



Office of Inspector General
Report of Audit

**PROCUREMENT UNDER MICHIGAN
SUPERFUND COOPERATIVE AGREEMENTS**

E1SGF2-05-0269-4100218

March 23, 1994

Inspector General Division
Conducting the Audit:

Northern Audit Division
Chicago, Illinois

Region Covered:

Region 5

Program Office Involved:

Waste Management Division

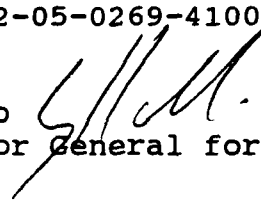


UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
OFFICE OF THE INSPECTOR GENERAL
NORTHERN DIVISION
77 WEST JACKSON BOULEVARD
CHICAGO, IL 60604-3590

March 23, 1994

MEMORANDUM

SUBJECT: Procurement Under Michigan Superfund
Cooperative Agreements
Audit Report E1SGF2-05-0269-4100218

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

TO: Valdas V. Adamkus
Regional Administrator
Region 5

This audit report contains findings that describe the results of our review regarding Procurement Under Michigan Superfund Cooperative Agreements. This audit report represents the opinion of the OIG. Final determinations on matters in this 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. We appreciate the assistance and cooperation provided to us by your staff.

Action Required

In responding to the findings in our draft report, your office agreed to take certain corrective actions; however, no milestone dates were included. In accordance with EPA Order 2750, you, as the action official, are required to provide this office a written response to this report within 90 days. For corrective actions planned, reference to specific milestone dates will assist this office in deciding whether to close this report.

We have no objections to the further release of this report to the public. Should you or your staff have any questions regarding this report, please contact Charles Allberry, Audit Manager, Northern Audit Division, at (312) 353-4222.

Attachment

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MDNR COOPERATIVE AGREEMENT PROCUREMENTS

EXECUTIVE SUMMARY

PURPOSE

The Office of Inspector General has completed an audit of procurements by the Michigan Department of Natural Resources (MDNR) under Superfund cooperative agreements with the Environmental Protection Agency (EPA). The objectives of our audit were to determine if: (1) MDNR's procurement policies and practices met the Federal requirements contained in Title 40 of the Code of Federal Regulations (CFR) Part 35, Subpart O and (2) Region 5 provided appropriate assistance and oversight for MDNR's procurement activities.

BACKGROUND

The Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), also called Superfund, 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 the state's cost-share.

All Superfund cooperative agreements require recipients to comply with provisions specified in Federal regulations. Prior to January 27, 1989, states with Superfund cooperative agreements were required to follow Federal regulations contained in 40 CFR Part 33 "Procurement Under Assistance Agreements." Effective January 27, 1989, 40 CFR Part 35, Subpart O (Subpart O), Interim Final Rule further codified the procurement requirements and added specific requirements unique to Superfund cooperative agreements. The final version of Subpart O became effective July 5, 1990. If a state certifies that its procurement practices meet or exceed the requirements of Subpart O, it can initiate contract awards under its cooperative agreements without prior EPA review and approval.

MDNR is responsible for administering the State of Michigan's environmental protection programs. This includes managing remedial activities at selected Superfund sites under EPA's CERCLA authority.

Michigan's Department of Management and Budget (MDMB) is responsible for procurement within the state. MDMB has

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developed standard state procurement procedures which are contained within its Administrative Manual.

RESULTS-IN-BRIEF

MDNR certified to EPA that its procurement system met all Subpart O requirements. Therefore, EPA did not review and approve individual procurement actions under cooperative agreements with MDNR, as allowed under Subpart O. However, our review found that MDMB's procurement procedures and MDNR's procurement practices may not have satisfied all of the requirements. In addition, MDNR submitted the self-certification form without conducting a periodic evaluation of its procurement system and without providing all requested supporting information. As a result of these deficiencies, Region 5 could not be certain that MDNR procurements under Superfund cooperative agreements met established Federal requirements.

