



U.S. ENVIRONMENTAL PROTECTION AGENCY

OFFICE OF INSPECTOR GENERAL

# Labor-Charging Practices at the New Mexico Environment Department

Report No. 13-4-0296

June 17, 2013



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## Report Contributors:

Bill Spinazzola  
David Kim  
Janet Lister  
Lela Wong

## Abbreviations

AQB	Air Quality Bureau
CFR	Code of Federal Regulations
DWB	Drinking Water Bureau
EPA	U.S. Environmental Protection Agency
FFR	SF 425 Federal Financial Report
FY	Fiscal year
GWQB	Ground Water Quality Bureau
IGMS	Integrated Grants Management System
NMED	New Mexico Environment Department
OGD	Office of Grants and Debarment
OIG	Office of Inspector General
OMB	Office of Management and Budget
Recovery Act	American Recovery and Reinvestment Act of 2009
SHARE	Statewide Human Resources, Accounting and Management Reporting
SWQB	Surface Water Quality Bureau

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# At a Glance

## Why We Did This Review

The U.S. Environmental Protection Agency, Office of Inspector General, conducted this audit to determine whether labor-charging practices at the New Mexico Environment Department comply with federal requirements. The OIG also sought to determine the effect of any noncompliance on amounts NMED claimed under EPA awards.

### This report addresses the following EPA Goals and Cross-Cutting Strategies:

- *Taking action on climate change and improving air quality.*
- *Protecting America's waters.*
- *Cleaning up communities and advancing sustainable development.*

For further information, contact our Office of Congressional and Public Affairs at (202) 566-2391.

The full report is at:  
[www.epa.gov/oig/reports/2013/20130617-13-4-0296.pdf](http://www.epa.gov/oig/reports/2013/20130617-13-4-0296.pdf)

## Labor-Charging Practices at the New Mexico Environment Department

### What We Found

We found that three of the four NMED bureaus audited did not always comply with requirements found in the Code of Federal Regulations under 2 CFR Part 225. The Air Quality Bureau and Drinking Water Bureau charged labor, fringe benefits, and indirect costs to federal grants based upon budget allocations instead of actual activities performed. Personnel activity reports we received from the Surface Water Quality Bureau to support charges for labor costs incurred prior to July 2006 did not meet 2 CFR Part 225 requirements.

Title 2 CFR Part 225 requires that where employees work on multiple activities or cost objectives, labor charges be based upon the after-the-fact distribution of an employee's actual activity and supported by employee-signed personnel activity reports or the equivalent. NMED personnel stated that they charged labor based upon budget allocations because they thought the practice was acceptable. NMED personnel also stated that the accounting system used for SWQB timekeeping before July 2006 is no longer accessible and that employee-signed personnel activity reports from this period are no longer available.

We questioned \$298,159 in labor, fringe benefits, and related indirect costs claimed by AQB; \$2,974,318 claimed by DWB; and \$2,733,798 claimed by SWQB. We also identified an additional \$486,305 charged to a DWB-administered grant, which has not yet been reported to the EPA.

### Recommendations and Planned Corrective Actions

We recommend that the Region 6 Regional Administrator disallow and recover unsupported costs of \$298,159 from AQB; \$2,974,318 from DWB; and \$2,733,798 from SWQB, unless NMED provides support that complies with 2 CFR Part 225 requirements. We also recommend that the regional administrator ensure NMED does not claim unallowable costs of \$486,305 under the DWB grant, unless it can provide support that complies with 2 CFR Part 225 requirements. In addition, we recommend that the regional administrator recover any unsupported costs claimed under AQB and DWB grants not covered in our cost-impact determination and ensure that labor-charging practices at remaining NMED bureaus with EPA grants comply with federal requirements. Region 6 agreed with our findings and four of the five recommendations. NMED agreed with recommendation 4 and disagreed with the remaining recommendations. NMED reiterated some of the comments provided during our fieldwork, but no additional information or supporting documentation was provided.

### Noteworthy Achievements

AQB and DWB took corrective actions promptly when the issue was brought to their attention. Both bureaus issued written procedures that require employees to charge labor hours based upon actual activities performed. We found that employees complied with these procedures. As of April 14, 2012, labor-charging practices at all four audited bureaus comply with federal requirements.




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

THE INSPECTOR GENERAL

June 17, 2013

**MEMORANDUM**

**SUBJECT:** Labor-Charging Practices at the New Mexico Environment Department  
Report No. 13-4-0296

**FROM:** Arthur A. Elkins Jr. 

**TO:** Ron Curry, Regional Administrator  
Region 6

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

**Action Required**

In accordance with EPA Manual 2750, you are required to provide us your proposed management decision on the findings and recommendations contained in this report before you formally complete resolution with the recipient. Your proposed management decision is due in 120 days, or on October 15, 2013. To expedite the resolution process, please email an electronic version of your proposed management decision to [adachi.robert@epa.gov](mailto:adachi.robert@epa.gov).

Your response 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 to be released to the public. If your response contains such data, you should identify the data for redaction or removal. We have no objection to the further release of this report to the public. This report will be available at <http://www.epa.gov/oig>.

If you or your staff have any questions regarding this report, please contact Richard Eyerman, acting assistant inspector general for the Office of Audit, at (202) 566-0565 or [eyermann.richard@epa.gov](mailto:eyermann.richard@epa.gov); or Robert Adachi, product line director, at (415) 947-4537 or [adachi.robert@epa.gov](mailto:adachi.robert@epa.gov).

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# Chapter 1

## Introduction

### **Purpose**

The U.S. Environmental Protection Agency, Office of Inspector General, conducted this audit to determine whether labor-charging practices at the New Mexico Environment Department comply with federal requirements. The OIG also sought to determine the effect of noncompliance on amounts NMED claimed under EPA awards.

### **Background**

NMED was established by legislative act in July 1991. Its mission is to provide the highest quality of life throughout New Mexico by promoting a safe, clean, and productive environment. NMED has about 650 employees and 13 bureaus, including the Drinking Water Bureau, Surface Water Quality Bureau, Ground Water Quality Bureau, and Air Quality Bureau. As of February 27, 2012, NMED had approximately \$95 million in active EPA grants. NMED had another \$58 million in grants closed within the last 3 years (i.e., on or after May 2009) and subject to the record-retention requirement.

