UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
REGION 5

IN RE:	)
	) Docket No. 05-97-AD01
City of Flint, Michigan	)
	) Report and Recommendation
	) of the Resources
	) Management Division and the
Request for Review of Disputes	) Office of Regional
Decision Official's Determination	) Counsel Pursuant to
Grant No. C263259-02	) 40 C.F.R. Part 30, Subpart L
	)

REVISED REPORT AND RECOMMENDATION

I. INTRODUCTION

This request for review arises from a March 12, 1997, decision by the Regional Disputes Decision Official (DDO) to disallow $1,805,865 comprising of $184,466 in administrative costs, $860,400 in architectural engineering fees, and $760,999 in construction costs that had been claimed for Federal participation by the Grantee, the City of Flint, Michigan, under Grant No. C263259-02. The DDO also determined that unclaimed allowable costs of $32,879 will offset disallowed costs under the grant.

On March 13, 1997, the Regional Administrator issued a Decision and Order in this matter based on the Agency's understanding that the Grantee had appealed the March 12, 1997 Final Determination Letter ("FDL"). The Grantee did not appeal the FDL until April 11, 1997. In its notice of appeal, the

Grantee requested an informal settlement conference. On August 12, 1997, pursuant to 40 C.F.R. § 30.1215, the Agency met with the Grantee to further discuss details of this matter and review additional information submitted by the Grantee. Accordingly, this Revised Report and Recommendation supersedes the previous version.

II. BACKGROUND

On January 11, 1978, the U.S. EPA awarded Grant No. C263259-02 to Flint, Michigan (the City or Grantee), pursuant to Title II of the Federal Water Pollution Control Act, as amended, 33 U.S.C. 1251 *et seq*. The purpose of the grant was to assist the City in constructing modifications to its existing wastewater treatment facilities. The amount of the grant was 75 percent of the estimated allowable costs at the time of the grant award. The total final incurred cost claimed by the city as allowable was $92,910,775 and total grant funds claimed and paid were $69,683,081, 75 percent of the claimed cost.

The Office of Inspector General, Northern Division, (OIG), completed a field audit and issued the Report of Final Audit on September 30, 1993. The report accepted $79,109,285 and questioned $13,801,490 of costs claimed by the Grantee.

The DDO reviewed the final report and issued a Final

Determination Letter on March 12, 1997. The DDO reinstated a total of $11,995,625. However, the DDO disallowed $1,805,865. The costs disallowed include the following:

A. Administrative costs of $184,466 (Note 2 of Report of Final Audit);

B. Engineering costs incurred after the contract completion date of $415,339 (Note 3);

C. Engineering costs of $385,450 for ineligible or unsupported time extensions for change orders (Note 4b);

D. Unidentified architectural engineering costs of $59,611 (Note 4c);

E. Construction costs of $150,970 (Note 5); and

F. Construction Costs of $610,029 (Note 6).

The City placed all costs disallowed by the DDO, except $452,436,[1] into issue for this 40 C.F.R. Part 30, Subpart L Review.

Documentation which was reviewed for purposes of this Subpart L review include Grantee submissions dated August 5, 1994, August 8, 1994, September 7, 1994, May 6, 1996, April 11,

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[1] The City did not attempt to substantiate $110,886 (Note 2a,b); $130,969 (Note 4b); $59,611 (Note 4c); $112,246 (Note 5a); and, $38,724 (Note 5b). Therefore, the amounts in issues A and C, below, are reduced by $110,886 and $130,969, respectively.

1997, August 12, 1997, August 14, 1997 and September 4, 1997. After careful consideration of the materials submitted by the Grantee, the decision rendered by the DDO, applicable law, regulations and guidance, the Office of Regional Counsel and the Resources Management Division recommend that the determination of the DDO be affirmed in part and reversed in part.