PRINCIPAL FINDINGS

MDNR Procurements May Not Have Met the Procurement Requirements of Subpart O

MDMB's procurement procedures and MDNR's procurement practices under Superfund cooperative agreements may not have met all EPA requirements. We reviewed MDMB's standard procurement procedures as outlined in its Administrative Manual and MDNR's specific procurements of Level Of Effort (LOE) contracts in 1989 and 1993. We found that both the standard procurement procedures and the actual practices for procuring the LOE contracts may have fallen short of the Subpart O requirements. Our specific concerns relate to (1) cost analysis, and (2) profit analysis.

MDNR's Certification of Its Procurement System Did Not Ensure That It Met All Subpart O Requirements

In applications for Superfund cooperative agreements, MDNR repeatedly certified to EPA that its procurement system met all applicable requirements. Based on this certification, EPA allowed MDNR to complete procurements under its Superfund cooperative agreements without prior review and approval. However, we found deficiencies in MDNR's certification. Specifically, MDNR (1) did not periodically evaluate its system in relation to Subpart O requirements and (2) was not clear on the meaning of all Subpart O requirements. We also

MDNR COOPERATIVE AGREEMENT PROCUREMENTS

found that MDNR had generally not provided all information required on the certification forms. As a result, MDNR's certification did not ensure that its procurements met all Subpart O requirements.

AGENCY COMMENTS AND ACTIONS

In responding to our draft report on March 17, 1994, the Regional Administrator agreed that MDNR should institute a requirement for cost analysis if it does not have such a requirement. The Region has established a workgroup to develop guidance and provide training to the states on contract management issues, including cost analysis.

The Region agreed to remind MDNR of the importance of maintaining documentation of its reviews of its procurement system when future reviews are performed. Region 5 also agreed to (1) remind MDNR to complete Part B of the certification form and reference 40 CFR Part 35, Subpart O and (2) communicate to MDNR the Region's procedure for providing procurement assistance to recipients.

RECOMMENDATIONS

We recommend that the Regional Administrator implement the planned corrective actions outlined in the response to our draft report. When implemented, these actions should fully address our findings.

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MDNR COOPERATIVE AGREEMENT PROCUREMENTS

CHAPTER 1

INTRODUCTION

PURPOSE

The Office of Inspector General has completed an audit of procurements by the Michigan Department of Natural Resources (MDNR) under Superfund cooperative agreements with the Environmental Protection Agency (EPA). The objectives of our audit were to determine if: (1) MDNR's procurement policies and practices met the Federal requirements contained in Title 40 of the Code of Federal Regulations (CFR) Part 35, Subpart O and (2) Region 5 provided appropriate assistance and oversight for MDNR's procurement activities.

BACKGROUND

The Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), also called Superfund, 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 the state's cost-share.

Although states may accept responsibility for managing specific Superfund activities, CERCLA does not allow EPA to delegate Superfund program authority to the states. EPA remains responsible for ensuring that states carry out these functions in accordance with CERCLA, Federal regulations, and Superfund program policies. Unlike other forms of Federal financial assistance, under a cooperative agreement, EPA maintains significant involvement throughout the project.

All Superfund cooperative agreements require recipients to comply with provisions specified in Federal regulations. Prior to January 27, 1989, states with Superfund cooperative agreements were required to follow Federal regulations contained in 40 CFR Part 33 "Procurement Under Assistance Agreements." Effective January 27, 1989, 40 CFR Part 35, Subpart O, Interim Final Rule further codified the procurement requirements and added specific requirements unique to Superfund cooperative agreements. The final version of Subpart O became effective July 5, 1990. The requirements for certification, cost analysis, and profit

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analysis discussed in this report were the same in both the interim final and final rule.

To alleviate the need to review and approve each individual state procurement under these regulations, EPA established a self-certification process. In brief, a state can certify, in writing, that its procurement practices meet or exceed the requirements of Subpart O. It can then initiate contract awards under its cooperative agreements without prior EPA review and approval.

MDNR is responsible for administering the state of Michigan's environmental protection programs. This includes managing remedial activities at selected Superfund sites under EPA's CERCLA authority. At the time of our audit, MDNR had more than 20 separate Superfund cooperative agreements with EPA. MDNR used the funds obtained through some of these agreements to contract out for various Superfund remedial activities. MDNR had routinely certified that its procurement procedures met the Subpart O requirements.

