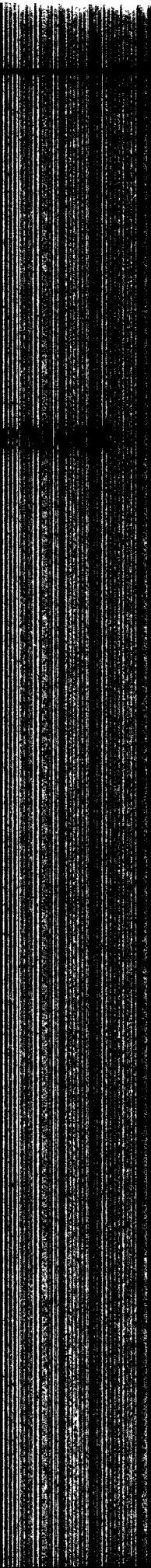


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UNITED STATES ENVIRONMENTAL PROTECTION AGENCY

OFFICE OF THE INSPECTOR GENERAL

NORTHERN DIVISION

77 WEST JACKSON BOULEVARD

CHICAGO, IL 60604-3590

905R94027

August 15, 1994

MEMORANDUM

SUBJECT: Audit Report No. E5FGF4-05-0138-4100488  
Minnesota Superfund Cooperative Agreement  
Ritari Post and Pole

FROM: Anthony C. Carrollo  
Divisional Inspector General for Audits  
Northern Division

TO: Valdas V. Adamkus  
Regional Administrator  
Region 5

This report contains findings and recommendations from our interim audit of Minnesota Pollution Control Agency's internal controls over costs at the Ritari Post and Pole site.

This audit report contains findings that describe problems the Office of Inspector General (OIG) has identified and recommendations for corrective action. This audit report represents the opinion of the OIG. Final determinations on matters in the audit report will be made by EPA managers in accordance with established EPA audit resolution procedures. Accordingly, the findings described in the audit report do not necessarily represent the final EPA position.

Action Required

In accordance with EPA Order 2750, you, as the action official, are required to provide this office a written response to the audit report within 90 days of the final report date. For corrective actions planned but not completed by your response date, please include specific milestones for when corrective action will be completed.

We have no objections to further release of this report to the public.

Should you or your staff have any questions or need additional information, please contact Audit Manager Charles Allberry at 353-4222.

cc: Howard Levin (MF-10J)  
James Warner, Division Manager  
MPCA Ground Water and Solid Waste Division

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EXECUTIVE SUMMARY

PURPOSE

The Office of Inspector General (OIG) has performed an interim audit of the internal controls over costs for the Ritari Post and Pole site (Ritari), under Multi-Site Cooperative Agreement (MSCA) No. V005794-01. The objectives of our review were to determine whether the state:

- exercised adequate controls over costs through its financial management, accounting, procurement, contract administration, and property management systems; and
- complied with Federal regulations and cooperative agreement requirements.

BACKGROUND

The Superfund program was established by the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) of 1980. The program was revised and expanded in 1986 by the Superfund Amendments and Reauthorization Act. Under Superfund, the Environmental Protection Agency (EPA) is responsible for managing the cleanup of hazardous waste sites that threaten human health and the environment.

CERCLA authorizes EPA to delegate remedial response activities at hazardous waste sites to individual states. When a state elects to manage the remedial response at a site, it enters into a cooperative agreement with EPA. The cooperative agreement (1) documents the division of responsibilities between the state and EPA, and (2) defines the Federal funding available to the state and its costshare.

The Minnesota Pollution Control Agency (MPCA) is responsible for administering the State of Minnesota's environmental protection programs. This includes managing remedial activities at selected Superfund sites under EPA's CERCLA authority. MPCA was awarded MSCA No. V005794-01 on September 29, 1984. The total funds awarded as of April 30, 1994, under the cooperative agreement and its amendments were \$20,286,037 for 13 sites, of which \$942,959 was for Ritari.

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RESULTS OF AUDIT

We found significant weaknesses in MPCA's internal controls and compliance with laws and regulations. These weaknesses affected MPCA's ability to ensure that all costs claimed under the cooperative agreement were allowable, and resulted in \$227,584 in questioned costs. MPCA needs to improve its internal controls to ensure that all future costs are claimed in accordance with laws and regulations.

Report on Internal Controls

MPCA had weaknesses in internal controls that affected its ability to ensure that all costs claimed were allowable, allocable, and reasonable. Our review noted weaknesses in internal controls in the following areas:

- allocation of employee leave costs,
- approval of contractor rate increases,
- review of contractor indirect cost rates,
- submission of documentation supporting contractor invoices, and
- review of contractor employee timesheets.

Report on Compliance

MPCA did not comply with applicable Federal regulations and cooperative agreement conditions in its (1) procurement of contracts, and (2) management of site activities. Specifically, MPCA awarded a contract for full scope RI/FS work to a company that did not submit a proposal for that type of contract. MPCA also did not receive approval from EPA prior to performing work outside the scope of the cooperative agreement. In our opinion, MPCA's performance of work outside the scope of the cooperative agreement was significant enough for us to question \$227,584 as ineligible costs.

MPCA COMMENTS AND ACTIONS

MPCA agreed to take corrective action for all weaknesses in internal controls we identified. However, MPCA did not agree with the report on compliance and costs questioned. A

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summary of MPCA's comments, and our evaluation of the comments, is included in Chapters 2 and 3.

RECOMMENDATIONS

We recommend that Region 5:

1. ensure MPCA implements its planned corrective actions to improve internal controls,
2. clarify with MPCA that all workplans and reports are to be submitted to the EPA project officer, and
3. recover the ineligible costs of \$227,584 associated with the work outside the scope of the contract.

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CHAPTER 1

INTRODUCTION

PURPOSE

The Office of Inspector General (OIG) has performed an interim audit of the internal controls and costs claimed for the Ritari Post and Pole site (Ritari), under Multi-Site Cooperative Agreement (MSCA) No. V005794-01. The objectives of our review were to determine whether the state:

- exercised adequate controls over costs through its financial management, accounting, procurement, contract administration, and property management systems; and
- complied with Federal regulations and cooperative agreement requirements.

BACKGROUND

The Superfund program was established by the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) of 1980. The program was revised and expanded in 1986 by the Superfund Amendments and Reauthorization Act. Under Superfund, EPA is responsible for managing the cleanup of hazardous waste sites that threaten human health and the environment.

CERCLA authorizes EPA to delegate remedial response activities at hazardous waste sites to individual states. When a state elects to manage the remedial response at a site, it enters into a cooperative agreement with EPA. The cooperative agreement (1) documents the division of responsibilities between the state and EPA, and (2) defines the Federal funding available to the state and its cost-share.

The MPCA is responsible for administering the State of Minnesota's environmental protection programs. This includes managing remedial activities at selected Superfund sites under EPA's CERCLA authority. MPCA was awarded MSCA No. V005794-01 on September 29, 1984. The total funds awarded as of April 30, 1994, under the cooperative agreement and its amendments were \$20,286,037 for 13 sites.

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For our detailed review, we judgmentally selected Ritari, because of concerns about the site expressed by Region 5 officials. Region 5 amended the MSCA on June 30, 1987, to provide funding of \$234,005 for Ritari. The cooperative agreement provided for a RI/FS to be 100 percent EPA funded. The original budget and project periods for the award were July 1987 to July 1989. There were six additional amendments to the cooperative agreement which increased the total award amount to \$942,963 and extended the project and budget periods to September 30, 1995. As of December 31, 1994, MPCA had claimed costs for Ritari of \$942,959.

<u>Cost Category</u>	<u>Costs</u>
Contractual	\$ 817,243
Salaries	77,284
Fringe benefits	15,505
Indirect costs	28,952
Travel	3,705
Supplies	18
Other expenses	<u>249</u>
Total costs	<u>\$ 942,959</u>

As of the completion of our fieldwork, EPA had approved the RI/FS and proposed plan, and MPCA was preparing the Record of Decision.

SCOPE AND METHODOLOGY

We performed our audit in accordance with the Government Auditing Standards issued by the Comptroller General of the United States (1988 revision), and included tests of the accounting records and other auditing procedures as we considered necessary. Our fieldwork was conducted between February 7 and May 12, 1994.

In planning and performing our audit, we considered relevant aspects of the internal control structure in order to determine our auditing procedures. Our purpose was to determine whether the costs claimed complied with the applicable Federal laws and regulations and conditions of the cooperative agreement, and not to provide assurance on the internal control structure.

For purposes of this report, we have classified the significant internal control structure policies and procedures in the following categories:

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- accounting
- contract procurement
- contract management

For these internal control structure categories, we obtained an understanding of the relevant policies and procedures and whether they had been placed into operation. We also relied upon the single audit report, prepared by the Minnesota Legislative Auditor, for the State of Minnesota, for the year ending June 30, 1992, to the extent that it was applicable to MPCA.

We tested MPCA's internal controls by reviewing the selected costs claimed for Ritari from the date of the first award, June 30, 1987, to December 31, 1993. To review selected categories of costs, we audited samples of those costs. We randomly selected a payroll sample of 51 employee payroll payments out of a universe of 504. The sample represented 10.4 percent of the total dollar amount of claimed salaries and fringes. We judgmentally selected a sample of the five largest contractor invoices that represented 38 percent of the total dollar amount of contract costs. We did not sample the other cost categories, as the amounts claimed for those categories were not material to the total amount claimed. Since we did not select a statistical sample, our results were not projectable to the universe.

