee for the original service for the October 15, 2006 through May 18, 2007 period. August 2011 Response p. 20 and Attachment 34. We have determined that 25% of the $129.99 monthly base fees ($32.50 or a prorated portion of this amount if appropriate in a given month) for the fourth cell phone plan are allowable for the reasons set forth in Note 5 b. (3)(a)(i) above. The cost of the original service is not relevant in determining the amount of allocable charges during the periods covered by subsequent cell phone plans.

(ii) You proposed to charge the CA $24.95 for the full monthly cost of "smart phone" services that you contend were "acquired specifically for the [CA]". August 2011 Response at p. 20 and Attachment 34. We have determined that only 50% of these costs ($12.48 or a prorated amount if appropriate) are allowable under the CA for the reasons set forth in Note 5 b. (3)(c)(iii) above.

(iii). You proposed to allocate to the CA $7.50 which is 50% of a $14.99 "Goodwill" credit to the monthly base fee for the that you received on May 18, 2010. We have determined that only 25% of this credit ($3.75) is allocable to the CA for the reasons specified in Note 5 b. (3)(a)(ii) above.

(iv) We have accepted all of the other proposed charges to the CA for cell phone costs for the period from late May 2009 through March 31, 2011 depicted on the spread sheet you provided as Attachment 34 to your August 2011 Response.

Note 6. Costs Claimed in Excess of Accounting System Amount

Amount Questioned: $1,836

Amount Disallowed: $0

Amount Allowed: See Agency Determination on OIG Recommendation 3 regarding verification that your final financial status report is properly supported by accounting records.

(1) Audit Report Finding.

The OIG questioned $1,836 in costs you claimed in excess of expenditures under the cooperative agreement as reflected in your accounting records as of September 30, 2010. According to the OIG, the excess amount of CA funds you had on hand was caused by your failure to comply with the cash management requirements of 40 CFR 30.22 and the terms of the CA (Administrative Condition 4) when you drew down CA funds in excess of your immediate needs to disburse cash. Audit Report at pp. 11, 12, 29 and 55. The OIG, after reviewing documentation you

provided, did not accept your contention that the $1,836 in the NTWC bank account were your personal funds. Audit Report at p. 55. However, they recognized that because ". . . cash draw is an ongoing process the excess cash draws may be different at the end of the [CA]." Audit Report at p. 12.

(2) Your August 2011 Response.

You argued that the OIG's recommendation that you repay the $1,836 based on a finding of a discrepancy between amounts claimed and expended under the CA prior to the end of the CA would be arbitrary and capricious. August 2011 Response at pp. 7, 20 and 21. Essentially, you contended on August 25, 2010 you deposited $4,500 of your personal funds into the NTWC bank account to pay for CA costs you incurred but had not paid due to delays in receiving reimbursement from EPA. After paying those costs, $1,836 of what you contend are personal funds remained in the NTWC bank account on September 30, 2010.[15] August 2011 Response at pp. 7, 21and 22.

(3) Agency Determination.

We have decided not to disallow the $1,836 in questioned costs at this time. As the OIG acknowledged, and you argued, it would be premature to make a final determination on whether the amount of costs you claimed under the CA exceeded your actual expenditures prior to the end of the budget and performance period. Rather, we will determine whether the costs you claim on your final financial status report are adequately supported by accounting records as part of the close-out process for the CA. EPA, therefore, does not need to determine whether the $1,836 in the NTWC bank account on September 30, 2010 were personal funds you "loaned" the CA pending receipt of reimbursement or excess cash draws which materially violated 40 CFR 30.22 and Administrative Condition 4 of the CA.

Recommendation 2: Verify that you have a financial management system that meets federal standards under 2 CFR 215.21[16] prior to any future awards.

(1) Audit Report Finding.

The OIG found that you did not have adequate controls to ensure that costs claimed met federal standards in 2 CFR Part 230, Appendix A, section A. 2. Audit Report at p. 5. This provision requires, in pertinent part, that allowable costs must:

> a. Be reasonable for the performance of the award and be allocable thereto under these principles.