### **Noteworthy Achievements**

When labor-charging issues were brought to the attention of AQB and DWB by an EPA contractor and OIG review, the bureaus took corrective actions and promptly issued written procedures that require employees to charge labor hours based upon actual activities performed. The EPA contractor's review was conducted from June 7 to 10, 2010, and AQB issued revised procedures on June 25, 2010. OIG auditors brought the issue to DWB's attention in January 2012, and DWB issued revised procedures on April 13, 2012. As of April 14, 2012, labor-charging practices at all four audited bureaus comply with federal requirements. In chapter 2 of this report, we further describe how both bureaus complied with federal requirements when the revised procedures were issued.

### **Scope and Methodology**

We conducted this performance audit from May 15, 2012, to February 21, 2013. We conducted the 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 upon our audit objectives. We believe that the

evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Based upon our risk assessment, we limited our audit to the following four bureaus: DWB, SWQB, GWQB, and AQB. These bureaus had the highest labor and fringe benefit amounts in our audit universe, which consisted of all EPA awards with a project end date of May 15, 2009, or later. The audit universe cut-off date was established to ensure that all grants selected for review were within the 3-year record-retention period required by 40 CFR § 31.42(b).

We used the information in EPA’s Integrated Grants Management System to identify the four bureaus with the most labor and fringe benefits. Our analysis included both open and closed awards. We searched the IGMS for grants and cooperative agreements awarded to NMED with a project end date of May 15, 2009, or later. We reviewed the grant budgets to determine EPA’s share of labor and fringe benefits for each award. We grouped the awards by NMED bureau and then selected the four bureaus with the most labor and fringe benefits. Table 1 below shows NMED bureaus, total labor and fringe benefits, and EPA’s share of labor and fringe benefits.

**Table 1: Labor and fringe benefits by NMED bureau**

<b>Bureau</b>	<b>Total</b>	<b>EPA’s share</b>	<b>EPA’s percent of total</b>
SWQB	\$23,740,613	\$16,256,496	36.64%
GWQB	13,342,409	12,759,844	28.76%
AQB	6,330,700	4,219,827	9.51%
DWB	4,112,690	3,124,853	7.04%
Petroleum Storage Tank Bureau	3,445,326	2,849,714	6.42%
Hazardous Waste Bureau	3,598,418	2,697,935	6.08%
Construction Programs Bureau	1,855,433	1,725,227	3.89%
Radiation Control Bureau	561,066	451,741	1.02%
Administrative Services Division (Program Support Grants)	388,898	286,165	0.64%
<b>Totals</b>	<b>\$57,375,553</b>	<b>\$44,371,802</b>	

Source: The amounts and percentages are from EPA’s IGMS. Bureau information is from NMED.

We obtained an understanding of labor-charging practices at each of the four bureaus by:

- Discussing labor-charging practices and timekeeping procedures with NMED management;
- Interviewing selected employees to determine the labor-charging practices used by NMED; and
- Reviewing sample payroll transactions to determine whether actual practices were consistent with the practices described by NMED employees and management, and whether these practices complied with federal requirements.

We tested payroll samples to determine whether:

- Hours that employees recorded on paper timesheets agreed with hours recorded on electronic timesheets.
- Timesheets were signed by employees and approved by a supervisor.
- Employees had been paid for the time period.
- Dollar amounts for each subaccount recorded in the labor-distribution report (i.e., the Human Capital Management Payroll Report) divided by the employee's hourly pay rate equal the hours reported on the employee's timesheet.
- The distribution of time percentages in the employee's task profile agree with the distribution on the employee's timesheet.

We identified 13 grants to use to estimate the cost impact of labor-charging practices that did not comply with federal requirements specified in 2 CFR Part 225, *Cost Principles for State, Local, and Indian Tribal Governments* (Office of Management and Budget Circular A-87). The 13 grants selected represent approximately 63 percent of EPA's share of labor and fringe benefits budgeted for the awards in our universe. The 13 grants are included in appendix A of this report.

The time period covered by the audit varied depending on the bureau. We audited AQB and DWB from the inception of NMED's current accounting system on July 1, 2006, to the start of our field work on May 15, 2012. For GWQB and SWQB, we extended the audited time period back to July 1, 2004, the earliest inception date of the grants selected for cost-impact estimate.

## **Follow-Up on Prior Audit Issues**

We followed up on NMED's actions in response to recommendations that addressed labor-charging issues made in a December 2010 report issued by EPA's Office of Grants and Debarment based upon a limited review conducted by a contractor. The report stated that NMED did not have timesheets or equivalent documentation to support personnel costs charged to EPA assistance agreements.



In response, NMED stated that labor hours charged to projects in the report were reconciled to actual time spent on the project, and adjustments were made to reduce expenditures charged to EPA awards. We reviewed the reconciliation and confirmed that adjustments were made; however, the adjustments were not based on employee timesheets that complied with federal requirements.

### ***Report on Internal Control and Financial Management Systems***

The OGD contractor completed a limited-scope review of NMED's administrative and financial management system. The review objectives were to assess the effectiveness of NMED's internal controls and to determine whether NMED's administrative and financial management systems met federal cost principles, as well as the terms and conditions of EPA assistance agreements. The period reviewed was January 1, 2009, through May 19, 2010.

The review covered five EPA assistance agreements awarded under the American Recovery and Reinvestment Act of 2009. One of the five awards was administered by AQB. The award was grant number 2D96690201 in the amount of \$1,730,000. During the period reviewed by the OGD contractor, NMED drew \$88,629. Of this amount, \$62,193 was reported as unallowable salaries, fringe benefits, and related indirect costs. The OGD contractor stated that:

- NMED did not have timesheets or the equivalent documentation to support personnel costs.
- Wages and fringe benefits were distributed to agreements as a percentage of an employee's time.
- The percentages were intended to approximate the budget.
- Calculated costs were not reconciled to actual time.

NMED did not dispute the OGD contractor's findings. NMED responded by stating it would begin using timesheets for staff working on Recovery Act grants, and timesheets would be used to identify actual hours charged to the grants. NMED also stated that hours charged to the AQB-administered grant were reconciled to actual hours, and journal entries were adjusted to reduce Recovery Act expenditures. NMED also planned to have written timekeeping procedures completed by January 15, 2011.

