



U.S. ENVIRONMENTAL PROTECTION AGENCY
OFFICE OF INSPECTOR GENERAL

Catalyst for Improving the Environment

Attestation Report

Costs Claimed by the Alaska Native Tribal Health Consortium Under EPA Interagency Agreement DW 75-95754001

Report No. 10-4-0241

September 30, 2010



Report Contributors:

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Abbreviations

ANTHC	Alaska Native Tribal Health Consortium
CFR	Code of Federal Regulations
CPA	Cooperative Project Agreement
DEHE	Division of Environmental Health and Engineering
EPA	U.S. Environmental Protection Agency
HHS	U.S. Department of Health and Human Services
IA	Interagency Agreement
IHS	Indian Health Service
OGC	Office of General Counsel
OIG	Office of Inspector General
OMB	Office of Management and Budget
PFA	Project Funding Agreement
VSW	Village Safe Water

Cover photo: New Stuyahok, Alaska, sewage lagoon constructed by ANTHC and partially funded by IA DW 75-95754001. (Photo obtained from ANTHC Website)



At a Glance

Catalyst for Improving the Environment

Why We Did This Examination

The U.S. Environmental Protection Agency's (EPA's) Office of Inspector General reviewed outlays reported under Interagency Agreement (IA) DW 75-95754001 by the Alaska Native Tribal Health Consortium (ANTHC). The purpose of the audit was to determine whether ANTHC complied with federal requirements applicable to EPA funding provided by the IA.

Background

EPA awarded the IA to the Indian Health Service (IHS). The IA became effective in July 2005 and provides sanitation facilities for native communities in Alaska. IHS is providing the facilities funded by the IA through sub-agreements with ANTHC. The IA as amended provides \$22,226,077 in federal assistance from EPA.

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

To view the full report, click on the following link:
www.epa.gov/oig/reports/2010/20100930-10-4-0241.pdf

Costs Claimed by the Alaska Native Tribal Health Consortium Under Interagency Agreement DW 75-95754001

What We Found

ANTHC did not meet financial management requirements specified by Title 2, Code of Federal Regulations, Part 225. In particular, ANTHC:

- Claimed indirect costs without approved rates or a certified proposal,
- Claimed labor costs that were not allocable,
- Claimed equipment costs that were not allocable,
- Claimed freight and material costs that were not allocable, and
- Claimed subcontract costs that were not allocable or allowable.

Because of these issues, EPA needs to recover \$1,007,690 of costs questioned under the IA. These issues also necessitate that EPA evaluate and other federal agencies and the State of Alaska consider evaluating costs claimed by ANTHC under other funding agreements.

What We Recommend

We recommend that EPA Region 10's Regional Administrator: (1) disallow \$1,493,893 in questioned costs, (2) recover \$1,007,690 in questioned costs, (3) require IHS to direct ANTHC to establish controls to ensure costs claimed under the IA meet federal financial criteria, (4) designate ANTHC as a "high-risk" recipient and require special conditions that establish additional oversight and monitoring, and (5) evaluate costs claimed by ANTHC under other open funding agreements to ensure costs meet federal criteria.

Region 10, IHS, and ANTHC disagreed with the findings and recommendations. However, ANTHC provided a proposed management improvement plan with its comments on the draft report to address some of the issues identified during our examination. The recommendations are undecided pending resolution.



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

THE INSPECTOR GENERAL

September 30, 2010

MEMORANDUM

SUBJECT: Costs Claimed by the Alaska Native Tribal Health Consortium Under
EPA Interagency Agreement DW 75-95754001
Report No. 10-4-0241

FROM: Arthur A. Elkins, Jr.
Inspector General

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

TO: Dennis McLerran
Regional Administrator, Region 10

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

The estimated cost of this report – calculated by multiplying the project's staff days by the applicable daily full cost billing rates in effect at the time – is \$750,973.

Action Required

In accordance with EPA Manual 2750, Chapter 3, Section 6(f), you are required to provide us your proposed management decision for resolution of the findings contained in this report before you formally complete resolution with the recipient. As part of the audit resolution process, your proposed decision is due in 120 days, or on January 27, 2011. To expedite the resolution process, please e-mail an electronic version of your proposed management decision to adachi.robert@epa.gov. Your response will be posted on the OIG's public Website, along with our comments on your response. Your response should be provided in an Adobe PDF file that complies with the accessibility requirements of section 508 of the Rehabilitation Act of 1973, as amended. If your response contains data that you do not want to be released to the public, you should identify the data for redaction. You should include a corrective actions plan for agreed-upon actions, including milestone dates.

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 Robert Adachi at (415) 947-4537 or adachi.robert@epa.gov, or Michael Owen at (206) 553-2542 or owen.michael@epa.gov.

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Introduction

Purpose

The Office of Inspector General (OIG) reviewed outlays reported for projects included under U.S. Environmental Protection Agency (EPA) Interagency Agreement (IA) DW 75-95754001 by the Alaska Native Tribal Health Consortium (ANTHC). The general objective of this audit was to determine whether ANTHC complied in all material respects with federal requirements applicable to EPA funding provided by the IA. To meet the objective, the audit addressed the following questions:

- Are costs claimed by ANTHC for projects funded through IA DW 75-95754001 reasonable, allocable, and allowable?
- Are ANTHC accounting and billing practices for funding through IA DW 75-95754001 in accordance with Title 2, Code of Federal Regulations (CFR), Part 225 (Office of Management and Budget Circular A-87)?

Background

EPA Region 10 awarded IA DW-75-95754001 to the Indian Health Service (IHS) with an effective date of July 14, 2005. The IA was awarded under Section 518 (c) of the Clean Water Act of 1987, as amended by Public Law 100-4, to provide sanitation facilities for native communities in Alaska. IHS is providing the facilities funded by the IA through sub-agreements with ANTHC. Under the sub-agreements, ANTHC's Division of Environmental Health and Engineering (DEHE) is managing the construction of the sanitation facilities. The IA's budget period started September 1, 2005, and ends June 30, 2016. The IA has been amended four times and provides \$22,226,077 in EPA funding and \$12,488,734 in IHS funding (or \$34,714,811) for 33 facilities projects.

Independent Attestation Report

As part of our oversight of IA awards by EPA, we have examined ANTHC's compliance with the requirements of Title 2 CFR Part 225 (*Cost Principles for State, Local, Indian Tribal Governments*) applicable to the outlays for IA DW 75-95754001. By accepting the funding provided through the IA, ANTHC has responsibility for complying with these requirements. Our responsibility is to express an opinion on ANTHC's compliance based on our examination.

Our examination was conducted in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States. Our review was also conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence supporting management's assertion and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

We made site visits to EPA Region 10's offices in Seattle, Washington, and Anchorage, Alaska, and performed the following steps:

- Reviewed EPA IA DW 75-95754001 awarded to IHS and its modifications to determine criteria relevant to the examination.
- Reviewed all payments made under the IA to determine whether there were any indicators of irregularities.
- Reviewed progress reports for projects funded by the IA.
- Conducted interviews with EPA's project officer for the IA to gather information concerning ANTHC's performance under the IA.

We made site visits to IHS' office in Anchorage, Alaska, and performed the following steps:

- Reviewed records showing payments made to ANTHC under the IA.
- Interviewed IHS managers to gain an understanding of their oversight and monitoring activities for project work and payments funded under the IA.

We made site visits to the ANTHC's DEHE office in Anchorage, Alaska, and performed the following steps:

- Reviewed requests for reimbursement to IHS under the IA.
- Selected a judgmental sample of costs reported in ANTHC's accounting system as incurred under the IA for the period ending January 29, 2009. Of the 33 projects funded by the IA, we selected cost transactions for the six projects with the highest recorded costs. The recorded costs for the six projects represented 74 percent of the \$9,878,940 in total recorded costs. We judgmentally selected transactions for each major cost type from the six projects to obtain an understanding of accounting and billing practices and to determine whether costs were reasonable, allocable, and allowable. Our judgmental

sample represented \$3,424,611 of the \$9,878,940 (or approximately 35 percent) in total costs reported under the IA. Because we judgmentally selected the transactions, we did not project our results to the total recorded costs.

- Reviewed support for the judgmental sample of \$3,424,611 in costs reported under the IA, including ANTHC's electronic accounting records, invoices, cancelled checks, and contracts.
- Conducted interviews of ANTHC personnel to gain an understanding of the organization's accounting system, internal controls, and costs reported under the IA.

We also made site visits to the State of Alaska Village Safe Water (VSW) program in Anchorage, Alaska, and performed the following steps:

- Interviewed State of Alaska management and staff to gain an understanding of costs incurred under the IA for project work managed by the state.
- Reviewed support for a judgmental sample of \$686,821 in costs incurred by VSW for projects funded through the IA and reported in ANTHC's accounting system as subcontract costs. The \$686,821 sample was part of the \$3,424,611 total judgmental sample of costs reported in ANTHC's accounting system as incurred under the IA. The support for the costs included invoices and contracts.

We conducted our audit work between February 2009 and January 2010. Our examination disclosed noncompliance and internal control weaknesses with financial management. In particular, the ANTHC:

- Claimed indirect costs without approved rates or a certified cost proposal,
- Claimed labor costs that were not allocable,
- Claimed equipment costs that were not allocable,
- Claimed freight and material costs that were not allocable, and
- Claimed subcontract costs that were not allocable or allowable.

As a result, we have questioned costs of \$1,493,893 and recommend EPA recover \$1,007,690 of these costs.

ANTHC is an inter-tribal consortium as defined by section 501(a)(5) of the Indian Self Determination and Education Assistance Act, Public Law 93-638, as amended. ANTHC is also a non-profit corporation and was formed for the purpose of providing all statewide health services to Alaska Native Americans. The IA was awarded under Section 518 (c) of the Clean Water Act of 1987. Section 518 (c) limits the funding for the IA to federally recognized Native American tribes. Therefore, ANTHC qualifies for the funding as a federally recognized tribal organization. As a tribal recipient of federal funding under the IA, ANTHC is obligated to comply with Title 2 CFR Part 225.

In our opinion, because of the effect of the issues described above, ANTHC has not complied with federal requirements for the period ending January 29, 2009.

A handwritten signature in black ink, reading "Robert K. Adachi", is displayed on a light blue rectangular background.

Robert K. Adachi
Director for Forensic Audits

Results of Examination

ANTHC did not meet financial management requirements specified by Title 2 CFR Part 225. In particular, ANTHC:

- Claimed indirect costs without approved rates or a certified proposal,
- Claimed labor costs that were not allocable,
- Claimed equipment costs that were not allocable,
- Claimed freight and material costs that were not allocable, and
- Claimed subcontract costs that were not allocable or allowable.

Because of these issues, EPA needs to recover \$1,007,690 of \$1,493,893 in costs questioned under the IA. The questioned costs identified during the audit were primarily caused by a miscommunication between ANTHC and the U.S. Department of Health and Human Services (HHS) on the application of approved indirect rates and ANTHC's unfamiliarity with or misinterpretation of:

- Federal indirect cost rate requirements,
- Basic criteria specified by federal cost principles, and
- Federal criteria for charging equipment costs.

Based on the findings above, ANTHC does not meet the minimum requirements for a financial management system and should be designated as a "high-risk" recipient in the Integrated Grants Management System. Also, special conditions should be imposed on all current and future awards of EPA funds to ANTHC.

Table 1 on the following page is a summary of the questioned costs.

Table 1: Summary of Questioned Costs

Cost Category	Questioned Costs Incurred	Questioned Costs Claimed	Note
Indirect	351,072	181,494	1
Labor	155,017	125,953	2
Equipment	326,531	182,893	3
Freight	4,999	4,235	4
Material	337,075	285,581	5
Subcontract	319,199	227,534	6
Total Costs Questioned	\$1,493,893	\$1,007,690	7
Amount Owed to EPA		\$1,007,690	

Sources: Costs recorded in ANTHC's accounting system as of January 29, 2009. Costs questioned were based on OIG analysis of the costs.

- Note 1: See discussion under "Indirect Costs Claimed without Approved Rates or Certified Proposal" section below.
- Note 2: See discussion under "Labor Costs Not Allocable to IA" section below.
- Note 3: See discussion under "Equipment Costs Not Allocable to IA" section below.
- Note 4: See discussion under "Freight Costs Not Allocable to IA" section below.
- Note 5: See discussion under "Material Costs Not Allocable to IA" section below.
- Note 6: See discussion under "Subcontract Costs Not Allocable to IA or Allowable" below.
- Note 7: Total Questioned Costs Claimed represent questioned costs that have been reimbursed to ANTHC under the IA.

Indirect Costs Claimed Without Approved Rates or Certified Proposal

ANTHC incurred indirect costs of \$351,072 under the IA that did not meet the requirements of Title 2 CFR Part 225. Title 2 CFR Part 225, Appendix E, Sections D and E require an organization claiming indirect costs under a federal award to either: (1) submit an indirect cost rate proposal for negotiation and approval to the cognizant federal agency or (2) maintain a certified proposal and supporting documentation on file for audit. During fiscal years 2008 and 2009, ANTHC incurred \$77,231 in indirect costs for its corporate office and allocated these costs to projects funded by the IA and managed by its DEHE. However, ANTHC only had approved indirect cost rates for fiscal years 2006 and 2007 that were applicable for indirect costs incurred by the corporate office for construction projects. ANTHC also did not have approved indirect cost rates or a certified indirect cost rate proposal on file to support \$273,841 in indirect costs for DEHE allocated during fiscal years 2007 through 2009 to projects funded by the IA. As a result, we question the \$351,072 of indirect costs incurred under the IA as not allocable. Of the \$351,072, ANTHC claimed \$181,494 for reimbursement under the IA.

Labor Costs Not Allocable to IA

ANTHC incurred labor costs of \$155,017 under the IA that did not meet the requirements of Title 2 CFR Part 225. The \$155,017 consisted of \$128,925 in labor costs transferred to a project funded by the IA and \$26,092 of indirect costs. Title 2 CFR Part 225, Appendix A, Section C.1.b, states that a cost must be allocable to the award in order to be allowable. Title 2 CFR Part 225, Appendix A, Section C.3.c requires that any cost allocable to a particular award or other cost objective may not be shifted to other federal awards to overcome funding deficiencies or to avoid restrictions imposed by law or by terms of the award.

ANTHC incurred labor costs of \$128,925 that were transferred from a project that is not funded by the IA. ANTHC transferred \$128,925 in costs from one phase of a sewer project for the City of Fort Yukon that was funded by an EPA infrastructure grant to another phase of the project that was funded by the IA. At the time of the transfer, ANTHC had exceeded the funding limit for the infrastructure grant. ANTHC could not demonstrate that the transferred costs benefited the IA. Therefore, we question the \$128,925 in labor costs as not allocable to the IA. ANTHC claimed \$109,229 of the \$128,925 in questioned costs for reimbursement under the IA.

ANTHC also incurred indirect costs of \$26,092 that were coded as labor costs for DEHE in the accounting system. As discussed earlier in the report, ANTHC did not have the required approved indirect cost rate agreements or a certified indirect cost rate proposal on file to support the costs incurred by DEHE. As a result, we question the \$26,092 as an unallowable cost. Of the \$26,092, ANTHC claimed \$16,724 for reimbursement under the IA.

Equipment Costs Not Allocable to IA

ANTHC incurred equipment costs of \$326,531 under the IA that were either not allocable or allowable. These costs are summarized in Table 2 and discussed in detail below.

Table 2: Equipment Costs Not Allocable or Allowable

Description	Cost
Equipment Cost Transfer Not Allocable to IA	\$ 74,833
Indirect Costs Classified as Equipment Costs Not Allocable to IA	24,481
Equipment Purchase Not Allocable to IA	227,217
Total Equipment Costs	\$326,531

Source: Costs recorded in ANTHC's accounting system and OIG analysis of the costs.

Equipment Cost Transfer Not Allocable to IA

ANTHC transferred a \$74,833 equipment cost that was not allocable to a project funded by the IA for the City of Saint Michael. The transferred cost was incurred for a water truck and originally charged in the accounting system to another project for the City 2 years before the IA was awarded. However, the cost was transferred to a newer project funded by the IA requiring a septic tank pumper truck. ANTHC management stated that the transfer was a mistake and agreed to reverse the entry in the accounting system. Therefore, we question the \$74,833 as not allocable to the IA. ANTHC claimed 100 percent of the questioned cost for reimbursement under the IA.

Indirect Costs Classified as Equipment Costs Not Allocable to IA

ANTHC also incurred equipment rental fees of \$24,481 under the IA that were indirect costs for DEHE. These indirect costs were included as an overhead component of ANTHC's equipment rental fee methodology that was implemented in October 2007. As discussed earlier in the report, ANTHC did not have the required approved indirect cost rate agreements or a certified indirect cost rate proposal on file to support the costs incurred by DEHE. Therefore, we could not verify the cost as allocable to the IA. As a result, we question the \$24,481 in costs as not allocable to the IA. Of the \$24,481, ANTHC claimed \$14,749 for reimbursement under the IA.

Equipment Purchase Not Allocable

ANTHC also purchased equipment with a cost of \$227,217 that was not fully allocable to the IA. ANTHC's justification for the purchase identified that the equipment was intended to be funded by a 2005 water and sewer project for the City of Fort Yukon. This project was funded through two federal sources. Approximately 49 percent of the project was funded by IHS and the remaining 51 percent through the IA. However, ANTHC allocated 100 percent of the equipment costs to a 2007 sewer project funded by EPA under the IA for the City of Fort Yukon. Because the justification for the equipment purchase did not support that the cost was allocable to the 2007 EPA-funded work, we question the \$227,217. ANTHC claimed \$93,311 of the \$227,217 in questioned costs for reimbursement under the IA.

Freight Costs Not Allocable to IA

ANTHC transferred \$4,999 in freight costs that were not allocable to a project funded by the IA. ANTHC transferred \$4,999 in freight costs from a safe drinking water project for the City of Hughes to the IA-funded part of a water and sewer project for the City of Fort Yukon. ANTHC management stated that the transfer was made in error and it agreed to reverse the entry in the accounting system. Therefore, we question the \$4,999 freight costs incurred under the IA. ANTHC claimed \$4,235 of the \$4,999 for reimbursement under the IA.

Material Costs Not Allocable to IA

ANTHC transferred \$337,075 in material costs that were not allocable to the IA. ANTHC initially charged the material costs to a phase of a City of Fort Yukon sewer project that was not funded by the IA. After completion of this phase, ANTHC transferred 100 percent of the material costs to a newer phase of the project that was funded by the IA. However, ANTHC's documentation supporting the costs did not demonstrate that the transferred costs benefitted the IA. As a result, we question the \$337,075 in material costs incurred under the IA. Of the \$337,075 in questioned costs, ANTHC claimed \$285,581 for reimbursement under the IA.

Subcontract Costs Not Allocable to IA or Allowable

ANTHC incurred subcontract costs of \$319,199 under the IA that were either not allocable or allowable. These costs are summarized in Table 3 and discussed in detail below.

Table 3: Subcontract Costs Not Allocable or Allowable

Description	Cost
Subcontract Costs Transfers Not Allocable to IA	\$130,622
Subcontract Costs for Equipment Rental Fees Not Allowable	188,577
Total Questioned Subcontract Costs	\$319,199

Source: Costs recorded in ANTHC's accounting system and OIG analysis of the costs.

Subcontract Costs Transfers Not Allocable to IA

ANTHC made two transfers of subcontract costs totaling \$130,622 that were not allocable to the IA. The cost transfers were from two projects supported by State of Alaska and EPA funding unrelated to the IA to two projects funded by the IA. One transfer removed \$120,000 of subcontract costs originally incurred under a 2003 sewer project for the City of Fort Yukon to a newer sewer project for the City. This transfer was based on a lump-sum amount rather than specific cost transactions. ANTHC also transferred \$10,622 in subcontract costs from an older sewer project for the City of Saint Michael to a newer sewer project for the City based on cost-overruns on the older project. The supporting documentation for both transfers did not provide an explanation and justification for the transfers. Therefore, we could not verify whether the transferred subcontract costs actually benefitted the two projects funded by the IA, and we question the \$130,622. ANTHC claimed \$112,290 of the \$130,622 in questioned costs for reimbursement under the IA.

Unallowable Subcontract Costs for ANTHC-Owned Equipment

ANTHC incurred \$188,577 in subcontract costs that were not allowable under the IA. These subcontract costs represented usage fees for ANTHC-owned equipment used for projects funded by the IA. Title 2 CFR Part 225, Appendix B, Sections 11 and 25, specifies that allowable equipment costs consist of depreciation based on acquisition cost and necessary maintenance and repair costs. ANTHC determined the equipment usage costs based on a methodology that charged 50 percent of the applicable rates listed in the *Rental Rate Blue Book*. However, ANTHC was unable to provide complete cost documentation showing that the equipment fees incurred under the IA did not exceed the allowable depreciation, maintenance, and repair costs as specified by Title 2 CFR Part 225. ANTHC was able to provide satisfactory depreciation documentation for the equipment, but was unable to provide documentation showing actual maintenance and repair costs incurred for the equipment. ANTHC was unable to provide the documentation because it pools the maintenance and repair costs rather than accounting for the costs by individual equipment item. Title 2 CFR Part 225, Appendix A, Section F.1, defines indirect costs as those that have been incurred for common or joint purpose benefitting more than one cost objective and are not readily assignable to the cost objectives specifically benefitted. Because the pooled costs cannot be readily identified to a specific item of equipment, the costs are considered indirect costs under Title 2 CFR Part 225. As discussed earlier in the report, ANTHC did not have the required approved indirect cost rate agreements or a certified indirect

cost rate proposal on file to support the costs incurred by DEHE. We questioned \$188,577 incurred under the IA as unallowable because ANTHC was unable to demonstrate that the costs met the equipment and indirect cost requirements of Title 2 CFR Part 225. Of the \$188,577, ANTHC claimed \$115,244 for reimbursement under the IA.