III. ISSUES PRESENTED

A. WHETHER $73,580 OF ADMINISTRATIVE COSTS IS ELIGIBLE FOR GRANT PARTICIPATION (NOTE 2).

B. WHETHER $415,339 INCURRED AFTER THE CONTRACT COMPLETION DATE IS ALLOWABLE (NOTE 3).

C. WHETHER $254,481 IN INELIGIBLE OR UNSUPPORTED TIME EXTENSIONS FOR CHANGE ORDERS IS NECESSARY AND WITHIN THE SCOPE OF THE PROJECT (NOTE 4b).

D. WHETHER $610,029 IN CONSTRUCTION COSTS IS NECESSARY, REASONABLE AND ALLOCABLE (NOTE 6).

E. WHETHER THE CITY OF FLINT IS ENTITLED TO AN OFFSET FOR ONGOING CAPITAL IMPROVEMENT PROJECTS.

IV. DISCUSSION

A. WHETHER $73,580 OF ADMINISTRATIVE COSTS IS ELIGIBLE FOR GRANT PARTICIPATION (NOTE 2).

Title 40 C.F.R. § 30.710 (1977) and Federal Management Circular (FMC) 74-4 dated July 18, 1974, state that employee fringe benefits and the cost of legal expenses required in the administration of grant programs are allowable. However, a

grantee may charge costs to a federal grant only if the grantee demonstrates through proper documentation that the costs are allocable to the grant program and necessary and reasonable to its proper and efficient administration. Office of Management and Budget Circular No. A-87 (May 9, 1968), City of Canton Ohio, Docket No. 05-85-AD27 (December 4, 1986). A grantee must support costs in the manner prescribed by the regulations in place at the time of the issuance of the grant. See City of Canton Ohio, Docket No. 05-85-AD27 (December 4, 1986).

The grantee shall maintain books, records, documents, and other evidence and accounting procedures and practices, sufficient to reflect properly the total costs of the project, including all direct and indirect costs of whatever nature incurred for the performance of the project for which the EPA grant has been awarded. 40 C.F.R. § 30.805 (1977). Payroll records, time sheets and canceled checks are the preferred form of documentation to support a grantee's cost claims. City of Eaton Rapids, Michigan, Docket No. 05-86-AD17 (July 28, 1987), at 5.

> However, EPA's regulations provide great flexibility to a grantee to produce any documents that potentially may support claimed costs. Id. A grantee is given wide discretion to respond to the unique factual

circumstances of each case. Medina County, Ohio, Docket No. 05-85AD-01 (November 28, 1986) at 7.

1. Whether Fringe Benefit Costs of $55,786 are allowable.

The audit report questioned all the costs claimed for fringe benefits because the costs were calculated using an unsupported fringe benefit rate. The Grantee did not provide to the DDO documentation to support the fringe benefit rate. Therefore, the DDO disallowed all costs related to fringe benefits.

The Grantee asserts that at least $24,244 of the $55,786 disallowed for fringe benefits should be allowable, since this amount reflects the fringe benefits attributable to the actual Department of Public Works (DPW) staff direct labor charges for grant related work. The City claims a fringe benefit rate of 43.46 percent. However, the City states that it has not been able to identity specific records establishing the basis for the 43.46 percent fringe benefit rate. Nevertheless, the Grantee asserts that the fringe benefit rate is low and that it is a necessary and reasonable expense.

The grantee has the burden of maintaining and providing pertinent financial reports that substantiate its claim for indirect cost reimbursement. U.S. EPA cannot determine the reasonableness of costs without supporting documentation. The

City acknowledges that it cannot identify specific records to establish the basis for the fringe benefit rate. Therefore, the costs for fringe benefits must be disallowed, since the Grantee has not provided to the U.S. EPA sufficient records to substantiate its claimed costs. Thus, the Grantee has failed to demonstrate that the costs are reasonable, necessary, eligible or otherwise allowable for federal funding. Metropolitan Water Reclamation District of Greater Chicago, Docket No. 05-91-Ad08 (June 25, 1992), at 7. Therefore, the DDO's determination to disallow $55,786 in fringe benefit costs should be sustained.

