



U.S. ENVIRONMENTAL PROTECTION AGENCY  
OFFICE OF INSPECTOR GENERAL

*Catalyst for Improving the Environment*

## **Audit Report**

# **EPA Did Not Fully Comply With Guidance Regarding OMB Circular A-123 Unliquidated Obligation Reviews**

**Report No. 11-1-0069**

**January 19, 2011**

**Report Contributors:**

Paul Curtis  
Arthur Budelier  
Cynthia R. Poteat  
Robert Hairston  
Sabrina Berry

**Abbreviations**

AA	Assistant Administrator
CFO	Chief Financial Officer
EPA	U.S. Environmental Protection Agency
FMFIA	Federal Managers' Financial Integrity Act
FY	Fiscal Year
OCFO	Office of the Chief Financial Officer
OIG	Office of Inspector General
OMB	Office of Management and Budget
RA	Regional Administrator
ULO	Unliquidated Obligation



# At a Glance

*Catalyst for Improving the Environment*

## Why We Did This Review

We performed this review to evaluate the U.S. Environmental Protection Agency's (EPA's) fiscal year (FY) 2009 Office of Management and Budget (OMB) Circular A-123 reviews of internal controls over the unliquidated obligation (ULO) review process. Our objectives were to determine whether EPA's regions and program offices (1) complied with guidance for conducting the FY 2009 A-123 reviews of the ULO review process; and (2) reported their A-123 review methodology, findings, and corrective actions in their FY 2009 management integrity assurance letters.

## Background

The Federal Managers' Financial Integrity Act (FMFIA) requires federal agencies to report annually to the President and Congress on the effectiveness of internal controls. OMB Circular A-123 guidance for implementing FMFIA requires federal agencies to assess internal controls over financial reporting. In prior audits, we reported on problems EPA had in deobligating funds no longer needed. In FY 2009, EPA expanded its internal control reviews to include ULOs.

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

The full report is at:  
[www.epa.gov/oig/reports/2011/20110119-11-1-0069.pdf](http://www.epa.gov/oig/reports/2011/20110119-11-1-0069.pdf)

## ***EPA Did Not Fully Comply With Guidance Regarding OMB Circular A-123 Unliquidated Obligation Reviews***

### What We Found

Seventeen of 22 EPA regions and program offices did not fully comply with the guidance for conducting and reporting on their FY 2009 OMB Circular A-123 reviews of internal controls over the ULO process. OMB A-123 guidance requires agencies to assess the effectiveness of internal controls over financial reporting. The Office of the Chief Financial Officer (OCFO) requested offices to conduct a thorough internal control review of their ULO review process. The following factors contributed to EPA's noncompliance:

- Some regions and program offices did not properly plan and staff the reviews.
- EPA's OCFO did not closely monitor the reviews.
- Neither the OCFO nor the Assistant Administrators and Regional Administrators held the review teams accountable for performing the reviews.

EPA benefits from internal control reviews by identifying control deficiencies and corrective actions for improvement. The reviews also provide support for the Administrator's assurance statement on the effectiveness of EPA's internal controls.

### What We Recommend

We recommend that the Chief Financial Officer:

- Develop and implement procedures to oversee the regional and program office A-123 ULO internal control reviews.
- Require regions and program offices to develop plans that address staffing A-123 ULO reviews and training reviewers.
- Develop an A-123 ULO review guide to assist those conducting the reviews.
- Implement standard performance measures to assess assurance letter completeness and timeliness.

The Agency concurred with our findings and recommendations.



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

THE INSPECTOR GENERAL

January 19, 2011

**MEMORANDUM**

**SUBJECT:** EPA Did Not Fully Comply With Guidance Regarding  
OMB Circular A-123 Unliquidated Obligation Reviews  
Report No. 11-1-0069

**FROM:**

Arthur A. Elkins, Jr.  
Inspector General

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

**TO:**

Barbara J. Bennett  
Chief Financial Officer

This is our report on the subject review 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 will make the final determinations on matters in this report in accordance with established audit resolution procedures.

The estimated cost of this report, calculated by multiplying the project's staff days and expenses by the applicable daily full cost billing rates in effect at the time, is \$267,632.