Primary Causes for Questioned Costs

The questioned costs identified during the audit were primarily caused by a miscommunication between ANTHC and HHS on the application of approved indirect rates and ANTHC's incorrect interpretation of federal indirect cost rate requirements, ANTHC's incorrect interpretation of the basic criteria specified by federal cost principles, and ANTHC's unfamiliarity with federal criteria for charging equipment costs.

Indirect Rates Were Not Clearly Communicated by Cognizant Agency and ANTHC Misinterpreted Federal Requirements

ANTHC claimed indirect costs on construction projects that were not allocable to the IA as a result of two primary issues. First, ANTHC management and staff from HHS, the cognizant federal agency responsible for approving ANTHC's indirect rates, did not clearly communicate about the applicability of the approved rates. Second, ANTHC management misinterpreted Region 10's guidance and Title 2 CFR Part 225 requirements for indirect costs.

ANTHC incurred \$77,231 in questioned costs based on indirect rate cost proposals approved by HHS. However, the indirect cost rates did not apply to ANTHC construction projects for fiscal years 2008 and 2009. The approved rates covered indirect costs incurred by ANTHC's corporate office for the support of hospital and non-hospital operations. Although ANTHC's indirect cost proposals submitted to HHS included indirect costs incurred for the support of construction projects, HHS excluded these costs from the approved rates for fiscal years 2008 and 2009. According to ANTHC management, they believed from discussions with the HHS staff involved in the approval process that the approved rates for non-hospital operations were allowable rates for claiming the corporate office's indirect costs incurred for supporting construction projects.

ANTHC also incurred \$273,841 in questioned indirect costs based on an allocation methodology that was developed by DEHE, but was not certified, fully documented, and maintained on file as required by Title 2 CFR Part 225, Appendix E. As discussed earlier in the report, ANTHC also incurred costs under the Labor category that we questioned because they were indirect costs and not based on approved indirect cost rates or a certified indirect cost rate proposal. These other indirect costs totaled \$26,092. Our discussion with ANTHC management and review of supporting documentation disclosed that they did not pursue obtaining approved rates for these costs based on general guidance from Region 10 staff. Region 10 staff advised ANTHC management in August 2008 that an allocation plan was an acceptable substitute for approved indirect costs rates under federal regulations. Region 10's guidance was based on Title 2 CFR Part 225. Despite the Region's guidance, ANTHC did not maintain a certified indirect cost rate proposal or allocation plan on file supporting DEHE's indirect costs incurred under the IA. Therefore, our review indicated that ANTHC management had misinterpreted Region 10's guidance and Title 2 CFR Part 225 requirements for indirect costs.

ANTHC Misinterpreted Basic Federal Cost Principles

ANTHC management's incorrect interpretation of the basic cost principles specified by Title 2 CFR Part 225 led to \$903,671 of the \$1,493,893 in total questioned costs. We questioned \$676,454 of the \$903,671 because ANTHC transferred costs from projects supported through other agreements and EPA and State of Alaska funding sources. ANTHC incurred these costs under the Labor, Equipment, Freight, Materials and Subcontracts categories. As discussed earlier in the report, supporting documentation for these transferred costs did not show that they were allocable to the projects funded under the IA. We also questioned \$227,217 incurred for an equipment purchase because the justification did not show that the cost was allocable to the IA.

During discussions with ANTHC about the costs incurred under the IA, ANTHC management explained that ANTHC constructs large projects at Alaskan Native villages through a series of smaller projects or phases that are funded by several sources. The management said that pulling funding from several sources to pay for a large project makes it difficult to track costs by funding source. According to the management, the transfers were made because costs were managed and tracked as large projects and not by funding source. They said they did not believe that the lack of tracking by individual village project phase and funding source was a problem as long as the scopes of work for projects funded by the IA and other sources are completed. The management also said that they believed that ANTHC had met federal financial management requirements. Therefore, our discussions with ANTHC management disclosed that they had misinterpreted basic federal cost principles. One of these principles is specified by Title 2 CFR Part 225, Appendix A, Section C.1.b. Section C.1.b states that a cost must be allocable to the award in order to be allowable. To meet this criterion, ANTHC must account for costs by each specific project phase and funding source.

ANTHC Believed That Equipment Usage Fees Met Federal Criteria

ANTHC incurred a total of \$213,058 for equipment usage fees that were not allowable or allocable because ANTHC management believed the costs met applicable federal cost criteria. The \$188,577 of equipment usage fees questioned as not allocable under the Subcontracts cost category was based on the *Rental Rate Blue Book* rates that were discounted by 50 percent. The management said it believed that the rates listed in the *Rental Rate Blue Book* were allowable under federal awards because the Federal Highway Commission has approved the use of the book on federally funded projects. The management explained that ANTHC inherited this methodology from IHS and used it for charging equipment usage fees to projects until October 2007. According to ANTHC management, the fees claimed under this methodology did not cover all costs incurred for the equipment. However, as discussed previously in the report, ANTHC was unable to provide supporting cost data showing that the rental fees claimed under the IA met cost criteria specified by Title 2 CFR Part 225. Title 2 CFR Part 225, Appendix B, Sections 11 and 25, limit equipment costs claimed under federal awards to depreciation based on acquisition cost and necessary maintenance and repair costs. Title 2 CFR Part 225, Appendix E requires, at a minimum, a certified cost proposal for indirect costs associated with equipment.

Equipment usage costs of \$24,481 were questioned as unallowable because they represented indirect costs. ANTHC determined these costs based on a new equipment usage rate methodology implemented in October 2007 to replace the *Rental Rate Blue Book* methodology. ANTHC management believed that the new methodology met Federal criteria because it consists of the following three components: (a) depreciation on equipment, (b) a fair and reasonable share of idle equipment costs, and (c) a fair and reasonable share of overhead costs for the support of equipment. However, the new methodology does not meet the cost criteria specified by Title 2 CFR Part 225 because the overhead component of the methodology represents indirect costs. Therefore, the equipment overhead costs should be included as part of ANTHC's approved indirect cost rates or certified indirect cost rate proposal as specified by Title 2 CFR Part 225, Appendix E.

Conclusion

Based on the findings above, ANTHC does not meet the minimum requirements for a financial management system and should be designated as a "high-risk" recipient in the Integrated Grants Management System. Under Title 40 CFR Part 31.12(a)(1) and (a)(3), a grantee may be considered high-risk if an awarding agency determines that a grantee has: (a) history of unsatisfactory performance, or (b) a management system which does not meet the management standards set forth in the regulation. Title 40 CFR Part 31.12(a)(5) also requires that special conditions and/or restrictions be included in awards to high-risk grantees. Therefore, we recommend that special conditions be imposed on all current and future direct and indirect awards of EPA funds to ANTHC. The special conditions should include: (a) payment on a reimbursement basis; including payments to IHS when funding is provided indirectly to ANTHC through an IA; (b) EPA review and approval of reimbursement requests prior to payment; and (c) additional project monitoring by EPA project managers.

Our evaluation of ANTHC's accounting system and internal controls also identified that EPA and other funding agencies have no assurance that costs claimed for projects and services are allocable to their funding agreements with ANTHC. As discussed in the report, we questioned \$676,454 of unallocable costs that were transferred to projects funded by the IA. We also identified during the evaluation that ANTHC transferred \$217,189 in freight costs from a project funded by the IA to a project funded by the State of Alaska's Village Safe Water and the U.S. Department of Agriculture's Rural Development programs. We did not question these costs because they were not claimed under the EPA IA. However, the \$217,189 transfer shows that this issue is not limited to costs claimed under the IA we reviewed. Therefore, Region 10 should evaluate costs claimed under other EPA agreements that fund construction projects managed by ANTHC. The U.S. Department of Housing and Urban Development, the U.S. Department of Agriculture, the Denali Commission, and the State of Alaska also provide funding to ANTHC for construction projects. They should consider also evaluating costs claimed by ANTHC for construction projects funded by their agreements.

Recommendations

We recommend that Region 10's Regional Administrator:

1. Disallow \$1,493,893 in costs questioned under IA DW 75-95754001.
2. Recover \$1,007,690 in questioned costs claimed under IA DW 75-95754001. If IHS provides documentation that meets appropriate federal financial management requirements and shows that some questioned costs are allocable and allowable to the IA, the amount to be recovered should be adjusted accordingly.
3. Require through an amendment to the IA that IHS direct ANTHC to establish controls which ensure costs claimed under the agreement meet criteria specified by Title 2 CFR Part 225. The controls should ensure:
 - a. Costs are tracked in the accounting system by project phase and funding source.
 - b. Billings to the Federal Government exclude unallocable and unallowable costs.
 - c. Indirect costs are claimed based on indirect cost rates approved by the cognizant federal agency or a certified indirect cost proposal meeting criteria specified by Title 2 CFR Part 225.
4. Designate ANTHC as a high-risk recipient in the Integrated Grants Management System. Also, require the following special conditions to be included for all existing (through amended agreements) and future EPA awards providing funding directly or indirectly to ANTHC, including funding from the American Recovery and Reinvestment Act:
 - a. Payment on a reimbursement basis, including payments to IHS when funding is provided indirectly to ANTHC through an IA.
 - b. Review and approval by EPA project managers of reimbursement requests including all supporting documentation for the claims prior to payment.
 - c. Additional project monitoring by EPA project managers to ensure requests for reimbursement are consistent with the scopes of work and progress of projects associated with the claims.
5. Evaluate costs claimed under other open agreements that fund construction projects managed by ANTHC to ensure costs claimed are reasonable, allocable, and allowable.

Region 10 and Recipient Comments

The OIG received comments on the draft report from Region 10, IHS, and ANTHC. Region 10 and ANTHC also provided supplemental documentation as support for their comments. All three respondents disagreed with the findings and recommendations in the draft report. Although ANTHC disagreed with the findings, it provided a proposed management improvement plan with its comments. The full text of the Region's, IHS's, and ANTHC's comments and the OIG's detailed response are included in Appendices A through C to this report. The supplemental

documentation provided by Region 10 and ANTHC is not included in the report. The supplemental documentation is available on request, except for documentation Region 10 has determined to be confidential and requested that it be withheld from distribution outside of EPA.

The Region disagreed with all recommendations and said that EPA has no authority to disallow and recover the questioned costs. The Region also said the recommendation to designate ANTHC as high-risk under Title 40 CFR Part 31 was inappropriate and overreaching. According to the Region, the application of Title 40 CFR Part 31 is inappropriate because the regulation applies only to grants and cooperative agreements. The Region said that the recommendation was overreaching because it encompasses all types of funding agreements potentially issued by a variety of programs and EPA grants management offices. The Region also questioned whether the OIG's examination was appropriate and said that the review and report could be perceived as inappropriate interference with the administrative oversight efforts of HHS. As a result, the Region suggested that the OIG reconsider publishing the report, and instead, consider sharing any concerns arising from the examination with HHS OIG for consideration or action.

IHS and ANTHC also disagreed with the recommendations. However, ANTHC said that IHS had been reimbursed for \$79,832 of the questioned costs (\$4,999 for freight costs and \$74,833 for equipment costs), and IHS said that the \$79,832 would be reimbursed to EPA. Although IHS and ANTHC disagreed with the recommendations, they said that the proposed management improvement plan included with ANTHC's comments provides assurance that ANTHC will meet all applicable administrative and accounting requirements with respect to federal funding. IHS also commented that EPA should consider issuing grants directly to Native American tribes if EPA internal review and approval for all reimbursement requests becomes a requirement. IHS's response also included a request that the OIG seriously consider the information provided in its and ANTHC's comments and cancel publication of the report.

OIG Response

Our position on the recommendations remains generally unchanged. However, we made revisions to the report as appropriate based on Region 10's and the recipients' comments. The changes included revisions to Recommendations 1 and 2 because of a \$39,653 reduction to the questioned indirect costs. We also revised Recommendation 3 by (1) removing the reference to Title 40 CFR Part 31 because ANTHC is not obligated to comply with the regulation under the IA; (2) adding a certified indirect cost proposal option to part (c) of the recommendation because a proposal meeting the criteria specified by Title 2 CFR Part 225 is allowable; and (3) removing part (d) of the recommendation because the misclassification errors identified during the examination were not a material issue.

We acknowledge the Region's comment that EPA has no authority to disallow and recover the questioned costs from ANTHC. However, the terms and conditions in the IA include a requirement that IHS credit EPA for unallowable costs identified during an audit. Therefore, Recommendations 1 and 2 are consistent with the terms and conditions specified by the IA. The recommendation for the high-risk designation is based on the material financial management issues associated with ANTHC's accounting system for DEHE discussed in the report and the

EPA funding ANTHC receives directly through grants. For example, ANTHC received over \$1.7 million through three EPA grant awards during Fiscal Year 2009. These grants were still active as of March 2010. Because ANTHC is a recipient of EPA funding through grant instruments, EPA may designate ANTHC as “high risk” under Title 40 CFR Part 31.12 based on the issues we identified during the examination as recommended in the report. The special conditions we recommend are intended to establish controls that provide assurance that costs reimbursed with EPA funds meet federal cost principles.

With regard to the Region’s comment questioning the appropriateness of the examination, the Inspector General Act of 1978 provides OIG with the authority to audit EPA funded programs. During the planning phase of the audit, we discussed the proposed examination with HHS OIG regional management. HHS OIG regional management did not express any concerns over our proposed examination of the costs claimed under the IA. Therefore, the attestation report is not inappropriate interference with the oversight efforts of HHS OIG.

IHS has agreed to reimburse EPA \$79,832 of the questioned costs; therefore, it should proceed with the reimbursement. We acknowledge ANTHC’s proposed management improvement plan. However, the proposed plan does not provide assurance that the issues identified during the audit will be satisfactorily resolved for two primary reasons. First, ANTHC has not indicated that it is fully committed to addressing the findings in the report. More specifically, ANTHC states in the plan: “ANTHC believes that the OIG Draft Audit Report’s proposed findings are largely without merit or foundation.” Second, the supplemental documents submitted by ANTHC to support its comments on the findings indicate that ANTHC continues to incorrectly apply the federal cost principles specified by Title 2 CFR Part 225. With regard to IHS’s comment that “EPA should consider issuing grants directly to Indian Tribes,” we recommend that EPA consider the suggestion if IHS is unwilling to concur with the reimbursement process established by Recommendation 4(b).

The recommendations are undecided pending resolution.

Status of Recommendations and Potential Monetary Benefits

RECOMMENDATIONS						POTENTIAL MONETARY BENEFITS (in \$000s)	
Rec. No.	Page No.	Subject	Status ¹	Action Official	Planned Completion Date	Claimed Amount	Agreed To Amount
1	13	Disallow \$1,493,893 in costs questioned under IA DW 75-95754001.	U	Region 10 Regional Administrator			
2	13	Recover \$1,007,690 in questioned costs claimed under IA DW 75-95754001. If IHS provides documentation that meets appropriate federal financial management requirements and shows that some questioned costs are allocable and allowable to the IA, the amount to be recovered should be adjusted accordingly.	U	Region 10 Regional Administrator		\$1,008	
3	13	Require through an amendment to the IA that IHS direct ANTHC to establish controls which ensure costs claimed under the agreement meet criteria specified by Title 2 CFR Part 225. The controls should ensure: <ul style="list-style-type: none"> a. Costs are tracked in the accounting system by project phase and funding source. b. Billings to the Federal Government exclude unallocable and unallowable costs. c. Indirect costs are claimed based on indirect cost rates approved by the cognizant federal agency or a certified indirect cost proposal meeting criteria specified by Title 2 CFR Part 225. 	U	Region 10 Regional Administrator			
4	13	Designate ANTHC as a high-risk recipient in the Integrated Grants Management System. Also, require the following special conditions to be included for all existing (through amended agreements) and future EPA awards providing funding directly or indirectly to ANTHC, including funding from the American Recovery and Reinvestment Act: <ul style="list-style-type: none"> a. Payment on a reimbursement basis, including payments to IHS when funding is provided indirectly to ANTHC through an IA. b. Review and approval by EPA project managers of reimbursement requests including all supporting documentation for the claims prior to payment. c. Additional project monitoring by the EPA project managers to ensure requests for reimbursement are consistent with the scopes of work and progress of projects associated with the claims. 	U	Region 10 Regional Administrator			
5	13	Evaluate costs claimed under other open agreements that fund construction projects managed by ANTHC to ensure costs claimed are reasonable, allocable, and allowable.	U	Region 10 Regional Administrator			

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

Appendix A

Region 10's Comments on the Draft Report and OIG's Evaluation

The response from Region 10 is provided verbatim. OIG responses to those comments have been inserted in text boxes.



**UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
REGION 10**
1200 Sixth Avenue, Suite 900
Seattle, WA 98101-3140

OFFICE OF
MANAGEMENT PROGRAMS

February 23, 2010

MEMORANDUM

SUBJECT: Attestation Report: Review of costs claimed by the Alaska Native Health Consortium (ANTHC), under EPA Interagency Agreement (IA) DW 75-95754001.

FROM: Mike Bussell, Director, Office of Water and Watersheds;
Julie Hagensen, Director, Office of Management Programs

TO: Robert Adachi, Director, Office of Forensic Audits, EPA OIG

Thank you for the opportunity to provide our response to findings and recommendations presented in the Attestation Report: Review of costs claimed by the Alaska Native Health Consortium (ANTHC), under EPA Interagency Agreement (IA) DW 75-95754001. Our detailed response is attached, along with relevant supporting documentation.

As discussed in our response, the Region fundamentally disagrees with the OIG's belief that EPA has privity with the Alaska Tribal Native Health Consortium (ANTHC) as a sub-recipient of funds provided to the Indian Health Service (IHS) via the referenced Interagency Agreement. Specifically, we disagree with the OIG's contention, as set out in the second bulleted point on page 1 of the Attestation Report, that ANTHC's accounting and billing practices are subject to EPA's regulations under Title 40 CFR Part 31, which incorporate the cost principles set out in Title 2 CFR Part 225 (OMB Circular A-87), and thus subject to oversight and review by EPA. Even if the sub-award vehicle utilized by IHS to pass EPA funds to ANTHC was an assistance agreement, issued under equivalent Department of Health and Human Services (HHS) regulations, we are of the opinion that EPA would have no authority. Given that

the agreement between IHS and ANTHC is in the form of Project Funding Agreement (PFA), issued pursuant to Section 7(a) (3) of Public Law 86-121 (42 U.S.C. 2004a, 73 Stat. 267), and such agreements were determined in 1992 by the Director, Division of Grants and Contracts, Public Health Service to be unconstrained by HHS regulations, this removes ANTHC even further from the authority of EPA grant regulations. As an agency within HHS, we hold that IHS alone is responsible for ensuring the compliance of its sub-recipient, ANTHC, with any requirements related to that PFA.

We find additional pertinent support for our position in opinion issued in 2006 by EPA's Office of General Counsel (OGC) (attached) which determined that ANTHC is required to comply with the terms and conditions of its agreement with IHS, which awards funds to ANTHC. The OGC opinion further finds that, because of the intervening award made by IHS, EPA is not the appropriate federal entity to seek reimbursement of funds from ANTHC. Janet Kasper, EPA OIG Director of Assistance Agreement Audits, concurred with the OGC determination.

OIG RESPONSE 1 We agree that EPA's primary contractual relationship is between EPA and IHS under the IA and have revised the report as appropriate. For PFAs between IHS and ANTHC that are partially or fully funded by EPA through the IA, ANTHC is a sub-recipient of EPA funding. Because EPA is the primary funding Agency under the IA, the recommendations in the report are directed to the Regional Administrator for Region 10 to disallow and recover questioned costs from IHS and to establish additional controls over EPA funding provided directly or indirectly to ANTHC.

We agree that the ANTHC is not obligated to comply with Title 40 CFR Part 31 under the IA. We have made changes to the report as appropriate. Although, ANTHC is not required to comply with Title 40 CFR Part 31 under the IA, Title 2 CFR Part 225 applies to the EPA funding provided through the IA. The IA was awarded under Section 518(c) of the Clean Water Act, which limits the funding for the IA to federally recognized Native American tribes. As a tribal recipient of federal funding under the IA, ANTHC is obligated to comply with Title 2 CFR Part 225. We also note that the PFAs supplement the Compact among the Alaska Native Tribes, ANTHC, and HHS. The PFAs clearly state that the provisions of the Compact apply to the projects funded under the agreements. The provisions of the Compact include a requirement that ANTHC and the other co-signers apply cost principles under the applicable Office of Management and Budget (OMB) Circular. Consistent with the provisions of the Compact, ANTHC recognizes the applicability of OMB cost principles in their response to the draft audit report and in their internal guidance for Cooperative Project Agreements.