2. Whether legal expenses of $17,794 are allowable.

The Grantee believes that $17,794 in legal expenses should be grant eligible. Additionally, $12,537 in legal expenses is being claimed for the first time. In this Subpart L dispute, the Grantee provided invoices for $17,794 in legal expenses that it claims are grant eligible, including four invoices for $167.31, $4008.56, $5,670.60, and $2,091.73 that total $11,938. The auditors included the costs associated with these invoices in the total for allowable legal expenses. Therefore, legal expenses amounting to $11,938 cannot be considered and accepted for grant participation a second time. The August 5, 1994 submission included invoices for the remaining $5,856 ($17,794 - $11,938).

These invoices include amounts for the following: $152.93-Litigation on Contract 9 with Greenfield Construction; $1,945.68-Arbitrator Fee for Contract 7; $881.74-Engineering Assistance with litigation concerning Contract 9; and, $2,875.44-Engineering assistance with Contract 9. It is not clear based upon the information provided by the Grantee that these invoices relate to grant number C263259-02. Therefore, legal expenses in the amount of $5,856 should not be reinstated.

As stated above, the Grantee also claims that $12,573 in previously unclaimed legal fees is eligible for grant funding. Allowable costs can be increased, to the extent the costs are supported by documentation. Ohio Environmental Protection Agency, Docket No. 05-86-AD22 (September 25, 1987). The Grantee provided vouchers that it asserts show that these documents relate to the grant project and that support the $12,573 in legal fees. However, the auditors previously included two of the vouchers (No. 0391027 and 03910213 for $2,002.25 and $906.80, respectively) in the total for allowable legal expenses. The Grantee cannot claim these costs a second time. Therefore, the amount in question is $9,664.

As to the remaining amount of $9,664, the Grantee has fulfilled its obligations under grant law. Documentation

submitted by the Grantee establishes that the costs incurred are allowable costs. The term "allowable costs" is defined at 40 C.F.R. § 30.135-3 (1977) as follows:

> Those eligible, reasonable, necessary and allocable costs which are permitted under the appropriate Federal cost principles, in accordance with EPA policy, within the scope of the project, and authorized for EPA participation.

Accordingly, the DDO's determination to disallow $82,015 in legal expenses should be sustained, but should be offset by $9664 in allowable legal expenses.

B. WHETHER $415,339 INCURRED AFTER THE CONTRACT COMPLETION DATE IS ALLOWABLE (NOTE 3).

Costs incurred after the contract completion date are not allowable unless the grantee shows specifically that these costs do not represent costs incurred due to grantee mismanagement or contractor failure to perform. See Office of Management and Budget Circular No. A-87 (May 9, 1968); Memorandum, Costs Incurred After the Contract Completion Date, James A. Hanlon and Kenneth A. Konz, October 1, 1990[2]. The Grantee must show that

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[2] The memorandum from James A. Hanlon, Director, Municipal Construction Division and Kenneth A. Konz, Assistant Inspector General for Audits, provides guidance for existing disputes in Subpart L proceedings concerning the allocability of postscheduled contract completion A/E fees. This memorandum is based on the grant regulations and OMB Circular A-87 and articulates the longstanding policy of the Agency concerning allowable costs.

costs incurred after the contract completion date are necessary, reasonable, and within the scope of the project to be allowable. See Hanlon and Konz Memorandum, October 1, 1990; Village of Iuka, 05-91-AD04 (September 24, 1991); and, Luce County, 05-90-AD10 (December 20, 1990). The grantee has the obligation to present to the U.S. EPA sufficient records to substantiate all of its claimed costs and to demonstrate that the costs are reasonable, necessary, eligible and otherwise allowable for federal funding. Macomb County, Michigan, Docket No. 05-89-AD06, (June 5, 1991), Delevan Lake Sanitary District, Docket No. 4-89-AD10 (June 7, 1990), Hanlon Memorandum, October 1, 1990. Costs for one-time services such as preparation of the O&M manual, as-built drawings, etc, (not related to on-going construction) are allowable, if documented adequately. City of Sun Prairie, 05-89-AD01 (September 6, 1989). The grantee must submit A/E billings to identify the work performed and the associated costs incurred in sufficient detail that permits a determination of the necessity and allocability of costs. City of Owasso, Docket No. 05-90-AD06 (June 21, 1991).