For remedial investigation and feasibility study (RI/FS) work, MDNR procured services from consulting engineering firms through what they term level of effort (LOE) contracts. Because of the large number of sites requiring work, MDNR found that it would be cumbersome to initiate a new procurement action each time RI/FS services were needed. MDNR's LOE contract process allowed it to select a group of contractors (usually between two and six) in one procurement action. MDNR then rotated work assignments among the contractors as work arose. According to MDNR officials, this practice divided work into more manageable segments and produced higher quality work. New contracts are generally awarded every four years.

Michigan's Department of Management and Budget (MDMB) is responsible for procurement within the state. Within MDMB, procurement authority is divided between two offices. The Office of Purchasing procures items including supplies, materials, equipment, services and printing needed by state departments and agencies. The Office of Facilities contracts for the design, construction, and management of facilities. MDNR's LOE contracts awarded in 1989 were handled by the Office of Purchasing. The new set of contracts, soon to be awarded, are being handled by the Office of Facilities.

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SCOPE AND METHODOLOGY

We conducted work at MDNR and MDMB. We reviewed Federal procurement regulations contained in 40 CFR Part 35, Subpart O, both interim final and final versions. We also examined EPA's internal guidance applicable to procurement under Superfund cooperative agreements. We analyzed MDMB's standard procedures for procuring consulting services as documented in its Administrative Manual. In addition, we reviewed the process MDNR used to award multi-year contracts for RI/FS services in 1989 and 1993. We compared MDMB's procedures and MDNR's practices with the requirements of Subpart O to determine if they met the intent of the regulations. We discussed with MDNR's Office of Budget and Financial Aid how MDNR evaluates its procurement system before certifying that all of the Federal requirements are met.

We also conducted work at EPA Region 5. We discussed with the Region 5 Waste Management Division Superfund project officer and the Planning and Management Division Contracts and Grants Branch how EPA monitors MDNR's procurement system certification process. We reviewed Region 5's cooperative agreement application files to determine if MDNR properly completed its procurement system certification forms. We also discussed how EPA provides procurement assistance to MDNR.

We conducted this audit from October 1, 1992 to December 6, 1993.¹ We discussed informal position papers with MDMB and MDNR officials on November 15, 1993. Based on their comments, we revised the position paper. We discussed the revised position paper with Region 5 Waste Management Division Superfund Program Management Branch on December 9, 1993, and with Region 5 Planning and Management Division Contracts and Grants Branch on December 13, 1993. We conducted further discussions of the position papers with these Region 5 organizations on December 21, 1993. Region 5, MDMB, and MDNR comments were incorporated into the draft report, which we issued on December 30, 1993. We discussed the draft report with Region 5 representatives on January 27 and March 10, 1994. The Regional Administrator responded to our draft report on March 17, 1994. The response is incorporated into the report and included as Appendix 1.

¹We suspended fieldwork from February 1, 1993 to August 1, 1993 in order to conduct other time critical work.

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We performed our evaluation in accordance with the Standards for Audit of Governmental Organizations, Programs, Activities, and Functions, issued by the Comptroller General. We reviewed internal controls related to MDNR's procurement process and its compliance with Federal regulations. Additionally, we reviewed the fiscal year 1992 and 1993 Federal Managers' Financial Integrity Act reports for Region 5 and the Waste Management Division.

PRIOR AUDIT COVERAGE

There were no recent audits of MDNR's procurement under Superfund cooperative agreements that applied to our audit objectives.

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CHAPTER 2

MDNR's SELF-CERTIFICATION PROVIDED INADEQUATE ASSURANCE OF COMPLIANCE WITH PROCUREMENT REQUIREMENTS

MDNR certified to EPA that its procurement system met all requirements of Subpart O. This self-certification gave MDNR the ability to initiate procurements and award contracts under its Superfund cooperative agreements without EPA's review and approval. However, our audit found that MDNR's procurements may not have met all the Subpart O requirements, and its self-certification was not well supported. Region 5 needs to increase its efforts to validate the self-certification process and assist MDNR with procurement under Superfund cooperative agreements.