The OGC opinion references recovery of funds from ANTHC. However, our recommendations are directed to recovering funds from IHS and not from ANTHC.

In light of the above, we question whether it was appropriate for the OIG to undertake the review resulting in the Attestation Report now under consideration. However, because we take

seriously the efforts of the OIG, understand that the review was undertaken under the presumed authority to do so, and we are committed to meeting our obligations to the OIG, we are providing a full response to the findings and recommendations arising from the review. In regards to the OIG's claims that specific costs are not reasonable, allocable or allowable, we are in agreement in some instances, but in most we offer information to show that those claims are unfounded. In other instances, we show that changes have been made to address the concerns raised by the OIG.

OIG RESPONSE 2 As discussed in OIG RESPONSE 1, the EPA funding provided through the IA is subject to the federal cost principles specified by Title 2 CFR Part 225. The Inspector General Act of 1978 provides the EPA OIG with the authority to audit EPA-funded programs and to keep the EPA Administrator as well as Congress fully informed about problems and deficiencies relating to administration of such programs and the necessity for corrective action. Our position remains unchanged on the questioned costs, except we have reduced the questioned indirect costs by \$39,653. We reduced the questioned indirect costs based on further review of ANTHC's certified indirect cost proposal dated November 20, 2007.

Finally, we are concerned that this Attestation Report and the review upon which it is based could be perceived as inappropriate interference with the administrative oversight efforts of HHS. We suggest that the OIG reconsider publishing this report and, instead consider sharing any concerns arising from the review with its counterparts at HHS for their consideration or action.

OIG RESPONSE 3 Our position remains unchanged. The scope of the examination and attestation report address costs claimed and reimbursed to ANTHC through the IA. The scope of the examination and attestation report do not address IHS' oversight activities under the IA. During the planning phase of the audit, we discussed the proposed examination with HHS OIG regional management. HHS OIG regional management did not express any concerns over our proposed examination of the costs claimed under the IA. Therefore, the attestation report is not inappropriate interference with the oversight efforts of HHS.

Once again, we appreciate receiving this draft report and being provided the opportunity to offer a response to it.

Enclosures

cc: Michael Owen, OIG
Jan Lister, OIG
Armina Nolan, Manager, GAU/IASSC-West
Paula vanHaagen, OWW
Dennis Wagner, OWW, AOO-Anchorage
Bob Phillips, Audit Followup Coordinator/Liaison

Region 10's response to the Attestation Report for Project No. 2008-507 is based on two fundamental objections concerning the EPA Office of the Inspector General's (OIG) review of costs claimed by the Alaska Native Health Consortium (ANTHC), under EPA Interagency Agreement (IA) DW 75-95754001.

1. OIG Has Not Successfully Established EPA Privity With the Alaska Native Tribal Health Consortium

In conducting this review, the OIG sought to determine if ANTHC was in compliance with the requirements Title 40 CFR Part 31, including the cost principles under Title 2 CFR part 225 (OMB Circular A-87) included by reference at Title 40 CFR Part 31.22. As a rationale for doing so, the OIG claims the applicability of that regulatory authority to the disbursement of funds provided through an Interagency Agreement with the Indian Health Service (IHS), a federal agency falling under the jurisdiction of the Department of Health and Human Services (HHS), which in turn provides a portion of those funds to ANTHC. The OIG cites ANTHC management's incorrect interpretation of the cost principles specified by Title 2 CFR Part 225 as a cause for designating as unallowable the bulk of the questioned costs from this review

Region 10 believes that the OIG has asserted an authority that does not exist in this case, implying a privity with ANTHC that is not legally supportable. Indeed, an opinion rendered by an attorney from the EPA's Office of General Counsel clearly establishes that such privity does not exist. Relevant to an earlier OIG investigation, which asserted that EPA should seek reimbursement of excess interest earned by ANTHC on advanced EPA funds received through the State of Alaska's Village Safe Water Program, the OGC attorney stated that the regulatory invoked by the OIG, Title 40 CFR Part 31.21(i) was not applicable since the funding was passed on to ANTHC by virtue of an intervening funding agreement made by IHS, under another authority. Though that authority did require repayment of excess interest, the EPA attorney held that because the agency did not have privity with ANTHC it was not entitled to seek repayment from ANTHC¹.

Region 10 used this determination as a basis for its final proposed determination concerning recommendation #4 from OIG Audit Reports 2006-3-00167 and 2006-3-00168, deferring to IHS the responsibility for recovery of excess interest from ANTHC.² On March 5, 2007, Janet Kasper, the OIG Director of Assistance Agreement Audits, indicated her approval of this action by accepting the Region's proposed and completed corrective actions.³

Given the opinion rendered by EPA's Office of General Counsel, and the implicit acceptance of its validity by the OIG in the case cited above, Region 10 believes EPA's lack of privity applies to the findings and recommendations concerning ANTHC in the matter at hand. EPA provided funds to IHS via an Interagency Agreement. HIS then provided the funds to ANTHC via a Project Funding Agreement (PFA), which carries its own compliance requirements. Indeed, at no point in the disbursement of these funds is an assistance agreement subject to the requirements of Title 40 CFR Part 31, or its HHS equivalent, employed. Thus, even the "flow

¹ Attachment #1

² Attachments #2 and #3

³ Attachment #4

down” principle cannot be said to apply in this case, which removes it even further from plausible consideration under grant regulations. Thus, EPA does not have the legal authority to recover any of the unsupported costs identified in the audit 2008-507.

OIG RESPONSE 4 As discussed in **OIG RESPONSE 1**, we agree that EPA’s primary contractual relationship is between EPA and IHS under the IA. For PFAs between IHS and ANTHC that are partially or fully funded by EPA through the IA, ANTHC is a sub-recipient of EPA funding. Although we agree that the ANTHC is not required to comply with 40 CFR Part 31, it is obligated to comply with Title 2 CFR Part 225 as a tribal recipient of federal funding under the IA. Because EPA is the funding Agency under the IA, the recommendations in the report are directed to the Regional Administrator for Region 10 to disallow and recover questioned costs from IHS and to establish additional controls over EPA funding provided directly or indirectly to ANTHC. The recommendation to recover questioned costs from IHS is consistent with the terms and conditions of the IA. The terms and conditions include a requirement that IHS credit EPA for unallowable costs identified during an audit.

2. OIG Does Not Establish That EPA Can Override HHS’s Indirect Cost Rate Determinations.

In its Attestation Report, the OIG cites “miscommunication between ANTHC and HHS on the application of approved indirect rates and ANTHC’s incorrect interpretation of federal indirect cost rate requirements” as a primary cause for the questioned costs identified by their review. (p. 9). To remedy this, the OIG recommends that EPA direct ANTHC to receive an indirect cost rate from HHS. Region 10 believes both the rationale for the finding and the recommended remedy are not appropriate.

As the OIG itself discovered during the course of this investigation, HHS has denied ANTHC an indirect rate since 2007. An e-mail to the OIG from HHS confirms they will continue with this determination and not approve an indirect rate or review an indirect methodology for the ANTHC construction program referred to as DEHE.⁴ Given that HHS is both the cognizant agency and a party to the PFA with ANTHC, we believe their determination and oversight responsibilities in this matter are primary, and do not see where EPA has standing to override this.

Further, we call the OIG’s attention to an audit they conducted of the Financial Management Practices of the National Rural Water Association (NRWA), which determined that NRWA employed an inappropriate method for allocating indirect costs to an EPA assistance agreement (see [OIG Attestation Report 2007-4-00027](#)). During resolution of the review’s findings and recommendation, EPA established that NRWA’s cognizant agency (USDA) had

⁴ Attachment #5

approved the method used by NRWA. In further discussions with the OIG, Janet Kasper agreed that because USDA approved the current methodology, EPA has to abide by a cognizant agency's past decisions with respect to indirect cost rates and indirect methods, and has no standing to seek reimbursement for the questioned indirect costs.⁵ That determination is consistent with the wider determination concerning privity, presented above. Simply put, just as EPA has no authority to require another federal agency to enforce compliance with regulatory requirements not part of its agreements with sub-awardees, it has no standing to override a cognizant federal agency's policies concerning the determination of indirect cost rates and the rate agreements it approves, and cannot seek reimbursement of questioned indirect costs from organizations which abide by its cognizant agency's determinations.

Thus, EPA must defer to HHS's determination concerning the establishment of an indirect cost rate for ANTHC's DEHE program. The determination of the potential disallowability of indirect costs identified in this Attestation Report should be reversed, and the recommendation that Region 10 recover those costs should be rescinded.

OIG RESPONSE 5 The attestation report does not recommend that EPA direct ANTHC to receive an indirect cost rate from HHS. Rather, the attestation report recommends Region 10 require through an amendment to the IA that IHS direct ANTHC to establish controls that ensure indirect costs are claimed based on indirect rates approved by the cognizant federal agency.

We agree that HHS is the cognizant federal agency for negotiating and approving indirect cost rates for ANTHC. Title 2 CFR Part 225, Appendix E requires an organization claiming indirect costs under a federal award to either: (1) submit an indirect cost rate proposal for negotiation and approval to the cognizant federal agency or (2) maintain a certified proposal and supporting documentation on file for audit. Consistent with Title 2 CFR Part 225, we have not questioned indirect costs incurred by ANTHC that are supported by rates that have been approved by HHS. We acknowledge that ANTHC's November 2007 certified indirect cost proposal submitted to HHS includes a construction indirect rate covering administrative costs incurred by DEHE for fiscal year 2006 that was overlooked in the draft report. The report has been corrected to reflect the construction indirect cost rate for 2006. The correction resulted in a \$39,653 reduction in questioned indirect costs. However, the rates approved by HHS and the 2007 certified proposal do not cover all indirect costs claimed under the IA for fiscal years 2007, 2008, and 2009. The terms and conditions in the IA include a requirement that IHS credit EPA for unallowable costs identified during an audit as discussed in OIG RESPONSE 4. Therefore, we continue to question \$351,072 in indirect costs incurred under the IA. We also continue to recommend that EPA recover the \$181,494 in questioned indirect costs claimed for reimbursement under the IA from IHS.

⁵ Attachment #6

Additional Comments:

Region 10 also believes that the OIG did not fully account for its efforts in conducting this review. According to its “Independent Attestation Report” statement on pp. 2 -3 of that report, the OIG states it made site visits to EPA Region 10’s offices in Seattle, Washington, and Anchorage, Alaska; to IHS’ office in Anchorage, Alaska; and to the ANTHC’s office in Anchorage, Alaska. Unaccounted for is an on-site review conducted by OIG staff at the offices of State of Alaska Village Safe Water (VSW) program, in April, 2009. We believe this review should be accounted for in the Attestation Report, as well.

According to VSW staff, it was understood that this review was being conducted in connection with the inquiry into IA DW-75-95754001, and a substantial amount of time was spent at the VSW offices. Presumably, expenses incurred in relation to that site visit will be included in accounting for this review. If there were findings from that review which had a bearing on the OIG’s findings, we believe they should be included in the Attestation Report. If the VSW review yielded no relevant findings, at a minimum the report for that review should note there were no issues identified during the review of the VSW financial management system in the audit.

OIG RESPONSE 6 We acknowledge that the review at the offices of State of Alaska Village Safe Water program was not disclosed in the draft report. We have corrected this error by disclosing the site visit was included in the scope of the examination in the final report. No findings or recommendations were addressed to the State of Alaska; therefore, we did not include a discussion of the results of the review in the final report.

Region 10’s Detailed Response to Review Findings

Questioned Costs:

The OIG’s review identified questioned costs in six areas. Region 10’s responses are below.

Questioned Cost & OIG Determination	Questioned Cost	Region 10 Response
Indirect Costs: Not incurred in compliance with Title 2 CFR Part 225	\$390,725	The Region does not accept this finding because it is in direct conflict with the determinations of ANTHC’s cognizant agency, and EPA has no authority to override those determinations. See detailed discussion of objection #2 above.

Questioned Cost & OIG Determination	Questioned Cost	Region 10 Response
Labor Costs: Did not meet the allocability requirements of Title 2 CFR Part 225.	\$155,017 (\$128,925 direct labor; \$26,092 indirect costs)	The Region does not accept this finding because it believes the cost principles under Title 2 CFR Part 225 are not relevant to the agreement between IHS and ANTHC, and EPA has no privity with ANTHC which allows it to invoke and require compliance with its provisions. See detailed discussion of objection #1 above. Also see Discussion Section below for further comment on the allocation issue.
Equipment Costs: not allocable to the IA or otherwise unallowable	\$326,531	The Region does not accept this finding because it believes the cost principles under Title 2 CFR Part 225 are not relevant to the agreement between IHS and ANTHC, and EPA has no privity with ANTHC which allows it to invoke and require compliance with its provisions. See detailed discussion of objection #1 above. Also see discussion on specific items of cost in Table 1 below.
Freight Costs: Not allocable to IA	\$4,999	We understand the misallocation of this cost was an accounting error and has been corrected by ANTHC.
Material Costs: Not Allocable to IA	\$337,075	The Region does not accept this finding because it believes the cost principles under Title 2 CFR Part 225 are not relevant to the agreement between IHS and ANTHC, and EPA has no privity with ANTHC which allows it to invoke and require compliance with its provisions. See detailed discussion of objection #1 above. Also see Discussion Section below for further comment on the transfer issue.
Subcontract Costs: Not Allocable or Allowable	\$319,199	The Region does not accept this finding because it believes the cost principles under Title 2 CFR Part 225 are not relevant to the agreement between IHS and ANTHC, and EPA has no privity with ANTHC which allows it to invoke and require compliance with its provisions. See detailed discussion of objection #1 above. See also comments in table 2 below.

OIG RESPONSE 7 We agree that HHS is the cognizant federal agency for negotiating and approving indirect cost rates for ANTHC. The questioned indirect costs are not in conflict with HHS's determinations on allowable indirect costs for ANTHC. We questioned indirect costs incurred by ANTHC that were not included in the rates approved by HHS, or ANTHC's November 2007 certified indirect cost proposal submitted to HHS, as discussed in OIG RESPONSE 5.

With regard to the Region's comments on the questioned labor, equipment, material, and subcontract costs in the table above, we agree that EPA's primary contractual relationship is between EPA and IHS under the IA. However, the cost principles under Title 2 CFR Part 225 are applicable to the PFAs that provide EPA funding to ANTHC as discussed in OIG RESPONSE 1. The terms and conditions in the IA include a requirement that IHS credit EPA for unallowable costs identified during an audit as discussed in OIG RESPONSE 4. Therefore, the IA allows EPA to recover the questioned costs identified during our examination.

We acknowledge the Region's comments on the \$4,999 in questioned freight costs in the table above. ANTHC claimed \$4,235 of the \$4,999 for reimbursement under the IA. The Region should disallow and recover the \$4,235 in questioned costs from IHS as recommended in the attestation report.

Table 1 - Equipment Costs

Cost Finding	Questioned Cost	Region 10 Response
Cost Transfer Not Allocable to IA	\$74,833	We understand the misallocation of this cost was an accounting error and has been corrected by ANTHC.
Indirect Costs Classified as Equipment Costs	\$24,481	In incurring these costs, ANTHC was following their cognizant agency's directive. We do not believe EPA has the authority to override the cognizant agency's determinations in this case. See detailed discussion of objection #2 above.

Cost Finding	Questioned Cost	Region 10 Response
Equipment Purchase Not Allocable	\$ 227,217	<p>The equipment justification referred to in the OIG's finding was developed by ANTHC for comparing the cost of renting an excavator compared to the cost of purchasing an excavator for the installation of infrastructure in Fort Yukon. This equipment justification memo was not the justification for the purchase of the excavator but purely a cost comparison document. The 2007 project in question was funded by EPA (76%) and IHS (24%). In the budget for the 2007 project, (see figure A, below) \$290,223 is available for equipment. The purchase in question was for an excavator used to install the sewer mains, service lines, lift station and force mains in Fort Yukon. Given that EPA funded 76% of the project 76% of the cost of the excavator would be allocable to the EPA portion of the project. ANTHC claimed 41% of the costs against the IA. The benefits received by EPA and the community are the same regardless of which project the cost comparison was made under to purchase or rent.</p>

Figure A

B. PROJECT COST

B 1. Cost Estimate Table

Job Type	Scope of Work	Qty	Units	Unit Cost*	Extended Cost	Funding Sources	
						CWA-ISA	IHS
S-BC	Sewer main	6500	LF	\$ 209.63	\$ 1,362,568.00	\$ 670,568	\$ 487,678
S-BL	Buried sewer lines	4000	LF	\$ 150.30	\$ 601,207.00	\$ 601,207	
S-LS	Lift station	1	EA	\$ 296,414.00	\$ 296,414.00	\$ 296,414	
S-BF	Buried sewer force mains	1,300	LF	\$ 213.07	\$ 276,990.00	\$ 276,990	
M-CB	Support services direct charges	1	LS	\$ 380,460.00	\$ 380,460.00	\$ 290,223	\$ 90,237
Total Estimated Cost					\$ 2,917,639.00	\$ 2,225,639	\$ 692,000

Project support services and technical support services include project-related salaries, materials, training, utilities, equipment, and travel.

OIG RESPONSE 8 We acknowledge the Region’s comments in Table 1 on Cost Transfer Not Allocable to IA finding. The Region should disallow and recover the \$74,833 in questioned costs from IHS as recommend in the attestation report.

OIG RESPONSE 9 With Regard to the Region’s comments in Table 1 above on the Indirect Costs Classified as Equipment Costs finding, the \$24,481 in questioned indirect costs were not supported by and did not follow HHS’s determinations on allowable indirect costs for ANTHC. We questioned the costs because ANTHC did not have indirect cost rate agreements approved by HHS or a certified indirect cost rate proposal on file to support the costs as specified by Title 2 CFR Part 225, Appendix E. Title 2 CFR Part 225, Appendix E, Sections D and E require an organization claiming indirect costs under a federal award to either: (1) submit an indirect cost rate proposal for negotiation and approval to the cognizant federal agency or (2) maintain a certified proposal and supporting documentation on file for audit.

OIG RESPONSE 10 The Region's comments in the Table 1 above on the Equipment Purchase Not Allocable finding are not consistent with ANTHC's equipment procurement procedures. ANTHC's equipment procurement procedures document states that equipment is to be purchased specifically for an individual project and direct billed to the project for specific scope items identified in the funding documents based on a cost-benefit analysis justification. ANTHC did not charge the \$227,217 to the project identified in the cost-benefit analysis justification as specified by its equipment procurement procedures. ANTHC's justification for the equipment purchase listed Fort Yukon Project AN 05-N96 as the intended project for the excavator. The justification also indicated that the excavator was required because of the deep burial depth of multiple sections of the water and sewer systems. According to the Cooperative Project Agreement (CPA) for Project AN 05-N96, 49 percent of the project was funded by IHS for sewer and water service work and 51 percent of the project was funded by EPA through the IA for sewer service work. Despite the justification, ANTHC charged 100 percent of the equipment costs to part of another project funded by EPA through the IA, Fort Yukon Project AN 07-NG5. The CPA for Project AN 07-NG5 identified that the scope of work was only for sewer service work, and 24 percent of the project was funded by IHS and 76 percent of the project was funded by EPA through the IA. Therefore, the scope of work and funding for Project AN 07-NG5 were not equivalent to the scope of work and funding for the project identified in ANTHC's justification for the excavator.

We are unable to verify from the budget information provided by the Region in Figure A that the excavator was purchased for and benefited Project AN 07-NG5. Title 2 CFR Part 225, Appendix A, Section C.1.b, states that a cost must be allocable to the award in order to be allowable. The Region and ANTHC have not provided information and documentation clearly showing that the excavator purchase was allocable to the IA funded part of Project AN 07-NG5. Therefore, we continue to question the \$227,217 in equipment costs incurred under the IA.

Table 2 - Subcontract Costs

Description	Cost	Region 10 Response
Subcontract Costs Transfers Not Allocable to IA	\$130,622	In its Attestation Report, the OIG fails to provide sufficient detail on this issue for R10 to respond.
Subcontract Costs for Equipment Rental Fees Not Allowable	\$188,577	ANTHC's use of the bluebook rates for equipment is in compliance with IHS's 2003 Memorandum of Agreement Guidelines, Chapter VI, Page 4, (B) Equipment Costs. ANTHC is following their cognizant agency's guidelines for equipment rental fees. As argued above, the Region holds that the cognizant agency has privity with ANTHC where EPA does not.

OIG RESPONSE 11 Our basis for questioning the \$130,622 in subcontract cost transfers included in Table 2 above was clearly explained in the draft report. However, we acknowledge that the draft report incorrectly identified that the two transfer transactions, totaling \$130,622, were made between sewer projects for the City of Saint Michael. The report should have identified that the \$120,000 transfer was made between two sewer projects for the City of Fort Yukon. ANTHC transferred the \$120,000 from Fort Yukon Project AN 03-R64, which was not funded through the IA, to a scope of work for Fort Yukon Project AN 05-N96 that was funded through the IA. The \$10,622 transfer between sewer projects for the City of Saint Michael identified in the draft report is correct. ANTHC transferred the \$10,622 from Saint Michael Project AN 02-Q77, which was not funded by the IA, to a scope of work for Saint Michael Project AN 05-NB1 that was funded by the IA. We have corrected the final report to identify that the \$120,000 transfer in subcontract costs was between projects for the City of Fort Yukon.