For all sampled items, we examined the source documents and performed other audit procedures that we considered necessary to determine the allowability of the costs. As criteria, we used the Code of Federal Regulations (CFR) Title 40, Parts 30, 31, 33, and 35; Office of Management and Budget (OMB) Circular A-87; and the general and special conditions contained in the cooperative agreement.

Weaknesses in internal controls and compliance with laws and regulations are discussed in Chapters 2 and 3, respectively. Nothing else came to our attention in connection with our review which caused us to believe that MPCA was not in compliance with any of the terms and conditions of the cooperative agreement, laws, and regulations for those transactions not tested.

The draft report was issued to MPCA on May 26, 1994. MPCA responded to the draft report on June 28, 1994. After reviewing the response and discussing it with Region 5, the report was reformatted to emphasize internal control issues. However, we did not change the nature of our findings.

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MPCA's response was incorporated into the report and is included as Appendix A.

CHAPTER 2

REPORT ON INTERNAL CONTROLS

MPCA had weaknesses in internal controls that affected its ability to ensure that all costs claimed were allowable, allocable, and reasonable. Our review noted weaknesses in internal controls in the following areas:

- allocation of employee leave costs,
- approval of contractor rate increases,
- review of contractor indirect cost rates,
- submission of documentation supporting contractor invoices, and
- review of contractor employee timesheets.

MPCA management is responsible for establishing and maintaining an internal control structure. The objective of an internal control structure is to provide management with reasonable, but not absolute, assurance that Federal financial assistance programs are managed in compliance with applicable laws and regulations.

EMPLOYEE LEAVE COSTS WERE NOT ALLOCATED EQUITABLY

MPCA's procedures for allocating the costs of employee leave (vacation, holiday, and sick time) to project sites did not provide an equitable distribution to Federal and state projects. In addition, MPCA was not following its own procedures for allocating leave time to Federal projects. OMB Circular A-87 states that leave costs are allowable if they are (1) provided pursuant to an approved leave system; and (2) equitably allocated to all related activities, including grant programs.

MPCA's procedures were to charge leave time directly to Federal or state projects based upon the percentage of time spent on Federal projects. If at least 50 percent of an employee's time during a pay period was spent on Federal projects, a portion of the leave time taken during the pay period was to be allocated to Federal projects. The allocation of leave hours was based on the percentage of quarterly budgeted time for Federal and state projects. If less than 50 percent of an employee's time during a pay

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period was spent on Federal projects, all leave time was charged to state projects.

The leave allocation procedures do not provide an equitable distribution of leave time. Leave time was not charged to projects in the same proportion as the direct time was charged. Also, the quarterly budgeted time may not accurately reflect the actual time spent on Federal and state projects.

We also found that MPCA employees were not consistently following the leave allocation procedures, and leave time was not always properly allocated to Federal projects. For example, during one pay period, an employee charged 40 hours of leave time to Ritari and 40 hours to another Federal project. This did not conform to the MPCA leave policy because (1) no time was spent on Federal projects that pay period, since the individual was on leave the entire pay period, and (2) the leave was not charged in the proportion of budgeted hours, as the employee also worked on state projects, and leave was not charged to any state projects.

At our request, MPCA computed the amount of actual leave time that was charged to Ritari from its inception on June 30, 1987, to December 31, 1993. Of the 4,452 labor hours charged to Ritari, only 138 hours, or 3.1 percent, were for leave time. In comparison, for fiscal year 1993, MPCA's total leave time was 14 percent of its total regular hours. MPCA's computation indicated that the charges to Ritari were not excessive, and may have been less than the proper amount that should have been charged. However, we have no assurance that MPCA charges for leave costs were not excessive at other Federal sites. MPCA's Chief Financial Officer agreed to work with EPA to establish an equitable leave allocation system.

**DIRECT LABOR RATE INCREASES EXCEEDED CONTRACT LIMITS**

MPCA approved direct labor rate increases for 1990 that were in excess of the limits allowed in the contract. MPCA approved the rate increases without obtaining supporting cost documentation or performing a thorough cost analysis. With a cost reimbursement type contract, the recipient should ensure that sufficient supporting documentation is obtained before rate increases are approved.

The contract provisions allowed an increase of 10.8 percent, which included an increase of 6 percent plus the increase in the Consumer Price Index of 4.8 percent. Delta Environmental

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Consultants, Inc. (Delta), the contractor on the Ritari site, explained to MPCA that its direct labor increases were 12.15 percent and its equipment and material costs did not increase. Delta stated that these rate changes represented an average increase of 9.72 percent in its direct labor and materials costs, which was within the 10.8 percent allowed in the contract. The contract did not allow the use of an average percentage increase in direct labor and material costs. The rates for each separate direct labor category and each item of material were subject to a maximum escalation factor of 10.8 percent.

MPCA approved the rate increase without obtaining supporting cost documentation or performing a thorough cost analysis. As a result, MPCA approved rate increases for several individual labor categories that were in excess of the allowed increase of 10.8 percent. Most of the Delta's billed labor hours were in categories that increased from 8.9 percent to 42 percent. We were unable to determine how Delta arrived at its calculation of a 12.15 percent increase; our calculation of the average labor rate increase was 15.1 percent. The direct labor rate increases resulted in additional direct labor costs, as well as related charges for indirect costs and profit.

MPCA NEEDS TO MORE THOROUGHLY REVIEW  
DELTA'S INDIRECT COST RATES

MPCA approved indirect rate increases based on accountant's and auditor's reports which Delta provided. While it is a good practice to require such reports, MPCA did not have a person, knowledgeable about Federal cost principles, review the reports submitted. We have some concerns over the appropriateness of Delta's indirect rates based on (1) our limited review of these reports and (2) problems found during an audit of a cost proposal from another Delta office. Due to our concerns, we do not believe that MPCA has adequate assurance that Delta's indirect rates include only costs allowable under Federal cost principles. Thus, EPA may have been overcharged if Delta's indirect rates include unallowable costs.

The contract allowed Delta to request a rate increase each year. Along with each proposed change, Delta was required to submit documentation to support its request. The documentation could be either (1) an audit report and projected budget adjustments or (2) a letter from a reputable accounting/auditing firm certifying that the audit upon which



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the change is based was performed in accordance with Federal Acquisition Regulations (FAR) cost principles.

Delta submitted an independent accountant's report which supported an indirect rate of 240 percent for 1989. However, MPCA negotiated an indirect rate of 140 percent for 1989. In 1990, Delta requested an increase to 160 percent, which MPCA approved. MPCA did not provide us with an additional report to support this rate increase, but stated that the increase was not very large and seemed reasonable.

In 1991, Delta requested an increase to 240 percent. Delta submitted to MPCA an independent auditor's report for the year ended December 31, 1990, which supported an indirect rate of 240 percent. MPCA approved the rate increase based on this report and on the fact that it believed that Delta's actual indirect rate had been higher than what it had been charging MPCA for the previous two years. Delta's indirect rate remained at 240 percent for the remainder of the contract.

We have some concerns whether the indirect rates Delta charged were accurate and whether they included unallowable costs. The first of the reports Delta provided to MPCA was not an audit report. From reading the report, it appears that the scope of the review was not sufficient to determine if the indirect cost rate was calculated in accordance with the FAR cost principles. The second report was an audit of Delta's 1990 indirect cost rate, which was reported as 240 percent. The auditor expressed an opinion that the computation fairly represented the overhead rate. The Minnesota Department of Transportation, which also has a contract with Delta, did review the auditor's report and accepted the 1990 indirect cost rate. However, the Department of Transportation did not review any of Delta's records to verify the information in the auditor's report. There was not sufficient information in the auditor's report for us to make complete determination whether unallowable costs were included in Delta's indirect cost rate.

Our concern about Delta's indirect cost rate is also based on a U.S. Postal Inspector's report on the audit of a price proposal submitted by Delta's Sacramento office. The indirect cost rate in the proposal was based on the audited financial statements, and the allowability of costs was determined by the same Certified Public Accounting firm which prepared the reports submitted to MPCA. The Postal Inspector's audit determined that the proposed indirect cost rate was higher than should have been allowed. When we

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compared the rates proposed for the Sacramento office to the amounts in the reports presented to MPCA, we found some similarities. Thus, we are concerned that some of the items questioned by the Postal Inspector could also be included in the rate charged to MPCA.

With a cost reimbursement type contract, MPCA needs to have strong internal controls to ensure that indirect cost rates are accurate and allowable, and that requested rate increases are justified. While MPCA did take steps to ensure the reasonableness of Delta's rates, by requiring Delta's submission of audit reports, we believe that further steps are necessary. MPCA should arrange an independent audit of Delta's rates if possible.

**SUPPORTING DOCUMENTATION FOR CONTRACTOR INVOICES**  
**WAS NOT SUBMITTED CONSISTENTLY**

Delta generally included supporting documents with its invoices, but did not submit them on a consistent basis. In some cases Delta did not provide the backup documents for the cost of meals, lodging, mileage, and supplies. The contract between MPCA and Delta required that supporting documents be submitted for reimbursable expenses in excess of \$25. Since Delta had a cost reimbursement type contract, it was important that MPCA only reimburse Delta for its actual costs. To ensure this, MPCA should have required Delta to submit all supporting documents required by the contract. For future cost reimbursement type contracts, MPCA should require all contractors to adhere to the contract terms and submit supporting documentation as proof that expenses billed were actually incurred.