MDNR PROCUREMENTS MAY NOT HAVE MET THE PROCUREMENT REQUIREMENTS OF SUBPART O

MDMB's procurement procedures and MDNR's procurement practices under Superfund cooperative agreements may not have met all Subpart O requirements. We reviewed MDMB's standard procurement procedures as outlined in its Administrative Manual and MDNR's specific procurements of LOE contracts in 1989 and 1993. We believe that both the standard procurement procedures and the actual practices followed for procuring the LOE contracts may have fallen short of the Subpart O requirements. Our specific concerns relate to (1) cost analysis and (2) profit analysis.

Cost Analysis

MDMB's procurement procedures did not include a requirement to conduct a cost analysis of contract proposals. However, in its actual procurement of LOE contracts, MDNR implemented some additional procedures in an effort to meet the Subpart O requirement for cost analysis. The Subpart O requirement for cost analysis is very general and no minimum steps are specified. Thus, it was difficult to determine whether MDNR's actions met the Subpart O requirements. We do not believe that MDNR's steps were a sufficient cost analysis to ensure that the contract prices were reasonable, allocable, and allowable. Region 5 needs to provide additional guidance to MDNR on conducting an adequate cost analysis.

Subpart O requires states to conduct and document a cost analysis for all negotiated contracts over \$25,000. It

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defines cost analysis as "the review and evaluation of each element of contract cost to determine reasonableness, allocability and allowability." The regulations exclude the need for a cost analysis only when (1) adequate price competition exists and (2) the recipient can establish price reasonableness. Price reasonableness must be based on (a) a catalog or market price of a commercial product sold in substantial quantities to the general public or (b) prices set by law or regulation.

MDNR's 1989 LOE contracts were negotiated and valued at over \$25,000. Although competition existed for the contract awards, MDNR could not establish price reasonableness based on the criteria in the regulation. Thus, a cost analysis was required.

MDMB's guidance called "Selecting Professional Service Contractors for Major Projects" includes a section on evaluating cost proposals. Suggested steps include reviewing (1) personnel classification and number of hours proposed for each task, (2) personnel hourly rates for appropriateness, and (3) the multiplier applied to hourly rates and reimbursable costs. Using this guidance, a committee evaluates and scores each cost proposal. This process is not a cost analysis since it does not include any examination of contractors' data supporting the rates (costs) proposed.

Although MDNR was not certain how to satisfy the Subpart O requirement for a cost analysis, it did review the cost proposals submitted. However, the objective of the review was to rank contractors for future work assignments. The evaluation of cost proposals did not include any examination of contractors' data supporting the costs proposed and was not used as a basis for negotiating final contract rates.

In addition, MDNR implemented several procedures in an effort to control costs in the 1989 LOE contracts. For labor rates, MDNR asked the contractors to submit ranges of their low and high hourly rates for each professional and technical level, as well as the names and pay rates of all staff assigned to the MDNR contract. However, MDNR did not analyze whether the proposed ranges were appropriate or accurate, nor verify whether the individuals were actually being paid the rates proposed.

For indirect costs, MDNR required the contractors to submit an analysis showing the components and methodology used in computing the proposed rate. This information was sent to an individual in MDNR's Surface Water Quality Division, who

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reviewed the submittal for reasonableness. However, MDNR never verified any of the contractors' supporting information.

MDNR also established procedures to try to determine "fair market prices" for certain equipment items. It contracted with a firm (Dataquest) to establish rates for equipment to be used under the contract. Dataquest already published a "blue book" of rental rates for construction equipment. MDNR's intention was that it develop a similar guide for equipment used in hazardous waste cleanups. However, MDNR encountered difficulties with the Dataquest contract and terminated it in early 1991 without producing the desired rate schedule.

MDNR subsequently established alternate procedures in an effort to manage equipment costs. It required contractors to obtain three written quotes and accept the lowest bid for the purchase or rental of all items over \$500. MDNR believed that this process would result in reasonable fair market prices for equipment.

For the 1993 LOE contracts being awarded, MDNR has predetermined prices for many items within the RFP and established maximums for others. For example, the RFP indicates the maximum amounts that will be allowed for meals and lodging. In another example, offerors were directed not to submit cost proposals for drilling activities. Instead, MDNR set prices for all drilling functions. Contractors were instructed to charge those rates regardless of their actual costs. MDNR arrived at those prices by taking an average of the drilling prices included in the proposals submitted in 1989, after throwing out the high and low rates. MDNR used the same process for reviewing equipment, labor, and indirect costs as in the earlier contracts.