**Action Required**

You concurred with the draft report recommendations and submitted an acceptable corrective action plan and milestone dates. Therefore, we will close the report in our tracking system upon issuance. We have no objections to the further release of this report to the public. We will post this report to our website at <http://www.epa.gov/oig>.

If you or your staff have any questions regarding this report, please contact Melissa Heist at (202) 566-0899 or [heist.melissa@epa.gov](mailto:heist.melissa@epa.gov), or Paul Curtis at (202) 566-2523 or [curtis.paul@epa.gov](mailto:curtis.paul@epa.gov).

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# Chapter 1

## Introduction

### Purpose

We performed this review to evaluate the U.S. Environmental Protection Agency's (EPA's) fiscal year (FY) 2009 Office of Management and Budget (OMB) Circular A-123 reviews of internal controls over the unliquidated obligation (ULO) review process. The Office of the Chief Financial Officer (OCFO) requested our review because FY 2009 was the first year it asked the regions and program offices to conduct A-123 reviews of the ULO review process. The objectives of our review were to determine whether EPA's regions and program offices:

- Complied with OCFO guidance for conducting the FY 2009 A-123 reviews of the ULO review process
- Reported their A-123 review methodology, findings, and corrective actions in their FY 2009 management integrity assurance letter

### Background

The Federal Managers' Financial Integrity Act of 1982 (FMFIA) requires agencies to establish and maintain a system of internal controls to reasonably ensure that programs are protected from fraud, waste, abuse, and mismanagement. FMFIA requires an annual assessment of internal controls and a statement of assurance from agency heads to the President and Congress on the effectiveness of internal controls over programmatic and financial operations.

OMB Circular A-123, *Management's Responsibility for Internal Control*, dated December 21, 2004, describes federal managers' responsibilities for internal control. Management is responsible for establishing and maintaining internal control to achieve the following objectives:

1. Effective and efficient operations
2. Reliable financial reporting
3. Compliance with applicable laws and regulations

Appendix A of the Circular requires federal agencies to separately assess effectiveness of internal controls over financial reporting. The senior assessment team must document the assessment process to include:

- Assessing internal controls at the process, transaction, or application level.
- Testing controls and related results.

- Identifying deficiencies.
- Suggesting improvements.

The documentation should be available for review.

EPA Order 1000.24 CHG 2, *Management's Responsibility for Internal Control*, outlines the roles and responsibilities of Agency personnel and organizations charged with implementing FMFIA and A-123. Some of the key roles and responsibilities are:

- **The Administrator:** Responsible for providing an annual assurance statement to the President and Congress on the overall adequacy and effectiveness of the Agency's internal controls.
- **The Agency Senior Assessment Team:** The team, which includes the Chief Financial Officer (CFO), Assistant Administrators (AAs), and Regional Administrators (RAs), is responsible for providing oversight and accountability for the Agency's management integrity program and internal controls over program operations and financial reporting.
- **The CFO:** Provides annual management integrity and A-123 guidance to the Agency and ensures that the appropriate organizational levels implement FMFIA and A-123.
- **Management Integrity Advisors:** These advisors, designated by the Senior Assessment Team, disseminate pertinent management integrity program information to the regions and program offices.

OCFO's management integrity guidance, *Management Integrity: EPA's FY 2009 Responsibilities and Major Milestones*, dated December 22, 2008, stated that EPA was expanding its reviews of internal controls over financial activities to include more regional and program office participation. OCFO's guidance requested that all AAs and RAs conduct a more formal internal control review with supporting documentation of their ULOs.

OCFO's supplemental guidance, *FY 2009 Guidance for Conducting A-123 Internal Control Reviews of Unliquidated Obligations*, dated March 18, 2009, requested the AAs and RAs perform a thorough A-123 review of the ULO process and supporting documents. FY 2009 was the first year that OCFO requested the regions and program offices to conduct an A-123 ULO review. The reviews were to determine whether:

- Evidence was on file to support the decisions to deobligate or retain funds.
- The review's sample size was large enough to provide the confidence necessary to support the assurance statement.
- The ULO reviewers followed standard operating procedures.
- Internal controls identified in the standard operating procedures functioned effectively.