### ***OIG Follow-Up***

The OIG asked NMED to provide supporting data for the adjusting journal entry that was referred to in its response to the OGD contractor's report. NMED responded by providing the computation sheets that it used to determine the adjustments, including a schedule that summarized the number of hours employees worked on the grant.

The OIG also asked NMED to provide supporting timesheets or other data for the schedule of hours worked on the AQB-administered grant. NMED management determined that the hours worked on the grant were based upon records of meetings, telephone calls, and documented calendars. NMED management did not retain any supporting timesheets or other data because they were unaware of the requirement to do so. NMED officials also said they could provide copies of emails from employees confirming the hours and tasks they worked on for the AQB-administered grant. NMED provided a spreadsheet summary showing employee names, dates, hours worked on the grant, and the source of the data. The sources of the data were mostly emails.

Title 2 CFR Part 225, Appendix B, Section 8.h.(4), requires that where employees work on multiple activities or cost objectives, salaries and wages be supported by personnel activity reports or equivalent documentation. The personnel activity reports or equivalent documentation must reflect an after-the-fact distribution of the actual activity of each employee, account for the total activity for which each employee is compensated, be prepared at least monthly and coincide with one or more pay periods, and be signed by the employee.

NMED has not complied with the requirements cited above or the recommendations in the OGD contractor's report. The adjustments NMED made to salaries and benefits in response to the OGD contractor's recommendations were not based upon personnel activity reports, as required by federal regulations.

## **Chapter 2**

### **Labor-Charging Practices**

### **Did Not Comply With Federal Requirements**

Two of the four NMED bureaus audited did not comply with federal requirements for charging labor costs. AQB and DWB charged labor, fringe benefits, and indirect costs to federal awards based upon budget allocation instead of actual activities performed. Title 2 CFR Part 225 requires labor charges be based upon the after-the-fact distribution of the actual activity. Budget estimates or other distribution percentages determined before the services are performed do not qualify as support for charges to federal awards. NMED personnel stated that they charged based upon budget estimates because they thought it was an acceptable method. As a result of the noncompliance, we questioned \$298,159 in labor, fringe benefits, and related indirect costs claimed by AQB; and \$2,974,318 claimed by DWB. We also identified an additional \$486,303 charged to a DWB-administered grant, which has not yet been reported to the EPA due to financial status report cut-off dates.

#### **Labor Charges Were Based Upon Budget Estimates**

We audited labor-charging practices at AQB, DWB, GWQB, and SWQB. We found that GWQB complied with federal requirements and charged based upon actual work performed for the entire period covered by the audit (July 1, 2004, to May 15, 2012). We also found that SWQB complied with federal requirements and charged based upon actual work performed for the period July 1, 2006, to May 15, 2012. For the period July 1, 2004, to June 30, 2006, based upon employee interviews, SWQB charged based upon actual work performed. However, SWQB was unable to provide the required personnel activity reports signed by the employees to support the costs claimed. This issue is further discussed in chapter 3 of this report.

AQB and DWB did not always comply with federal requirements. Both bureaus charged labor hours based upon budgeted percentages from the inception of NMED's current accounting system—the Statewide Human Resources, Accounting and Management Reporting—in July 2006. For AQB, the practice continued through June 25, 2010. For DWB, the practice continued through April 13, 2012.

#### ***AQB Timekeeping Procedures***

From July 2006 to June 25, 2010, AQB recorded and charged labor costs to federal awards based upon budgeted percentages determined for each employee at the beginning of the fiscal year. On June 25, 2010, AQB revised its timekeeping procedures in response to a review performed by the OGD contractor. The change

required employees to record on their timesheets actual hours worked on each project. AQB issued written timekeeping procedures on June 25, 2010, to document the new requirements.

To verify the change in timekeeping procedures, we tested the payroll documentation of two employees for the pay period ending October 1, 2010, and two employees for the pay period ending April 30, 2010. These two pay periods represent labor-charging practices before and after the June 25, 2010, change. The two samples allowed us to test compliance with both the old and new procedures.

Our tests confirmed that AQB recorded and charged labor and associated fringe benefits and indirect costs based upon budgeted percentages through June 25, 2010; after this date, charges were based upon actual activities performed.

### ***DWB Timekeeping Procedures***

From July 2006 to April 13, 2012, DWB recorded and charged labor costs based upon budgeted percentages determined for each employee at the beginning of the fiscal year. DWB revised its timekeeping procedures on April 13, 2012, after the OIG raised the issue during our January 2012 visit. The new procedures require employees to record labor hours based upon their actual activity. DWB issued written timekeeping procedures on April 13, 2012, to document the new procedures.

To verify the change in timekeeping procedures, we tested payroll documentation for pay periods before and after the April 13, 2012, change. In our samples, we included two employees from each of the pay periods ending on the following dates: May 11, 2012; February 17, 2012; August 5, 2011; and September 19, 2008. Our tests confirmed that DWB recorded and charged labor and the associated fringe benefits and indirect costs based upon budgeted percentages through April 13, 2012, and actual activities performed after that date.

## **Using Budget Estimates Did Not Meet Federal Requirements**

Federal cost principles require labor charges to be based upon actual activities performed. Title 2 CFR Part 225, Appendix B, Section 8.h. requires labor charges to be supported by personnel activity reports or equivalent documentation that meet the requirements in Section 8.h.(5) to be allowable for reimbursement under federal awards. Two of the requirements are that personnel activity reports must reflect an after-the-fact distribution of the actual activity of each employee and must be signed by the employee. Budget estimates or other distribution percentages determined before the services are performed do not qualify as support for charges to federal awards.

In the past, both the AQB and DWB did not comply with these requirements. As described above, AQB and DWB charged labor and related costs to federal awards based upon budget allocation. These costs do not comply with federal requirements and are not allowable for reimbursement.

## **NMED Believed Charges Based Upon Budget Estimates Were Acceptable**

NMED believed that it was an acceptable practice to charge labor and related costs to federal awards based upon budget estimates. NMED's belief was based upon prior audit experience and communications with EPA Region 6.