The Auditor questioned $415,339 of A/E costs incurred after the contract completion date for the following contracts:

Contract No.	Original Completion date	EPA time Extension	EPA Approved Completion Date
3	3/31/81	75	6/14/81
8	3/31/81	0	3/31/81
9	3/31/81	35	5/05/81
12	3/31/81	183	9/30/81

The costs disallowed include $285,978 from the prime engineering consultant, Hubbell, Roth & Clark and $129,361 from subconsultants.

The Grantee argues that the post construction A/E costs can be sustained as grant eligible. The Grantee argues that its position is consistent with the Hanlon Memo and requirements applicable at the time the grant was issued. Specifically, the Grantee states that the accounting systems used at the time of the grant, did not identify and segregate the costs associated with certain eligible costs. The Grantee argues that EPA requirements, at the time of the project, were imprecise, and the Hanlon Memo was not written until ten years later. Nevertheless, the Grantee attempted to identify the types of work performed by providing chronological lists of documents that the Grantee asserts indicate that the engineers were attempting, on

behalf of the City, to resolve post construction disputes and contractor claims.

The City of Flint provided chronological correspondence logs for Contracts 3, 8, 9, and 12. The City states that the logs are an inventory of all the post construction correspondence that helps explain the large A/E expenditures. However, the log entrees do not sufficiently identify the work performed and the associated costs incurred.

It is not clear whether the activities performed by the engineers are grant eligible. First, the chronologies provided by the Grantee do not describe in sufficient detail the activities performed by the engineers. Second, there is no clear correlation between the activity described in the chronology and the costs incurred by the Grantee. Further, the City's submission does not succeed in showing that these costs do not represent costs incurred due to grantee mismanagement or contractor failure to perform.

The City has failed to provide sufficient documentation that identifies the work performed and the associated costs incurred to permit a determination of necessity and reasonableness of the A/E fees. Therefore, the DDO's determination to disallow

$415,339 in A/E fees incurred after the contract completion date should be sustained.

C. WHETHER $254,481 IN INELIGIBLE OR UNSUPPORTED TIME EXTENSIONS FOR CHANGE ORDERS IS NECESSARY AND WITHIN THE SCOPE OF THE PROJECT (NOTE 4b).

It is well established that approval of construction grant plans, specifications, estimates, contracts and contract documents by U.S. EPA, its delegated state agent, or the Corps of Engineers (COE) does not automatically make all costs allowable for U.S. EPA grant participation. See City of Owosso, 05-90-AD06 (June 26, 1991); City of Fountain, 05-88-AD09 (September 25, 1988); City of Bloomington 05-88-AD03 (September 23, 1988). All costs are subject to final audit. Metropolitan Water Reclamation District of Greater Chicago, Docket No. 05-91-AD08 (June 25, 1992); City of Bloomington, Indiana, Docket No. 5-88-AD03 (August 5, 1991); Macomb County, Michigan, Docket No. 05-89-AD06 (May 24, 1991). The Regional Administrator may at any time review and audit a request for payment and make appropriate reductions for payments that are found, on the basis of the review or audit, not to constitute allowable costs. 40 C.F.R. § 35.945(c).

1. Whether A/E expenses of $127,787 are allowable.

These costs are associated with an increase in the project scope and budget to cover mitigation for problems associated with

residential wells that went dry. The City hired Neyer, Tiseo & Hindo, a hydrological engineering firm, to investigate the alleged causal connection between the dry well problems and construction of a deep sanitary relief tunnel.