OCFO requested that the AAs and RAs discuss the A-123 review methodology, findings, and corrective actions in their management integrity assurance letter due August 14, 2009.

## **Noteworthy Achievements**

Some regions and program offices achieved positive results from their internal control reviews that may lead to improved future ULO reviews. For example, the reviewers offered ways to improve the ULO reviews by:

- Identifying control deficiencies and recommending corrective action.
- Providing clarity and guidance on the types of documentation needed to support decisions to retain or deobligate funds.
- Proposing more effective techniques to research the ULOs and make supportable decisions.
- Identifying a need for project officers and contracting officers to monitor the funding for their projects more carefully.

During our review, OCFO issued guidance for the FY 2010 management integrity process and for conducting A-123 internal control reviews of financial activities. The FY 2010 guidance was more detailed and easier to understand than the FY 2009 guidance. The FY 2010 guidance included a management integrity assurance letter template with specific instructions for the A-123 ULO review and reporting requirements.

OCFO developed an FY 2010 assurance letter checklist to confirm whether the regional and program offices addressed the required elements. OCFO also provided several tools for the FY 2010 A-123 ULO reviews, such as a risk criteria matrix and instructions for selecting a random sample.

OCFO provided Agency-wide A-123 training sessions on January 28, February 3, March 31, and April 1, 2010. The training provided an overview of A-123 requirements and specific A-123 review techniques and concepts.

## **Scope and Methodology**

We conducted this review in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the review to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our review objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our review objectives. We conducted our review from February through September 2010. Appendix A contains a detailed discussion of our scope and methodology.



## **Chapter 2**

### **Most Regions and Program Offices Did Not Fully Comply with Guidance Regarding A-123 Unliquidated Obligation Reviews**

Seventeen of 22 EPA regions and program offices did not fully comply with the guidance for conducting and reporting the FY 2009 A-123 ULO review of internal controls. This occurred because:

- Some regions and program offices did not properly plan and staff the reviews.
- OCFO did not closely monitor the reviews.
- Neither OCFO nor the AAs and RAs held the review teams accountable for their reviews.
- OCFO's guidance was not clear.
- Some personnel performing the A-123 reviews did not have a review guide to ensure they performed a complete review.
- Some personnel did not comply with all the reporting requirements.

The noncompliant reviews did not help EPA identify areas for improvement and ensure the internal controls were effective. The review work in the noncompliant regions and program offices did not support their assurance statements on internal controls.

#### **EPA Did Not Fully Comply with A-123 ULO Review Guidance**

OCFO's management integrity guidance stated that EPA was expanding its reviews of internal controls over financial activities to include more regional and program office participation. OCFO's guidance requested that all AAs and RAs perform a thorough A-123 review of the ULO process and supporting documents.

Seventeen of 22 EPA regions and program offices did not fully comply with the guidance for conducting and reporting the FY 2009 A-123 ULO review of internal controls. We considered a review to be incomplete if it did not:

- Include sufficient testing and documentation to support the assurance statement;
- Report the review methodology, findings, and corrective actions in the assurance letter; and/or
- Complete the requirements by the assurance letter due date.

Eight either did not perform a review or had no supporting documentation that a review was performed. Six performed an incomplete review because they did not comply with all the guidance. Three completed their reviews but reported the results in an assurance letter addendum submitted after the August 14, 2009, assurance letter due date.

The types of noncompliance included:

- Not testing a sample of unliquidated obligations
- Testing only the deobligations and not the retained obligations
- Not maintaining supporting documentation for the samples tested
- Conducting a review (by a contractor) that did not cover the FY 2009 period needed for the assurance statement
- Not including an A-123 review discussion in the FY 2009 assurance letter

While the 22 regions and program offices certified completion of the ULO reviews by June 30, 2009, and generally discussed the ULO review, 13 regions and program offices did not report their A-123 review methodology, findings, and corrective actions in their assurance letters as required.