**MPCA SHOULD REVIEW CONTRACTOR EMPLOYEE TIMESHEETS**

Although Delta's contract was a cost reimbursable type contract, MPCA never examined Delta's timesheets supporting its direct labor charges. MPCA's contract with Delta did not require Delta to provide employee timesheets in support of direct labor charges, and MPCA never requested timesheets. MPCA also never audited Delta. We believe that this was an internal control weakness, as MPCA had no way of knowing whether the hours Delta billed truly represented hours worked on MPCA projects. Requesting and reviewing timesheets from Delta, even on a periodic basis, would have provided some level of assurance that the labor charges were appropriate.

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MPCA has entered into additional cost reimbursement type contracts with Delta as well as other contractors. Labor hours are generally a significant portion of costs for RI/FS work, so it is important that the contractors' billings accurately reflect their costs. MPCA should require its contractors to provide additional support for labor charges, and ideally should try to conduct some type of audit or spot check periodically.

**MPCA COMMENTS AND ACTIONS**

MPCA agreed to take action to address each of the weaknesses in internal controls. In regards to the allocation of leave costs, MPCA received additional guidance from EPA on how to allocate leave. MPCA is waiting for an example of an equitable leave distribution method. Upon receiving the example, MPCA will apply the leave allocation plan to one Federally funded site and send the information to EPA and OIG for approval. After approval is received, MPCA staff will be trained to follow the new system.

Concerning contractor rate increases, MPCA obtained information from Delta subsequent to our fieldwork to support the 1990 labor rate increases. MPCA agreed to require contractors to submit documentation of personnel rate increases in the future, and for any increases approved since January 1, 1994.

MPCA intends to either hire an auditor or contract with an independent auditor for indirect cost determinations. This will ensure that audit reports contractor submit are complete and indirect cost rates do not contain any unallowable costs.

MPCA's corrective action concerning review of contractor invoices and timesheets is to have the procurement specialist conduct periodic reviews of invoices. These reviews will include examination of contractor timesheets. Also, mandatory training is scheduled for all project officers on proper invoice submittal and review.

**OIG EVALUATION/RECOMMENDATION**

MPCA's proposed corrective actions, when implemented, should address the internal control weaknesses.

We recommend that Region 5 ensure MPCA implements the corrective actions.

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CHAPTER 3

REPORT ON COMPLIANCE

MPCA did not comply with applicable Federal regulations and cooperative agreement conditions in its (1) procurement of contracts, and (2) management of site activities. Specifically, MPCA awarded a contract for full scope RI/FS work to a company that did not submit a proposal for that type of contract. MPCA also did not receive approval from EPA prior to performing work outside the scope of the cooperative agreement. In our opinion, MPCA's performance of work outside the scope of the cooperative agreement was significant enough for us to question \$227,584 as ineligible costs.

PROCUREMENT REGULATIONS NOT MET

EPA procurement regulations for cooperative agreements require that recipients determine qualified offerors solely on the basis of the evaluation criteria in the request for proposals (RFP). The RFP for the Multi-Site II contracts stated that those contractors submitting a limited scope proposal would only be evaluated for a contract for limited scope work. However, MPCA awarded a full scope contract to a company which submitted only a limited scope proposal. As a result, MPCA did not comply with the RFP or EPA procurement regulations.

MPCA issued the RFP in May 1988 for contractors to conduct both full and limited scope work at hazardous waste sites located in Minnesota. According to the RFP, full scope work would meet all EPA requirements, and would be conducted at Federally funded sites. Full scope work included RI/FS. The purpose of an RI was to identify the type and sources of contamination, and the effects of the contamination on public health, welfare, and the environment. An FS was to identify, investigate, and recommend alternative response actions for sites. In contrast, the limited scope work would be conducted only at state funded sites. Limited scope work included limited remedial investigations and focused feasibility studies (LRI/FFS). The purpose of the LRI was to generate data only to the extent it was necessary to identify and design an interim or early response action, including a limited source removal. Similarly, the FFS was to identify, investigate, and recommend alternative permanent water supply systems and/or limited source removal methods.

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The RFP requested the proposers to submit one of two types of proposals: either limited scope or full scope. The RFP clearly stated that those contractors submitting a limited scope proposal would only be evaluated for a contract for limited scope work. The RFP requirements for the limited scope option were less stringent and less information was required than for the full scope option. The RFP included two different sets of assumptions. Those contractors submitting proposals for full scope work were required to address both sets of assumptions, and prepare cost estimates for each. Those submitting proposals for limited scope work only had to address one set of assumptions and prepare one cost estimate. Thus, much more work was required of a contractor to prepare a proposal for full scope work than limited scope work.

MPCA received eight proposals in response to the RFP. Seven proposals were full scope and only one, submitted by Delta, was a limited scope proposal. MPCA awarded Delta a full scope contract in April 1989, even though it had only proposed to do limited scope work. The MPCA selection team did not disqualify Delta from consideration for a full scope contract even though it had submitted only a limited scope proposal. Delta was subsequently assigned to do full scope work on Ritari, a Federally-funded site.

MPCA did not comply with the terms of the RFP when it awarded Delta a contract to perform full scope work. The regulations, 40 CFR 33.510, require the recipient to publicize RFPs and evaluation factors and to identify their relative importance. The RFP indicated that proposers of the limited scope proposal option would be evaluated only for a limited scope contract. Title 40 CFR 33.515 states that recipients must base their determination of qualified offerors solely on the evaluation criteria in the request for proposal. MPCA, in awarding a full scope contract to Delta, did not comply with the evaluation criteria in the RFP.

MPCA's award of a full scope contract to Delta did not conform to 40 CFR 33.230, which requires the recipient to conduct all procurement transactions in a manner that provides open and free competition. Any arbitrary action in the procurement process would be an inappropriate restriction on competition. Awarding a full scope contract to Delta, who submitted a limited scope proposal, was an arbitrary action that restricted open and free competition.

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A state is required by 40 CFR Part 35, Subpart O<sup>1</sup>, to either (1) certify that its procurement system meets the intent of the requirements in Subpart O or (2) allow EPA preaward review of proposed procurement actions. MPCA has not complied with either of these options. The last MPCA certification was in 1988. It was the understanding of MPCA officials that they were not required to certify the procurement system after 1988. We informed Region 5 officials of this situation in a flash report (Report No. 4400061) on May 13, 1994. We recommended that Region 5 require MPCA to certify its procurement system meets the requirements of 40 CFR Part 35, Subpart O. MPCA submitted a certification for its procurement system on July 27, 1994.

WORK OUTSIDE APPROVED SCOPE

MPCA did not request a change in the scope of the cooperative agreement when additional tasks were added at Ritari. States are required to request an amendment to the cooperative agreement when there are changes to the scope of the project. Since MPCA did not request an amendment, the tasks were outside the scope of the cooperative agreement.

EPA must approve changes to the scope of work before costs can be incurred for the changes. Changes to the scope of work are generally outlined in workplans. One of the assurances in the cooperative agreement between EPA and MPCA is that MPCA agreed to submit all plans and reports, including workplans, to the EPA project officer for review and concurrence prior to implementation. The Superfund Memorandum of Agreement also states that the project officer will coordinate reviews of all work products.

Delta's original workplan, approved by EPA, included tasks 1-13. Tasks 14 and 15 were for activities that EPA had separately approved and added to the scope of the cooperative agreement, but were not formally added to the workplan. During the remedial investigation, MPCA instructed Delta to submit a workplan amendment because new developments at the site required revision of the work schedule and tasks. Delta submitted a workplan amendment, which revised the budgets for several existing tasks, and added tasks 16-19, which were for

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<sup>1</sup> While 40 CFR Part 33 was the regulation in place at the time MPCA procured the MSII contract, the current regulations on procurement for Superfund cooperative agreements are found in 40 CFR Part 35, Subpart O.

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new activities. However, MPCA did not request an amendment to the cooperative agreement for the additional tasks. Therefore, these new tasks were outside the original cooperative agreement scope.

<u>Task Number</u>	<u>Task Description</u>	<u>Task Amount</u>
16	PCP matrix study	\$ 2,436
17	Phase II well drilling	91,151
18	Groundwater sampling, 4th & 5th rounds	98,482
19	Dioxin exposure survey	6,054
		<u>\$ 198,123</u>

The cooperative agreement requires that all workplans be submitted to the EPA project officer for review and concurrence prior to implementation. MPCA completed these tasks with the apparent knowledge of the EPA remedial project manager, but without the knowledge or approval of the EPA project officer. While the remedial project manager was MPCA's contact for technical changes to the work at the site, project officer approval is needed before costs are incurred for the changes to the scope of work.

MPCA's performance of activities outside the scope of the contract resulted in costs being incurred which were contrary to the regulations and cooperative agreement conditions. As a result, we have questioned as ineligible the \$198,123 MPCA paid to Delta for tasks 16 through 19. We have also questioned as ineligible MPCA's labor, fringe benefits, and indirect costs that were related to the unapproved tasks. MPCA's accounting system does not track project costs by tasks, so we were not able to directly match the MPCA's costs with the project tasks. Therefore, we used a ratio to calculate the portion of the MPCA's costs allocable to the work completed outside the scope of the cooperative agreement. The ratio of questioned contractual costs (\$198,123) to total contractual costs (\$817,243) was 24.2 percent. We applied that percent to MPCA's costs:

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<u>Cost Category</u>	<u>Costs Claimed</u>	<u>Percent Ineligible</u>	<u>Costs Questioned Ineligible</u>
Salaries	\$ 77,284	24.2%	\$ 18,703
Fringe benefits	15,505	24.2%	3,752
Indirect costs	<u>28,952</u>	24.2%	<u>7,006</u>
	<u>\$121,741</u>		\$ 29,461
Contractual costs			<u>198,123</u>
Total questioned costs			<u>\$ 227,584</u>

MPCA COMMENTS AND ACTIONS

MPCA disagreed with our conclusions. MPCA's position was that it did follow the state contractual procurement requirements in obtaining the contract with Delta. The request for proposal did not contain any language precluding MPCA from exercising its discretion and extending full scope contracts to an otherwise qualified proposer that submitted only a limited scope proposal. All interested companies had the same opportunity to submit proposals for either limited or full scope contracts and to be subsequently evaluated by MPCA. MPCA also stated that the audit did not contain any allegations that the services Delta provided were deficient in any way.