OIG RESPONSE 12 With regard to the Region's comments on the questioned subcontract costs for equipment rental fees in Table 2 above, we acknowledge that ANTHC followed IHS's 2003 Memorandum of Agreement guidelines which state that there are standard construction industry reference manuals that provide assistance in establishing rates for equipment usage. Use of an industrial rate does not preclude ANTHC from meeting the requirements under Title 2 CFR Part 225 for funding provided through the IA. As discussed in the report, ANTHC was unable to provide complete cost documentation showing that the equipment usage costs incurred under IA did not exceed the allowable depreciation, maintenance, and repair costs as specified by Title 2 CFR Part 225. Therefore, our position on the \$188,577 in questioned subcontract costs remains unchanged.

Questioned Costs – Discussion Section:

Labor Costs:

The Region would like to offer its perspective on the allocation issue. Funding of the wastewater project in Fort Yukon comes from EPA, IHS, USDA-RD through multiple projects. Often costs are charged to one project by field staff with the costs dispersed to the various funding sources and projects at the office level. An example of this is the labor to unload a barge with materials for the multiple projects is charged by the field personnel to a single project. The labor costs are then distributed by transfers to eligible projects by office staff at a later date. We do not believe any material harm accrues to the project from this practice, and the benefits received by EPA and the community are the same regardless of which project the labor was originally charged under.

OIG RESPONSE 13 We questioned the labor costs because ANTHC could not demonstrate that the transferred costs benefited the IA. The accounting records did not support that the transferred costs were allocable to the IA. Title 2 CFR Part 225, Appendix B, Section 8.h.4 requires a distribution of wages based on personal activity reports for employees working on multiple projects or a substitute system approved by the cognizant agency. Appendix B, Section 8.h.5 requires that the personal activity reports reflect a distribution of the actual activity of each employee, are prepared at least monthly, and are signed by the employee. ANTHC does have a labor distribution system meeting the criteria of Title 2 CFR Part 225. However, the \$128,925 in questioned labor costs were transferred as a lump sum amount and not supported by employee timesheets showing that the costs were incurred for the phase of City of Fort Yukon Project AN 05-N96 funded by the IA.

Quarterly progress reports prepared by ANTHC staff also do not indicate that any of the transferred labor costs were for anything other than accomplishing the scope of work for the project it was initially charged to. The \$128,925 was originally charged to Fort Yukon Project AN 02-Q66 for work that was not funded by the IA. We acknowledge that projects consist of several phases and funding sources. However, we cannot make a determination on whether the cost transfers are reasonable and allocable to project work funded by the IA without the assurance of a labor distribution system that properly allocates costs between phases at the time the costs are incurred. Therefore, our position on the \$128,925 in questioned labor costs remains unchanged.

Material Costs:

The Region would like to offer its perspective on the transfer issue. Often bulk orders for materials such as pipe are made by the early phases of large projects such as Fort Yukon. These bulk orders allow for later phases to move forward more quickly because the pipe is on site instead of waiting the two years it takes the pipe to arrive on site from the date of funding of a project. These communities often only get one material barge per year so the delivery times can be from one to two years. Further, these bulk orders results in lower unit costs to the government due to economy of scale of a bulk order and no increase in material costs over time. To order materials on an individual project basis as suggested by the OIG would result in a higher cost to the government and increase construction time. The flexibility to transfer material costs from one project to another project results in more efficient projects with a lower cost to the Federal government.

OIG RESPONSE 14 We acknowledge the efficiencies in ordering materials in bulk. However, ANTHC did not provide the documentation necessary to verify that the \$337,075 in material costs transferred from Fort Yukon Project AN 02-Q66 benefitted and was allocable to the EPA funded part of Fort Yukon Project AN 05-N96. We continue to question the \$337,075 in material costs incurred under the IA.

Primary Causes for Questioned Costs

In its Attestation Report, the OIG cites the following as the primary causes for the questioned costs findings:

Indirect Rates Were Not Clearly Communicated by Cognizant Agency and ANTHC Misinterpreted Federal Requirements:

The OIG determined that ANTHC's lack of an indirect rate is due to miscommunication and misinterpretation of Federal Requirements.

Region 10 Response:

As established in our detailed discussion of objection #2 above, the Region believes this reflects a fundamental misunderstanding of ANTHC's relationship with, and obligations to, HHS in regards to the establishment of and adherence to its indirect cost rate agreements. The effect of this misunderstanding is to erroneously blame ANTHC for not having an indirect rate, when in fact it has been acting in accordance with its agreement with HHS.

OIG RESPONSE 15 As discussed in OIG RESPONSE 5, we have not questioned indirect costs incurred by ANTHC that are either supported by rates approved by HHS or ANTHC's November 20, 2007, certified indirect cost proposal. However, the rates approved by HHS and the 2007 proposal do not cover all indirect costs incurred under the IA for fiscal years 2007, 2008, and 2009. At a minimum, ANTHC needs to prepare a new proposal meeting the requirements of Title 2 CFR Part 225, Appendix E, in order to claim costs incurred for fiscal years 2007 through 2009 that are not covered by the indirect cost rates approved by HHS or the 2007 cost proposal. Therefore, our position that the questioned indirect costs were claimed primarily because of miscommunication between ANTHC and HHS on the application of approved indirect rates and ANTHC's incorrect interpretation of federal indirect cost rate requirements remains unchanged.

ANTHC Misinterpreted Basic Federal Cost Principles

The OIG asserts that ANTHC management's incorrect interpretation of the basic cost principles under Title 2 CFR Part 225 led to \$903,671 of the \$1,533,546 in total questioned costs: \$676,454 transferred from projects supported through other agreements; \$227,217 incurred for an equipment purchase considered unallocable to the IA.

Region 10 Response:

ANTHC accounts for costs by each specific project phase and funding sources in accordance with the terms and conditions of the IA, and as demonstrated in the progress reports reviewed by OIG. As there were no findings associated with the progress reports, we believe ANTHC was in full compliance with the applicable accounting requirements.

However, we agree in principle that ANTHC could improve the process of transferring costs between projects by including additional information on the transfers and ensuring transfers are completed within a timely manner (i.e., when funds are made available for a project). We fundamentally disagree that the cost principles cited by the OIG apply to ANTHC, and thus they cannot be held at fault for their misinterpretation. IHS has committed to working with ANTHC to develop a corrective action plan to address the transfer of costs.

OIG RESPONSE 16 The OIG examined ANTHC's accounting system, detailed supporting documentation, and the reported outlays for EPA funded projects. The issues addressed in the attestation report resulted from our examination of ANTHC's accounting system and supporting records. With regard to the Region's comments on the progress reports, the reports are summary level outputs from ANTHC's accounting system and do not show ANTHC's compliance with accounting and Title 2 CFR Part 225 requirements.

We appreciate Region 10's recognition that ANTHC could improve its process for transferring costs. However, as discussed in OIG RESPONSE 1, ANTHC is obligated to comply with Title 2 CFR Part 225 for costs that are reimbursed from EPA funding provided through the IA. Therefore, our position that ANTHC management did not correctly interpret the basic cost principles under Title 2 CFR Part 225 remains unchanged.

ANTHC Erroneously Believed That Equipment Rental Fees Met Federal Criteria

The OIG determined that ANTHC incurred a total of \$213,058 for equipment rental fees that were not allowable or allocable because ANTHC management mistakenly believed the costs, based on the *Rental Blue Book*, met applicable federal cost criteria.

Region 10 Response:

See our response to this issue in the discussion of specific questioned costs findings in table #1 above.

OIG RESPONSE 17 The Region's responses for the \$213,058 in equipment costs questioned are actually in Tables 1 and 2 above. The Region's comments for \$24,481 of the questioned costs are included in Table 1. The Region's comments for the other \$188,577 in questioned costs are included in Table 2. We have responded to the Region's comments on these costs in OIG RESPONSE 9 and OIG RESPONSE 12.

ANTHC Did Not Ensure that Costs Were Consistently Classified

In its review of the costs discussed above, the OIG determined that ANTHC was inconsistent in its classification of costs within its accounting system because staff working in the field did not consistently follow ANTHC's coding for classifying costs in the accounting system. The OIG states that ANTHC must be consistent in its classifications to be in compliance with the financial management requirements under Title 40 CFR Part 31.20(b)(2).

Region 10 Response:

1. We refer the OIG to our fundamental contention that the regulatory requirements cited are not applicable to ANTHC's agreement with IHS under this IA.
2. Of the five identified inconsistencies identified by the OIG in its discussion of this finding, three are based on HHS's not issuing an indirect rate to ANTHC. We refer the OIG to our fundamental contention that EPA cannot override HHS's determinations in this regard.
3. The remaining two entries total \$34,295, or 1% of the costs reviewed by the OIG findings. Given that ANTHC completes tens of thousand entries for more than 600 projects that they manage, this seems well within acceptable limits.
4. We agree, in principle, that ANTHC could improve the consistency of coding costs by field staff. IHS has agreed to include improved coding policies in its previously proposed corrective action plan for ANTHC.

OIG RESPONSE 18 We agree that the ANTHC is not obligated to comply with Title 40 CFR Part 31 under the IA. However, consistency is one of the concepts that underlie generally accepted accounting standards and promotes understanding of, and confidence in, financial information on the part of users of the information. Treatment of costs in a consistent manner aids in the determination of reasonable, allowable, and allocable costs. Considering the multiple funding sources for ANTHC projects, consistent treatment will provide assurance that resources were used in accordance with the various funding sources. As discussed in the draft report, we did not question costs because of this misclassification issue. Because we did not consider the misclassification errors identified during the examination as material, the issue and corresponding recommendation were not included in the final report.

Region 10's Response to the OIG's Recommendations

In its Attestation Report, the OIG makes the following recommendations to EPA Region 10 to address the findings of the review:

1. **Disallow \$1,533,546 in costs questioned under IA DW 75-95754001.**
2. **Recover \$1,047,339 in questioned costs claimed under IA DW 75-95754001. If ANTHC provides documentation that meets appropriate federal financial management requirements and shows that some questioned costs are allocable and allowable to the IA, the amount to be recovered should be adjusted accordingly.**

Region 10 Response:

As established and discussed elsewhere, Region 10 believes EPA has no authority to disallow and recover any amount of these funds. Alternatively, we suggest that, once these findings have been adjusted and finalized, this recommendation be provided to HHS for their review and possible action.

OIG RESPONSE 19 The IA was awarded under Section 518(c) of the Clean Water Act, which limits the funding for the IA to federally recognized Native American tribes as discussed in OIG RESPONSE 1. As a tribal recipient of federal funding under the IA, ANTHC is obligated to comply with Title 2 CFR Part 225. The terms in the IA include the recovery from IHS of unallowable costs identified during an audit. Consistent with these terms, our recommendations include the recovery of \$1,007,690 in questioned costs claimed by ANTHC from IHS. Therefore, our position on Recommendations 1 and 2 remain unchanged.

3. **Require through Amendment to the IA that IHS direct ANTHC establish controls which ensure costs are claimed under the agreement meet criteria specified by title 2 CFR Part 225 and Title 40 CFR Part 31.**

Region 10 Response:

As established and discussed previously, the funds are awarded to ANTHC by IHS pursuant to Section 7(a)(3) of Public Law 86-121 (42 U.S.C. 2004a, 73 Stat. 267). The requirements of Title 40 CFR Part 31 and Title 2 CFR Part 225 do not apply.

OIG RESPONSE 20 We agree that the ANTHC is not obligated to comply with Title 40 CFR Part 31 under the IA as discussed in OIG RESPONSE 1. We have made changes to the report, including Recommendation 3, as appropriate. Although, ANTHC is not required to comply with Title 40 CFR Part 31 under the IA, Title 2 CFR Part 225 applies to the EPA funding provided through the IA. Therefore, our position that the Region require controls that ensure costs claimed under the agreement meet the criteria specified by Title 2 CFR Part 225 remains unchanged.

OIG Recommended controls:

- a. Costs are tracked in the accounting system by project phase and funding source.**

Region 10 Response:

Though we believe that oversight in this area properly belongs to IHS, which has committed to working with ANTHC to develop a corrective action plan to address any accounting system deficiencies, we disagree with this particular finding on its own merits. ANTHC accounts for costs by each specific project phase and funding sources in accordance with the terms and conditions of the IA, and as demonstrated in the progress reports reviewed by the OIG.

OIG RESPONSE 21 The OIG examined ANTHC's accounting system, detailed supporting documentation, and the reported outlays for EPA funded projects. The issues addressed in the attestation report resulted from our examination of ANTHC's accounting system and supporting records as discussed in OIG RESPONSE 16. The progress reports are summary level outputs from ANTHC's accounting system and do not show ANTHC's compliance with accounting and Title 2 CFR Part 225 requirements. Therefore, our position on Recommendation 3(a) remains unchanged.

- b. Billing to the Federal Government excludes unallocable and unallowable costs.**

Region 10 Response:

Though we agree with this recommendation as a matter of principle, we hold that oversight in this area properly belongs to IHS.

OIG RESPONSE 22 Recommendation 3(b) does not state that Region 10 provide direct oversight over ANTHC. The recommendation specifies that the Region require IHS to direct ANTHC to establish controls that ensure reimbursements provided through EPA funding and the IA are allocable and allowable under Title 2 CFR Part 225. Therefore, our position on Recommendation 3(b) remains unchanged.

c. Indirect costs are claimed based on indirect cost rates approved by the cognizant federal agency.

Region 10 Response:

As discussed in detail above, the cognizant federal agency for ANTHC (HHS) has made the determination not to grant ANTHC an indirect cost rate for the construction program referred to as DEHE. Insofar as ANTHC is complying with the determination of HHS in this regard, and HHS is the proper authority for determining compliance, there is no corrective action to be taken by EPA.

OIG RESPONSE 23 We acknowledge that HHS has not agreed to provide ANTHC with approved rates for indirect costs incurred by DEHE. As discussed in **OIG RESPONSE 5**, Title 2 CFR Part 225, Appendix E, Sections D and E, require an organization claiming indirect costs under a federal award to either: (i) submit an indirect cost rate proposal for negotiation and approval to the cognizant federal agency or (ii) maintain a certified proposal and supporting documentation on file for audit. Consistent with Title 2 CFR Part 225, we questioned a total of \$351,072 in indirect costs because they were either not covered by indirect cost rates approved by HHS or ANTHC's November 2007 certified indirect cost proposal submitted to HHS. Recommendation 3 (c) does not state that Region 10 provide direct oversight over ANTHC. The recommendation specifies that the Region require IHS to direct ANTHC to establish controls that ensure indirect cost reimbursements provided through EPA funding and the IA are allocable and allowable under Title 2 CFR Part 225. We have revised the recommendation in the report to clarify that allocable indirect costs may also be based on a certified indirect cost proposal meeting criteria specified by Title 2 CFR Part 225. Therefore, our position on Recommendation 3(c) remains unchanged.

d. Costs are correctly coded in the accounting system.

Region 10 Response:

While we agree that ANTHC could improve the consistency of coding costs by field staff, we hold that EPA has no oversight authority in this matter. IHS has agreed to include improved coding policies in its corrective action plan for ANTHC.

OIG RESPONSE 24 We did not consider the misclassification errors identified during the examination a material issue as discussed in OIG RESPONSE 18. Therefore, the issue and corresponding recommendation were not included in the final report.

4. Designate ANTHC as a high-risk grantee in the Integrated Management System. Also require the following conditions to be included for all existing (through amended agreements) and future EPA awards providing funding directly or indirectly to ANTHC, including fund from the American Recovery and Reinvestment Act.

- a. Payment on a reimbursement basis, including payments to IHS when funding is provided indirectly to ANTHC through an IA.**
- b. Review and approve by EPA project managers of reimbursement requests including all supporting documentation for the claims prior to payment.**
- c. Additional project monitoring by EPA project managers to ensure requests for reimbursement are consistent with the scopes of work and progress of projects associated with the claims.**

Region 10 Response:

Region 10 considers this recommendation to be inappropriate in one regard, and overreaching in another. Title 40 CFR Part 31.12 permits an EPA Award Official to impose “High Risk” restrictions on a state or local government or tribal organization who is a recipient or sub-recipient of EPA funds through a grant or cooperative agreement. As established and discussed at the beginning of this response, the Region believes this authority does not extend to federal agencies or their sub-recipients who receive funds via an Interagency Agreement or other type of agreement. As the sub-recipient of EPA funds via an agreement with IHS which is neither a grant or cooperative agreement, it is not appropriate for EPA to impose high-risk restrictions on ANTHC, or to even require IHS, as the primary recipient of those funds via an IA, to do so, based on the findings of this review. Any corrective measures to be taken in this case would be the province of IHS.

Further, this recommendation overreaches in seeking to encompass all types of agreements, including grants and cooperative agreements, potentially issued by a variety of programs and grants management offices. The Region believes that the findings of this review, conducted without proper authority, cannot be used to impose high-risk restrictions on ANTHC. While a review such as that conducted by the OIG in this case could be considered appropriate where ANTHC was the recipient or sub-recipient of EPA funds via a grant or cooperative agreement, we are not aware of any such review having been accomplished. Any deficiencies identified in the routine monitoring of those agreements, where they exist, will be addressed and remedied accordingly by virtue of the established authorities.

Even setting aside consideration of the above objections, the Region still disagrees that the “findings” which gave rise to this recommendation merit the imposition of “high risk” restrictions. We believe that our oversight of this IA, in accordance with OCFO Financial Guidance for Disbursement Interagency Agreements and Interagency Agreement Policy 09-01 Billings Under Funds Out Interagency Agreements, has been more than adequate. This is reflected in the progress reports reviewed by the OIG. In addition to this, improvements to its financial management system have already been made by ANTHC on a voluntary basis, and a corrective action plan has been proposed by IHS, as the entity with direct oversight authority. We believe these actions are more than sufficient to render a “high risk” designation unnecessary.

OIG RESPONSE 25 Our position on designating ANTHC as a “high risk” recipient under Title 40 CFR Part 31 remains unchanged. Our position is based on the material financial management issues associated with ANTHC’s accounting system for DEHE discussed in the report and the EPA funding ANTHC receives directly through grants. For example, ANTHC received over \$1.7 million through three EPA grant awards during Fiscal Year 2009. These grants were still active as of March 2010. Because ANTHC is a recipient of EPA funding through grant instruments, EPA may designate ANTHC as “high risk” under Title 40 CFR Part 31.12 based on the issues we identified during the examination as recommended in the report. The special conditions we recommend are intended to establish controls that provide assurance that EPA funds are spent and accounted for in accordance with federal cost principles. With regard to the Region’s comment that our examination was conducted without the proper authority, the Inspector General Act of 1978 provides OIG with the authority to audit EPA funded programs as previously discussed in OIG RESPONSE 2.

The Region indicates in its comments that the progress reports show that its oversight has been more than adequate as reflected in ANTHC’s progress reports. As discussed previously in OIG RESPONSE 16, the reports are summary level outputs from ANTHC’s accounting system and do not show ANTHC’s compliance with accounting and Title 2 CFR Part 225 requirements. The issues addressed in the attestation report were identified from our examination of ANTHC’s accounting system and supporting records rather than general summary information presented in the progress reports.

The Region also indicates in its response that ANTHC has made improvements to its financial management system and a corrective action plan has been proposed by IHS. The Region has not provided information and documentation for the OIG to verify that ANTHC has satisfactorily resolved the financial management issues identified during the examination. Supplemental information provided by ANTHC with its comments to the draft report, including the proposed corrective action plan, also do not show that the issues have been satisfactorily resolved as discussed in our response to those comments. ANTHC’s comments and our responses are in Appendix C of this report.

5. Evaluate costs claimed under other open agreements that fund construction projects managed by ANTHC to ensure costs claimed are reasonable, allocable, and allowable.

Region 10 Response:

As with the previous recommendation, we find this recommendation to be overreaching, as well lacking in specifics. As implied in its response to recommendation #4 above, in general Region 10 believes that its oversight responsibilities of such agreements are met to the best of the abilities of its staff. Specific to this review, we believe the current oversight by IHS of ANTHC is equivalent to the level of oversight EPA devotes to the performance of a primary recipient of funds through a grant or cooperative agreement.

OIG RESPONSE 26 Our position on Recommendation 5 remains unchanged. The financial management issues addressed in the attestation report were identified from our examination of ANTHC's accounting system and supporting records. As discussed in the attestation report, ANTHC has not correctly applied the cost principles specified by Title 2 CFR Part 225. Therefore, ANTHC may have been reimbursed for construction project costs that were not allocable or allowable under other agreements that are funded by EPA. EPA needs to ensure that its funding is only used to pay for project costs that meet federal cost principles.

Attachments (6)

Appendix B***Indian Health Service's Comments on the Draft Report
and OIG's Evaluation***

The response from IHS is provided verbatim. OIG responses to those comments have been inserted in text boxes.