[15] Your August 2011 Response contains a discrepancy regarding the amount of funds in the NTWC bank account on September 30, 2010 that you claim to be personal funds. On two occasions (the tops of p.21 and the top of p. 22) you assert that the amount of personal funds in the NTWC bank account was $1,721.98. You also claimed that the entire $1,836 remaining in the bank account on September 30, 2010 was your personal funds. We need not resolve this discrepancy given our decision not to disallow the $1,836 in questioned costs at this time.

[16] This citation is to an OMB regulation codifying OMB Circular A-110. EPA has implemented that provision of the Circular at 40 CFR 30.21.

b. Conform to any limitations or exclusions set forth in these principles or in the award as to types or amount of cost items.

c. Be consistent with policies and procedures that apply uniformly to both federally-financed and other activities of the organization.

d. Be accorded consistent treatment.

e. Be determined in accordance with generally accepted accounting principles (GAAP).

. . .

g. Be adequately documented.

As discussed above, the OIG questioned the allowability of $80,721 of the $726,587 in costs you claimed under the cooperative agreement as of the September 10, 2010 cut-off date for the OIG's audit. This amounts to 11.1% of the costs you claimed. The grounds the OIG asserted for questioning the costs at issue included allocability, noncompliance with specific limitations on costs contained in Appendix B of 2 CFR Part 230, inconsistent treatment of costs for CA funded activities other activities, and your failure to properly account for CA funds. Audit Report at pp. 6 through 11.

(2) Your August 2011 Response.

You contended that the OIG erred on the grounds that:

> the accounting records examined were supported and documented according to the EPA approved cash-based accounting system. The auditors were able to identify the costs associated with the grant expenses by budget category in the paper records of the grantee. The accounting records of the grantee were also memorialized in a Quickbooks accounting system that was in the exclusive control of an independent contractor, and the accounting records were reconciled to a dedicated bank account.
>
> What is at issue in the auditor's report is not that the accounting documents do not record and support the grant expenses, instead the OIG auditors take issue with the approved EPA grant budget and associated grant costs. If the grantee did not have the records to support the grant costs in question, the auditors would not have been able to determine the exact dollar amount and budget category for each grant expense "in question". Additionally, the auditors seem to ignore the fact that the grantee must comply with state and federal business and labor laws, and IRS rules and regulations that apply to businesses. Instead, the auditors allege that compliance with those laws and the negotiated terms and conditions of the grant "do not meet federal standards" that apply to nonprofit entities.

August 2011 Response at pp. 6 and 7.

(3) Agency Determination.

We have accepted the OIG Recommendation 2. It is prudent to ensure that a recipient's financial management procedures and capabilities are adequate in the wake of adverse OIG audit findings and EPA determinations.

Although we did not agree with all of the OIG's findings regarding the allowability of all of the costs they questioned, we did determine that $33,781.21 of the $726,587 in costs you claimed were not allowable. Our determinations were based on your failure to properly allocate costs (AD Section A, Notes 1 and 5 b.) and adequately document a credit due the CA (AD Section A, Note 2). The fact that you initially did not recognize that charging the CA for office space you rented from your daughter and subsequently owned yourself required compliance with the "less than arms length lease" provision of 2 CFR Part 230, Appendix B, Item 43 b. and .c. (AD Section A, Note 5 a.) is a significant internal control weakness. Further, you claimed that the OIG's finding (Audit Report pp.11 and 12) that you drew down funds in excess of your immediate cash needs in violation of 40 CFR 30.22 and Administrative Condition 4 of the CA stemmed from your confusion regarding the drawdown process as well as the lack of clear guidance from EPA. August 2011 Response at pp. 23 through 26. If the Agency verifies that your financial management system complies with federal standards before awarding funds to you or organizations you manage or control, similar problems may be avoided in the future.

Recommendation 3: Verify that your final financial status report is supported by accounting records.

(1)Audit Report Finding.