In regards to the work outside the scope of the cooperative agreement, MPCA's position was that cooperative agreement amendment no. 35, dated March 6, 1991, with a value of \$149,489, was for additional soil and ground water samples for the presence of dioxin. Also, copies of all documents relating to the tasks were submitted to the remedial project manager, and the Superfund Memorandum of Agreement (SMOA) requires the project manager is to coordinate with the project officer in reviewing and approving tasks.

OIG EVALUATION

The OIG continues to believe the procurement of the contract with Delta was not in compliance with Federal procurement regulations. We did not cite violations of state procurement regulations because MPCA is to follow Federal regulations when procuring contracts to be used in conjunction with Federal monies. Federal regulations, 40 CFR Part 33.515, require that states base their determinations of qualified offerors solely on the evaluation criteria in the RFP. The RFP stated that contractors submitting limited scope



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proposals would only be evaluated for a contract for limited scope work. In exercising its discretion, MPCA deviated from the evaluation criteria in the RFP. While all companies were given the opportunity to submit proposals, all companies were not given an opportunity to submit a limited scope proposal and be considered for a full scope contract.

In its response, MPCA stated that the report did not contain any allegations that the services Delta provide were deficient. The purpose of the audit was to review MPCA's internal controls over costs and not the technical quality of the work performed. Notwithstanding, it should be noted that MPCA removed Delta from further working on the project because of Delta's difficulty in producing the remedial investigation report.

In regards to the work outside the scope of the cooperative agreement, amendment no. 35 was for more tasks than dioxin sampling: additional soil and ground water sampling and a remedial action. The contractual costs associated with each of the tasks were \$64,500 for the sampling and \$69,500 for the remedial action. MPCA later determined that the remedial action was not needed, but did not have approval from EPA to use the \$69,500 on other site activities.

The \$64,500 of contractual costs EPA awarded to MPCA in amendment no. 35 was for task 14, a dioxin survey, and not tasks 16 through 19. MPCA files indicated that MPCA and Delta had estimated the cost of task 14 to be \$64,500, the same amount MPCA included in its application for additional funds. As a result, tasks 16 through 19 were not what was intended by amendment no. 35, or any subsequent cooperative agreement amendment. We continue to believe that tasks 16 through 19 were outside the scope of the cooperative agreement.

MPCA has always been required to submit plans and report to the project officer, and not the remedial project manager, for review and approval. The SMOA does state that the EPA project officer and remedial project manager are to coordinate their reviews of plans and reports, but the ultimate responsibility is with the project officer. While the SMOA mentions that EPA is to coordinate its review, the cooperative agreement specifically states that the plans and reports are to be submitted to the project officer.

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RECOMMENDATION

We recommend that Region 5:

- clarify the requirement that MPCA submit all workplans and reports to the EPA project officer, and
- recover the questioned costs of \$227,584.

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## **Minnesota Pollution Control Agency**

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June 28, 1994

Mr. Anthony C. Carrollo  
Divisional Inspector General for Audits  
U.S. Environmental Protection Agency  
Office of Inspector General  
Northern Division  
77 West Jackson Boulevard  
Chicago, Illinois 60604

Dear Mr. Carrollo:

Enclosed please find the Minnesota Pollution Control Agency (MPCA) response to the draft Audit Report ESBGL4-05-0138. In accordance with a telephone conversation on June 27, 1994, between Juline Holleran of my staff and Janet Kasper of the Office of Inspector General, this response is provided within 30 days of MPCA receipt of the draft Audit Report (May 31, 1994). The MPCA staff has reviewed the draft report and has provided comments which reflect MPCA's position on the audit findings, as you requested. The comments to follow are organized in order of the issues raised in the draft report.

In addition to the MPCA staff's comments, documentation is provided from the MPCA files which supports MPCA's position on the audit. Most of the supporting documentation has had the relevant passages highlighted to focus attention on those issues as referenced.

MPCA appreciates the opportunity to review and comment on the draft report. I hope you will find the information provided in this response clearly demonstrates MPCA's competent performance as the lead agency on the Ritari Post & Pole Site (Site) Remedial Investigation/Feasibility Study (RI/FS), and that the expenditure of federal funds has been in accordance with all applicable federal and state policies, regulations and procedures. In the absence of any allegation that services rendered were inadequately performed, MPCA anticipates full resolution of this audit with no questioned costs.

This response begins by addressing the issue of procurement requirements not being met. State of Minnesota Attorney General's staff has cited state and federal statutes and laws which support the argument that the MPCA did in fact follow all applicable contract law, policy, and regulation in hiring the Multi-Site contractors.

The next section of the response covers the question of the appropriate expenditure of funds for tasks completed during the Remedial Investigation. The MPCA staff has supplied numerous documents to show continual involvement by the U.S. Environmental Protection Agency (EPA) throughout the process and documents appropriate EPA approval of funds and revision of scope.

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The last section of the response addresses the issues raised regarding MPCA compliance and internal controls. This section demonstrates internal improvements and represents MPCA's commitment to resolve any problems which may have occurred in the past and corrective action being implemented to prevent future problems.

COMPLIANCE WITH PROCUREMENT REQUIREMENTS

In the Office of the Inspector General's (OIG) draft Audit Report regarding Multi-Site Cooperative Agreement No. V005794, you state that in the course of conducting their review, significant weaknesses in the internal controls in the area of contract procurement were found, which resulted in the questioned costs. As a consequence of these findings, OIG recommends that Region 5 recover costs in the amount of \$785,121.00 from MPCA as ineligible costs. Of that amount, OIG has identified \$755,660.00 of contractual costs paid by MPCA to Delta Environmental Consultants, Inc. (Delta) as ineligible because the MPCA did not properly follow contract procurement requirements. It is the position of MPCA that it indeed did properly follow state of Minnesota's (State) contractual procurement requirements, and that the reportedly ineligible costs have improperly been determined to be ineligible. The basis for MPCA's position is explained and discussed below and is supported by Attachment A to this letter. Further, MPCA notes that the OIG audit contains no allegations that the services provided by Delta were inadequately performed, substandard, or otherwise deficient in any way. In the absence of any such allegations, a request for reimbursement of \$755,660.00 paid to Delta is unconscionable and contrary to established principles of contract law.

The Multi-Site II (MSII) procurement process started in January of 1988, and culminated in April 1989 with the execution of four (4) MSII contracts, including the MSII contract with Delta. On February 8, 1988, MPCA initiated the process whereby requests for proposals for the Multi-Site contract would be solicited with the intention of procuring two to four contractors. The procurement planning process started with the establishment of the MSII procurement team (MSII Team). The MSII Team was composed of Barb Jackson, Barb Gnabasik, Dave Douglas, Mike Convery, Orbbie Webber, and team leader, Mike Vennewitz from MPCA. The MSII Team also included two EPA staff, Fred Bartman, remedial project manager, and Dr. Cheng-Wen Tsai, a laboratory quality assurance/quality control specialist. Debra McGovern and Doug Day of MPCA were the State's Authorized Agents, and assisted Mr. Vennewitz in contract negotiations. Drafting of the MSII request for proposal/request for qualifications (RFP) began in February of 1988. On March 25, 1988, the draft RFP was sent to EPA Region 5 office for review. On April 15, 1988, MPCA sent a request for authority to negotiate to the State Department of Administration (MDA) which was subsequently granted. Later that month, April 26, 1988, EPA's comments on the draft RFP were received and incorporated. RFP notification was published in the State Register on May 30, 1988, in the June 8, 1988, edition of Business Commercial Daily, and in the Hazardous Waste News and Superfund Report. Further, notice was sent to all parties on the consultant's list and on the Minority Business Enterprise/Women's Business Enterprise (MBE/WBE) consultant's list. The deadline for receipt of proposals was June 27, 1988. A pre-proposal meeting was held on June 8, 1988, and was attended by more than 50 people.

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While the RFP was on notice, the MSII Team drafted two proposal review forms from criteria listed in the RFP. The cost review form was designed to assure that cost data submitted with each proposal was in sufficient detail and proper format to allow the review team to perform a cost and price analysis. The second form was the technical review form which contained the following criteria: personnel, qualifications, staffing capabilities, past appropriate experience, management capability, financial capability, and quality of a technical analysis of a theoretical problem present in the RFP.

From the pool of more than 50 attendees at the pre-proposal meeting came a total of eight proposals received on June 27, 1988. Proposals were received from Malcolm Pirnie, Inc. (MP), Barr Engineering Company (Barr), Ecology and Environment (E&E), Woodward-Clyde (WC), Weston, Camp Dresser & McKee, Inc. (CDM), Delta and Lee Wan and Associates. The proposal from Lee Wan and Associates was considered completely inadequate. It did not pass the "Pass/Fail" requirements outlined in the RFP upon receipt, and, therefore, was not reviewed by the MSII Team. Six of the qualified proposals received were full scope proposals and one qualified proposal, from Delta, was a limited scope proposal.