February 18, 2010

Robert Adachi
Director, Forensic Audits
EPA OIG—Office of Audit
75 Hawthorne Street, 7th Floor, Mailcode IGA-1
San Francisco, CA 94105

Dear Mr. Adachi:

Thank you for the opportunity to comment on the draft Attestation Report (AR) entitled *Costs Claimed by the Alaska Native Tribal Health Consortium under EPA Interagency Agreement (IA) DW 75-95754001*, dated January 8, 2010. I am providing comments for Alaska Area Indian Health Service and incorporating comments from the Alaska Native Tribal Health Consortium (ANTHC). ANTHC directed their detailed response to the IHS because the IA is between the EPA and the IHS in Alaska. The IHS is providing the facilities funded by the IA through a separate Project Funding Agreement (PFA) with ANTHC. ANTHC's Division of Environmental Health and Engineering (DEHE) is managing the construction of the sanitation facilities. I am enclosing the official ANTHC response for your records.

General Comments:

The IHS does not accept the OIG's position that EPA has privity over ANTHC as stated on page one, second bulleted point of the AR. This interpretation by the OIG would subject the accounting and billing practices of ANTHC to a review by EPA under Title 2, CFR, Part 225, OMB Circular A-87 and Title 40, CFR Part 31. The PFA between the IHS and ANTHC is issued pursuant to Section 7 (a)(3) of P.L. 86-121 (42 U.S.C. 2004A, 73 Stat. 267). In 1992, the Director, Division of Grants and Contracts, Public Health Service determined these agreements to be unconstrained by HHS regulations. The IHS is responsible for the completion of the work in the IA. ANTHC, as a sub-recipient of

funds, is subject to the agreement they are a signatory to, thus the regulations in the PFA would prevail. Please note Section 1, pages 2 – 3 of the enclosed ANTHC memorandum.

OIG RESPONSE 1 We agree that EPA’s primary contractual relationship is between EPA and IHS in the IA. We also agree that the ANTHC is not obligated to comply with Title 40 CFR Part 31 under the IA. We have made changes to the report as appropriate. Although, ANTHC is not required to comply with Title 40 CFR Part 31 under the IA, Title 2 CFR Part 225 applies to the EPA funding provided through the IA. The IA was awarded under Section 518(c) of the Clean Water Act, which limits the funding for the IA to federally recognized Native American tribes. As a tribal recipient of federal funding under the IA, ANTHC is obligated to comply with Title 2 CFR Part 225. We also note that the PFAs supplement the Compact between the Alaska Native Tribes, ANTHC, and HHS. The PFAs clearly state that the provisions of the Compact apply to the projects funded under the agreements. The provisions of the Compact include a requirement that ANTHC and the other co-signers apply cost principles under the applicable OMB Circular. Consistent with the provisions of the Compact, ANTHC recognizes the applicability of OMB cost principles in their response to the draft audit report and in their internal guidance for Cooperative Project Agreements.

Indirect Costs Claimed without Approved Rates or Certified Proposal: (AR, pg. 5)

The IHS strongly disagrees with this finding and supports ANTHC’s position that an indirect rate was requested from DHHS on November 20, 2007 for Fiscal Year (FY) 2006. (DHHS has not negotiated an indirect rate for construction projects.) ANTHC asked for and received approval from the EPA to use a Cost Allocation Plan (CAP) methodology in the absence of an approved indirect rate. However, to resolve this issue, the IHS and ANTHC will draft a Joint Operating Guideline (JOG) to describe a mutually agreeable methodology for indirect costs by September 1, 2010. The JOG will be added to all PFAs and P.L. 86-121 agreements between ANTHC and IHS. Please note pages 7 – 11, Supplemental Submission No. 3, pg. 1 – 23 of the enclosed ANTHC memorandum.

OIG RESPONSE 2 We acknowledge that ANTHC has attempted to obtain indirect cost rates subsequent to the start of our audit work and that HHS will not approve a rate for construction projects. Title 2 CFR Part 225, Appendix E, Sections D and E require an organization claiming indirect costs under a federal award to either: (1) submit an indirect cost rate proposal for negotiation and approval to the cognizant federal agency or (2) maintain a certified proposal and supporting documentation on file for audit. ANTHC's November 20, 2007, certified indirect cost proposal submitted to HHS is an acceptable cost allocation plan that is in compliance with Title 2 CFR Part 225, Appendix E. Consistent with Title 2 CFR Part 225, we have not questioned indirect costs incurred by ANTHC that are supported by rates that have been approved by HHS. We acknowledge that ANTHC's November 2007 certified indirect cost proposal includes a construction indirect rate covering administrative costs incurred by DEHE for fiscal year 2006 that were overlooked in the draft report. The report has been corrected to reflect the construction indirect cost rate for 2006. The correction resulted in a \$39,653 reduction in questioned indirect costs. However, the rates approved by HHS and the 2007 certified proposal do not cover all indirect costs incurred under the IA for fiscal years 2007, 2008, and 2009. Therefore, we continue to question \$351,072 in indirect costs that are not supported by rates approved by HHS or the November 2007 certified indirect cost proposal.

IHS' plan to resolve the indirect cost rate issue with a "Joint Operating Guideline," does not meet the requirements of Title 2 CFR Part 225, Appendix E. The planned "Joint Operating Guideline" appears to be a description of the methodology to allocate indirect costs rather than a certified indirect cost rate proposal. Title 2 CFR Part 225 Appendix E, Section D.2 requires the indirect cost proposal to include the rate proposed, including subsidiary worksheets cross referenced and reconciled to financial data. Appendix E, Section D.2 also specifies that the proposal should include a copy of the financial data upon which the rate is based, as well as the amount of base costs incurred under federal awards.

Unallowable Costs: (AR, pg. 6 – 9)

The labor, indirect, equipment, freight, material and subcontract costs have been reviewed by the IHS. The explanation and documentation of these charges can be found on pages 11 – 14 of the ANTHC memorandum. The IHS finds the explanation and documentation provided by ANTHC to be reasonable.

OIG RESPONSE 3 Our position remains unchanged on the questioned costs, with the exception of the corrected questioned indirect costs previously discussed in OIG RESPONSE 2. The explanation and documentation presented in ANTHC's comments to the draft report do not show the questioned costs are allocable or allowable under Title 2 CFR Part 225 as discussed in our detailed responses to those comments. Our detailed response to ANTHC's comments is included in Appendix C of this report.

Recommendations: (AR, pg. 12 – 13)

1. The IHS disagrees with this recommendation with the exception of Item(s) C.1., Equipment Cost for the St. Michael Water Truck (\$74,833) and D., Freight Costs (\$4,999) miscoded for a Fort Yukon project. The IHS will reimburse the EPA for the costs listed above. The explanation and documentation provided by ANTHC in the enclosed documentation, pages 10 – 17, seems reasonable and appropriate.

OIG RESPONSE 4 We accept IHS' decision to reimburse EPA for the water truck and freight costs questioned in the examination report. ANTHC claimed \$74,833 for reimbursement for the water truck and \$4,235 for reimbursement for the freight costs as discussed in the draft report. IHS should proceed with reimbursing EPA for these costs.

Our position on the remaining questioned costs and Recommendation 1 is unchanged, with the exception of the \$39,653 reduction in questioned indirect costs previously discussed in OIG RESPONSE 2. The explanation and documentation presented in ANTHC's comments to the draft report do not show the questioned costs are allocable or allowable under Title 2 CFR Part 225 as discussed in our detailed responses to those comments.

2. The attached documentation provided by ANTHC clearly shows the questioned costs to be allocable, allowable, and reasonable, when the complexity of the questioned projects and the monetary value of this IA are considered.

OIG RESPONSE 5 Our position on the questioned costs and Recommendation 2 remains unchanged, with the exception of the correction in questioned indirect costs previously discussed in **OIG RESPONSE 2**. Based on the correction to the questioned costs, we revised the amount EPA should recover from \$1,047,339 to \$1,007,690 in the final report. Our position on the recommendation is unchanged because the documentation presented in ANTHC's comments to the draft report do not show the questioned costs are allocable or allowable as discussed in our detailed responses to those comments.

3. a., b., d. ANTHC developed a proposed Management Improvement Plan to complement existing systems and provide specialized training for employees. Please see the enclosed ANTHC memorandum, Supplemental Submission No. 1, pages 1 – 6.

OIG RESPONSE 6 IHS's response does not satisfactorily address Recommendation 3(a) and (b). The recommendation specifies that Region 10 require through an amendment to the IA that IHS direct ANTHC to establish cost accounting and billing controls which ensure costs claimed under the agreement meet federal financial criteria. ANTHC's Management Improvement Plan provided with its response to the draft report does not provide assurance that the issues identified during the audit will be satisfactorily resolved for two primary reasons. First, ANTHC has not indicated that it is fully committed to addressing the findings in the report. More specifically, ANTHC states in the plan: "ANTHC believes that the OIG Draft Audit Report's proposed findings are without merit or foundation." Second, the other supplemental submissions submitted by ANTHC supporting its position on the findings indicate that ANTHC continues to incorrectly apply the federal cost principles specified by Title 2 CFR Part 225.

We removed Title 40 CFR Part 31 from Recommendation 3 because ANTHC is not obligated to comply with 40 CFR Part 31 under the IA, as previously discussed in **OIG RESPONSE 1**. We also did not include Recommendation 3(d), which specified establishing controls that ensure costs are correctly coded in ANTHC's accounting system, in the final report. The inconsistent coding issue and associated recommendation were not included in the final report because we did not consider the issue to be material.

3. c. As previously noted, the IHS and ANTHC will draft a JOG prescribing a mutually agreeable methodology for indirect costs by September 1, 2010. The JOG will be added to all future PFAs and P. L. 86-121 agreements. Please see the enclosed ANTHC memorandum, pg. 10.

OIG RESPONSE 7 IHS's response does not satisfactorily address Recommendation 3(c). The recommendation specifies that Region 10 require through an amendment to the IA that IHS direct ANTHC to establish controls which ensure indirect costs are claimed based on indirect cost rates approved by the cognizant federal agency. As discussed previously in OIG RESPONSE 2, IHS's plan to resolve the indirect cost rate issue with a "Joint Operating Guideline," does not meet the requirements of Title 2 CFR Part 225, Appendix E. The planned "Joint Operating Guideline" appears to be a description of the methodology to allocate indirect costs rather than the certified indirect cost rate proposal required by 2 CFR 225, Appendix E.

4. The IHS does not agree that ANTHC should be designated as a high-risk grantee. ANTHC acknowledges that their systems, methodologies and internal controls over reporting costs can be improved. The proposed Management Improvement Plan should improve accuracy in coding and data entry, expand ANTHC guidelines for coding and cost allocation and provide training for employees responsible for those entries. Please see the enclosed ANTHC memorandum, Supplemental Submission No. 1, pages 1 – 6.

OIG RESPONSE 8 Our position recommending that Region 10 designate ANTHC as a high-risk recipient remains unchanged. Our position is based on the material financial management issues associated with ANTHC's accounting system for DEHE discussed in the report and the EPA funding ANTHC receives directly through grants. For example, ANTHC received over \$1.7 million through three EPA grant awards during Fiscal Year 2009. These grants were still active as of March 2010. Because ANTHC is a recipient of EPA funding through grant instruments, EPA may designate ANTHC as "high risk" under Title 40 CFR Part 31.12 based on the issues we identified during the examination as recommended in the report. The special conditions we recommend are intended to establish controls that provide assurance that EPA funds are spent and accounted for in accordance with federal cost principles. As previously discussed in OIG RESPONSE 6, ANTHC's Management Improvement Plan does not provide assurance that the issues identified during the audit will be satisfactorily resolved.

4.a. The IHS disagrees with this recommendation. We recognize the need for documentation of costs. ANTHC will provide supporting documentation for all costs with each reimbursement request. The requirement to seek approval and reimbursement from the EPA for each request makes this recommendation impractical given the value of the Agreements and the number of requests received.

OIG RESPONSE 9 IHS’s comments do not provide sufficient information to assess whether the recommendation is impractical. Therefore, our position on Recommendation 4(a) remains unchanged. The recommendation to require payment on a reimbursement basis is based on the special conditions for high-risk recipients suggested by Title 40 CFR Part 31.12(b). The recommendation is necessary to establish controls that provide assurance that payments made directly or indirectly to ANTHC with EPA funding are allocable and allowable under federal cost principles.

4.b. The IHS cannot agree to this recommendation. The IHS values the opportunity to collaborate with the EPA; however, if the EPA internal review and approval for all reimbursement requests becomes a requirement, then the EPA should consider issuing grants directly to Indian Tribes.

OIG RESPONSE 10 Our position on Recommendation 4(b) remains unchanged. The recommendation to “require review and approval by EPA project managers of reimbursement requests prior to payment” is based on the special conditions for high-risk recipients suggested by Title 40 CFR Part 31.12(b). The recommendation is necessary to establish controls that provide assurance that payments made directly or indirectly to ANTHC with EPA funding are allocable and allowable under federal cost principles.

In regard to IHS’s comment that “EPA should consider issuing grants directly to Indian Tribes,” we recommend that EPA consider the suggestion if IHS is unwilling to concur with the reimbursement process established by Recommendation 4(b).

4.c. The EPA currently receives quarterly updates on each project.

OIG RESPONSE 11 Our position on Recommendation 4(c) remains unchanged. The recommendation to require additional project monitoring by EPA project managers is based on the special conditions for high-risk grantees suggested by Title 40 CFR Part 31.12(b). We acknowledge that the Region 10 project manager for the IA receives quarterly progress reports on the projects funded under the IA. However, the current level of monitoring by the EPA project manager does not appear to be effective based on the findings in our examination report. For example, we questioned \$337,075 in material costs transferred from Fort Yukon Project AN 02-Q66 that was not funded through the IA. ANTHC transferred these costs to the part of Fort Yukon Project AN 05-N96 that was funded through the IA. The scope of work associated with the costs transferred from Fort Yukon Project AN 02-Q66 exceeded the funding limit by \$976,526 before the transfer. Although the scope of work for both Fort Yukon projects included buried sewer mains, the cooperative project agreement for each project identified different areas of the community for the work. Despite the similarities in work, ANTHC's \$337,075 transfer to Project AN 05-N96 removed 100 percent of the material costs recorded in the accounting system for Project AN 02-Q66 at the time of the transaction. ANTHC's quarterly progress reports for Project AN 02-Q66 did not disclose that costs incurred for Project AN 05-N96 caused or contributed to funding limit issue. We questioned the \$337,075 in transferred costs because ANTHC was not able demonstrate in the accounting records, progress reports, and other documents that the costs were allocable to the Fort Yukon project funded through the IA. Recommendation 4(c) is necessary to establish controls that provide assurance that payments made directly or indirectly to ANTHC with EPA funding are allocable and allowable under federal cost principles.

5. The Management Improvement Plan should address financial management processes questioned in the draft Audit Report and provide assurance that ANTHC will meet all applicable administrative and accounting requirements with respect to federal funding.

OIG RESPONSE 12 IHS's response does not satisfactorily address Recommendation 5. The recommendation specifies that Region 10 evaluate costs claimed under other open agreements that fund construction projects managed by ANTHC to ensure costs claimed are reasonable, allocable, and allowable. ANTHC's Management Improvement Plan does not establish an EPA evaluation of costs claimed under other open agreements for construction projects funded by EPA and managed by ANTHC as specified by the recommendation. The Management Improvement Plan also does not provide assurance that the issues identified during the audit will be satisfactorily resolved as previously discussed in OIG RESPONSE 6.

The original projects funded by EPA through IA DW 75-95754001 have been constructed or are currently under construction by ANTHC. The IHS respectfully requests that the OIG review and seriously consider the information provided in this letter and in the enclosed response from ANTHC and cancel the official publication of this Report.

OIG RESPONSE 13 Our position on the findings and recommendations generally remains unchanged, with the exception of the \$39,653 reduction in questioned indirect costs and the inconsistent coding issue as discussed previously in OIG RESPONSE 1 through OIG RESPONSE 12. The questioned costs in the report are based on the federal cost principles specified by Title 2 CFR Part 225. The information and documentation presented in and with IHS's and ANTHC's comments to the draft report do not resolve the findings and recommendations. IHS's comment that the original projects funded by EPA through the IA have been constructed or are under construction by ANTHC also does not address the questioned costs identified during our examination. Therefore, we did not cancel publication of the final report.

If you have questions or need additional information, please contact CAPT Steve Bolan, Director, Sanitation Facilities Construction Branch, Area Office of Environmental Health & Engineering. CAPT Bolan can be reached at (907) 729-2711 or by email at steven.bolan@ihs.gov.

Sincerely,

Christopher Mandregan, Jr., MPH
 Director
 Alaska Area Native Health Service, IHS, DHHS

cc. Michael Owen, EPA
Jan Lister, EPA
Dennis Wagner, EPA
Don Kashevaroff, ANTHC
Steven Weaver, ANTHC DEHE
Matthew Dixon, ANTHC DEHE
Gary Hartz, IHS
Ron Ferguson, IHS
Dale Mossefin, AANHS
Steve Bolan, AANHS

Attachments: ANTHC Memorandum to IHS—Attestation Report Rebuttle Comments
ANTHC DEHE Proposed Management Improvement Plan

Appendix C

Alaska Native Tribal Health Consortium's Comments on the Draft Report and OIG's Evaluation

The response from ANTHC is provided verbatim. OIG responses to those comments have been inserted in text boxes.

February 4, 2010

TO: Christopher Mandregan, Jr., Director
Alaska Area Native Health Services
Indian Health Service

CC: Michael Owen
Janet Lister
EPA OIG – Office of Audit

Michelle Pirzadeh, EPA, Acting Regional Administrator, Region 10

FROM: Don Kashevaroff, CEO, Alaska Native Tribal Health Consortium

RE: EPA OIG Draft Audit Report “Costs Claimed by the Alaska Native Tribal Health Consortium under EPA Interagency Agreement DW 75-95754001,”
Project No. 2008-507 (January 8, 2010)

At your request, pursuant to the terms of certain Project Funding Agreements (“**PFAs**”)¹ between the Alaska Native Tribal Health Consortium (“**ANTHC**”) and the Indian Health Service, U.S. Department of Health and Human Services (“**IHS**”), we provide the following comments with respect to the above-captioned Draft Audit Report (the “**Draft Audit Report**”) to facilitate the response of the IHS to the U.S. Environmental Protection Agency (“**EPA**”), Office of Inspector General (“**OIG**”). ANTHC takes all of the proposed findings contained in the Draft Audit Report very seriously. We provide a response to each specific proposed finding below.

We also include a proposed Management Improvement Plan as we have discussed. That Management Improvement Plan is presented as Supplemental Submission No. 1 in the package of materials that accompany these comments. Those Supplemental Submissions provide

¹ ANTHC and IHS have entered into twenty-nine PFAs with respect to projects for which IHS has received funding pursuant to the Interagency Agreement DW 75-95754001.

(1) documentary support for responses to some of the Draft Audit Report’s specific questioned costs and proposed findings and (2) context and background on certain matters relevant to your response more generally. The Management Improvement Plan addresses several issues identified in the Draft Audit Report, and provides further assurances that ANTHC will continue to meet all applicable administrative and accounting requirements with respect to IHS funding that it manages, whether derived directly from IHS appropriations or through interagency agreements and other arrangements between IHS and other federal agencies. Such IHS funding includes that provided by EPA to IHS under Interagency Agreement DW 75-95754001 (the “**Interagency Agreement**”) for Sanitation Facilities Construction (“**SFC**”) projects in Alaska.

Prior to addressing the specific proposed findings of the Draft Audit Report, ANTHC wishes to correct several misunderstandings, mischaracterizations, and misstatements contained in the Draft Audit Report concerning (1) the distinct legal relationships between EPA and IHS, and IHS and ANTHC, with respect to the administration and management of the funding provided to IHS by EPA under the Interagency Agreement, and (2) the operative rules that result from those relationships and apply to the administration and management of such funding.

I. Relationships, Authority, and Responsibility Regarding Interagency Agreement Funding for Alaska SFC Projects

The “Introduction” and “Independent Attestation Report” sections of the Draft Audit Report do not reflect an accurate understanding of the Interagency Agreement, the legal form and function of ANTHC, or its relationship with IHS. This Memorandum will explain the effect of the correct characterization of these matters on the applicable regulatory and oversight regime for these SFC projects.

Pursuant to Section 518 (c) of the Clean Water Act, 33 U.S.C. § 1377, EPA is required to set aside a portion of its available funding for water treatment improvement projects benefiting Indian tribes and Alaska Native Villages. In Alaska, EPA discharges this obligation through the Interagency Agreement with IHS.²

² The Interagency Agreement, at Programmatic Terms and Conditions – Authority and Purpose, states that:

The services and facilities will be provided to [each Tribe with an approved project] by the U.S. Alaska Area Indian Health Service (IHS) pursuant to an Interagency Agreement (IAG) between EPA and IHS under the authorities of PL 86-121, and section 518 (c) of the Clean Water Act of 1987, as amended (Public Law 100-4).