The Grantee argues that the audit report incorrectly states that the costs were not identified with any of the construction contracts. These costs were identified as Contract 13 for accounting purposes. Further, the City argues that it carefully documented the investigation and mitigation of this problem, and that U.S. EPA approved it. The Grantee argues that the expenses incurred to cover the dry well problem ($127,787) should be reinstated as grant eligible, in accordance with EPA's eligibility determination and the grant amendment of June 24, 1983.

The U.S. EPA thoroughly reviewed the measures taken by the City to mitigate the problem and concluded that the activities relating to the engineering and legal services "appear to be allowable supporting costs providing the activities and costs can be well documented."[3] The project file indicates that the U.S.

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[3] March 1, 1983 letter from Todd A. Cayer, Chief, Municipal Facilities Branch, to Richard Hinshon, Chief Grants Administrator Section, MDNR.

EPA, MDNR, and the City engaged in extensive discussion about investigating and mitigating the problem associated with the dry wells. Further, the City explains that the costs associated with the dry well mitigation are set forth in Contract 13 and provides the supporting invoices. The costs in the invoices are consistent with the costs figures submitted to the U.S. EPA and MDNR during discussions about increasing the scope of the project to address the problems with the residential wells. Therefore, the DDO's determination to disallow $127,787 in A/E expenses should not be sustained.

2. Whether miscellaneous costs of $126,694 are allowable.

The auditor disallowed $126,694 of direct charges for "miscellaneous" costs under Contract 13. The Grantee argues that these costs are grant eligible and that sufficient documentation exists to explain the nature of these expenses. The Grantee states that the miscellaneous costs disallowed by the DDO relate to four basic items under Contract 13. These items include the following:

1. Monthly adjustments to the indirect charges to reflect the proportion of costs incurred for non-grant related work;

2. Two adjustments to correct the estimated indirect rate and substitute the final approved indirect rate;

3. A one time adjustment to the fixed fee resulting from a contract amendment which increased the scope of work; and

4. Minor amounts of mileage expenses.

All of the miscellaneous costs were incurred after the construction contract completion date. However, these costs are associated with the dry well problem. Additionally, such costs are consistent with this type of construction project. Therefore, we must conclude that the costs are necessary and within the scope of the project. The DDO's determination to disallow miscellaneous costs of $126,694 should not be sustained.

D. WHETHER $610,029 IN CONSTRUCTION COSTS IS ALLOCABLE, REASONABLE AND NECESSARY (NOTE 6).

The contract price or time may be changed only by a change order. 40 C.F.R. § 35.938.5(b) (1977). Costs associated with change orders must be supported by cost and pricing data. See 40 C.F.R. § 35.938-5 (1977). The grantee must present to the U.S. EPA records sufficient to substantiate all claimed costs, and to demonstrate that all are necessary, reasonable, eligible and otherwise allowable for federal funding. Metropolitan Water Reclamation District of Greater Chicago, Docket No. 05-91-AD08 (June 25, 1992) and City of Riverside, Docket No. 08-85-AD01 (March 27, 1986).

1. Whether $73,958 for actual costs of repairs awarded under arbitration is allowable.

The DDO disallowed $73,958 claimed for time and materials as the actual cost for mining machine repairs[4] because the Grantee failed to support this amount with cost and pricing data. On August 15, 1980, Greenfield Construction Company received an Arbitration Award that included an award for mining machine repairs. However, as pointed out by the Grantee, the Arbitration Award did not assign a dollar value to the repairs and the cost had not been established. The Grantee argues that the cost for the repairs are grant eligible and should be allowed because the arbitration action established the purpose and cost basis ("time and materials") of the machine repair, the arbitration decision reflected the effective lump sum nature of the machine repair cost, and the cost at issue is less than $100,000.