When the OIG discussed the issue with NMED in March 2012, NMED personnel said that they believed it was a difference in interpretation of the federal requirements. NMED had been audited by single auditors every year but had never been told that there was an issue with its labor-charging method. Although the issue was reported in the administrative and financial management system review conducted by the OGD contractor, NMED believed that the requirement to maintain timesheets and to charge based on actual activities performed were specific to the Recovery Act awards.

We met with the firm that performed NMED's single audits for fiscal years 2009 through 2011 and reviewed relevant audit documentation for FY 2011. It appears that the single auditor did not identify the labor-charging issue because the firm had different criteria for risk assessment from the OIG. Risk assessment method and criteria may vary for each audit based on the auditor's judgment. An audit provides reasonable but not absolute assurance that the information presented is free of material misstatement.

NMED also believed that EPA Region 6 officials approved labor charges based upon budget estimates. NMED provided an email from EPA Region 6 dated March 21, 2011. According to NMED, the email indicated EPA's approval of the labor-charging practices. However, the subject of the email was "Allocation of Rent," and Region 6 personnel stated in the email that the "EPA is comfortable with the Base program being based on the proportion of time." We discussed the March 2011 email with Region 6 staff and they said NMED misunderstood EPA's intent. The email correspondence was concerned with the allocation of rent, and labor was referenced because rent was based on labor costs. The email was unclear about whether the statement referred to the allocation of facilities cost or labor charges. Also, although the email was dated March 2011, NMED has been using budget estimates since July 2006.

NMED also provided a written summary of a February 8, 2011, meeting between officials from NMED, the EPA, and the New Mexico Finance Authority.

Although the meeting summary appeared to discuss timesheets, labor hours, and allocations, there was no indication of EPA’s approval to charge labor based upon budget. Furthermore, the meeting was held in 2011, while NMED had been using budget estimates since July 2006.

## NMED Claimed Unallowable Costs

To demonstrate the effect of noncompliance on costs claimed by NMED under EPA awards, we initially selected a sample of 13 grants from the four NMED bureaus that were audited (see appendix A).

The noncompliance explained above applied to three of the 13 grants (one awarded to AQB and two awarded to the DWB). We identified unsupported labor and related costs of \$3,758,782 charged to the three grants due to the noncompliance. Table 2 below summarizes these costs.

In addition, NMED was unable to provide the required personnel activity reports for FY 2005 and FY 2006 for a grant awarded to SWQB, which is addressed in chapter 3 of this report. The remaining nine grants were in compliance and no costs were questioned.

**Table 2: Unallowable amounts by NMED bureau and cost category**

	Direct labor	Fringe benefits	Indirect costs	Total
<b>Reported to the EPA</b>				
<b>AQB</b>				
PM96666701	\$ 175,349	\$ 74,545	\$ 48,265	\$ 298,159
<b>DWB</b>				
F00620309	1,044,907	436,339	287,271	1,768,517
F00620311	728,575	287,327	189,899	1,205,801
<b>Subtotal DWB</b>	<b>1,773,482</b>	<b>723,666</b>	<b>477,170</b>	<b>2,974,318</b>
<b>Total Reported to the EPA</b>	<b>1,948,831</b>	<b>798,211</b>	<b>525,435</b>	<b>3,272,477</b>
<b>Unreported</b>				
<b>DWB</b>				
F00620311	294,854	108,853	82,598	486,305
<b>Grand Total</b>	<b>\$2,243,685</b>	<b>\$907,064</b>	<b>\$608,033</b>	<b>\$3,758,782</b>

Source: NMED accounting records.

Grant number PM96666701 was the only AQB grant included in our sample of 13 grants. The latest SF 425 Federal Financial Report available to us for this grant was dated October 24, 2011, which covers the period April 1, 2008, to September 30, 2011, and has a total of \$644,811 in federal share of expenditures. We obtained the supporting accounting reports from NMED and identified \$298,159 in labor, fringe benefits, and related indirect costs charged to the grant through June 25, 2010. These costs are not allowable for reimbursement because they were charged based upon budget estimates and did not comply with federal requirements.

DWB grant numbers F00620309 and F00620311 were also included in our sample. The latest FFR available to us for grant number F00620309 was dated December 2, 2010, which covers the period July 1, 2008, to June 30, 2010, and has a total of \$2,077,426 in federal share of expenditures. This amount reconciled to accounting records without exception. As described in a previous section of this report, DWB labor-charging practices through April 13, 2012, did not comply with 2 CFR Part 225, Appendix B, Section 8.h., and are not allowable for reimbursement. Labor, fringe benefits, and related indirect costs claimed through April 13, 2012, totaled \$1,768,517. This amount is unallowable for reimbursement because it was based upon budgeted or predetermined hours.

The latest FFR available to us for DWB grant number F00620311 was dated October 26, 2011, which covers the period July 1, 2010, to September 30, 2011, and has a total of \$1,401,216 in federal share of expenditures. We reconciled, with no exceptions, the \$1,401,216 to detailed accounting reports. Labor, fringe benefits, and related indirect costs recorded in accounting records through April 13, 2012, and included in the FFR, totaled \$1,205,801. This amount is not allowable for reimbursement.

We also identified an unreported amount of \$486,305 for grant number F00620311, which was recorded in accounting records after September 30, 2011 (the cut-off date of the most recent FFR) and through April 13, 2012 (the date DWB issued the new timekeeping procedures to record actual labor hours). This unreported amount is not allowable for reimbursement, because it was based upon budgeted or predetermined hours. Region 6 should ensure that NMED excludes this amount from subsequent claims for reimbursement.

We provided NMED with a written summary of the results of our audit on September 20, 2012, and obtained NMED's verbal comments in a meeting on October 3, 2012. NMED management stated that they are working on addressing the DWB issue, but they have reconstructed a work history report as support for labor charges through June 25, 2010 for AQB. The work history report was based upon data from an AQB project management system called "Envista." The system documented the time employees actually spent monitoring air quality for AQB projects across the state. We reviewed the work history report and determined the report does not meet federal requirements. The report summarized dates; employee names; site names; tasks performed; and the number of hours worked, which included monitoring times and minimum driving times. No other hourly data were included. However, to meet the requirements of 2 CFR Part 225, Appendix B, Section 8.h., the data would have to reflect an after-the-fact distribution of the employee's time and include the employee's total activity. The data would also have to be prepared at least monthly, coincide with one or more pay periods, and be signed by the employee. The work history report provided by NMED did not present the required information. As a result, we continue to question the costs.