Proposal review was conducted in July of 1988, utilizing the formal criteria as advertised in the RFP and the proposal review forms. Two team members, Orbbie Webber and Dr. Tsai, reviewed only the Quality Assurance Project Plan portions of each proposal. The MSII Team scored and ranked the proposals based on the technical, business, and cost/price analyses. Using the scoring method established during the RFP planning process, proposals were scored as follows:

<u>Company</u>	<u>Full Scope</u>	<u>Limited Scope</u>
Barr	386	370
E&E	344	334
Delta	N/A	340
MP	336	326
CDM	331	331
Weston	287	288
WC	Not Scored	Not Scored

The proposal submitted by WC was not scored because its proposal was deemed inadequate and its experience insufficient. E&E, CDM, MP, and Barr were determined to be qualified for full scope contracts. These four proposers and Delta were determined to be qualified for limited scope contracts. Weston and WC were determined to be less qualified or unqualified, and were not invited to the next phase of proposal review, interviews with the MSII Team.

Interviews were held on July 19-21, 1988. Based upon the interview score sheets and interview answers, a short list of finalists was selected to advance on to the negotiation phase for the MSII contracts. E&E was eliminated from further consideration at this stage based upon poor performance in the interview process, lack of State experience, weak subcontractors, limited RI/FS work and a technically weak hydrologist. This resulted in a determination that E&E was not technically competent for either

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full scope or limited scope work. CDM, MP, Barr, and Delta were determined to be the most technically competent and price competitive and, therefore, more suitable to enter into contract negotiations.

The contract negotiation process began in August of 1988, when the four finalists were introduced to the negotiation team of Debra McGovern, Doug Day, Mike Vennewitz, and Robert Einweck. On January 10, 1989, draft contracts based on language outlined in the RFP were sent to the four firms for comment. Their comments were received in February and incorporated as appropriate. Contract negotiations were then held on February 24 and 25, 1989. As a result of negotiation sessions, certain changes were made to the contracts for each of the four firms. Best and final offers were received from the four firms and final contracts drafted between February 16 and March 20, 1988. Final contracts were signed and executed by the contractors and the State Department of Finance in April of 1989.

Although the RFP solicited proposals for limited scope work, no limited scope work was forecast at the time of contract negotiations. Full scope work was projected to be the MPCA's workload for the foreseeable future, and MPCA management determined that the workload was beyond the capability of three contractors. Given the strong interest on the part of the MPCA to have four contractors available for the anticipated workload, Delta, having clearly demonstrated to the RFP review team that it was fully qualified for full scope work, was included in contract negotiations. Delta's broad range of experience in performing full scope RI/FS's was reviewed by the team of MPCA staff and supervisors during the interview stage of the procurement process.

MPCA acknowledged a concern that Delta did not have the same breadth of organization possessed by the other three contractors. Consequently, the initial site assignments made to Delta were of a scope determined to be commensurate with their organization's capabilities. The Union Scrap Site was tasked to Delta on May 24, 1989, for development of an RI/FS support document work plan. A work order to perform the RI/FS was issued to Delta on July 28, 1989, for the Union Scrap Site. Delta performed this project competently and demonstrated its expertise in performing full scope RI/FS's. Consequently, the work assignment for the Ritari Post and Pole Site (Site) Project was issued to Delta on September 5, 1989. The OIG Audit Report contains no allegations or findings contrary to performance.

OIG states in the draft Audit Report that MPCA did not properly follow procurement requirements; but OIG has not identified any procurement requirement in State statute or rule with which MPCA failed to comply.

The State's statutory requirements for issuance of State contracts are found in Minn. Stat. ch. 16B. Generally and specifically relevant statutory sections are Minn. Stat. §§ 16B.01 through 16B.102, and § 16B.17. As a general rule, all State contracts for construction or repairs and all purchases of and all contracts for supplies, materials, purchase or rental of equipment and utility services are required to be based upon competitive bids (Minn. Stat. § 16B.07, Subd. 1). However, this general rule does not apply if Minn. Stat.

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Chapter 16B otherwise provides for alternative procurement methods (Minn. Stat. § 16B.07, Subd. 1). Requests for proposal are expressly provided for as an alternative to sealed competitive bids.

Subd. 3. Publication of Notice. Expenditures Over \$15,000.00 and Requests for Proposals. If the amount of an expenditure or sale is estimated to exceed \$15,000.00, sealed bids or requests for proposals provided in Section 16B.08, Subd. 4, clause (b), must be solicited by public notice.

Minn. Stat. § 16B.07, Subd. 3. Subdivision 4(b) of Section 16B.08 provides

In lieu of the requirement for competitive bidding in Section 16B.07, Subd. 1, purchases and contracts may be negotiated in those circumstances determined by the Commissioner, and in any of those circumstances the Commissioner shall advertise for a request for proposal as a basis for negotiation.

Chapter 16B contains only the two above-quoted references with respect to requests for proposal, requiring publication of notice and expressly authorizing contract negotiation by requests for proposal.

As noted above in the discussion of the procurement process, authorization to negotiate was granted by the Commissioner of the MDA and the request for proposal was public noticed for more than seven days before the final proposals were due. The requirements of the two above-cited statutory provisions were met.

The State's regulatory requirements for State contracts are found in Minnesota Rules Chapter 1230. Generally relevant sections of Chapter 1230 are sections 1230.0100 through 1230.1300. Minnesota contract procurement rules do not provide or contain any specific requirements relative to requests for proposals and negotiation of contract.

In the absence of statutory or regulatory requirements or restrictions upon the request for proposal process, a contracting agency has considerable discretion in the negotiation process. That discretion, though not controlled by, may be guided by the general principles of openness and fairness embodied in the State contracting laws and regulations.

The RFP procurement process was conducted consistent with those general principles, and was open and fair. The RFP was public noticed and a pre-proposal meeting was held. Fifty prospective proposers attended, of which eight submitted proposals. Proposals meeting "Pass/Fail" requirements were reviewed, scored and ranked by the MSII Team. Interviews were conducted leading to contract negotiations and ultimately to execution of contracts with qualified contractors.



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The RFP transmittal letter did indicate that one of two types of proposals may be submitted in response to the RFP, a limited scope proposal or a full scope proposal, and indicates that at page 37 of the RFP a description of the two types of proposals is provided. As noted in the draft Audit Report, the RFP stated that those contractors submitting a limited scope proposal would only be evaluated for a contract for limited scope. The request for proposal does not contain any language precluding MPCA from exercising its discretion and extending full scope contracts to an otherwise qualified proposer that submitted only a limited scope proposal.

The difference in the two types of proposals was only in the hypothetical problem that a proposer must address. The purpose of the hypotheticals and other evaluation criteria is to identify the most qualified proposers. Evaluation criteria are identified at page 48 of the RFP. The Evaluation of Proposal section of the RFP specifically states, "The number and scope of contracts entered into will be a function of the proposer's qualifications and capabilities." Ultimately, it is the proposers' qualifications and capabilities that determine the scope of contract for which they are eligible. Further, the RFP at page 51 expressly states: "The MPCA authorized agents shall have authority to issue work orders or contract(s) to the contractor best meeting specifications and conditions." The RFP contained only one model contract with no indication that two different contracts, one for limited scope, another for full scope, would be written or entered into. The same contract was contemplated for all qualified proposers.

Although proposal review was for both full and limited scope, questions during the interview process dealt with both limited and full scope work abilities. Delta answered questions for both full scope and limited scope RI/FS work. Their answers indicated that they had considerable experience with RI/FS, worked with EPA in Illinois and Wisconsin, and that they had personnel on staff with prior MPCA experience working on full scope RI/FS's. Through the course of the evaluation process, Delta demonstrated that it had extensive experience with full scope work and was qualified for such work.

OIG's entire position rests upon a single statement in the RFP: "Proposers choosing this option will be evaluated on proposal development for the Limited Scope Proposal Option only." This was a statement of intent and not a requirement imposed upon any potential proposer. The statement did not preclude the MPCA from considering a proposer that chose this option for a full scope contract if subsequently determined to be qualified through any stage of the procurement process. Procurement by RFP is different than procurement by competitive bid. For the latter, there are statutory and regulatory requirements that prescribe the steps of the process and impose specific requirements upon the contracting agency. This is not true for procurement by RFP which is a procurement by negotiation. The purpose of the RFP is to identify qualified contractors. This purpose was not compromised. Rather, it was served by including Delta in MSII contract negotiations.

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OIG cites to 40 CFR 35.6555, 35.6565, and 31.36 as further support for its position. First, it is important to note that 40 CFR Part 35, subp. 0 was not in place at the time the contract with Delta was awarded and contains no indication of retroactive application. It is the MPCA's position that the requirements of Sections 35.6555 and 35.6565 are, therefore, improperly cited and inapplicable. Further, even though inapplicable, the actions of MPCA otherwise fully complied with the provisions of these sections.

With respect to 40 CFR 35.6565, OIG states, "The regulations, . . . , require the recipient to publicize RFPs and evaluation factors and to identify their relative importance." The draft report goes on to conclude without support that the award to Delta did not comply with the terms of the RFP. The RFP was public noticed and evaluation criteria were identified and relative importance indicated. See RFP at pages 48-51. MPCA was also in compliance with Section 35.6565, which states, "The recipient must honor any response to publicized requests for proposals to the maximum extent practical," as MPCA considered Delta for a full scope contract subsequent to Delta's demonstration of extensive experience and qualifications.