The first regulations to specifically address the allowability of settlement costs were set forth at 40 C.F.R. Part 35, Subpart I, Appendix A ("Appendix A"). These regulations were promulgated as Interim Rules on May 12, 1982, 47 *Fed. Reg.* 20450, and became final rules on February 17, 1984. 49 *Fed.*

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[4] The contractor had demanded $864,056 for future repairs and downtime on Machine #2.

Reg. 6224. Paragraph A.1.g. of Appendix A states, in relevant part, as follows:

> A. Costs Related to Subagreements
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> 1. Allowable costs related to sub-agreements include:
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> g. Change orders and the costs of meritorious contractor claims for increased costs under subagreements as follows:
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> (1) Change orders and the costs of meritorious contractor claims provided the costs are:
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> (i) Within the scope of the project;
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> (ii) Not caused by the grantee's mismanagement; and
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> (iii) Not caused by the grantee's vicarious liability for the improper actions of others.
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> * * *
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> (3) Settlements, arbitration awards and court judgments which resolve contractor claims shall be reviewed by the grant award official and shall be allowable only to the extent that they meet the requirements of paragraph g(1), are reasonable, and do not attempt to pass on to EPA the cost of events that were the responsibility of the grantee, the contractor, or others.

Since these substantive regulations had not been promulgated at the time the grant was awarded, they do not govern this grant *per se*, because doing so would contravene the general rule against the retroactive application of substantive regulations. City of Bloomington, Indiana, Docket No. 05-88-AD03 (Decision of the Assistant Administrator for Water; August 5, 1991). However, the standards set forth in substantive regulations promulgated after the effective date of the grant may govern the resolution of issues arising in a dispute under the grant if those standards

constitute reasonable criteria that are consistent with the regulations in effect at the time the grant was issued and are applied in a common sense manner. Id.; Washtenaw County Department of Public Works, Docket No. 05-93-AD02 (September 29, 1995). Since the Appendix A regulations constitute reasonable criteria which merely codify cost principles that have long been applicable to EPA grants, they supply the appropriate legal standard for determining the allowability of arbitration awards, settlements and court judgments arising from contractor claims even if the subject grant was issued prior to promulgation of Appendix A. Washtenaw County Department of Public Works, Docket No. 05-93-AD02 (September 29, 1995); County of Nassau, Docket No. 02-90-AD03 (April 20, 1995); Sacramento Regional County Sanitation District, Docket No. 09-87-AD13 (September 27, 1990); Rochester Pure Waters District, Docket No. 02-87-AD20 (February 20, 1990); Jackson County Department of Public Works, Docket No. 05-86-AD12 (September 28, 1987); City of Hitchcock, Texas, Docket No. 06-86-AD03 (June 30, 1987); City of Stockton, Docket No. 09-86-AD17 (June 18, 1987); City of Stockton, Docket No. 09-86-AD18 (June 18, 1987); Oneida County Sewer District, N.Y., Docket No. 02-85-AD19 (December 16, 1986); Bismarck, North Dakota, Docket No. 08-86-AD01 (October 29, 1986).

U.S. EPA has applied the foregoing standards to determine the allowability of lump sum settlements, court judgments and arbitration awards resolving contractor claims. Washtenaw County Department of Public Works, Docket No. 05-93-AD02 (September 29, 1995) (arbitration award); County of Nassau, Docket No. 02-90-AD03 (April 20, 1995) (court judgment); Sacramento Regional County Sanitation District, Docket No. 09-87-AD13 (September 27, 1990) (arbitration award); Rochester Pure Waters District, Docket No. 02-87-AD20 (February 20, 1990) (settlement/jury award); Jackson County Department of Public Works, Docket No. 05-86-AD12 (September 28, 1987) (arbitration award); City of Hitchcock, Texas, Docket No. 06-86-AD03 (June 30, 1987) (arbitration award); City of Stockton, Docket No. 09-86-AD17 (June 18, 1987) (settlement); City of Stockton, Docket No. 09-86-AD18 (June 18, 1987) (settlement); Oneida County Sewer District, N.Y., Docket No. 02-85-AD19 (December 16, 1986) (arbitration award); Bismarck, North Dakota, Docket No. 08-86-AD01 (October 29, 1986) (arbitration award).