## Recommendations

We recommend that the Region 6 Regional Administrator:

1. Disallow and recover unsupported labor costs of \$298,159 from AQB and \$2,974,318 from DWB, unless NMED can provide support that complies with 2 CFR Part 225, Appendix B, Section 8.h.
2. Ensure that NMED does not claim unsupported costs of \$486,305 for the period October 1, 2011, to April 13, 2012, for grant F00620311, unless NMED can provide support that complies with 2 CFR Part 225, Appendix B, Section 8.h.
3. Identify and recover any unsupported costs from AQB- and DWB-administered grants, which are not covered in our cost-impact determination.
4. Ensure that labor-charging practices at any of the remaining nine NMED bureaus that have EPA grants comply with federal requirements.

## EPA and Recipient Comments

The OIG received comments on the draft report from the Region 6 deputy regional administrator and the Office of the Secretary for NMED. We held an exit conference with Region 6 on April 25, 2013, and with NMED on April 24, 2013.

Region 6 agreed with our findings and recommendations 1, 2, and 4 and requested clarification on the scope of recommendation 3. For recommendations 1 and 2, the region stated that it will provide NMED the opportunity to submit documentation that substantiates the questioned costs and will take necessary corrective action, including the recovery of costs as appropriate. The region said it will address recommendation 4 as part of its compliance, review, and monitoring conducted under EPA Order 5700.6 A2 CHG 2. During our exit conference, Region 6 clarified that compliance-monitoring reviews only involve verifying that drawdowns were supported by source documentation. The reviews do not include interviews or other procedures to ensure that employees charge their time based on actual activities performed.

NMED did not address our recommendations by number. However, it responded to recommendation 4 by stating that staff who work on federal grants are now required to charge time and labor hours based on actual activities performed and maintain personal activity reports. It disagreed with the remaining recommendations by requesting that it not be required to return federal funds. In addition, NMED reiterated some of the comments provided during our fieldwork, but no additional information or supporting documentation was provided. The full text of NMED's comments is included in appendix C of this report.



## OIG Response

We agree with the actions Region 6 proposed. However, in connection with recommendations 1 and 2, Region 6 should ensure that the documentation complies with the timekeeping and labor-charging requirements of 2 CFR Part 225 when reviewing any additional documentation from NMED.

On recommendation 3, we clarified that Region 6 should include in its review all open and closed grants that are within the record-retention period established under 40 CFR § 31.42. Subsection (c) requires records to be retained for 3 years from the date of the final expenditure report. Furthermore, subsection (b)(2) states: “If any litigation, claim, negotiation, audit or other action involving the records has been started before the expiration of the 3-year period, the records must be retained until completion of the action and resolution of all issues which arise from it, or until the end of the regular 3-year period, whichever is later.” Additionally, we clarified that it would not be necessary to review labor charges to AQB grants after June 25, 2010, and DWB grants after April 13, 2012. Both bureaus complied with the federal requirements for labor charging after those dates.

We advised Region 6 that its regular compliance-monitoring reviews would not be adequate to address recommendation 4. Adequate review procedures need to be performed to ensure that employees charge their time based on actual activities performed, as required under 2 CFR Part 225.

Since NMED’s comments were already addressed in the draft report, no changes to the final report will be necessary. Our position on the reported findings and recommendations remains unchanged. The details of our responses to NMED’s comments are embedded as text boxes in appendix C.

# Chapter 3

## NMED Claimed Unsupported SWQB Labor Costs

NMED was unable to provide the required personnel activity reports to support costs claimed by SWQB for the period July 1, 2004, to June 30, 2006 (FYs 2005 and 2006). Title 2 CFR Part 225, Appendix A, requires all costs to be adequately documented, and Appendix B requires that where employees work on multiple activities or cost objectives, charges for salaries be supported by personnel activity reports or equivalent documentation that meets federal standards. Because of NMED's noncompliance, we questioned \$2,733,798 in labor, fringe benefits, and related indirect costs.

### NMED Was Unable to Provide Personnel Activity Reports

NMED could not provide the personnel activity reports required under 2 CFR Part 225 to support labor costs charged to the EPA by SWQB in FYs 2005 and 2006. We selected a labor sample from FY 2005 and requested supporting personnel activity reports such as timesheets. SWQB could not provide timesheets or equivalent documents signed by employees. SWQB personnel said NMED used a different timekeeping system prior to FY 2007, which began on July 1, 2006. Although SWQB employees maintained timesheets to accumulate actual hours and the timesheets were the basis for recording labor charges in the timekeeping system, the timesheets are no longer available. The SWQB finance manager said the hard-copy timesheets have been destroyed and the bureau can no longer access the prior accounting system to obtain copies of the electronic timesheets. We asked employees in our sample about their timekeeping practices in FY 2005. Employees confirmed their use of timesheets to record actual labor hours, but they did not have copies of these timesheets.

As a substitute for timesheets, the finance manager provided a labor-distribution report, which listed by pay period the hours and projects that each of the three employees in our sample charged. NMED personnel said that the labor-distribution report is an adequate alternative to providing personnel activity reports. However, labor-distribution reports do not contain employee signatures or other evidence of employees attesting to the hours charged.

### Federal Cost Principles Require Personnel Activity Reports

Title 2 CFR Part 225, Appendix A, Section C.1.j, requires all costs to be adequately documented. Title 2 CFR Part 225, Appendix B, Section 8.h., provides standards for support of salaries and wages under federal awards.

Appendix B, Section 8.h.(4), states that when employees work on multiple activities or cost objectives, the distribution of their salaries or wages will be

supported by personnel activity reports or equivalent documentation that meets the standards in Section 8.h.(5). Under Section 8.h.(5), the personnel activity reports are required to: (1) reflect an after-the-fact distribution of the actual activity of each employee, (2) account for the total activity for which each employee is compensated, (3) be prepared at least monthly and coincide with one or more pay periods, and (4) be signed by the employee.

The SWQB did not comply with these requirements. Instead, SWQB provided a labor-distribution report that provided the pay period, project number, hours charged to each project, associated dollar amounts, and various accounting codes for each employee. The labor-distribution report is a summary accounting report and does not represent personnel activity reports in accordance with 2 CFR Part 225, Appendix B, Section 8.h.(4) requirements. In addition, the labor-distribution report did not identify the data-entry date or the person, and entries were not signed by the employee.