Contrary to OIG's characterization, the RFP process that resulted in an award of a full scope contract to Delta did provide full and open competition. Again, with respect to Section 35.6555, OIG merely states a conclusion without support. OIG has not identified any unfairness in the process or any company harmed or disadvantaged by the process. All interested companies had the same opportunity to submit proposals for either limited or full scope contracts and to be subsequently evaluated by the MSII Team.

Citing to Section 31.36, OIG states that, "recipients are required to make awards only to responsible contractors who possess the ability to perform successfully under the terms and conditions of a proposed procurement." MPCA did award a contract to a "responsible contractor" as the term is generally understood. (The term is not defined. State rules do provide a definition of "responsible bidder." Minn. Rules 1230.0150, subp. 20. Delta would have qualified under State rules as a responsible bidder.) Contrary to OIG's assertion, MPCA was able to and did evaluate Delta's qualifications and ability to perform successfully. The extent of the evaluation process and of Delta's qualifications have been discussed above and in supporting documents in Attachment A to this letter. Review of the evaluation process and supporting documentation should clearly demonstrate MPCA's compliance with this requirement.

The MPCA's action in awarding a contract to Delta was reasonable and was based upon full and complete consideration of its proposal and qualifications. Those actions cannot properly be characterized as "arbitrary" rather they represent the reasoned decision of the MSII Team. As such, they were fully consistent with the OMB Circular A-87 and applicable state and federal policies, regulations and procedures.

MPCA submits that there was no weakness on its contract procurement process. MPCA complied with State requirements for issuance of contracts by RFP. Delta was a responsible contractor fully and duly qualified for full scope work.

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Delta fulfilled its contract responsibilities competently and professionally in the absence of substantiated allegations to the contrary. OIG's recommendation is improper and should not be followed.

Attachment A to this letter contains all additional supportive documentation relative to procurement.

EXPENDITURE OF FUNDS

The draft Audit Report for the Site questions several practices used by the MPCA staff in carrying out the Multi-Site Cooperative Agreement (MSCA) No. V005794. In Exhibit A, Summary of Costs Claimed and Questioned, Note 2, page 8, OIG questioned the eligibility of "\$198,123 of contractual costs for work that was outside the approved scope of the cooperative agreement." The report goes on to say,

"During the remedial investigation, MPCA instructed Delta to submit a workplan amendment because new developments at the site required revision of the work schedule and tasks. Delta submitted a workplan amendment, which revised the budgets for several existing tasks, and added tasks 16-19, which were for new activities. However, EPA never approved the amendment."

OIG points out "[t]he EPA Project Officer is the only person who has the authority to approve a change in the scope of work." OIG then concludes, "MPCA completed these tasks with the apparent knowledge of the EPA Remedial Project Manager, but without the knowledge or approval of the EPA Project Officer."

MPCA believes that OIG erred in these findings. The following paragraphs present the factual basis for MPCA's contention that the EPA Project Officer (PO) did in fact provide advance written approval for the revision of scope in the form of an amendment to the MSCA. Also, the subsequent technical approvals of the revision in scope were properly obtained in accordance with the State Memorandum of Agreement (SMOA) between the MPCA and the EPA dated September 20, 1989.

Enclosed please find documentation in Attachment B which shows that the PO approved the additional work necessary at the Site in Amendment #35 to the MSCA. On January 28, 1991, the Regional Administrator sent a letter to the MPCA Commissioner acknowledging the submittal of the amendment application and stating, "It is the understanding of the Regional V Office of Superfund that the August Application was replaced by the Minnesota Pollution Control Agency's (MPCA's) December 7, 1990, application for the same amount (\$149,859) to be used for additional soils and ground water analyses to evaluate dioxin contamination at Ritari." The Narrative Statement of the December 9, 1990, application clearly states "[t]he need to shift focus at the Ritari Post and

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Pole Site (Site) is caused by the discovery of dioxins in the soils " The \$149,859 requested is needed to analyze additional soil and ground water samples for the presence of dioxins "

The approval letter dated March 6, 1991, from the Regional Administrator approved MPCA's request for additional funds by stating, "[t]he enclosed Assistance Amendment confirms my approval of your requests to increase and extend the Ritari Remedial Investigation/Feasibility Study " Contrary to OIG's finding, it is MPCA's understanding that the PO prepared this approval letter

However, MPCA is concerned about OIG's finding which specifies that the PO is the only person who has the authority to approve a change in the scope of work, as 40 CFR 31.30 only specifies that the "grantee obtain the prior written approval of the awarding agency " Such written approval was obtained in the form of MSCA amendment #35, which revised the scope to include investigation and analysis for dioxin

Approval of the MSCA amendment, and the language in the two documents cited above from the Regional Administrator clearly shows the Office of Superfund and the PO were aware of and in agreement with the need to expand the scope of the RI/FS at the Site to evaluate the extent of dioxin contamination Subsequent to these approval actions, MPCA commenced revision of the technical work products to reflect the approved revision of scope.

Regarding the subsequent Work Plan Amendment which added tasks #16-19 to the scope of the RI/FS, MPCA contends that the actions taken to gain approval were in accordance with the SMOA dated September 20, 1989. Copies of documents are enclosed in Attachment B which show that, in accordance with Attachment 4 of the SMOA, Draft RI/FS Work Plan amendments were submitted for Support Agency "review, comment, and conditional approval." Documents in the file show EPA Remedial Project Manager (RPM), Tom Barounis, Kathy Warren's replacement, was consulted throughout the planning process for revising the RI/FS Work Plan. In accordance with the SMOA, on April 4, 1991, MPCA sent the RPM a copy of the draft RI/FS Work Plan Amendments. On April 11, 1991, the contractor (Delta) sent to the MPCA and EPA revised pages to the first draft RI/FS Work Plan Amendments During this time EPA RPM provided comments to the MPCA Project Manager via telephone, discussing the specific direction of the amended Work Plan. In accordance with the SMOA, on April 15, 1991 the Final RI/FS Work Plan Amendments for the Site were mailed to EPA for file maintenance At no time did the RPM offer any opposition to the revision of scope to address dioxin contamination at the Site.

Again, MPCA contends that OIG's finding that the PO must approve the Work Plan in writing is in error, as the SMOA executed by EPA specifies that the support agency (EPA in this case) is provided with drafts for review and comment, which was done, and the final Work Plan is submitted to EPA for file maintenance. Page 5 of the SMOA states that the EPA RPM is "the EPA point of contact for all technical and enforcement issues." Further, the EPA RPM is obliged under the SMOA to "in coordination with the EPA Project Officer, review, comment, and consult on technical aspects of submittals according the the event schedule in Attachment 4." MPCA complied with its obligation under

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the SMOA in making appropriate submittals. It appears that the RPM was remiss in fulfilling obligations as required under the SMOA to coordinate with the PO on the technical aspects of the revision of scope.

The Site file has additional documentation which demonstrates that it has also been EPA's past practice to have the RPM issue approvals of RI/FS Work Plans. As Attachment B shows, RPM Kathleen Warren issued the approval letter to the MPCA on May 7, 1990, for the Ritari Post and Pole RI/FS Support Document (the initial Work Plan). The Support Document contained the original 13 tasks which the contractor was to complete. However, as previously discussed and in accordance with the SMOA, this approval letter was unnecessary as final Work Plans are submitted for file maintenance.

EPA knew the original RI/FS Work Plan made assumptions about the limited amount of contamination at the Site which we later discovered were not valid. Based on new data to show the extent and magnitude of dioxin contamination at the Site, all parties involved with the administration of the Site understood the need for expanding the scope of work in order to adequately address the remedial actions necessary to be protective of public health and the environment.

In summary, existing documentation clearly shows the personnel in the Office of Superfund knew and concurred with an expansion of the scope of the RI/FS Work Plan. Discussions with EPA began in October 1990 on the need to expand the scope of the RI/FS. The RPM attended a meeting at the MPCA office on November 7, 1990, to discuss specific issues relating to expanding the scope of the RI/FS. All drafts and the final Work Plan Amendments were sent to EPA prior to EPA's final approval of an MSCA Amendment on March 6, 1991. Subsequently, the work order to Delta to increase the scope of the RI/FS was not issued until June 3, 1991.

Additional documentation in Attachment B shows EPA's continual involvement in the decisions made on issues related to the RI/FS. Included in Attachment B are monthly reports submitted by Delta entitled, "Project Status Report" and other specific documents. These documents show EPA's intimate involvement in the whole process. Relevant passages have been highlighted in yellow.

Successful completion of the RI/FS would not have been possible without completing tasks 16, 17, 18, and 19. These tasks addressed issues which needed to be answered before reasonable alternatives could be developed in the FS.

Each task was designed to accomplish the following:

Task 16 resolved the pentachlorophenol (PCP) matrix problem. Data could have been under or over estimated by a factor of three. The problem of correcting the 30-40 percent spike recovery was essential to having PCP data that could be used with some reasonable assurance.

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Another important reason for resolving the PCP matrix problem was tied directly to using PCP data as a surrogate parameter for dioxin. During the early stages of the RI, MPCA found dioxin never appeared in any meaningful concentrations when PCP was not present. MPCA also found dioxin concentrations increased as PCP concentrations increased. Since PCP is far more soluble than dioxin, being able to accurately identify the presence of PCP, would provide MPCA with an excellent surrogate for the presence of dioxin at a fraction of the cost of doing dioxin analysis at all locations on a regular basis.

MPCA felt the resolution of the PCP matrix problem was a critical issue which needed to be resolved in order to establish a strong relationship between the presence of PCP and the likely presence of dioxin. Since PCP analysis costs less than ten percent of the cost of dioxin analysis, this relationship could represent a significant cost savings for all future analytical work at the Site.