While MDNR is not required to follow the exact cost analysis procedures established in the Federal Acquisition Regulations, it should have procedures that are equivalent and will produce the same result. In the absence of specific guidance on cost analysis, MDNR took steps in awarding its LOE contracts aimed at determining "fair market prices". We do not believe, however, that these steps constituted a cost analysis. MDNR's steps did not provide a basis for negotiations with contractors nor did they ensure that the costs proposed were reasonable. Region 5 needs to work with MDNR to outline the minimum requirements of a cost analysis and specific steps needed to meet those requirements.

Profit Analysis

Subpart O Section 35.6585 also requires a profit analysis in all cases in which cost analysis is performed. Subpart O states:

To establish a fair and reasonable profit, consideration will be given to the complexity of work to be performed, the risk borne by the contractor, the contractor's investment, the amount of subcontracting, the quality of its record of past performance, and industry rates in the surrounding geographical area for similar work.

However, there are no further instructions on how to determine a fair and reasonable profit.

We found that MDNR did not perform a profit analysis for the contracts it awarded in 1989. Contractors proposed profit rates on the various cost categories ranging from 4 to 16 percent. MDNR accepted all of the proposed rates, without negotiation. As a result, MDNR may have paid higher rates than were necessary or appropriate. The contract administrator stated that she believed since there was competition for the contracts (more than one offeror), profit analysis was not required. However, as noted above, cost analysis was required in this case, so profit analysis was automatically required.

For the 1993 LOE contracts, MDNR took a different approach. The contract administrator set the profit rate at 10 percent of each element (total labor, other direct costs and subcontracts) so that all the contracts were consistent. The 10 percent figure represented the average rates charged by the six current contractors. However, averaging previous rates does not constitute a profit analysis. Also, MDNR's setting of the profit rates eliminated the benefits of competition.

Some or all of the contractors may have proposed less than 10 percent if allowed to do so. For example, in the 1989 contracts, the profit rates on labor were generally at 10 percent or above. However, many of the contractors proposed and accepted lower profit rates on other direct costs and subcontracts - some at 4 and 6 percent.

Also, since contractors were willing to accept 10 percent profit on labor in 1993, it is quite possible that MDNR could have negotiated lower rates for the 1989 contracts, instead

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of accepting the proposed rates. However, there was no competition or negotiation involved in this aspect of the contracts, and MDNR never performed an actual analysis to determine whether the profits proposed and paid were reasonable.

MDNR'S CERTIFICATION OF ITS PROCUREMENT SYSTEM DID NOT ENSURE THAT IT MET ALL SUBPART O REQUIREMENTS

In applications for Superfund cooperative agreements, MDNR repeatedly certified to EPA that its procurement system met all applicable requirements. Based on this certification, EPA allowed MDNR to complete procurements under its Superfund cooperative agreements without prior review and approval, as allowed under Subpart O. However, we found deficiencies in MDNR's certification. Specifically, MDNR (1) had not periodically evaluated its system in relation to Subpart O requirements and (2) was not clear on the meaning of all Subpart O requirements. We also found that MDNR had generally not provided all information required on the certification forms. As a result, MDNR's certification did not ensure that its procurements met all Subpart O requirements.

MDNR Had Not Evaluated Its System

MDNR had not completed a systematic evaluation of its procurement system by comparing its procedures to EPA requirements. MDNR relied on past EPA approval, the absence of procurement related findings in its Single Audit reports, and informal reviews of individual procurement plans as a basis for its continued certification. Thus, MDNR's certification did not provide sufficient assurance that its procurement practices satisfied the Subpart O requirements.

Cooperative agreement recipients must periodically evaluate their procurement system to determine if it meets the requirements of Subpart O. Recipients must complete and submit the "Procurement System Certification" form with each cooperative agreement application. On this form, the recipient may

- (1) state that the system has been certified within the past two years and has not substantially changed;
- (2) certify that the system meets all requirements of Subpart O and list the applicable state procedures and regulations; or

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- (3) elect not to certify that its system meets all requirements of Subpart O, thus agreeing to prior EPA review and approval of all procurement actions.