## **Several Factors Contributed to EPA's Noncompliance**

We identified the following causes of noncompliances:

- Some regions and program offices did not properly plan and staff the A-123 ULO reviews, train the reviewers, and perform the reviews. Although many personnel said they did not understand the guidance, they did not contact OCFO to ask questions or seek clarification about how to fulfill their A-123 review responsibilities. Some personnel said they asked questions about the guidance but did not receive satisfactory answers.
- OCFO did not monitor the A-123 review process closely enough to detect the compliance problems in a timely manner. OCFO communicated primarily with the Management Integrity Advisors, who disseminated guidance information to the regions and program offices. The OCFO manager responsible for coordinating the A-123 reviews informed us that OCFO did not require status reports from the A-123 review teams and was not aware of the compliance problems until it received the assurance letters.
- OCFO and the regions and program offices did not have an effective method to hold the A-123 review teams accountable for their reviews. They did not have formal procedures to require regions and program offices to plan and staff the A-123 ULO reviews, train the reviewers, and submit status reports to OCFO and the AAs and RAs. They did not have performance measures for assurance letter completeness and timeliness.

For example, the U.S. Department of Defense uses a scorecard to rate statements of assurance for timeliness, proper format, program execution, training, and reporting material weaknesses.

- OCFO's guidance was not clear because it did not always clearly distinguish the A-123 internal control review guidance from the ULO review guidance.
- Some personnel performing the A-123 reviews did not have a review guide to use as a tool to ensure they performed a complete review. A review guide is a description or outline of the procedures undertaken or particular work done. The review guide serves as a planning document and a control on the work to be done. It serves to document the work performed, completion dates, and information on the persons performing the work.<sup>1</sup>
- Although some personnel used the FY 2009 management integrity guidance with the assurance letter template to help them meet the reporting requirements, they did not comply with all the requirements for the A-123 ULO review. For example, personnel who prepared the assurance letters would have benefited from using a checklist to ensure they included all financial reporting requirements in the assurance letter.

EPA regional and program office personnel offered several reasons why they did not comply with the guidance for the FY 2009 A-123 ULO reviews, including:

- OCFO's guidance was not clear and personnel did not understand the new FY 2009 requirements. Some of the personnel overlooked parts of the guidance and other personnel said they asked questions about the guidance but did not receive satisfactory answers.
- Personnel performing the reviews did not receive the training needed to perform an effective A-123 review.
- Regions and program offices did not have sufficient time or resources to perform the review.

## Conclusions

EPA achieved some positive results from its FY 2009 A-123 internal control reviews of the ULO process that may lead to improved future ULO reviews. Program and regional offices that performed the reviews identified control deficiencies and recommended corrective actions. One region provided clarity and guidance regarding the types of documentation needed to support

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<sup>1</sup> Kohler's Dictionary for Accountants, 6<sup>th</sup> Edition, Prentice Hall, 1983.

retain/deobligate funding decisions. Finally, they proposed more effective techniques to research ULOs and make supportable decisions. However, many EPA regions and program offices did not fully comply with the review guidance and perform complete reviews. Some regions and program offices did not properly plan and staff the reviews. OCFO did not closely monitor the reviews and neither OCFO nor the AAs and RAs held the review teams accountable. OCFO's guidance was not clear. Some personnel performing the A-123 reviews did not have a review guide to ensure they performed a complete review and some personnel did not comply with all reporting requirements. As a result, EPA did not properly determine and report whether the internal controls were effective.

Internal control reviews that do not fully comply with guidance are an internal control deficiency. To correct the deficiency, EPA should conduct thorough internal control reviews that ensure the controls are effective, comply with applicable guidance, and support the annual assurance statement. EPA would improve its A-123 ULO reviews by implementing headquarters oversight procedures and promoting accountability for proper reviews in the regions and program offices.

## **Recommendations**

We recommend that the Chief Financial Officer:

1. Improve accountability for the A-123 ULO reviews by developing and implementing oversight procedures to promote accountability by the regions and program offices and ensure the proper performance of their A-123 reviews.
2. Require AAs and RAs to develop plans for the design and staffing of the A-123 ULO reviews and train the reviewers. Require AAs and RAs to submit their review plans to OCFO on a standard form provided by OCFO.
3. Develop an A-123 ULO review guide to assist those conducting the reviews.
4. Implement performance measures for assurance letter completeness and timeliness.