Among other matters, Pub. L. 86-121 authorizes the Secretary of Health and Human Services:

to make such arrangements and agreements with appropriate public authorities and nonprofit organizations or agencies and with the Indians to be served by such sanitation facilities (and any other person so served) regarding contributions toward the construction, improvement, extension and provision thereof, ...

42 U.S.C. § 2004a(a)(3).

An interagency agreement is a vehicle through which a federal department or agency may acquire goods or services through another federal department or agency under specific authority, such as Pub. L. 86-121, or the more general authority of the Economy Act, 31 U.S.C. § 1535, 52 Comp. Gen. 128 (1972). An interagency agreement is not a grant agreement. Instead, it is a means by which one federal department or agency may utilize the resources of another to enable such first contracting department or agency to carry out its own mission.³

OIG RESPONSE 1 The term “grant” was an oversight in the Independent Attestation Report. We have revised the report to the correct term of “interagency agreement.”

The Interagency Agreement acknowledges that IHS may provide services funded by the Interagency Agreement through PFAs with ANTHC, as authorized by Title III [superseded by Title V] of the Indian Self-Determination and Educational Assistance Act (“**ISDEAA**”), Pub. L. 93-638, 25 U.S.C. § 450(f) note, and Section 325 of Pub. L. 105-83, and that IHS intends to do so. However, the contractual relationship and associated responsibility under the Interagency Agreement is clearly between IHS and EPA.⁴

ANTHC is not simply a subcontractor or sub-recipient of federal funding. It serves a much more comprehensive and unique role with respect to the conduct of the IHS Alaska Area Office’s federal programs, functions, services, and activities (“**PFSAs**”). Congress authorized the formation of ANTHC to provide all statewide health services provided by IHS through the Alaska Native Medical Center and the Alaska Area Office. Pub. L. 105-83, § 325(a). This Act provided that any PFSAs provided as part of statewide health services “may only be provided by the Consortium.” *Id.* § 325(c). Except for certain retained IHS functions,⁵ ANTHC has assumed

³ “The 1987 Amendments to the Clean Water Act (Section 518(e)), directed EPA to work with IHS to identify and address the sanitation needs of tribes. To accomplish this, EPA entered into an interagency agreement and memorandum of understanding with IHS in 1988 to provide help with the administration of the Clean Water Act Indian Set Aside (“CWISA”) Program. Because EPA does not have the resources necessary at the field level to administer project grants by itself, this partnership has allowed EPA and IHS to work together to leverage the technical resources available through both agencies to address tribal sanitation needs. However, final decisions to fund CWISA Program projects are made by the EPA.” EPA, Clean Water Indian Set-Aside Grant Program, Answers to Frequently Asked Questions (March 2007) (“CWISA FAQs”), #33.

⁴ “Notwithstanding the above [concerning IHS’s intent to provide its services through PFAs with ANTHC], IHS shall ensure that the work is carried out in accordance with the scope of work and conditions of the IAG.” Interagency Agreement: Programmatic Terms and Conditions – Authority and Purpose. (Emphasis added.)

⁵ Among the IHS retained functions identified on pages 5 and 6 of a Memorandum of Agreement Describing Continuing Services of IHS, attached to ANTHC’s Annual Funding Agreement as Appendix C, are (1) allocation of federal project funding, (2) “oversight, facilitation and management of contributed sanitation facility construction funding from other federal and state agencies,” (3) evaluation and approval of projects, and (4) verification of project development, documentation,

and manages IHS's SFC Program in Alaska. Thus, ANTHC is actually operating the federal PFSA's pursuant to Pub. L. 105-83 and Title V of the ISDEAA, and is not a subcontractor of the IHS's SFC Program.

A review of the relevant documentation and agreements shows that there is no contractual relationship established between EPA and ANTHC. The Interagency Agreement contemplates that some deliverables owed from IHS to EPA may actually be provided by ANTHC as manager of the SFC Program, pursuant to Pub. L. 105-83 and Title V of the ISDEAA, 25 U.S.C. § 458aaa, *et seq.*, but does not create any direct obligation or relationship between ANTHC and EPA.⁶ The PFAs between IHS and ANTHC incorporate the terms of the Interagency Agreement, with respect to the description of the scope of each particular project to which it applies, but at no point does it include an assignment and assumption of duties owed by IHS to EPA under the Interagency Agreement.⁷ Some versions of the PFA include provisions that require ANTHC, "as the sanitation facilities program manager," to IHS to "abide by the

funding, construction and closeout. A copy of this Memorandum of Agreement is provided as Supplemental Submission No. 2.

⁶ Under the terms of the Interagency Agreement, responsibility for the performance of the duties owed to EPA rests with IHS.

- Programmatic Condition #13 requires IHS, "as the Federal Government's manager of the funds under all phases of the project," to maintain records reflecting transfers and expenditures of "funds received from EPA for Clean Water Act Indian Set-aside projects"; sets out the requirements of periodic reports IHS is to provide to EPA; requires separate reports for each EPA funded project; and mandates that EPA funds be highlighted in the report if combined with other funds. Programmatic Condition #13 also mandates that: "The reports shall be certified by the IHS Director – DSFC."
- "The IHS through the Alaska Native Tribal Health Consortium (ANTHC) will complete the design, construction, and provide construction management of the project described in Attachment A" IHS Contributions #7.
- A number of the IHS Contribution Conditions provide that duties to be performed will be performed by IHS or ANTHC, IHS and/or ANTHC, or IHS/ANTHC. IAG, IHS Contributions #: 2, 5, 6, 9, 10, 11, 18, 20, 22, and 23, but it is the IHS which is ultimately responsible to EPA. (See footnote 4 above.)
- Pursuant to IHS Contributions #24, "The IHS shall provide the EPA Project Officer a final financial accounting of project expenditures for the work at the end date of this Agreement."
- IHS Contributions #27 requires that "IHS shall provide" a final technical report "prepared by IHS and/or the ANTHC" to EPA, including "the final costs incurred" within one year of completion.

(Emphasis added.)

⁷ Each PFA clearly states that the entirety of the funding is being provided by IHS/DHHS, although each PFA for a project partially funded under the Interagency Agreement states that a portion of the funding will be requested from EPA as the contributor. The PFA describes all duties of ANTHC as being owed to IHS.

conditions provided in the [Interagency Agreement]” and to provide “all requested reporting and managerial requirements” under the Interagency Agreement “to IHS as requested.”⁸ These provisions recognize the IHS will need assistance of ANTHC, as SFC Program Manager, to meet IHS’s duties to EPA, but do not represent an undertaking by ANTHC to (a) render performance directly to EPA, or (b) assume any direct obligation to EPA.⁹ The Cooperative Project Agreement between ANTHC, as SFC Program Manager, and the beneficiary Tribe or Native Village defines the scope of the project consistently with the Interagency Agreement and PFA, and deals with project-specific issues of interest to the beneficiary, but does not affect the separate and distinct relationships under the Interagency Agreement and PFA.¹⁰ The Interagency Agreement creates a bilateral contractual relationship between EPA and IHS, and the PFA creates a bilateral contractual relationship between IHS and ANTHC. IHS coordinates the terms of both agreements so that it can require performance and meet its obligations as the pivotal party in the execution of SFC projects, but no direct relationship between EPA and ANTHC is formed.

With respect to an earlier audit resulting in an informal OIG finding that ANTHC had, in its view, inappropriately earned interest on advance payment of EPA-sourced funding, EPA acknowledged that it does not have contractual privity with ANTHC, and that IHS has the sole authority to consider the merits of the OIG’s informal finding and determine whether to seek recovery from ANTHC.¹¹ Although the EPA-sourced funding in that earlier episode was

⁸ Emphasis added. Twelve of the PFAs have this language, while the others are silent on this point.

⁹ Each PFA is exclusively between IHS and ANTHC. IHS may require ANTHC to provide information and act in a manner that enables IHS to discharge its duties under its separate bilateral agreement with EPA. However, there is no provision in any PFA that provides for ANTHC to undertake any direct duty to EPA.

¹⁰ On page 3 of the Draft Audit Report, EPA OIG reasons that ANTHC is eligible for funding under Section 518(c) of the Clean Water Act as a Tribal Organization, and so 2 C.F.R. Part 225 applies to it. In fact, the Interagency Agreement, as well as the PFAs and Cooperative Project Agreements for each project, make clear that the eligible recipients, and the actual beneficiaries, of Indian Set-aside funding are Tribes or Native Villages. ANTHC is the manager of the IHS Alaska Area Office’s SFC Program that executes the SFC Project pursuant to the PFA, not the beneficiary or recipient of funding.

¹¹ In her October 3, 2006 Letter to Adm. Gary Hartz regarding the issue of ANTHC earning interest on EPA contributed funds, EPA Region 10’s Acting Regional Administrator, stated:

Notwithstanding it’s [*sic*] informal finding that the interest is not exempt, EPA’s OGC concluded that EPA is not the appropriate federal entity to seek reimbursement of funds from ANTHC because of the intervening award made by IHS. ANTHC is not a true sub-recipient to an EPA grant. ANTHC is required to comply with the terms of its agreement with IHS and not the terms of the agreement between Alaska and EPA. In other words, EPA is not in privity with ANTHC. Thus, responsibility to address any interest or dividend issues rests with IHS. EPA Region 10 concurs with this opinion.

channeled through the State of Alaska Village Safe Water Program, as with the contractual arrangements used to administer the funding transferred by EPA to IHS under the Interagency Agreement, the only party that had a contractual relationship with ANTHC was IHS pursuant to its PFAs and Self-Governance Compact and Funding Agreement. As in the prior case, EPA has no contractual privity with ANTHC, and the determination of the merits of the proposed findings of the Draft Audit Report, and whether any action should be taken with respect thereto, rests with IHS. The same conclusion is compelled here.

OIG RESPONSE 2 We agree that EPA's primary contractual relationship is between EPA and IHS under the IA. For PFAs between IHS and ANTHC that are partially or fully funded by EPA through the IA, ANTHC is a sub-recipient of EPA funding. Because EPA is the primary funding agency under the IA, the recommendations in the report are directed to the Regional Administrator for Region 10 to disallow and recover questioned costs from IHS and to establish additional controls over EPA funding provided directly or indirectly to ANTHC. The terms in the IA include the recovery from IHS of unallowable costs identified during an audit. Consistent with these terms, our recommendations include the recovery of \$1,007,690 in questioned costs claimed by ANTHC from IHS.

II. Applicable OMB Cost Principles and Agency Regulations

A. Agency Regulations. When one federal agency enters into an interagency agreement with another to procure goods or services, the funds provided by the requesting agency (in this case, the EPA) will be administered and the project carried out in accordance

Given that Indian Health Service is the Federal expert in 42 U.S.C. 2004a and the Indian Self Determination Act, and has privity with ANTHC, EPA requests that you accept our referral for IHS to review and take action on the recommendation of the EPA IG for ANTHC to remit the portion of interest representing dividends from EPA-invested funds since the formation of ANTHC. EPA will respect the Indian Health Service's findings and actions on this issue and will consider the findings and actions the final resolution on this issue. Further, EPA will notify EPA's IG that this recommendation has been formally referred to the Indian Health Service.

Subsequently, EPA formally acknowledged that, on advice of EPA Office of General Counsel, the interest issue was referred to IHS which had legal responsibility over it, and that IHS determined not to accept the OIG's informal finding and not to seek repayment since IHS determined there was nothing prohibiting ANTHC from earning interest in the circumstance at issue. EPA OIG Audit Report No. 09-P-0085, January 21, 2009. As the basis of such IHS determination, Adm. Hartz verified that, consistent with IHS national guidance and requirements, ANTHC had supplemented the funding for the projects with at least as much as or more than the amount of the interest earned to enhance the projects for which it had received the funding.

with the servicing agency's rules and regulations (in this case, those of IHS). EPA recognizes this principle in its "Frequently Asked Questions" published guidance.¹² The IHS recognizes this principle in its Manual.¹³ And both the Alaska Area Native Health Service and EPA Region 10 have recognized this principle in an MOU between them.¹⁴ Therefore, the Common Rule as stated in 45 C.F.R. Part 74 or 92 will apply to the administration of funding provided by EPA to IHS under the Interagency Agreement, and not 40 C.F.R. Part 31, as the Draft Audit Report states.¹⁵

OIG RESPONSE 3 We agree that the ANTHC is not obligated to comply with Title 40 CFR Part 31 under the IA. We have made changes to the report as appropriate. However, our position on designating ANTHC as a "high risk" grantee under Title 40 CFR Part 31 remains unchanged. Our position is based on the material financial management issues associated with ANTHC's accounting system for DEHE discussed in the report and the EPA funding ANTHC receives directly through grants. For example, ANTHC received over \$1.7 million through three EPA grant awards during Fiscal Year 2009. These grants were still active as of March 2010. Because ANTHC is a recipient of EPA funding through grant instruments, EPA may designate ANTHC as "high risk" under Title 40 CFR Part 31.12 based on the issues we identified during the examination as recommended in the report.

B. OMB Circulars. ANTHC is both (1) a consortium of tribes and tribal

¹² "The CWISA Program funds are transferred by the EPA Region to the IHS Area office using an Inter-Agency Agreement (IAG) signed by both EPA and IHS. CWISA Program funds that are transferred to the IHS Area office will be administered by IHS under its policies and guidelines including applicable Federal requirements, such as environmental review, and subject to its authorizing statutes (including the Indian Self-Determination Act, Indian Health Care Improvement Act, and P.L. 86-121 (42 U.S.C. 2004a))." CWISA FAQs #28.

¹³ "When another agency enters into an inter-agency agreement to transfer project funds and responsibilities to the IHS, the IHS administrative policies and procedures will generally apply (e.g., procurement, environmental review, and audit procedures) subject to any specific mutually agreed upon provisions in an inter-agency agreement." IHS Manual, Part 5, Chapter 2, page 62.

¹⁴ MOU Between the IHS and the Environmental Protection Agency for Development of Indian Sewer Set-Aside Projects in Alaska, Public Law 86-121, April 1990 ("Where EPA enters into an agreement to transfer project funds and responsibilities to IHS, IHS administrative policies and procedures will apply [e.g. procurement, environmental review, audit procedures, and accounting principles].")

¹⁵ There is a separate issue whether the Common Rule applies at all given that the PFAs and funds provided thereunder are supplements to ANTHC's Title V ISDEAA Funding Agreement as well as Pub. L. 86-121 agreements. However, it is not necessary to resolve that issue for purposes of this response to EPA OIG, and the Common Rule as stated in HHS regulations will be assumed to apply.

organizations established pursuant to Congressional authority under Pub. L. 105-83, § 325, and (2) a not-for-profit organization formed under Alaska law to carry out its Congressionally sanctioned mission. Therefore, either OMB Circular A-87, 2 C.F.R. Part 225, or OMB Circular A-122, 2 C.F.R. Part 230, may apply to it, to the extent cost principles are relevant to the operation of particular programs. It is not clear that the application of one Circular in certain circumstances would necessarily preclude the application of the other in differing circumstances, or that there are not circumstances in which each Circular may apply in part. However, those issues are beyond the scope of what is required to address the Draft Audit Report. The Draft Audit Report applies the cost principles applicable to Tribal Governments, OMB Circular A-87, 2 C.F.R. Part 225. Given the nature of ANTHC's role in the transactions at issue, ANTHC has formulated these comments on the basis of the application of the cost principles of A-87, Part 225, to the Projects with respect to which EPA OIG proposes to make findings.

OIG RESPONSE 4 We acknowledge ANTHC's comments on the applicability of Title 2 CFR Part 225 and 230. Our position remains unchanged. As discussed in the Independent Attestation Report, the IA was awarded under Section 518(c) of the Clean Water Act, which limits the funding for the IA to federally recognized Native American tribes. As a tribal recipient of federal funding under the IA, ANTHC is obligated to comply with Title 2 CFR Part 225.

C. Indirect Cost Rate/Cost Allocation Plan. A substantial portion of the questioned/claimed costs identified in the Draft Audit Report arise from the EPA OIG's proposed finding that ANTHC claimed indirect costs for which it did not have an approved rate or certified proposal. We address the specific proposed findings below, but will begin by describing the circumstances out of which it arises more generally in order to provide the appropriate context for the discussion that follows.

First, we wish to correct a factual premise behind EPA OIG's proposed finding: that ANTHC did not have a certified cost proposal that included SFC construction indirect costs of ANTHC's Division of Environmental Health and Engineering ("DEHE"). We provide a copy of the certified indirect cost proposal that was submitted to ANTHC's cognizant agency, U.S. Health and Human Services Department, Division of Cost Allocation, as Supplemental Submission No. 3. This submission should be dispositive and lead to the withdrawal of the proposed findings regarding indirect costs. However, to provide IHS with the complete picture, we will describe the basis of the refusal of HHS to issue a negotiated construction indirect rate, the position in which it has placed ANTHC, the guidance received from EPA's Grants Officer, and the alternate method that ANTHC has been required to use to recover these clearly allowable costs that are appropriately allocable to the SFC Projects consistent with the principles of 2 C.F.R. Part 225.

OIG RESPONSE 5 We acknowledge that the referenced certified indirect cost proposal dated November 20, 2007, includes a construction indirect rate covering administrative costs incurred by DEHE for fiscal year 2006 that was overlooked in the draft report. The report has been corrected to reflect the construction indirect cost rate for 2006. The correction resulted in a \$39,653 reduction in questioned indirect costs. However, the proposed rates from this 2007 submission do not apply to all indirect costs incurred. Therefore, we continue to question \$351,072 in indirect costs incurred under the IA.

ANTHC has actively sought a construction indirect rate to simplify its administration and management of SFC projects. It remains willing and motivated to negotiate such a rate if available. However, HHS has taken the position that, since its rules do not allow for construction indirect costs for projects such as SFC,¹⁶ it will not negotiate such a rate with ANTHC. Unless that position changes, further efforts to obtain a construction indirect rate are futile.

OIG RESPONSE 6 We acknowledge that ANTHC has attempted to obtain indirect rates subsequent to the start of our audit work and that HHS will not approve a construction rate. However, Title 2 CFR Part 225, Appendix E, does allow for preparation of a certified and documented indirect cost proposal in order to claim indirect costs under a federal award. The proposal and related documentation must be maintained for audit. Under Title 2 CFR Part 225, Appendix E, ANTHC is not required to submit the proposal unless the submission is specifically requested by the cognizant agency. We have not questioned indirect costs incurred by ANTHC that are either supported by approved rates or the November 20, 2007, indirect cost proposal. However, the rates approved by HHS and the 2007 proposal do not cover all indirect costs claimed under the IA for Fiscal Years 2007, 2008, and 2009. At a minimum, ANTHC needs to prepare a new proposal meeting the requirements of Title 2 CFR Part 225, Appendix E in order to claim costs incurred for Fiscal Years 2007 through 2009 that are not covered by the indirect cost rates approved by HHS or the 2007 cost proposal.

Lacking the ability to obtain a negotiated construction indirect rate, ANTHC was required to use a Cost Allocation Plan methodology authorized by Attachment C of 2 C.F.R. Part 225. That approach was accepted and confirmed in e-mails from HHS's Senior Negotiator and EPA's Grants Officer.¹⁷ The methodology used by ANTHC was consistent with the principles

¹⁶ A Guide for Nonprofit Organizations, Cost Principles and Procedures for Establishing Indirect Costs and Other Rates for Grants and Contracts with the Department of Health and Human Services, OASMB-5, page 6.

¹⁷ In August, 2008, several e-mails concerning this topic were exchanged among Garvin Federenko, ANTHC's Senior Director, Finance and Administration; Patrick Smith, HHS Senior Negotiator, Division of Cost Allocation; and Bob Phillips, EPA Grants Officer.

described in Attachment C of 2 C.F.R. Part 225 and ANTHC's certified indirect cost proposal for

An August 6th e-mail discussed HHS's position regarding the ANTHC requested construction indirect rate and Mr. Smith's understanding of conversations that he had with Mr. Phillips and Mr. Federenko regarding that matter, as follows:

This is regarding the Alaska Native Tribal Health Consortium (ANTHC) request to issue a separate indirect cost rate to be used on EPA construction awards. According to our base descriptions, capital (construction) projects are a base exclusion. It is our understanding that, generally, indirect cost rates are not used to reimburse indirect costs on construction awards.

The following is a summary of our conversations regarding an indirect cost rate for the Construction function of ANTHC:

I talked with Bob Phillips, US-EPA Grants Officer, and discussed EPA's need for a separate construction rate. Mr. Phillips stated that EPA did not have a direct construction grants with ANTHC. The direct construction grants are with the St. of Alaska and that ANTHC is a sub-grantee. As such, a published Construction indirect cost rate is not necessary, but that ANTHC should have documentation on file to support the indirect costs allocated to the construction function.

In discussions and emails with Garvin Federenko, ANTHC Finance Officer, he stated that for FY08 and beyond, ANTHC is implementing a methodology in accordance with the Federal cost principles to allocate the indirect costs between the Hospital, Non-hospital, and Construction (ANTHC Environ. Health & Engineering Division) functions. Garvin stated that there will be a separation, and therefore no duplication of indirect costs between the various functions. HHS-DCA will continue to issue only Hospital and Non-Hospital indirect cost rates for ANTHC.

On August 7, Mr. Phillips provided the following clarification to Mr. Smith:

Patrick,

I want to clarify my statement just a bit.