Appendix B, Section 8.h.(3) states that when employees are expected to work solely on a single federal award or cost objective, charges for their salaries and wages will be supported by periodic certifications. These certifications will be prepared at least semiannually and will be signed by the employee or a supervisory official with first-hand knowledge of the work performed by the employee. NMED did not have these certifications.

## **NMED Claimed Unsupported Costs**

Under grant number C999610112, we identified \$2,733,798 in labor, fringe benefits, and related indirect costs incurred and claimed between July 1, 2004, and June 30, 2006. These costs are not allowable because NMED could not provide adequate supporting documents to comply with the CFR requirements. Grant number C999610112 was the only SWQB grant that was from our sample and active prior to July 1, 2006 (the beginning of FY 2007), and within the 3-year record-retention period. The grant period is July 1, 2004 to June 30, 2012. The latest FFR available to us for this grant was dated June 9, 2008, and covered the period July 1, 2004, to June 9, 2008.

The federal share of expenditures reported was \$7,069,500. A review of the accounting records provided by NMED showed that they incurred \$7,218,427, a difference of \$148,927 when compared to the amount NMED reported. NMED intends to submit an amended FFR showing the correct amount incurred.

## Recommendation

We recommend that the Region 6 Regional Administrator:

5. Disallow and recover unsupported SWQB labor costs of \$2,733,798 claimed under grant number C999610112, unless NMED can provide support that complies with federal requirements.

## EPA and Recipient Comments

Region 6 agreed with recommendation 5. The region stated that it will provide NMED the opportunity to submit documentation that substantiates the questioned costs and take necessary corrective action, including the recovery of costs as appropriate.

NMED did not address our recommendations by number, but disagreed with the recommendation by requesting that it not be required to return federal funds. NMED reiterated some of the comments provided during our fieldwork, but no additional information or supporting documentation was provided. The full text of NMED's comments is included in appendix C.

## OIG Response

We agree with the actions Region 6 proposed. However, when reviewing any additional documentation from NMED, Region 6 should ensure that the documentation complies with the timekeeping and labor-charging requirements of 2 CFR Part 225.

Since NMED's comments have already been discussed in the draft report, no changes to the final report will be necessary. Our position on the reported finding and recommendation remains unchanged. The details of our responses to NMED's comments are embedded as text boxes in appendix C.

## **Status of Recommendations and Potential Monetary Benefits**

RECOMMENDATIONS						POTENTIAL MONETARY BENEFITS (\$000s)	
Rec. No.	Page No.	Subject	Status <sup>1</sup>	Action Official	Planned Completion Date	Claimed Amount	Agreed-To Amount
1	11	Disallow and recover unsupported labor costs of \$298,159 from AQB and \$2,974,318 from DWB, unless NMED can provide support that complies with 2 CFR Part 225, Appendix B, Section 8.h.	U	Region 6 Regional Administrator		\$3,272	
2	11	Ensure that NMED does not claim unsupported costs of \$486,305 for the period October 1, 2011, to April 13, 2012, for grant F00620311, unless NMED can provide support that complies with 2 CFR Part 225, Appendix B, Section 8.h.	U	Region 6 Regional Administrator		\$486	
3	11	Identify and recover any unsupported costs from AQB- and DWB-administered grants, which are not covered in our cost-impact determination.	U	Region 6 Regional Administrator			
4	11	Ensure that labor-charging practices at any of the nine NMED bureaus that have EPA grants comply with federal requirements.	U	Region 6 Regional Administrator			
5	15	Disallow and recover unsupported SWQB labor costs of \$2,733,798 claimed under grant number C999610112, unless NMED can provide support that complies with federal requirements.	U	Region 6 Regional Administrator		\$2,734	

- 1 O = Recommendation is open with agreed-to corrective actions pending.  
 C = Recommendation is closed with all agreed-to actions completed.  
 U = Recommendation is unresolved with resolution efforts in progress.

## NMED Grants Selected for Review

Open grants										
NMED bureau	Grant number	Project start date	Project end date	Total project costs	Award amount	EPA share	Budgeted labor	Budgeted fringe benefits	Budgeted labor and fringe benefits	EPA's share of labor and fringe benefits
AQB	PM96666701-4	4/1/2008	3/30/2012	\$ 1,124,765	\$ 1,124,765	100%	\$ 334,742	\$ 110,465	\$ 445,207	\$ 445,207
DWB	F00620311-4	7/1/2010	6/30/2012	2,626,028	1,969,521	75%	1,478,994	530,045	2,009,039	1,506,779
GWQB	V96618901-E	4/1/2006	9/30/2012	6,690,241	6,246,635	93%	2,690,763	988,450	3,679,213	3,435,258
GWQB	RP96678901-3	10/1/2008	9/30/2013	2,193,750	2,193,750	100%	1,079,820	337,938	1,417,758	1,417,758
SWQB	I00635009-6	7/1/2009	12/31/2011	3,487,668	3,047,500	87%	2,071,564	741,553	2,813,117	2,458,082
SWQB	C999610112-5	7/1/2004	6/30/2012	12,835,033	7,219,500	56%	4,220,230	1,566,827	5,787,057	3,255,127
SWQB	C999610113-5	7/1/2007	6/30/2013	10,834,267	6,357,800	59%	3,393,900	1,227,630	4,621,530	2,712,021
SWQB	C999610114-5	7/1/2009	6/30/2015	7,926,400	4,719,800	60%	2,503,369	777,269	3,280,638	1,953,466
			<b>Subtotal</b>		<b>\$32,879,271</b>				<b>\$24,053,559</b>	<b>\$17,183,698</b>
Closed grants										
SWQB	I00635008-6	7/1/2007	12/31/2009	\$ 4,064,368	\$ 3,624,200	89%	\$ 2,133,440	\$ 709,136	\$ 2,842,576	\$ 2,534,727
DWB	F00620309-3	7/1/2008	6/30/2010	2,815,733	2,111,800	75%	1,382,897	559,414	1,942,311	1,456,733
GWQB	V97630201-5	7/1/2004	12/31/2009	6,111,111	5,500,000	90%	402,748	140,957	543,705	489,335
GWQB	V96618901-B	4/1/2006	9/30/2011	5,450,140	5,241,635	96%	2,265,057	832,541	3,097,598	2,979,094
GWQB	V96618901-C	4/1/2006	9/30/2011	5,887,473	5,660,635	96%	2,443,886	899,739	3,343,625	3,214,799
			<b>Subtotal</b>		<b>\$22,138,270</b>				<b>\$11,769,815</b>	<b>\$10,674,688</b>
			<b>Total</b>		<b>\$55,017,541</b>				<b>\$35,823,374</b>	<b>\$27,858,386</b>

Source: Bureau information is from NMED. All other information is from the EPA's IGMS.