## **Preliminary Agency Actions**

During our review, OCFO issued guidance for the FY 2010 management integrity process and for conducting A-123 internal control reviews of financial activities. The FY 2010 guidance was more detailed and easier to understand than the FY 2009 guidance and included an assurance letter template with specific instructions and reporting requirements. Since OCFO improved its A-123 review

guidance in FY 2010 and developed a template and checklist for reporting requirements, we did not make a recommendation for improving the guidance or developing a checklist for reporting requirements.

During our review, OCFO addressed the need for training by conducting Agency-wide A-123 training sessions. Therefore, we did not make a recommendation for A-123 training.

## **Agency Comments and OIG Evaluation**

EPA agreed with our recommendations and proposed acceptable corrective action plans to address them. Appendix B provides the full text of the Agency's comments.

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

RECOMMENDATIONS						POTENTIAL MONETARY BENEFITS (in \$000s)	
Rec. No.	Page No.	Subject	Status <sup>1</sup>	Action Official	Planned Completion Date	Claimed Amount	Agreed To Amount
1	7	Improve accountability for the A-123 ULO reviews by developing and implementing oversight procedures to promote accountability by the regions and program offices and ensure the proper performance of their A-123 reviews.	O	Chief Financial Officer	12/31/10*		
2	7	Require AAs and RAs to develop plans for the design and staffing of the A-123 ULO reviews and train the reviewers. Require AAs and RAs to submit their review plans to OCFO on a standard form provided by OCFO.	O	Chief Financial Officer	12/31/10*		
3	7	Develop an A-123 ULO review guide to assist those conducting the reviews.	C	Chief Financial Officer	01/12/11**		
4	7	Implement performance measures for assurance letter completeness and timeliness.	O	Chief Financial Officer	12/31/10*		

<sup>1</sup> 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

\* The Agency has developed draft guidance that, as of January 5, 2011, was still in the signature chain for final approval; therefore, we consider these recommendations to be in an open status

\*\* The Agency issued an A-123 ULO review guide on January 12, 2011.

## ***Details on Scope and Methodology***

We reviewed EPA guidance for conducting the FY 2009 A-123 ULO reviews. We interviewed personnel and reviewed the management integrity assurance letters for EPA's 10 regions and 12 program offices. We examined the A-123 review supporting documentation for 10 selected regions and program offices that had more complete narratives of results in the A-123 assurance letters.

During our review, EPA issued FY 2010 A-123 review guidance and conducted A-123 training. We compared the FY 2010 and FY 2009 guidance and reviewed the content of EPA's training sessions to identify the improvements that EPA achieved in FY 2010.

We assessed EPA's internal controls related to the A-123 ULO reviews. We gained an understanding of the internal controls through examination of management integrity assurance letters, interviews with applicable region and program office personnel, and examination of A-123 review supporting documentation for 10 selected regions and program offices.

We reviewed the following prior EPA OIG reports that had findings and recommendations related to EPA's implementation of FMFIA or problems with deobligating funds no longer needed.

**Table A-1: Prior Reports Reviewed**

Report Title	Report No.	Date
EPA Has Improved Efforts to Reduce Unliquidated Obligations in Superfund Cooperative Agreements, But a Uniform Policy Is Needed	09-P-0241	September 22, 2009
EPA Should Use FMFIA to Improve Programmatic Operations	09-P-0203	August 6, 2009
EPA Should Strengthen Internal Controls over Interagency Agreement Unliquidated Obligations	09-P-0086	January 26, 2009
EPA Should Continue Efforts to Reduce Unliquidated Obligations in Brownfields Pilot Grants	08-P-0265	September 16, 2008

Source: OIG analysis.