Therefore, MPCA used dioxin funding to pay for the PCP matrix study because MPCA viewed the matrix study, when resolved, could greatly increase the number of analytical samples at the Site for far less money. The cost of completing the PCP matrix study was less than the cost of analyzing two water samples for dioxin. MPCA was able to collect and analyze ten times more water samples for the same amount of money once the PCP matrix study was completed. This allowed MPCA to cover more area in and surrounding the Site to insure the PCP/dioxin contamination had not migrated beyond the Site boundaries.

Task 17 added the ten additional monitoring wells MPCA needed to determine whether the contamination had migrated into the lower aquifer or migrated off site into the adjacent properties. Had that been the case, the local water supply would be supplying the local residents with dioxin or PCP contaminated drinking water and/or the surrounding property could pose a threat to neighbors and the local habitat. The additional wells were monitored during task 18 to determine whether the PCP and dioxin/furan contamination had moved into the lower aquifer and/or off site, and if so, where and at what concentrations.

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Task 18 funded additional ground water sampling. During the fourth round of sampling, 15 of the original monitoring wells and the ten new monitoring wells were sampled for dioxin and PCP. During the fifth round of sampling, 15 of the original monitoring wells and the ten new monitoring wells were once again sampled, but MPCA was able to cut the number of dioxin samples to five. The approximate cost savings realized by using PCP data as a surrogate for dioxin data was approximately \$33,000.

This additional data gave MPCA the assurance needed that the public health and environment were not in danger from migration of these contaminants off site.

Task 19 was the Dioxin Exposure survey. This task was absolutely necessary to determine whether contaminants from the Site had migrated off site and contaminated the surrounding lands and vegetation. Preliminary data indicated wind blown contaminants could have migrated off site and contaminated soils and vegetation on the adjacent property where grazing cows might have ingested contaminated plants and produced milk contaminated with dioxin.

The risk to public health and the potential dangers from dioxin contaminated milk getting into the public milk supply far outweighed any other information which this RI study developed. Data collection and analysis resolved this issue. However, at the time the EPA, Minnesota Department of Health (MDH), and MPCA all agreed this task was of paramount importance.

COMPLIANCE AND INTERNAL CONTROLS

Allocation Of Employee Leave Costs

It has been noted that the MPCA needs to establish an equitable allocation system for employee leave costs. The existing procedures allow leave time to be directly charged to federal or state projects based on the percentage of time spent on federal projects. If at least 50 percent of an employee's time was spent on federal projects during a two week pay period, the employee was able to allocate that leave time proportionately to the budgeted time for federal and state projects during that quarter. It has been determined that the percentage of leave time charged to the Site was 3.1 percent which was not considered excessive and actually was less than the allowable amount of leave time that could have been charged.

The MPCA discussed this issue with EPA and has requested guidance in determining an equitable allocation system for employee leave costs. It appears that other states in Region 5 are also experiencing difficulty in determining an equitable allocation system for employee leave costs (based on Management Assistance Reviews in Illinois and Indiana). The MPCA is willing to change the current system to one that is more equitable, however, guidance

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from EPA and OIG is needed. Prior to establishing a new system, the MPCA must ensure that the system is acceptable by both EPA and OIG. The following is guidance recently received by EPA:

"OMB Circular A-87 requires distributing the cost of employee benefits equitably to all relevant programs, including grant programs. However, the Circular does not define what methods ensure such an equitable distribution. Each of the following three methods are acceptable to the Office of Superfund for meeting this objective:

1. Including leave in the indirect cost rate
2. Including leave in the fringe benefits rate
3. Distributing leave as part of a leave cost allocation plan

EPA recognizes that these methods may require a state to charge the leave initially to a state account before charging it to the appropriate CA account. If a state recovers leave costs through the application of a fringe benefits rate or indirect cost rate, it would charge leave to a State fund as it is taken and recover these costs through the appropriate rate. EPA would need to approve inclusion of leave costs in the indirect cost rate as part of the indirect cost proposal or inclusion in the fringe benefits rate as part of the CA budget. The inclusion of leave in the fringe benefits rate may not be the best option if a state charges CAs for actual fringe benefits expenses and uses the fringe benefits rate for budgeting purposes only. If a state uses a cost allocation plan, it should ensure that it distributes leave costs equitably based on time worked on all the programs the employee supports. For example, during the first quarter of a year, the State could use the previous fiscal year's percentages worked on various programs to allocate costs while a new historical base is being established. Any such allocation plan should be documented by a State and available for EPA review."

After receiving this information, the MPCA still was unclear as to how to equitably allocate employee leave costs. Since leave cannot be included in the indirect cost rate or fringe benefit rate, we must distribute leave as part of a leave cost allocation plan. After additional phone conversations and conference calls with EPA, it was agreed that EPA would send us an actual example of a leave cost allocation plan. As soon as we receive this information we will apply this plan to one of our federally funded sites and forward this information to EPA and OIG for their approval. Once this approval is obtained, we will schedule a training session for MPCA staff and



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begin following the approved leave cost allocation plan. The MPCA wants to ensure that leave allocation procedures provide an equitable distribution of leave time. Once that is determined, the MPCA Accounting Office will assist us in assuring that the leave allocation procedures developed are consistently followed.

Approval Of Contractor Rate Increases

It has been noted that direct labor rate increases were in excess of the limits allowed in the contract and were approved without obtaining supporting cost documentation or providing a thorough cost analysis.

Delta submitted a request to increase its direct costs and indirect rate per the MSII Contract (April 1989) on January 31, 1990. The contract allows for an escalation factor of six percent plus the estimated annual percent increase in the Consumer Price Index (CPI). The new rates for labor, equipment, materials, supplies, and subcontractors as well as the new indirect rate were to be effective as of January 1, 1990, per the contract upon approval by the state which is the MPCA.

When the four MSII contracts were routed to the MDA for execution, a cover memo was submitted for each of the contracts and it was stated by the Division's RFP/contract coordinator that, "These contracts are identical except that each contract contains a different level of profit payable to the contractor (Part XXI) and each contract contains a different suite of subcontractors (Attachment B-1)."

After reviewing the contracts, it was determined that there were a few other differences in the contracts. One of which was in Attachment B.1 4., Escalation Factor where it states, "The following costs and rates are subject to escalation. These costs and rates may be adjusted by up to 6% plus the estimated annual percentage increase in the CPI annually and changes are effective on January 1: a. Direct labor costs, b. Equipment, materials, and supplies, and c. Subcontractors' costs (See Section 3.1 of this attachment)." The contracts for Delta and Barr Engineering Company contained the above language. The contracts for CDM, Inc. and Malcolm Pirnie, Inc. contained language that differed as follows, ".... These costs and rates may be adjusted by up to 8% (on the average) annually and changes are effective ...."

Since January 1990 was the first year annual increases were allowed under MSII, the Authorized Agents and the procurement specialist discussed how these increases would be approved equally and within the limits of the contract. Since the contracts were considered identical except for the profit payable and subcontractors, it was decided by the Authorized Agents and the procurement specialist to allow the contractors to adjust their direct costs on the average. The procurement specialist recalls discussing the issue of allowing direct cost increases on an average for all MSII contractors, but cannot remember if the decision was made by the MPCA's contract officer or someone at EPA. In the future, written documentation regarding information such as this will be sent to the file.

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Barr requested an annual adjustment for 1990 direct costs and indirect rate on January 4, 1990. At the time of the request, they were unaware of changes in equipment, material, supplies or subcontractor's costs. They reserved the right to modify these costs in the near future if they were informed of any increases. Their direct labor costs were within the allowable six percent plus the estimated annual percent increase in the CPI.

Delta requested an annual adjustment for 1990 direct costs and indirect rate on January 31, 1990. As it was unclear by their request what the new 1990 rates were for labor, equipment, materials, supplies, and subcontractor's costs, it was discussed at the February 16, 1990, quarterly contractor evaluation meeting. The Authorized Agent for Delta stated that the MPCA had received Delta's request for an increase in direct rates. It was noted in the minutes of the meeting that, "Specific numbers were received, but we need the percentage (average increase) of the increase. The cap according to the contract (Attachment B, page B-2) is 6% plus the estimated annual percentage increase in the CPI annually." Delta also mentioned at that time that they would contact their subcontractors to see if they had any cost increases and if so, would include this information in the direct rate follow-up letter to the MPCA.

On February 26, 1990, Delta submitted a follow-up letter to the MPCA's request at the quarterly contractor evaluation meeting. Delta's direct labor costs had increased on the average 12.15 percent higher than the 1989 costs. Delta's equipment and material charges remained unchanged. Historical project billing information indicated that approximately 80 percent of Delta's billed amounts was direct labor costs and approximately 20 percent of Delta's billed amounts was equipment and material charges. On the average, the labor, equipment, and materials price increases were therefore 9.72 percent (12.15 percent x 80 percent of direct labor and 0 percent x 20 percent of equipment and material billings). Subcontractor costs also remained unchanged.

The contract states that these costs and rates may be adjusted by up to six percent plus the estimated annual percentage increase in the CPI annually. The MPCA's interpretation of this contract language was that direct cost (direct labor costs, equipment, materials, and supplies, and subcontractor's costs) increases on the average may not exceed six percent plus the annual percentage increase in the CPI. This rationale was based on the fact that two of the four contracts explicitly stated that cost and rate adjustments would be based on the approved percentage on an average annually. The MPCA considered all contracts identical except for the profit payable and suite of subcontractors at the time of execution.