In my understanding of the general rules and regulations governing indirect costs, a cost allocation plan is considered an acceptable substitute for an established indirect cost rate agreement. It is understood that ANTHC has established indirect rates through HHS as their cognizant agency, but based on my understanding of the general rules and regulations, they would be entitled to use a cost allocation methodology for construction grants, in lieu of having to establish a separate indirect cost rate agreement.

* * *

It is correct that we do not currently have any direct construction grants with ANTHC – EPA does have other types of direct agreements with ANTHC.

which it was unable to negotiate a rate. In fact, ANTHC's DEHE Administration and Pool Cost Allocation Plan resulted in an effective recovery rate that was essentially the same as the certified indirect proposal would have permitted, had HHS been willing to negotiate a construction rate. Given the obstacle raised by its cognizant agency's position, and ANTHC's good faith efforts to deal with that circumstance, any technical objection that EPA OIG may raise with respect to ANTHC's approach must be considered in light of the record as a whole.

OIG RESPONSE 7 Comments by EPA Region 10 referenced in Footnote 17 are general guidance regarding an acceptable methodology to claim indirect costs under Title 2 CFR Part 225. The applicable criteria for use of a cost allocation plan are provided in Title 2 CFR Part 225, Appendix E. Appendix E, Section D.1.d, requires indirect cost proposals to be developed within 6 months after the close of the governmental unit's fiscal year, unless an exception is approved by the cognizant agency. Appendix E, Section D.2, requires the proposal include the rate proposed, including subsidiary worksheets cross referenced and reconciled to financial data. The proposal should include a copy of the financial data upon which the rate is based, as well as the amount of base costs incurred under federal awards. The proposal must also include a certification as specified by Appendix E, Section D.3. The DEHE Administration and Pool Cost Allocation Plan is a general narrative of the methodology used to allocate indirect costs, and does not include the supporting details and data specified by 2 CFR Part 225, Appendix E. Therefore, our position on the \$351,072 in questioned costs discussed in OIG RESPONSE 5 above remains unchanged.

The proper methodology for submission and documentation of a cost allocation plan is covered under Title 2 CFR Part 225, Appendix E, rather than the cited Appendix C in ANTHC's response. Appendix C covers State/Local-Wide central services such as motor pools and computer centers. Appendix E covers state and local indirect cost rate proposals.

ANTHC is willing to use the Cost Allocation Plan approach going forward in recognition of HHS's position, even though negotiation of a construction indirect rate would simplify ANTHC's administrative burden in this area. Should EPA Region 10 no longer concur in that approach, it is incumbent on EPA to notify HHS as ANTHC's cognizant agency pursuant to 2 C.F.R. Part 225, Attachment C, Section E.1, and to convince HHS to change its position. ANTHC will continue its on-going efforts to resolve this matter in a reasonable manner and requests IHS's assistance in doing so. However, given ANTHC's good faith and diligence in dealing with the obstacle presented, EPA OIG's proposed finding – that ANTHC's use of a valid method for recovering clearly allowable and allocable costs was not permissible, even though it was the only one available to ANTHC because of HHS's position – is clearly unfair and incorrect.

OIG RESPONSE 8 A cost allocation plan prepared in accordance with Title 2 CFR Part 225, Appendix E, is an acceptable method for claiming indirect costs. ANTHC's November 20, 2007, certified indirect cost proposal is the most recent proposal submitted to HHS that meets the requirements of 2 CFR Part 225, Appendix E. As explained in OIG RESPONSE 6, we have not questioned indirect costs that are either supported by approved rates or the November 20, 2007, indirect cost proposal. ANTHC needs to prepare a new proposal meeting the requirements of Title 2 CFR Part 225, Appendix E, in order to claim costs that are not covered by the indirect cost rates approved by HHS or the 2007 cost proposal. Therefore, our position on the questioned \$351,072 in indirect costs incurred under the IA remains unchanged.

We enclose a copy of the DEHE Administrative and Pool Cost Allocation Plan that reflects the recovery principles that ANTHC-DEHE consistently used for DEHE administrative and pooled costs throughout the audit period as Supplemental Submission No. 4. As stated in the Management Improvement Plan, we are willing to consider any comments that IHS may provide to improve this DEHE Administrative and Pool Cost Allocation Plan and to modify the Plan for prospective use, as appropriate.

OIG RESPONSE 9 The referenced DEHE Administrative and Pool Cost Allocation Plan is a narrative description of the methodology used to allocate costs. However, the plan does not meet the requirements of Title 2 CFR Part 225, Appendix E. Appendix E, Section D.1.d, requires indirect cost proposals to be developed within 6 months after the close of the governmental unit's fiscal year unless an exception is approved by the cognizant agency. ANTHC's plan covers prior, current, and future fiscal years, but was not certified until February 2010. Therefore, the plan was not developed within this 6-month period, nor was an exception from HHS obtained as specified by Title 2 CFR Part 225, Appendix E. Title 2 CFR Part 225 Appendix E, Section D.2, requires the proposal include the rate proposed, including subsidiary worksheets cross-referenced and reconciled to financial data. Appendix E, Section D.2, also specifies that the proposal should include a copy of the financial data upon which the rate is based, as well as the amount of base costs incurred under federal awards. ANTHC's plan did not include the proposed rate or rates and the specified supporting financial data.

III. Response to Specific Proposed Findings

A. Indirect Costs Claimed without Approved Rates or Certified Proposal – Draft Audit Report, page 5.

1. *Disallowance of \$77,230 of corporate indirect cost for alleged lack of approved rate for construction projects during 2008 and 2009.* This proposed finding is based

on an erroneous reading of ANTHC's negotiated rate agreement for those years. HHS's negotiator added a confusing footnote to the agreement regarding the exclusion of DEHE's indirect costs from the indirect cost pool numerator to compute the rate, which the negotiator failed to clarify despite the request of ANTHC's CFO to do so. However, it is clear from the data submitted in support of the rate negotiation that DEHE administrative salaries consistently were included in the allocation base denominator, and properly allocated to DEHE's individual projects, including SFC, throughout the audit period. *See* Supplemental Submission No. 5. Therefore, this proposed finding must be withdrawn and a corresponding adjustment needs to be made with respect to questioned and claimed costs.

OIG RESPONSE 10 HHS's negotiator has been consistent in his discussions with the OIG that he removed all DEHE costs from the base used to calculate the provisional non-hospital indirect cost rates for fiscal years 2008 and 2009. Therefore, the indirect cost rates approved by HHS are not applicable to DEHE construction projects. We also note that, in order to properly allocate costs to the individual construction projects, the base should include costs that represent construction activities. DEHE administrative salaries are indirect costs and do not represent construction activities. We continue to question the \$77,230 in indirect labor costs incurred under the IA.

2. *Disallowance of \$313,495 in indirect costs due to alleged lack of approved rate or certified proposal.* As explained at Section II.C above, this proposed finding is based on the premise that ANTHC did not have a certified rate proposal for these costs. This is incorrect. In addition, these costs were properly allocated pursuant to a cost allocation plan methodology consistent with 2 C.F.R. Part 225, to which ANTHC was forced to resort due to its cognizant agency's refusal to issue it a construction rate. As documented at footnote 17, the EPA Grants Officer properly observed that the use of a cost allocation plan to allocate these costs to particular projects is permitted under 2 C.F.R. Part 225. The EPA Grants Officer thus concurred in the approach that ANTHC was forced to take out of necessity. Therefore, this proposed finding must be withdrawn, and a corresponding adjustment needs to be made to questioned and claimed costs.

OIG RESPONSE 11 Indirect costs that ANTHC correctly allocated based on the certified indirect cost proposal dated November 20, 2007, have not been questioned in the final report as explained previously in OIG RESPONSE 6. The referenced DEHE Administrative and Pool Cost Allocation Plan does not meet the requirements of Title 2 CFR Part 225, Appendix E, as discussed previously in OIG RESPONSE 9. Therefore, we continue to question the \$273,841 in indirect costs incurred under the IA.

B. Labor Costs Not Allocable to IA – Draft Audit Report, page 6.

1. *Disallowance of \$128,925 of labor costs transferred from a project not funded by the IA.* As described at greater length at Section III.H.2 below, SFC administration in Alaska is a complex process that can result in costs being initially allocated among projects in a manner that is determined incorrect upon review of senior DEHE accounting personnel. The Inter-Project Cost Transfer Memorandum provided as Supplemental Submission No. 6 contains the justification for, and an itemized breakdown of, the adjusting entry of \$128,925 highlighted in the Draft Audit Report. This amount came from a project supported by funding from the Alaska Native Village Program and was transferred to the project funded through a PFA partially funded by IHS from EPA's contribution to it under the Interagency Agreement. All of those costs are allowable and appropriately allocable to the project to which this transfer was made, as documented by Supplemental Submission No. 6. The EPA-supported project derived a benefit from all of the transferred costs. Therefore, this proposed finding must be withdrawn and, as invited by EPA OIG in proposed Recommendation #2 on page 12 of the Draft Audit Report, a corresponding adjustment needs to be made to the amount of questioned and claimed costs.

OIG RESPONSE 12 Supplemental Submission No. 6 does not provide the details necessary to verify that the \$128,925 in labor costs transferred from Fort Yukon Project AN 02-Q66 benefited and was allocable to the EPA funded Fort Yukon Project AN 05-N96. Supplemental Submission 6 is a memorandum dated February 4, 2010, explaining ANTHC's justification for the transfer with an attachment showing the adjusting transaction for the transfer in accounting system. The memorandum explains that the transferred costs were part of a "reconciliation to insure cost allocations amongst projects are fair and to correct erroneous coding." However, Supplemental Submission No. 6 does not include payroll data showing that the labor costs were incurred for work that was allocable to the EPA-funded project.

We also note that, at the time of the transfer to the EPA funded part of Project AN 05-N96, Project AN 02-Q66 had exceeded the funding limit by \$976,526. Although Project AN 02-Q66 had exceeded its funding limit, ANTHC's quarterly progress reports did not disclose that the costs incurred for the EPA-funded part of Project AN 05-N96 caused or contributed to the cost issue. ANTHC has not provided information and documentation clearly showing that the transferred costs were allocable to the IA. Therefore, we continue to question the \$128,925 in labor costs incurred under the IA.

2. *Disallowance of \$26,092 of Indirect Costs.* As explained at Section II.C above, these costs are allowable and appropriately allocable to this project. They represent DEHE central service costs appropriately classified as labor. Therefore, this proposed finding must be withdrawn and a corresponding adjustment needs to be made to questioned and claimed costs.

OIG RESPONSE 13 As discussed in the report and in OIG RESPONSE 5 through OIG RESPONSE 11, ANTHC did not have the required approved indirect cost rate agreements or a certified indirect cost rate proposal on file to support the costs incurred for DEHE. Therefore, we continue to question the \$26,092 in indirect labor costs incurred under the IA.

C. Equipment Cost Transfer Not Allocable to IA – Draft Audit Report, pages 6-7.

1. *Equipment Cost Transfer Not Allocable to IA -- \$74,833 for Saint Michael Water Truck.* ANTHC agrees this item was inadvertently miscoded and allocated to a project for which some of the funding provided by IHS pursuant to its PFA with ANTHC was derived from IHS's Interagency Agreement with EPA. ANTHC has reversed its entry and has refunded this amount to IHS pursuant to the PFA.

OIG RESPONSE 14 We acknowledge ANTHC's concurrence on this finding. EPA Region 10 should recover the \$74,833 in questioned costs from IHS as recommended in the report.

2. *Indirect Costs Classified as Equipment Costs Not Allocation to IA – Disallowance of \$24,481 “overhead component” of equipment rental fee methodology implemented in October 2007.* As explained at page 3 above, ANTHC assumed management and operation of IHS's Alaska Area SFC Program pursuant to Pub. L. 105-83, § 325, and its Title V Self-Governance Compact and Funding Agreement with IHS, in FY 1999. Part of the IHS SFC Program over which ANTHC assumed control was an equipment pool serving all of the SFC projects in Alaska.¹⁸ Part of the cost associated with that pool was the centralized administration and management functions associated with managing the state-wide equipment fleet, which we discuss in this section regarding the proposed finding described above. Historically, IHS also pooled all other equipment maintenance and repair costs – a practice ANTHC modified on 10/01/07. We discuss that pooling method with respect to another proposed finding at Section F.2. below. Under the current methodology, maintenance and repair for a piece of equipment is directly billed to the project it is working on. Therefore, the issue here concerns only the small portion of the administrative and management function associated with managing the fleet.

¹⁸ The associated issue of the use of a “Percentage of Blue Book” cost allocation plan methodology for the DEHE project equipment pool prior to FY'08 is discussed below at Section III.F.2.

While ANTHC is authorized to make changes to the programs it has compacted,¹⁹ such as SFC, it is not required to do so. ANTHC has progressively made improvements in the SFC Program it assumed, such as those described at Section III.H.3 below. However, ANTHC must deal with its on-going challenge of operating hundreds of active projects and keeping them appropriately supported with properly repaired and maintained equipment as it designs and implements such improvements. ANTHC has also had to address the expectations of the multiple funding agencies it works with regarding SFC projects and their concerns that the IHS Program that they were comfortable dealing with not be changed too radically or quickly.

ANTHC, through much effort and as noted above, has succeeded in assigning to specific pieces of equipment direct depreciation and idle time charges, as well as nearly all repair and maintenance costs. However, the pooled equipment support function – essentially administration and overhead associated with supporting the entire Unit managing the equipment pool and the handful of maintenance and repair costs that cannot be reasonably assigned to a specific project – continues to be treated as a pool because of the difficulty in directly allocating such costs, particularly in view of the administrative structure that ANTHC inherited from IHS. This pool approach is consistent with a cost allocation plan under Appendix C of 2 C.F.R. Part 225. Therefore, the allocation of these costs to the project at issue is appropriate and in accordance with 2 C.F.R. Part 225, this proposed finding must be withdrawn, and a corresponding adjustment needs to be made with respect to questioned and claimed costs.

We enclose a copy of the DEHE Pooled Equipment Support Cost Allocation Plan reflecting these cost recovery principles and consistently used for DEHE since 10/01/07. (*See* Supplemental Submission No. 7). As stated in the Management Improvement Plan, we are willing to consider any comments that IHS may provide to improve this DEHE Pooled Equipment Support Cost Allocation Plan and to modify the Plan for continuing use accordingly.

OIG RESPONSE 15 As discussed in the report, ANTHC did not have the required approved indirect cost rate agreements or a certified indirect cost rate proposal on file to support indirect costs claimed by DEHE. The referenced DEHE Pooled Equipment Support Cost Allocation Plan is a narrative description of the methodology to allocate equipment support costs. However, the plan does not meet the requirements of Title 2 CFR Part 225, Appendix E. Appendix E, Section D.1.d, requires indirect cost proposals to be developed within 6 months after the close of the governmental unit's fiscal year unless an exception is approved by the cognizant agency. ANTHC's plan covers fiscal year 2008 and forward, but was not certified until February 2010. Therefore, the plan was not developed within this 6-month period, nor was an exception from HHS obtained as specified by Title 2 CFR Part 225, Appendix E. Title 2 CFR Part 225 Appendix E, Section D.2, requires the proposal include the rate proposed, including subsidiary worksheets cross-referenced and reconciled to financial data. Appendix E, Section D.2, also specifies that the proposal should include a copy of the financial data supporting the rate, as well as the amount of base costs incurred under federal awards. ANTHC's plan did not include the proposed rate or rates and the specified supporting financial data. Therefore, we continue to question the \$24,481 in indirect costs.

¹⁹ 25 U.S.C. § 458aaa-5(e).

3. *Equipment Purchase Not Allocable -- \$227,217 questioned as not fully allocable to the IA.* First, the Draft Audit Report's reference to the purchase justification utilized by ANTHC is misleading. That document was generated in response to an administrative requirement that called for an evaluation of the available sources of equipment and the costs and benefits of each option, prior to making any procurement request. Once the evaluation is complete, it may be used to support equipment decisions for similar projects. Therefore, the evaluation merely analyzes whether purchase, rental, or another procurement option is the most appropriate for an item of equipment, not to which project any purchase should be allocated.

Further, the funding provided by EPA through the Interagency Agreement was combined with direct IHS funding to perform a scope of work described consistently in attachments to the Interagency Agreement, PFA, and Cooperative Project Agreement for the project. However, the scope described the EPA supported portion of the work as construction of buried sewer collector, lift station, and force main facilities, while the direct IHS contribution funded service lines. The portion of the work funded by the money that EPA provided to IHS under the Interagency Agreement required significantly deeper excavation than the directly IHS-funded service lines. The excavator required to dig to the depth required for the EPA-funded portion of the overall project was properly charged to that portion, and the EPA-supported portion of the work derived the benefit of this expenditure.²⁰ Given all these factors, and particularly the basis on which this allocation was made, this proposed finding must be withdrawn and a corresponding adjustment needs to be made with respect to the questioned and claimed costs.

²⁰ In addition, the portion of the overall funding ultimately sourced to EPA for the Project was over 76%, rather than the 51% stated in the Draft Audit Report, so the basis of proportional allocation suggested by EPA OIG is erroneous.

OIG RESPONSE 16 ANTHC's comments are not consistent with its equipment procurement procedures. ANTHC's equipment procurement procedures document states that equipment is to be purchased specifically for an individual project and direct-billed to the project for specific scope items identified in the funding documents based on a cost-benefit analysis justification. ANTHC did not charge the \$227,217 to the project identified in the justification as specified by its equipment procurement procedures. ANTHC's justification for the equipment purchase listed Fort Yukon Project AN 05-N96 as the intended project for the excavator. The justification also indicated that the excavator was required because of the deep burial depth of multiple sections of the water and sewer systems. According to the CPA for Project AN 05-N96, 49 percent of the project was funded by IHS for sewer and water service work and 51 percent of the project was funded by EPA through the IA for sewer service work. Despite the justification, ANTHC charged 100 percent of the equipment costs to part of another project funded by EPA through the IA, Fort Yukon Project AN 07-NG5. The CPA for Project AN 07-NG5 identified that the scope of work was only for sewer service work, and 24 percent of the project was funded by IHS and 76 percent of the project was funded by EPA through the IA. Therefore, the scope of work and specific funding for Project AN 07-NG5 were not equivalent to the scope of work and specific funding for the project identified in ANTHC's justification for the excavator.

Title 2 CFR Part 225, Appendix A, Section C.1.b, states that a cost must be allocable to the award in order to be allowable. ANTHC has not provided information and documentation clearly showing that the excavator purchase was allocable to the IA-funded part of Project AN 07-NG5. Therefore, we continue to question the \$227,217 in equipment costs incurred under the IA.

D. Freight Costs Not Allocable to IA – Draft Audit Report, page 7. *Disallowance of \$4,999 of freight costs transferred from a safe drinking water project for the City of Hughes.* ANTHC concurs that this cost was inadvertently miscoded and charged to the project to which funding was supplied through the Interagency Agreement, and ANTHC has reversed this entry and returned this amount to IHS.

OIG RESPONSE 17 We acknowledge ANTHC's concurrence. Of the \$4,999 in questioned freight costs, ANTHC claimed \$4,235 for reimbursement under the IA. EPA Region 10 should recover the \$4,235 in questioned costs from IHS as recommended in the report.

E. Material Costs Not Allocable to IA – Draft Audit Report, page 7. *Disallowance of \$337,075 of material costs alleged not to be allocable to IA.* Supplemental Submission No. 8 confirms that all costs transferred from (1) a phase of the Fort Yukon project not supported by

EPA, to (2) a phase partially funded by monies contributed by EPA to IHS under the Interagency Agreement, are properly allocable to the EPA-supported phase. The EPA-supported phase derived the benefit of these expenditures. Therefore, this proposed finding must be withdrawn and, as invited by proposed Recommendation #2 of the Draft Audit Report, a corresponding adjustment needs to be made with respect to questioned and claimed costs.

OIG RESPONSE 18 Supplemental Submission No. 8 does not provide the details necessary to verify that the \$337,075 in material costs transferred from Fort Yukon Project AN 02-Q66 benefitted and was allocable to the EPA-funded part of Fort Yukon Project AN 05-N96. Supplemental Submission 8 is a memorandum dated February 4, 2010, explaining ANTHC's justification for the transfer with an attachment showing an itemized list of the transferred costs. The memorandum explains that the transferred costs were part of a "reconciliation to insure cost allocations amongst projects are fair and to correct erroneous coding." However, Supplemental Submission 8 does not include documentation showing that costs were incurred for work that was allocable to the EPA-funded project.

We note that the scope of work associated with the costs transferred from Fort Yukon Project AN 02-Q66 exceeded the funding limit by \$976,526 before the transfer. Although the scope of work for both Fort Yukon projects included buried sewer mains, the CPA for each project identified different areas of the community for the work. Despite the similarities in work, ANTHC's \$337,075 transfer to Project AN 05-N96 removed 100 percent of the material costs recorded in the accounting system for Project AN 02-Q66 at the time of the transaction. ANTHC's quarterly progress reports for Project AN 02-Q66 did not disclose that costs incurred for Project AN 05-N96 caused or contributed to funding limit issue. ANTHC has not provided information and documentation clearly showing that the transferred material costs were allocable to the IA. Therefore, we continue to question the \$337,075 in material costs incurred under the IA.