Report No. 09-P-0203 disclosed that EPA offices had not developed strategies to assess the effectiveness of their programmatic internal controls. OCFO had not devoted needed resources to validate assurance letters. EPA agreed with the report's recommendations that OCFO provide FMFIA training for managers and staff and revise the internal checklist for validating Agency-wide FMFIA compliance. Report Nos. 09-P-0241, 09-P-0086, and 08-P-0265 disclosed Agency problems with deobligating unneeded funds. We used the findings of these reports in conducting this review of FMFIA reviews of financial operations. We did not evaluate whether EPA has taken appropriate corrective action to address the findings and recommendations from these reports because they were not significant to our review objectives.

## ***Agency Response to Draft Report***

October 21, 2010

### **MEMORANDUM**

**SUBJECT:** Response to the Office of Inspector General Draft Audit Report: EPA Did Not Fully Comply With Guidance Regarding OMB Circular A-123 Unliquidated Obligation Reviews, Project No. OA-FY10-A-0058, dated September 22, 2010

**FROM:** Barbara J. Bennett  
Chief Financial Officer

**TO:** Arthur A. Elkins, Jr.  
Inspector General

Thank you for providing us with the opportunity to comment on and respond to the findings and recommendations made in the “Draft Audit Report: EPA Did Not Fully Comply With Guidance Regarding OMB Circular A-123 Unliquidated Obligation Reviews.”

We appreciate the annual opportunity to provide project topics to your office, such as the FY 2009 A-123 ULO review process, for improving operating efficiencies. We agree with the findings and recommendations in the draft report; our corrective action plan is attached.

If you have any questions concerning the audit response, please contact Stefan Silzer, Acting Director, Office of Financial Management, at (202) 564-5389 or Sandy Dickens of the Office of Financial Management at (202) 564-0606.

Attachment

cc: Mark Bialek  
Melissa Heist  
Paul Curtis  
Arthur Budelier  
Maryann Froehlich  
Joshua Baylson  
Stefan Silzer  
David Bloom  
Howard Corcoran  
John Bashista



### OCFO's Response to OIG Draft Report

*“EPA Did Not Fully Comply With Guidance Regarding OMB Circular A-123  
Unliquidated Obligation Reviews”*

Project No. OA-FY10-A-0058, dated September 22, 2010

Rec. No.	OIG Recommendation	Action Official(s)	Proposed Corrective Action	Proposed Completion Date
1.	Improve accountability for the A-123 ULO reviews by developing and implementing oversight procedures to promote accountability by the regions and program offices and ensure the proper performance of their A-123 reviews.	OCFO/Office of Financial Management (OFM)	<p>OCFO agrees with this recommendation.</p> <p>1.1 OCFO will issue Resources Management Directives System (RMDS) 2520-03-P1, <i>Responsibilities for Reviewing Unliquidated Obligations</i>.</p> <p>1.2 OCFO will issue FY 2011 Annual OCFO Guidance which will include ULO performance measures.</p>	<p>11/1/10</p> <p>12/31/10</p>
2.	Require AAs and RAs to develop plans for the design and staffing of the A-123 ULO reviews and train the reviewers. Require AAs and RAs to submit their review plans to OCFO on a standard form provided by OCFO.	OCFO/OFM	<p>OCFO agrees with this recommendation.</p> <p>2.1 OCFO will issue FY 2011 A-123 guidance which will require AAs/RAs to: (1) develop plans for the design and staffing of the A-123 ULO reviews and training for the reviewers; and (2) submit plans to OCFO on a standard form provided by OCFO.</p>	12/31/10

<b>Rec. No.</b>	<b>OIG Recommendation</b>	<b>Action Official(s)</b>	<b>Proposed Corrective Action</b>	<b>Proposed Completion Date</b>
3.	Develop an A-123 ULO review guide to assist those conducting the reviews.	OCFO/OFM and Office of Budget (OB)	<p>OCFO agrees with this recommendation.</p> <p>3.1 OCFO/OFM and OB will jointly develop an A-123 ULO review guide to assist those conducting the reviews.</p>	1/31/11
4.	Implement performance measures for assurance letter completeness and timeliness.	OCFO/OFM	<p>OCFO agrees with this recommendation.</p> <p>4.1 OCFO will issue a checklist in the FY 2011 A-123 guidance.</p>	12/31/10

## ***Distribution***

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