The OIG found that you violated 40 CFR 30.22 and Administrative Condition 4 of the CA from October 2006 through May 2010 by making quarterly advance draws of $50,000 or $60,000 rather than requesting payment from EPA in amounts necessary to make immediate cash disbursements.[17] They determined that as of May 7, 2010 you drew $62,229 in CA funds in excess of actual expenditures. According to the Audit Report, you based the amount of your draw downs on anticipated expenditures and obligations for future events without regard to when you actually incurred the costs. Audit Report at pp. 11, 12, and 29.

The OIG also found that after EPA placed you in reimbursement status on that date you applied the excess cash in the NTWC bank account to costs you incurred under the CA such that as of September 30, 2010, the amount of cash you drew in excess of expenditures had been reduced to $1,836. The OIG questioned this amount. Nonetheless, the OIG recognized that cash draw is an ongoing process and also recommended that the Agency verify that your final financial status report is supported by accounting records which establish that as of March 31, 2011 your expenditures corresponded with the amount EPA paid you. Audit Report at pp. 11, 12, 13, and 29.

[17] EPA placed you in reimbursement status in May 2010 due to your practice of requesting payments in excess of actual disbursement needs.

(2).Your August 2011 Response.

You contended that the cash draw process you followed was disclosed in your proposal for the CA and agreed to by EPA's original Project Officer in negotiations leading to the award of the CA. August 2011 Response at pp. 5, 7, and 23; Attachments 43. In support of this contention you provided a document styled as a "Application Estimate of $50,000.00 Spending Rate for Grant Activities" which was apparently a worksheet you used to calculate your quarterly draw downs and a November 9, 2006, email to EPA's original Project Officer that refers to quarterly advances of approximately $50,000. August 2011 Response, Attachments 37 and 43. Additionally, you asserted that you were confused by the drawdown process due to inadequate guidance from Agency personnel. August 2011 Response at pp. 23 through 26. You also argued that the excessive draw down issue was moot because the matter had been resolved at a May 2010 meeting with EPA where, among other things, the Agency decided that your practice of requesting payments in quarterly lump sums was based on a misunderstanding. August 2011 Response at p. 26.

(3). Agency Determination.

We agree with the OIG's finding that your practice of drawing down quarterly lump sums without regard to your immediate needs to disburse cash for costs you had actually incurred materially violated 40 CFR 30.22 and Administrative Condition 4 of the CA.

While Dr. Dupris' November 9, 2006, email to EPA's original Project Officer does state that you expected to receive cash advances of approximately $50,000 "as we wrote in the proposal" the record does not demonstrate that EPA agreed that you could follow such a practice. [18] Our review of the proposal attached to your March 9, 2006 application for the CA did not identify any reference to your intention to draw down CA funds in $50,000 lump sums on a quarterly basis. We could not locate a copy of the document you characterize as "Application Estimate of $50,000.00 Spending Rate for Grant Activities" in the Agency's files. The fact that Administrative Condition 4, which expressly provides that you must request funds based on your "immediate disbursement requirements" was included in the CA indicates that the Agency did not agree to provide lump sum advances to you notwithstanding any discussions you may have had with EPA's Project Officer. Moreover, for the Agency to authorize you to draw down funds in advance of your immediate cash disbursement needs would have necessitated a formal deviation from for CFR 30.22 as provided for in 40 CFR 30.4. No deviation was granted.

With regard to your confusion and purported lack of guidance from EPA personnel, we agree with the OIG that it was your responsibility to become familiar with the regulations and terms of the CA. Audit Report at p. 34. We also agree with you that your practice of drawing down excess funds was based on a genuine misunderstanding of the applicable requirements as we stated in our May 27, 2010 letter to you. Nonetheless, it is prudent under the circumstances for EPA to accept the OIG's Recommendation that EPA verify that amount of costs you claim on your final financial status report are adequately supported by your accounting records. While we

[18] If you needed CA funds to cover estimated disbursement needs at the beginning of the CA the Agency could have provided you with an initial "working capital advance" under 40 CFR 30.22(f) if you requested one. However, after that initial advance EPA would have reimbursed you for actual cash disbursements.

will not conduct a comprehensive review of these records, we will verify that the amount of costs you claim corresponds with the amount of your expenditures under the CA reflected in your GL.