MDNR officials stated that EPA reviewed and approved their procurement system several years ago. They assumed that this approval was still valid. However, Subpart O states that

The certification will be valid for two years or for the length of the project period specified in the Cooperative Agreement, whichever is greater, unless the recipient substantially revises its procurement system....

Although MDNR submitted certification forms on a bi-annual basis, there is no evidence that it performed an evaluation of its system prior to each certification.

MDNR also used the Single Audit reports as a basis for believing its procurement system met Subpart O requirements. Since the Single Audit reports did not report any procurement weaknesses, MDNR assumed that its system was sufficient. However, the Single Audit scope was very general and did not include a comparison of MDNR's procurement system to the procurement requirements in Subpart O. Thus, the Single Audit was not sufficient to ensure the system meets all requirements.

An MDNR official also explained that each time they undertake a procurement they compare the planned procedures to the requirements in Subpart O. However, such comparisons are informal reviews and not documented. If MDNR certified that its system met the requirements, and if MDNR followed the system it certified, then such a review would not be necessary. In the case of the LOE contracts, the contract administrator maintained copies of Subpart O which she referred to when developing the RFP, but again, no actual comparison was documented.

MDNR Was Not Certain That It Met All Requirements

MDNR certified to EPA that its procurement system met all Subpart O requirements. MDNR believed it was meeting the requirements, however, officials acknowledged that several aspects of the regulation were not clear to them. MDNR has periodically requested guidance from EPA on aspects of Subpart O, however, EPA has not provided sufficient clarification.

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For example, as previously discussed, Subpart O requires cost and profit analysis. However, the regulation does not describe the minimum steps required in each of these areas. The MDNR contract administrator told us that during the procurement of LOE contracts in 1989 she tried to find out exactly what type of cost and profit analysis was required. No one within EPA could provide guidance. We examined an MDNR internal memo which supported the contract administrator's statement regarding cost analysis. Without further guidance from EPA, the contract administrator developed procedures which she felt were sufficient to meet the requirement. Our review concluded that MDNR's actions in both of these areas were not sufficient.

Certification Forms Did Not Include Adequate Supporting Information

Our review of 17 certification forms, which MDNR submitted from 1983 through 1991, showed that MDNR had generally not provided all information required. Region 5 had not followed-up to obtain this information. The missing information was necessary for EPA to assess the appropriateness of MDNR's system evaluation.

If a recipient chooses to certify that its system meets Subpart O requirements, it must list its applicable state procurement regulations or procedures in Part B of the form. Listing the applicable state regulations gives some evidence that the state has compared its system to Subpart O requirements. This section was not filled out on any of the MDNR forms we reviewed. Requiring MDNR to completely fill out the form would provide Region 5 with information needed to evaluate the adequacy of the certification statement.

We also noted that EPA had not yet revised the certification form to reflect the current regulation which applies to Superfund cooperative agreements (40 CFR Part 35, Subpart O). Although the new regulation became effective in 1989, the current certification form still refers to 40 CFR Part 33. Region 5 officials stated that EPA Headquarters decided not to revise the form. Region 5 asked states to make a handwritten change on the form. However, none of the certification forms we reviewed contained the change.

**REGION 5 SHOULD PROVIDE ADDITIONAL
PROCUREMENT ASSISTANCE TO MDNR**

Region 5 has taken steps to improve state procurement under Superfund cooperative agreements. However, it needs to take further action to assist MDNR, especially in the areas where we found problems or uncertainty, such as cost analysis and profit analysis.

Self-certification places the primary responsibility for meeting the procurement requirements of Subpart O on MDNR. However, EPA has a responsibility to monitor and assist MDNR with its procurement activity. EPA's Superfund State-Lead Remedial Project Management Handbook (OSWER Directive 9355.2-1) says that EPA must be able to provide technical or administrative procurement assistance to the states. Since EPA has more procurement expertise and is more knowledgeable about Federal requirements than the states, EPA is in a better position than a state to understand the regulatory requirements. This does not mean that the Region must review every procurement transaction. However, it should have a clear and consistent process to answer specific questions about the requirements in Subpart O.