F. Subcontract Costs Not Allocable to IA or Allowable – Draft Audit Report, pages 7-8.

1. *Subcontract Costs Transfers Not Allocable to IA – Disallowance of \$130,622 of costs transferred from projects not supported from funding provided by EPA to IHS under the Interagency Agreement.* Supplemental Submissions Nos. 9 and 10 detail the costs transferred in the two transactions identified in this proposed finding. As documented in Supplemental Submission No. 9, the \$120,000 transfer was between two projects for the City of Fort Yukon, rather than Saint Michael as the Draft Audit Report erroneously states. The justification for the other transfer is documented in Supplemental Submission No. 10. All of these costs are allocable to the projects which received funding from the monies contributed by EPA to IHS under the Interagency Agreement, and those projects derived a benefit from such

costs. Therefore, this proposed finding must be withdrawn and, as invited by proposed Recommendation #2 of the Draft Audit Report, a corresponding adjustment needs to be made to questioned and claimed costs.

OIG RESPONSE 19 We agree that the \$120,000 transfer was between two projects for the City of Fort Yukon rather than the City of Saint Michael. We have made the appropriate change to the report.

Supplemental Submissions No. 9 and No. 10 do not provide the details necessary to verify that the \$130,622 in subcontract costs transferred between projects benefitted and was allocable to the projects funded through the IA. Supplemental Submission No. 9 explains ANTHC's \$120,000 lump-sum transfer from Fort Yukon Project AN 03-R64 to the EPA-funded part of Fort Yukon Project AN 05-N96. Supplemental Submission No. 10 explains ANTHC's \$10,622 transfer from Saint Michael Project AN 02-Q77 to the EPA-funded part of Saint Michael Project AN 05-NB1. Each supplemental submission is a memorandum dated February 4, 2010, explaining ANTHC's justification for the transferred costs that includes an attachment showing the adjusting transaction for the transfer in accounting system. Each memorandum explains that the transferred costs were part of a "reconciliation to insure cost allocations amongst projects are fair and to correct erroneous coding." However, the two supplemental submissions do not include documentation showing that costs were incurred for work that was allocable to the EPA-funded part of Fort Yukon Project AN 05-N96 and Saint Michael Project AN 05-NB1.

ANTHC has not provided information and documentation clearly showing that the transferred costs were allocable to the IA. Therefore, we continue to question the \$130,622 in subcontract costs incurred under the IA

2. *Unallowable Subcontract Costs for ANTHC-Owned Equipment – Disallowance of \$188,577 alleged "rental fees" for ANTHC-owned equipment.* Again, as addressed at Section III.C.2 above with respect to DEHE Pooled Equipment Support Costs, the factual background surrounding this proposed finding arises out of the cost allocation practices of IHS prior to ANTHC's assumption of management and control of the Alaska Area Office SFC program. ANTHC found the IHS's method of allocating repair and maintenance, as well as DEHE Pooled Equipment Support Costs to particular projects based on the Percentage of the Equipment Rental Rate Blue Book measure provided a remarkably accurate estimate of actual aggregate overall equipment costs, and a reasonable and consistent measure of allocating them among individual items of equipment at the 50% level. Out of practical necessity, ANTHC used this IHS-developed cost allocation guide pending the time that equipment-specific depreciation and idle time charges could be feasibly broken out within the system ANTHC inherited. It was not used as a rental charge as the Draft Audit Report suggests.²¹

²¹ The fact that the measure was set at 50% of recognized allowable rental costs illustrates how cost efficient the centralized equipment pool approach is for SFC Projects. The IHS MOA Manual

While EPA OIG vaguely acknowledges that ANTHC demonstrated the accuracy of this method based on records with respect to depreciation and other equipment-related charges,²² the Draft Audit Report disallows legitimate maintenance and repairs costs, as well as centralized equipment pool administration and management charges, to the individual projects because of the pooled allocation methodology which it characterizes as an unallowable indirect cost. These costs have been disallowed even though industry standard references (such as the Equipment Rental Rate Blue Book) acknowledge that equipment operation and repair costs generally make up 50% or more of the rate charged for commercially leased equipment. In addition, as explained at Section III.C.2 above, all costs were allocated on the basis of the methodology originally developed by IHS that accurately recovered actual equipment usage costs. Therefore, this proposed finding should be withdrawn and a corresponding adjustment made with respect to questioned and claimed costs.

authorizes rental at recognized reference book rates and the Federal Highway Administration authorizes Blue Book rate rental on projects it funds. (*See, e.g.*, IHS, MOA Guidelines, Ch. VI, page 4 [June 2003 Working Draft].) ANTHC could have legitimately rented equipment from commercial sources at effectively double its cost allocation rate. The equipment pool costs allocated through the DEHE Pooled Equipment Support methodology were half of what those projects would have borne under a more conventional equipment procurement approach, such as simply renting equipment from a commercial enterprise.

²² The Draft Audit Report does not credit ANTHC with its accomplishment of bringing equipment costs more solidly within OMB cost principles by finally being able to break out individual depreciation and idle time charges rather than having to pool them, beginning on October 1, 2007.

OIG RESPONSE 20 Throughout the audit, ANTHC management referred to the Equipment Shop’s use of the Rental Rate Blue Book “rental rates” for equipment cost charges to projects prior to October 1, 2007. DEHE’s Division Operating Guideline No. 202: Heavy Equipment specifically refers to “project rental” and “monthly rental” of heavy equipment. However, we have revised the report by changing “rental” to “usage” costs based on ANTHC’s comments.

With respect to the \$188,577 in questioned costs, ANTHC was unable to provide complete cost documentation showing that the equipment usage costs incurred under the IA did not exceed the allowable depreciation, maintenance, and repair costs as required by Title 2 CFR Part 225. ANTHC was not able to provide documentation supporting maintenance and repair costs for each equipment item because of its pooled method of accounting for these costs. Title 2 CFR Part 225, Appendix A, Section F.1, defines indirect costs as those that have been incurred for common or joint purpose benefitting more than one cost objective and are not readily assignable to the cost objectives specifically benefitted. Because the pooled costs cannot be readily identified to a specific item of equipment, the costs are considered indirect costs under Title 2 CFR Part 225. As discussed in the report, ANTHC did not have the required approved indirect cost rate agreements or a certified indirect cost rate proposal on file to support the costs incurred by DEHE. Therefore, we continue to question \$188,577 incurred under the IA as unallowable.

G. Costs Were Not Consistently Classified – Draft Audit Report, page 9. The Draft Audit Report identifies several allegedly misclassified costs. First, as explained at Section II.A above, the applicable regulation is 45 C.F.R. Part 92, not 40 C.F.R. Part 31. The largest alleged misclassification in amount by far is the DEHE Pooled Equipment Support Costs charges that were consistently charged to “Subcontract” as a means to isolate this cost center in accordance with the recordkeeping system inherited from IHS. The actual purpose of this classification was to differentiate these DEHE Pooled Equipment Support Costs from direct equipment purchases for projects. In retrospect, using a “Subcontract” classification for those costs does not appear the most intuitive choice given the nature of these costs, but the selection of this classification was reasoned and consistently applied. ANTHC reclassified these costs as “Equipment,” beginning October 1, 2007 at the same time it changed the allocation methodology. The other items questioned in the Draft Audit Report were correctly classified as explained in Supplemental Submission No. 11, with the one exception of \$33,050 of freight charges misclassified as materials. With the exception of this one error that is immaterial in amount in the context of an enterprise of the size of DEHE’s SFC Program, ANTHC adequately identified outlays of federal funds through proper and consistent entry classifications. Therefore, this proposed finding should be withdrawn.

The suggestion of the Draft Audit Report that ANTHC-DEHE’s financial management systems did not adequately identify outlays of federal funds is without any foundation. DEHE uses an industry standard, state of the art cost accounting system currently named “Spectrum,” once known as “Forefront.” All costs for all projects are tracked by

(1) community, (2) project, (3) funding agency, (4) phase code or scope item, and (5) cost type. DEHE provides quarterly reports, which itemize costs in the first four of these categories to IHS and they are made available to all contributing funding agencies. The suitability of the accounting and reporting structure of these reports has never been questioned.

OIG RESPONSE 21 We agree that the ANTHC is not obligated to comply with Title 40 CFR Part 31 under the IA. However, consistency is one of the concepts that underlie generally accepted accounting standards and promotes understanding of, and confidence in, financial information on the part of users of the information. Treatment of costs in a consistent manner aids in determining reasonable, allowable, and allocable costs. Considering the multiple funding sources for ANTHC projects, consistent treatment will provide more assurance that resources are used in accordance with the various funding sources. As discussed in the report, we did not question costs because of this misclassification issue. Because we did not consider the misclassification errors identified during the examination as material, the issue was not included in the final report.

H. Primary Causes for Questioned Costs – Draft Audit Report, pages 9-11.

1. *Indirect Rates Were Not Clearly Communicated by Cognizant Agency and ANTHC Misinterpreted Federal Requirements.* ANTHC, IHS, and EPA Region 10 acted in a manner that was entirely reasonable and consistent with 2 C.F.R. Part 225 regarding questioned indirect costs. With respect to the corporate indirect costs questioned by EPA OIG, as explained at Section III.A.2, it is EPA OIG that misunderstood the ANTHC indirect rate agreement negotiated with HHS for 2008 and 2009, since the record shows that corporate indirect costs were allocable to DEHE when the record as a whole is reviewed. EPA OIG's misreading of a footnote in ANTHC's rate agreement does not change the fact that the negotiated rate was based on the allowance of an allocation base that included DEHE. See Supplemental Submission No. 5.

OIG RESPONSE 22 HHS's indirect cost rate negotiator has been consistent during discussions with the OIG audit team that he removed all DEHE costs from the base used to calculate the provisional non-hospital rate for fiscal years 2008 and 2009. Therefore, the approved indirect cost rates for fiscal years 2008 and 2009 are not applicable to DEHE construction projects as disclosed in the indirect cost rate agreement with HHS. We continue to question the \$77,230 in indirect costs incurred for the corporate office's support of construction projects.

With respect to DEHE indirect costs, ANTHC would prefer its cognizant agency, HHS, negotiate a construction indirect rate with ANTHC. However, ANTHC understands

HHS's reasoning even if it does not wholly agree. In any event, continued efforts to negotiate a construction indirect rate have proven futile. Therefore, by necessity, ANTHC has been forced to fall back on a cost allocation plan methodology. For the reasons explained at Section II.C, this approach is appropriate and allowable under 2 C.F.R. Part 225. IHS and EPA Region 10 properly understood and communicated that fact to ANTHC.

OIG RESPONSE 23 We agree that a cost allocation plan prepared in accordance with Title 2 CFR Part 225, Appendix E, is an acceptable method for claiming indirect costs. For the period covered by the audit, ANTHC's November 20, 2007, submission to HHS is the only indirect cost proposal that meets the requirements of 2 CFR Part 225. The DEHE Administration and Pool Cost Allocation Plan is a narrative description of the methodology used to allocate costs and does not meet the requirements of Title 2 CFR Part 225, Appendix E, as previously discussed in OIG RESPONSE 9. We have not questioned indirect costs incurred by ANTHC that are either supported by approved rates or the November 20, 2007, indirect cost proposal.

2. *ANTHC Misinterpreted Basic Federal Cost Principles.* All of the costs associated with this purported "cause" have been established as allowable and allocable. Therefore, the associated proposed findings must be withdrawn. EPA OIG's characterization of conversations with ANTHC Management is not accurate. ANTHC Management described the difficulty of executing SFC projects in rural Alaska which involves the need for multiple funding sources to pay for the scope of work necessary to address the scope of need, as well as logistical and environmental challenges.²³ ANTHC Management did not say that it is approved ANTHC practice to draw funding from multiple funding sources to which costs are not appropriately allocable, as the Draft Audit Report implies. Rather, ANTHC pointed out that, despite ANTHC's efforts to appropriately charge all costs in the first instance, mistakes and uncertainties regarding appropriate allocation of costs do occur in the field due to this complexity. When incorrect allocations are made in the field, they must be reconciled through transfers between projects. The Management Improvement Plan provided as Supplemental Submission No. 1 describes further checks and balances to assure that fewer incorrect allocations are made in the first instance, and that transfers are justified and described in sufficient detail to clearly confirm that, when required, the reallocation of costs to another project is appropriate.

²³ EPA OIG did not avail itself of ANTHC's offer to visit project sites to better understand the nature of Alaska SFC Projects.

OIG RESPONSE 24 Our position on the \$903,671 in questioned costs associated with this cause remains unchanged as discussed previously in OIG RESPONSE 12, 14, 16, 17, 18, and 19. The report does not mischaracterize our conversations with ANTHC management. During the audit, ANTHC management indicated to the audit team that cost transfers were made because costs were managed and tracked as large projects and not by funding source. ANTHC management also indicated that the lack of tracking by individual project phase and funding source was not a problem as long as the scopes of work for projects funded by the IA and other sources are completed. As discussed in the report, ANTHC’s documentation supporting costs transferred to EPA-funded projects did not demonstrate that the costs benefitted the IA. The supplemental submissions included in ANTHC’s response also did not include documentation showing that the transferred costs were incurred for work that was allocable to the IA.

We acknowledge ANTHC’s Management Improvement Plan provided in Supplemental Submission No. 1. However, the plan does not provide assurance that the issues identified during the audit will be satisfactorily resolved for two primary reasons. First, ANTHC has not indicated that it is fully committed to addressing the findings in the report. More specifically, ANTHC states in the plan, “ANTHC believes that the OIG Draft Audit Report’s proposed findings are without merit or foundation.” Second, the other supplemental submissions submitted by ANTHC supporting its position on the findings indicate that ANTHC continues to incorrectly apply the federal cost principles specified by Title 2 CFR Part 225.

3. *ANTHC Believed that Equipment Rental Fees Met Federal Criteria.* Again, the Draft Audit Report misstates ANTHC’s position and practice. ANTHC did not charge equipment rental to any project. The Blue Book rate did not establish a rental rate, but was a reasonable and accurate guide used to allocate allowable equipment pool costs to projects. The reference to Federal Highway Administration’s approval of Blue Book rates was made to point out that the costs charged to EPA-supported projects were significantly less than federal cost principles would have allowed if equipment were procured in another more conventional manner.²⁴ ANTHC Management did explain that its approach was largely dictated by IHS’s SFC Program practices in place when ANTHC took it over. IHS practices were reasonable and appropriate when the Program was under direct operation by a federal agency. Nonetheless, ANTHC recognized that the IHS approach may not represent best practice for ANTHC as a Tribal Consortium/Not-for-Profit Organization. ANTHC has made steady progress in improving this aspect of the SFC Program since it assumed management of the Program, but there are clear limits to how quickly the improvements can be implemented within the context of the on-going needs of the Program and its many projects. Instead of giving ANTHC credit for all that it has been able to accomplish, EPA OIG challenges the remnants of the Program’s past practices which ANTHC has not been able to fully improve to date. As described in detail at Sections III.C.2 and III.F.2, the methods used by ANTHC during the audit period are acceptable under the

²⁴ It is also permitted by IHS, as reflected in the IHS MOA Manual, as described in footnote 21 above.

principles of 2 C.F.R. Part 225. ANTHC will continue to improve the Program policies and practices for efficiency and economy, and to appropriately address the legitimate concerns and needs of agencies that contribute funding to these critical projects.

OIG RESPONSE 25 As discussed in **OIG RESPONSE 20**, ANTHC’s management throughout the examination referred to the Equipment Shop’s use of the Blue Book “rental rates” for equipment cost charges to projects prior to October 1, 2007. DEHE’s Division Operating Guideline No. 202: Heavy Equipment specifically refers to “project rental” and “monthly rental” of heavy equipment. However, we have revised the report by changing “rental” to “usage” costs based on ANTHC’s comments.

We acknowledge that ANTHC took over the Sanitation Facilities Construction Program in 1998 and inherited practices and procedures from IHS. However, regardless of the origins of the ANTHC’s equipment cost allocation system used prior to October 2007, the system did not meet cost allocation requirements specified by Title 2 CFR Part 225 as explained in the report and previously in **OIG RESPONSE 20**.

With regard to ANTHC’s comment about providing credit for all that it has been able to accomplish, the scope of our financial examination was limited to the costs claimed under the IA. We did not evaluate progress and improvements over the period of more than 10 years ANTHC has managed the Sanitation Facilities Construction Program. Therefore, we are unable to express an opinion on ANTHC’s overall management of the program over this period.

4. *ANTHC Did Not Ensure Costs Were Consistently Classified.* First, as shown at Section III.G, ANTHC in all material respects consistently classified its costs. Field staff do make occasional mistakes under the difficult circumstances in which they operate, but those mistakes are identified and corrected by ANTHC DEHE senior accounting staff. The Draft Audit Report’s suggestion that there is a pattern of misclassification of costs is without foundation for the reasons we explain above.

OIG RESPONSE 26 As discussed in the report and previously in **OIG RESPONSE 21**, we did not question costs because of this misclassification issue. The issue was excluded from the final report because we did not consider the misclassification errors identified during the examination as material.

IV. Comments Regarding Proposed Conclusions and Recommendations

We have fully addressed in this Memorandum:

- (1) the indirect cost issue created by HHS's position on a construction indirect rate, and ANTHC's response to it through an allowable cost allocation plan;
- (2) centralized equipment pool costs under the system inherited from IHS, the improvements that ANTHC made to that system, and the cost allocation plan methodology used for the DEHE Equipment Pool Support Costs, which are the only pooled element that remains; and
- (3) transfers between projects that we have shown were appropriate and justified.

Therefore, only two relatively minor proposed findings of the Draft Audit Report have any merit for the reasons explained above. (See Sections III.C.1 and III.D.)

OIG RESPONSE 27 Our position on the questioned costs remains the same, except for a \$39,653 reduction to the questioned indirect costs as explained the previous OIG responses to ANTHC's comments. Therefore, we continue to question \$1,493,893 in costs incurred under the IA.

The conclusion that ANTHC does not meet minimum requirements for a financial management system and should be designated "high risk" is totally without any reasonable basis or foundation. The Draft Audit Report also misconstrues the applicable administrative principles for the reasons that we explain in Part I. The proposal to recommend special conditions, therefore, lacks any legal basis, and would interfere with the successful execution and completion of necessary SFC works in Alaska which ANTHC, IHS, and EPA Region 10 have been accomplishing through cooperation and collaboration for many years.

OIG RESPONSE 28 We agree that the ANTHC is not obligated to comply with Title 40 CFR Part 31 under the IA as discussed previously in OIG RESPONSE 3. However, our position on designating ANTHC as a “high risk” recipient under Title 40 CFR Part 31 remains unchanged. Our position is based on the material financial management issues associated with ANTHC’s accounting system for DEHE discussed in the report and the EPA funding ANTHC receives directly through grants. Because ANTHC is a recipient of EPA funding through grant instruments, EPA may designate ANTHC as “high risk” under Title 40 CFR Part 31.12 as recommended in the report. The special conditions we recommend are intended to establish controls that provide assurance that EPA funds are spent and accounted for in accordance with federal cost principles. ANTHC has not explained in the response how implementing these controls over EPA funds will interfere with the successful execution and completion of its Sanitation and Facilities Construction projects.

* * * *

ANTHC has addressed each of the proposed findings of the Draft Audit Report and offered a Management Improvement Plan based on our consideration of these issues to ensure that we continue to improve the SFC Program and better carry out its mission. We have shown that much of the Draft Audit Report rests on inaccurate premises and fails to appreciate the context in which its proposed findings arise. We believe that IHS should urge EPA OIG to rewrite the Draft Audit Report accordingly, as well as to reflect more accurately the positive and productive relationship of EPA and IHS under the Interagency Agreement, and the effective management of the IHS Alaska Area SFC Program by ANTHC.

OIG RESPONSE 29 Our position on the findings in the report remains unchanged except for a \$39,653 reduction to the questioned indirect costs and the inconsistent coding issue as explained the previous OIG responses to ANTHC’s comments. The questioned costs in the report are based on the federal cost principles specified by Title 2 CFR Part 225. As discussed previously in OIG RESPONSE 24, ANTHC’s Management Improvement Plan does not provide assurance that the issues identified during the audit will be satisfactorily resolved for two primary reasons. First, ANTHC has not indicated that it is fully committed to addressing the findings in the report. Second, the other supplemental submissions submitted by ANTHC supporting its position on the findings indicate that ANTHC continues to incorrectly apply the federal cost principles specified by Title 2 CFR Part 225.

With regard to ANTHC’s comment about its relationship with EPA and IHS and the effective management of the Sanitation Facilities Program, the scope of our financial examination did not include evaluations of those areas. Therefore, we are not able to express an opinion on the relationship or the effectiveness of ANTHC’s management of the Sanitation Facilities Program.

Should you have any questions regarding these comments or require further information from ANTHC, please contact me or appropriate members of ANTHC-DEHE's Senior Management with whom you are well acquainted.

Respectfully submitted,

Don Kashevaroff
Chief Executive Officer

Attachment: Supplemental Submission Package

Appendix D

Distribution

EPA

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