During the review of Delta's 1990 direct labor rate adjustments, the MPCA recognized that a few of the direct labor rate categories had substantial rate increases. This was discussed with Delta since the MPCA's costs for Superfund clean-up activities would be considerably higher. Delta felt that the 1990 direct costs were fair and reasonable based on the external marketplace conditions. Delta also explained that when the consulting firm was hired under MSII, it was a smaller firm that was expanding rapidly.

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Additional staff at higher competitive pay rates was hired and a number of existing staff was being promoted (i.e. Project Professional II at \$18.47 to Senior Professional II at \$26.64)

As a part of the review process, Delta's proposed 1990 direct labor rates were compared with the other three contractor's rates and Delta's rates were lower in some labor categories. Please refer to the enclosed document titled, "MSII Contracts Approved 1990 Direct Labor Rates Comparison" in Attachment C. Delta's direct labor rates were substantially lower in the upper ranges (ceilings) of each labor category. Also taken into consideration was Delta's 1990 indirect rate. An increase of 0.20 (1.40 to 1.60) was requested and approved. With General and Administrative expenses included, Delta's indirect rate was actually calculated as 2.304. Again, Delta only requested an indirect increase of 0.20 as it was their interpretation of a competitive rate within the industry at that time.

When calculating direct labor rates, Delta takes the average of all direct rates of personnel within a labor category (i.e. Project Professional I). Averages were based on direct labor rates. This was considered most cost effective and reasonable at that time since the consulting firm was expanding rapidly and labor rates were constantly changing due to additional staff being hired at various labor rates compared to market rates and the uncertainty of what staff would be working on Superfund projects. A comparison was made of the direct rates versus the average rates charged by Delta on a Site invoice and it was determined that the total average labor rates charged for that invoice were less than the total direct labor rates provided by Delta. Please see the enclosed documentation in Attachment C (August 1990 invoice and direct versus average labor rates for the three staff listed in the invoice).

The MPCA wanted to be fair and equitable in its approval of Multi-Site Contract direct cost and indirect rate escalations. It was understood and made clear that these approvals must be within the guidelines of the contract. All contractors were reminded during quarterly evaluation meetings and telephone conversations what the contract allows as an escalation factor according to the MSII Contract. We felt that our review of these cost and rate escalations were allowable based on reasonableness, allocability, and generally accepted accounting principles and procedures.

The MPCA felt that Delta's request for a 9.72 percent (average) increase in 1990 direct costs (approximately 80 percent direct labor and 20 percent equipment and materials) was reasonable and within the escalation factor guidelines of the contract. A direct labor rate comparison among the contractors was made at that time to ensure the rates were reasonable. Discussions and additional information was also requested from Delta in order to better understand the direct labor rate increases. In addition, review of Delta's August 1990 invoice has proven that the MPCA actually paid less for average direct labor rates than the direct labor rates.

To avoid confusion and standardize contract compensation, the Multi-Site III (MSIII) contracts effective April 2, 1993, list individual salaries for each staff person. The contract also allows the Contractor's Corporate Policy to

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dictate allowable increases based on promotion to a higher class. This new contract eliminates individual labor categories and average annual increases for labor, equipment, and subcontractor costs.

To ensure that the appropriate supporting cost documentation is submitted for future direct labor rate increases, MSIII contractors were informed at their March 1994 Quarterly Evaluation meetings with the MPCA of the need to submit documentation of personnel rate increases when revising contractual labor rates. Documentation could be in the form of a pay or status form, current company salary listing or individual personnel raise authorization memorandums. This documentation must be in order before the MPCA will approve future labor rate increase requests and is also required to be submitted for January 1, 1994, increases already received.

Review Of Contractor Indirect Cost Rates

It was noted that there were concerns over approved indirect rate increases for Delta. It was questioned whether the MPCA has adequate assurance that Delta's indirect rates include only costs allowable under federal cost principles. Per the MSII contract, MPCA approves indirect rates based on either an audit report or a letter from a reputable accounting/auditing firm certifying that the audit was performed in conformance with the cost principles contained in Federal Acquisition Principles regulations. Concerns were raised regarding the MPCA's limited review of these reports and problems found during an audit of a cost proposal from another Delta office.

Delta submitted an independent accountant's report supporting an indirect rate of 240 percent for 1989. Delta's negotiated indirect rate for 1989 (original contract) was 140 percent. In 1990, Delta requested an increase from 140 percent to 160 percent which was approved by the MPCA. Delta's indirect rate was higher than 140 percent for 1989 and 160 percent for 1990, according to independent audit reports submitted by Delta.

Delta submitted an independent accountant's report supporting an indirect rate of 240 percent for 1991. The report indicated that the computation fairly represented Delta's overhead rate. It was noted in the MPCA's audit report that some of the indirect costs listed were considered to be unallowable (i.e. overtime premium). Also, there was concern over a U.S. Postal Inspector's report on the audit of a price proposal submitted by Delta's Sacramento office. Indirect cost rates from the Sacramento office were similar to those submitted to the MPCA.

The MPCA does not have an auditor on staff. The Minnesota Department of Transportation (MnDOT) does a large amount of highway work with federal funds and we contacted them to see if they have contracted Delta in the past five years and if so, did they have an approved (audited) indirect rate for Delta. Information we received was that they had contracted Delta, however, they did not have an approved indirect rate for 1991. The approved indirect rate for 1990 was 239.62 percent (document enclosed in Attachment C), proposed indirect rate for 1991 was 267.90 percent (but not approved), and the approved indirect rate for 1992 was 259.00 percent.

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In comparison, MnDOT's approved indirect cost rate for Delta (1990) was the same as MPCA's approved indirect cost rate for Delta (1991). MnDOT requires consulting firms to submit an independent auditor's report and also has staff that conduct desk audits of these indirect cost rates.

The MPCA will arrange to have an independent audit of Delta's 1991 indirect rate by an auditor if requested. The MPCA intends to either hire an auditor or contract with an independent auditor (to include the State Legislative Auditor) for specific needs such as indirect cost determinations. This will ensure the audit reports are complete and indirect rates do not contain any unallowable costs.

Submission Of Documentation Supporting Contractor Invoices And Review Of Contractor Employee Time Sheets

It was noted that Delta did not submit supporting documents with its invoices on a consistent basis. The MSII contract requires supporting documents to be submitted for reimbursable expenses in excess of \$25.00. MPCA also needs to examine Delta's time sheets to ensure direct labor charges are accurate. In addition, MPCA must ensure that hours billed by Delta are actual hours worked on MPCA projects.

The MPCA is currently addressing the concern over invoice reviews. To assure proper documentation the procurement specialist will be conducting periodic audits of invoices received from the MSIII contractors. Supporting documents for reimbursable expenses in excess of \$25.00 will be required to be submitted with all invoices. These audits will also include a detailed review of the contractor's direct labor charges in comparison to personnel time sheets which will be requested from the contractors prior to the periodic audit. Direct labor and equipment charges will also be compared to the approved rates in the contract.

In order to improve the internal controls of contract management, a mandatory project manager and Authorized Agents training session is scheduled for July 21, 1994, at the MPCA to address proper invoicing submittals and reviews (this portion will be open to MSIII contractors to attend also). The training session will also focus on a policy for charging/allocating leave time to federally funded sites and the need for documentation of all EPA decisions and approvals in writing. Please see the enclosed project manager training session agenda for details on topics to be discussed.

In addition to the above training, additional training and/or guidance will soon be available to MPCA staff regarding contractor performance evaluations, code of ethics/conflict of interest, statement of work models, cost and price analysis of Independent Government Cost Estimates, and overall contract management. The Office of Superfund in Region 5 has formed a work group including states to look at these contract management issues. This work group is currently developing guidance in these contract management areas. One of the main areas of concern is the cost and price analysis requirement under federal procurement regulations, 40 CFR Part 35. States need clarification and guidance on what the requirements are for a thorough cost and price analysis. The MPCA Superfund

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Cooperative Agreement/Contract Administrator is a member of this work group and will be providing guidance to MPCA staff once the work group finalizes the guidance documents

In closing, MPCA appreciates the opportunity to review and comment on the draft Audit Report. MPCA has expended a very significant level of effort to represent in this letter to EPA that MPCA has in fact followed all applicable contract law, policy and regulations in hiring contractors and expenditure of funds awarded through cooperative agreements. Additionally, enhancements to internal controls are being made to provide for continuous quality improvement in contract administration. MPCA expects EPA to incorporate its expressed interest in partnering with states by acknowledging the information presented in this letter and making a final determination that all costs claimed shall be allowable. Please contact me at (612) 296-7333 to discuss this matter as you see fit.

Sincerely,



James L. Warner, P.E.  
Division Manager  
Ground Water and Solid Waste Division

JLW pk

Enclosures

cc: Howard Levin, Chief, Financial Analysis Section, EPA, Region 5  
Jolynn Traub, Acting Associate Division Director, Office of Superfund,  
EPA, Region 5  
Karen Yeates, Chief, State Relations Section, EPA, Region 5

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ABBREVIATIONS

CERCLA	Comprehensive Environmental Response, Compensation, and Liability Act
CFR	Code of Federal Regulations
EPA	Environmental Protection Agency
FAR	Federal Acquisition Regulations
LRI/FFS	Limited Remedial Investigation and Focused Feasibility Study
MPCA	Minnesota Pollution Control Agency
MSCA	Multi-Site Cooperative Agreement
RFP	Request for Proposal
RI	Remedial Investigation
RI/FS	Remedial Investigation and Feasibility Study
SMOA	Superfund Memorandum of Agreement



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