Region 5 has taken several steps to assist the states with procurement. In 1989, shortly after Subpart O was promulgated, the Region held a training class which covered procurement under the new regulation. The Region formed a contract management workgroup to address state procurement and contract management issues. Also, Region 5 has conducted Management Assistance Program (MAP) reviews. In such reviews, a contractor visits the state and reviews its management of cooperative agreements. These reviews look at several different areas, including procurement, financial management, and property management. In the past, MAP reviews have generally covered more than one of these areas. Region 5 officials expressed an interest in tailoring a future MAP review to focus on procurement issues. This should help MDNR answer some of its procurement questions.

Region 5 did not have a procedure by which MDNR could easily obtain assistance from procurement experts. Providing procurement assistance is included as part of Region 5's state project officers' responsibilities. However, as the project officers do not usually have the needed expertise to provide such assistance themselves, it was unclear to MDNR

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who specifically should provide this assistance. The Region needs to clarify its process to ensure the states are provided with adequate technical assistance in procurement.

CONCLUSION

Through the certification process, EPA has placed the responsibility on MDNR for ensuring that its procurements under Superfund cooperative agreements meet the requirements of Subpart O. Our review found that MDNR's standard procedures and MDNR's procurement of LOE contracts did not fully follow the regulations. Also, although MDNR routinely certified that its procurement system met all Subpart O requirements, it had not conducted periodic evaluations to support this conclusion. Region 5 needs to increase its review of the self-certification process and work with MDNR to improve its procurement system.

AGENCY COMMENTS AND ACTIONS

The Region agreed that MDNR should institute a requirement for cost analysis if it does not have such a requirement. However, it stated that the regulations in Subpart O are so general and vague that it is difficult to conclude that MDNR did not meet the regulatory requirements. The Region has established a workgroup, which includes state representatives, to develop guidance and provide training to the states on contract management issues, including cost analysis.

The Region also agreed that MDNR is required by Subpart O to review and document its review of its procurement system. The Region will remind MDNR of the importance of maintaining this documentation when future reviews are performed. The Region believes that past EPA approval, the absence of procurement related findings in the Single Audit reports and informal reviews of individual procurement plans are important indicators for reasonable assurance that procurement requirements are met. Region 5 also agreed to (1) remind MDNR to complete Part B of the certification form and reference 40 CFR Part 35, Subpart O and (2) communicate to MDNR the Region's procedure for providing procurement assistance to recipients.

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OIG EVALUATION/RECOMMENDATION

The corrective actions proposed by the Region, when implemented, should fully address our finding. However, the Region has not provided specific milestone dates for (1) reminding MDNR of the importance of maintaining documentation when conducting future reviews of its procurement system, (2) reminding MDNR to complete Part B of the certification form and reference 40 CFR Part 35, Subpart O, and (3) communicating to MDNR the Region's procedure for providing procurement assistance to recipients. Please provide us with milestone dates for completion of the proposed actions.

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APPENDIX 1
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UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
REGION 5
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MAR 17 1994

REPLY TO THE ATTENTION OF

SUBJECT: Draft Audit Report E1SGF2-05-0269
Audit of Procurement Under MDNR Superfund
Cooperative Agreements

FROM: Valdas V. Adamkus
Regional Administrator

TO: Anthony C. Carrollo, Divisional Inspector General
For Audits, Northern Division

Thank you for the opportunity to comment on the findings in the subject draft audit report. The attached comments, prepared by staff of the Planning and Management Division and the Waste Management Division, represent Region 5's response to the draft audit report findings and recommendations.

If you have any questions regarding the attached comments, please contact Howard Levin at 6-7522.


Valdas V. Adamkus

Attachment

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Cost Analysis

We agree that if the Michigan Department of Natural Resources (MDNR) does not have a requirement for cost analysis for contracts under the Superfund program, they should institute such a requirement. However, the regulations are so general and vague that we believe it is very difficult to conclude that MDNR did not meet the regulatory requirements. This lack of specificity has been an ongoing frustration to both the Region and the states. In order to provide more specific guidance to states on contract management issues, including cost analysis, the Region has established a workgroup to develop guidance and provide training. Three states participate as members of the workgroup, but all states will benefit from its products.

The audit report is critical of the MDNR for not doing an "examination of contractors actual cost data." The report needs to clarify what is meant by "actual cost data." It is our understanding that the intention was to refer to the contractors supporting documentation for their budget projections, not their "actual costs." As you are aware, the Level of Effort contracts are "enabling" only and involve work not yet identified, so there are no actual costs to be examined. Actual costs are examined by individual project managers when an individual work assignment is made under the umbrella contract.