## ***Region 6 Comments on the Draft Report***



**UNITED STATES ENVIRONMENTAL PROTECTION AGENCY**  
REGION 6  
1445 ROSS AVENUE, SUITE 1200  
DALLAS, TX 75202-2733

April 8, 2013

### **MEMORANDUM**

**SUBJECT:** Response to Office of Inspector General – Draft Report Project No. OA-FY12-0497  
“Labor Charging Practices at the New Mexico Environment Department” dated  
February 21, 2013

**FROM:** Sam Coleman  
Deputy Regional Administrator  
Region 6

**TO:** Robert K. Adachi  
Director of Forensic Audits  
Office of the Inspector General

As required by EPA Manual 2750, Part 2, Section B(3), I am providing for your review the proposed management decision in response to the recommendations listed in the Draft Report Project No. OA-FY12-0497 (“OIG report”). The audit provided five recommendations that affect the overall budget and subsequently operational capability of the New Mexico Environment Department (NMED) specifically its Air Quality (AQB), Surface Water Quality (SWQB), and Drinking Water (DWB) Bureaus.

Region 6 agrees with the Inspector General’s findings that three of the four NMED bureaus audited did not always comply with the federal requirements specified in 2 CFR Part 225. However, the OIG report acknowledges that the AQB and DWB have already implemented corrective actions and complied with federal requirements before the issuance of the OIG report. As described below, Region 6 agrees with Recommendations 1, 2, 4 and 5 and requests clarification on the scope of Recommendation 3.

To ensure that NMED is funded for the important work they completed under the assistance agreements examined by the OIG, the Region will provide NMED the opportunity to submit documentation that support the questioned costs. Region 6 will continue to assist NMED with their efforts to implement labor charging practices that comply with federal requirements.

*Recommendation No. 1. Disallow and recover unsupported labor cost of \$298,159 from AQB and \$2,974,318 from DWB unless NMED can provide support that complies with 2 CFR 225, Appendix B, Section 8.h.*

Region 6 will provide NMED the opportunity to submit documentation that substantiates the questioned costs. The Region will review the documentation and take necessary corrective action, including the recovery of costs as appropriate. It will also continue to assist NMED with their efforts to implement corrective actions and comply with federal requirements.

*Recommendation No. 2. Ensure that NMED does not claim unsupported cost of \$486,305 for the period of October 1, 2011, to April 13, 2012, for grant F00620311, unless NMED can provide support that complies with 2 CFR 225, Appendix B, Section 8.h.*

Region 6 will provide NMED the opportunity to submit documentation that substantiates the questioned costs. The Region will review the documentation and take necessary corrective action, including the recovery of costs as appropriate.

*Recommendation No. 3. Identify and recover any unsupported cost from AQB- and DWB-administered grants, which are not covered in our cost-impact determination.*

Region 6 requests clarification regarding the scope of this recommendation, including identification of the universe of assistance agreements that would have to be reviewed by the Region.

*Recommendation No. 4. Ensure that labor charging practices at any of the nine NMED bureaus that have EPA grants comply with federal requirements.*

Region 6 will specifically address compliance with 2 CFR Part 225, Appendix B, Section 8.h as part of its monitoring of NMED Bureaus under EPA Order 5700.6 A2 CHG 2, *Policy on Compliance, Review and Monitoring*. Additionally, Region 6 will establish Standard Procedures for Project Officers to use during Advanced Programmatic Reviews focused on the evaluation of labor charging practices by NMED Bureaus. Region 6 will continue to provide technical assistance to the NMED Bureaus to facilitate proper labor charging practices.

*Recommendation No. 5. Disallow and recover unsupported SWQB labor costs of \$2,733,798, unless NMED can provide support that complies with federal requirements.*

Region 6 will provide NMED the opportunity to submit documentation that substantiates the questioned costs. The Region will review the documentation and take necessary corrective action, including the recovery of costs as appropriate. It will also continue to assist NMED with their efforts to implement corrective actions and comply with federal requirements.

## **Conclusion**

Region 6 has a valued relationship with NMED and an obligation to manage grants in accordance with federal fiduciary and stewardship standards. The Region fully intends to continue working with NMED to resolve the findings of the OIG audit and take necessary corrective action. If you have any questions regarding this response, please contact Missy Milbeck, Comptroller at (214)665-6540 or Donna Miller, Grants Management Officer at (214)665-8093.

cc: F. David Martin, Secretary NMED



Butch Tongate, Deputy Secretary NMED  
Vince Lithgow, Chief Financial Officer NMED  
Arthur A. Elkins Jr., Inspector General  
Lela Wong, Project Manager, Office of Inspector General  
Howard Corcoran, Director, Office of Grants and Debarment

bcc: Ronnie Crossland, Acting ARA  
David Gray, External Affairs Division  
William Honker, Water Quality Protection Division  
David Garcia, Multimedia Planning and Permitting Division  
Missy Milbeck, Comptroller  
Susan Jenkins, Audit Liaison  
Donna Miller, Grants Management Officer

## ***NMED's Comments on the Draft Report and OIG Evaluation***



**SUSANA MARTINEZ**  
Governor  
**JOHN A. SANCHEZ**  
Lieutenant

*State of New Mexico*  
**ENVIRONMENT DEPARTMENT**

*Office of the Secretary*

Harold Runnels Building  
1190 Saint Francis Drive, PO Box 5469  
Santa Fe, NM 87502-5469  
Telephone (505) 827-2855 Fax (505) 827-2836  
www.nmenv.state.nm.us