The audit report also discusses MDNR's predetermined prices for some items and states: "contractors must charge those rates regardless of their actual costs." This statement is not true in all cases. Some rates are "not to exceed prices." MDNR reports that contractors have submitted invoices for less than the established price.

Recommendation 1 Response

We would agree that the MDNR is required to review and document the review of the Department's procurement system in accordance with 40 CFR Part 35, Subpart O. MDNR believes that they have done the equivalent of a Subpart O review prior to each certification, but did not offer evidence of documentation. The Region will remind the MDNR of the importance of maintaining this documentation when future reviews are performed and ask that such documentation be provided to the Region when it is requested. Further, we believe that past EPA approval, the absence of procurement related findings in the Single Audit reports, and informal reviews of individual procurement plans are important indicators for reasonable assurance that these procurement requirements have been met.

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Recommendation 2 Response

The Region will remind the MDNR to complete Part B of the certification form and ask them to reference 40 CFR Part 35, Subpart O rather than Part 33 on the form. MDNR has agreed to comply.

Recommendation 3 Response

The Region believes that the procurement methods used by the MDNR are consistent with the optional competitive process described in 40 CFR Part 35.6565 (5). This regulation states: "recipients may use competitive proposal procedures for qualifications-based procurement of architectural engineering (A/E) professional services whereby competitor's qualifications are evaluated and the most qualified competitor is selected, subject to negotiation of fair and reasonable compensation." The audit report claims that the MDNR did not use this optional method because "technical capability and price are considered in selecting the best qualified offeror." We agree that technical capability was the key factor in the selection process as evidenced by the use of a "Statement of Qualifications" to create a short list of qualified contractors. However, we do not agree that price was an equal factor. Price was considered (after the short list of qualified contractors was determined) because, in accordance with the above regulations, the price must be fair and reasonable. Therefore, Subpart O requirements have been met and re-certification is not necessary. Further, based on a March 9, 1994 discussion with Office of the Inspector General representatives, we understand that the finding and recommendation discussed here will not appear in the final version of the audit report.

Recommendation 4 Response

The Region's procedure is to provide a single point of contact with an assistance recipient by identifying a project officer for each award. The project officer is responsible for routine contact between the Region and the recipient on all matters related to the award. On matters related to grant regulations (including issues related to the Subpart O procurement regulations), the Grants Management Section (GMS) is responsible for providing guidance, interpretation, and assistance. GMS works directly with project officers and customarily with recipients either through, or in coordination with a project officer. We will ensure that this information is communicated to the MDNR.

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Recommendation 5 Response

The Region will continue to provide such assistance to the MDNR. In 1989, the Region sponsored a two-day financial seminar which included cost and price analysis instruction. These subjects were again covered in June , 1993, at a Regional two-day seminar on Superfund administrative issues. Headquarters contracting/grants experts attended both seminars. Recently, Region 5 has formed a workgroup on state contract management under Superfund Cooperative Agreements. The workgroup is made up of Superfund Cooperative Agreement project officers, grants specialists, contracting project officers, Superfund Remedial Project Managers, and some state representation. The ultimate goals of this workgroup are to develop guidance to be used by state personnel who work with contracts, and to provide meaningful training in areas which are identified as weak areas.

General Comments

We believe the audit report should clarify the Subpart O regulations which were in effect in 1989 and 1993, the years of MDNR's Level of Effort contracts. In 1989, the regulations had not yet been finalized, but there was an Interim Final regulation, effective January 27, 1989. The final version of the Subpart O regulations became effective July 5, 1990.

ABBREVIATIONS

CERCLA	Comprehensive Environmental Response, Compensation, and Liability Act
CFR	Code of Federal Regulations
EPA	Environmental Protection Agency
LOE	Level of Effort
MAP	Management Assistance Program
MDMB	Michigan Department of Management and Budget
MDNR	Michigan Department of Natural Resources
OSWER	Office of Solid Waste and Emergency Response
RI/FS	Remedial Investigation and Feasibility Study
RFP	Request for Proposal

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