**DAVE MARTIN**  
Secretary  
**BUTCH TONGATE**  
Deputy Secretary

April 8, 2013

Lela Wong  
Project Manager  
USEPA Office of the Inspector General  
75 Hawthorne Street, 7th Floor (IGA-1)  
San Francisco, CA 94105

RE: Response to OIG Report: Project No. OA-FY12-0497

Dear Ms. Wong:

The New Mexico Environment Department (NMED) offers the following responses for the findings contained within the Office of Inspector General audit report entitled *Labor-Charging Practices at the New Mexico Environment Department*, dated February 21, 2013. It is the position of the NMED that the deliverables required by each federal award were completed within the grant cycle. Additionally, all expenditures charged to the federal awards were legitimate, properly allocable and in direct function with the grant-related activities. The report appropriately does not allege that NMED committed fraud, waste or abuse; rather, a lack of proper procedural documentation of some of NMED's activities resulted in audit findings. Finally, in some cases, NMED both received written and verbal approval of our time and labor practices from EPA based on the time and labor practices which was percentage based.

**OIG Response 1.** As stated in chapter 1 of our report, the objective of our audit is to determine whether labor-charging practices at NMED comply with federal requirements and the effect of any noncompliance on amounts NMED claimed under EPA awards. We did not address grant deliverables or expenditures other than labor. We reported that three of the four NMED bureaus audited (DWB, AQB, and SWQB) did not always comply with the labor-charging requirements in 2 CFR Part 225.

In chapter 2 of our report under the subheading “**NMED Believed Charges Based on Budget Estimates Were Acceptable,**” we addressed NMED’s comment concerning the approval of its time and labor practices by the EPA.

Upon notification of the improper procedures and to fully comply with 2 CFR Part 225 the NMED changed the time and labor procedures. Staff who work on federal grants are now required to charge time and labor hour based on actual activities performed. Staff is required to maintain and upon request, provide personal activity reports justifying the work activities supported by the grant(s). In addition, signed certification from staff that work solely on federal grants are required and will be available upon request.

**OIG Response 2.** We acknowledged in our report under the “**Noteworthy Achievements**” subheading that current practices at the four bureaus audited are in compliance with federal requirements. It is NMED’s responsibility to ensure that its timekeeping practices continue to comply with federal requirements.

NMED also notes that there were no findings of non-compliance related to time and labor reporting that qualified the opinion of the Single Audit for the time periods involved, with the only exception being for the State Fiscal Year 2012 Single Audit. The qualification was based on the disclosure of the OIG Audit. Additionally, year-end reviews with each grant program and EPA have all been favorable and the NMED has never been notified that the agency had been conducting business improperly or contrary to 2 CFR 225 standards.

**OIG Response 3.** We addressed this comment in chapter 2 of our report under the “**NMED Believed Charges Based on Budget Estimates Were Acceptable**” subheading, paragraphs 2 and 3. It appears that the single auditor had different criteria for risk assessment from the OIG. Risk assessment method and criteria may vary for each audit based on the auditor’s judgment. An audit provides reasonable but not absolute assurance that the information presented is free of material misstatement.

We also discussed programmatic reviews with Region 6 staff. They indicated their reviews verified the drawdowns were supported by source documentation. The reviews did not include interviews and other procedures to ensure that labor-charging practices comply with federal requirements.

NMED is disappointed that the IOG audit team did not accept documentation which verifies that NMED staff worked on the activities of the grants in question. Documentation included a work history report that identifies staff, travel dates, description of work activity, time and labor costs, and travel costs. The NMED also provided copies of e-mails and meeting notes that, in our opinion, clearly indicated that EPA was aware of and approved the time and labor procedures.

**OIG Response 4.** We addressed the documentation cited above and explained why the documentation did not comply with federal requirements. Details of the work history reports can be found in chapter 2 of our report under the subheading “**NMED Claimed Unallowable Costs,**” last paragraph. EPA’s approval was addressed in chapter 2 of our report under subheading “**NMED Believed Charges Based on Budget Estimates Were Acceptable,**” last two paragraphs.

NMED would also like to point out that the difficulty in supplying supporting documentation for some grants is based on the fact that the time period covered by a single grant extended several years – in one case from July 4, 2004 through June 30, 2012. If the time periods between the issuance and completion of each grant were shorter, it would be significantly less burdensome to reconcile labor charges with applicable funding sources. Financial software changes and staff changes limit the state’s ability to retain historical knowledge and documentation through the extended life of the grant and retention period.

**OIG Response 5.** We indicated in chapter 1 of our report that all of the grants in our review were within the records-retention period. Title 40 CFR § 31.42(b) states that records must be retained for 3 years from the date the recipient submits its final expenditure report.

NMED and EPA have discussed several times the need for training by EPA’s grant management staff. At a minimum, the training should cover the accountability measures that should be followed by both grantee and grantor financial and program staff to ensure that grant activities are accurately recorded and appropriately funded. The requirement for such training would be a reasonable recommendation to address the OIG’s audit findings.

**OIG Response 6.** Training on the proper procedures for identifying, accumulating and reporting labor costs would help to eliminate the problems we noted during our review. However, it is NMED’s responsibility to ensure that its employees obtain the proper training to comply with federal requirements.

The NMED respectfully requests that the agency should not be required to return any federal dollars. A punitive penalty to the NMED would jeopardize the ability to perform the day to day functions of the agency. The NMED is not in a position financially to fully support the functions and activities required by our mission without co-reliance on the federal awards to assist in meeting the objectives of the agency. At this time EPA and NMED are working collaboratively to justify expenditures were appropriate.

**OIG Response 7.** It is the responsibility of Region 6 to determine whether funds should be returned, not the OIG. In addition, NMED can only be reimbursed for expenditures that comply with federal requirements. As stated in our audit report, NMED's labor-charging practices did not comply with federal requirements.

Sincerely,

F. David Martin  
Cabinet Secretary

***Distribution***

Regional Administrator, Region 6  
Deputy Regional Administrator, Region 6  
Director, Grants and Interagency Agreements Management Division,  
Office of Administration and Resources Management  
Agency Follow-Up Official (the CFO)  
Agency Follow-Up Coordinator  
Audit Follow-Up Coordinator, Region 6  
Public Affairs Officer, Region 6  
Secretary, New Mexico Environment Department