Other cases have resolved the allowability of such costs under the same general analysis without relying directly upon Appendix A. Grosse Ile Township, Docket No. 05-92-AD11 (August 1, 1994) (settlement); City of Parma, Ohio, Docket No.

05-85-AD11 (June 30, 1987) (jury award); City of Baytown, Texas, BAA Docket No. 82-99 (December 19, 1984) (settlement). These cases hold as a general rule that, where a lump sum expense may contain both eligible and ineligible cost elements, the grantee bears the burden of clearly segregating the eligible and ineligible costs so that an allowability determination can be made. Where the grantee is unable to reasonably segregate eligible and ineligible cost items, the entire lump sum is disallowed. County of Nassau, Docket No. 02-90-AD03 (April 20, 1995); Grosse Ile Township, Docket No. 05-92-AD11 (August 1, 1994); Rochester Pure Waters District, Docket No. 02-87-AD20 (February 20, 1990); City of Parma, Ohio, Docket No. 05-85-AD11 (June 30, 1987); City of Stockton, Docket No. 09-86-AD17 (June 18, 1987); City of Stockton, Docket No. 09-86-AD18 (June 18, 1987); Oneida County Sewer District, N.Y., Docket No. 02-85-AD19 (December 16, 1986); Bismarck, North Dakota, Docket No. 08-86-AD01 (October 29, 1986); City of Baytown, Texas, BAA Docket No. 82-99 (December 19, 1984). Where the grantee has sustained its burden of reasonably segregating the grant eligible costs, such costs will be allowed even though an exact calculation may be impossible. Washtenaw County Department of Public Works, Docket No. 05-93-AD02 (September 29, 1995);

Sacramento Regional County Sanitation District, Docket No. 09-87-AD13 (September 27, 1990); Jackson County Department of Public Works, Docket No. 05-86-AD12 (On Remand from the Assistant Administrator for Water; July 7, 1989).; City of Hitchcock, Texas, Docket No. 06-86-AD03 (June 30, 1987); *see also* Bolinas Community Public Utility District, BAA Docket No. 79-43 (August 31, 1982).

Applying the above rational to the instant matter, the DDO erred in disallowing the costs associated with the mining machine repairs. As the arbitration award provides a detailed breakdown of the costs awarded, it reasonably segregates eligible from ineligible costs. Furthermore, the costs awarded are for work that is within the scope of the project and, thus, are eligible for reimbursement. Finally, there is no evidence in the record to conclude that the award resulted from grantee or contractor mismanagement or negligence. Therefore, the Grantee has shown that the costs of the mining machine repairs constitute reasonable costs. Based on the above analysis, the DDO's determination to disallow $73,958 in mining machine repairs should be reversed.

It should be noted, however, that the Grantee is incorrect in its assertion that the need for cost and pricing data is eliminated because the cost at issue is less than $100,000. For

each change order in excess of $100,000, the contractor shall submit to the grantee for review sufficient cost and pricing data. 40 C.F.R. § 938-5(d) (1977). In this instance, the costs questioned for mining machine repairs are only a portion of the total amount of Change Order 4-4[5]. Cost and pricing data must be provided for the all change orders.

2. Whether $130,399 in interest awarded under arbitration is allowable.

In a submission dated August 8, 1994, the City argues that interest is not an issue in this dispute, because interest is not a part of the arbitration award. Also, the Grantee argues that interest would be allowed in this case pursuant to regulation at 40 C.F.R. § 35.940-(2)(f) even if interest[6] was an issue. The threshold issue here is whether the arbitration award included interest[7].

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[5] The total claimed cost for Change Order 4-4 is $6,434,665.

[6] The Federal Regulation effective at the time of issuance of this grant states that interest on bonds or any other form of indebtedness required to finance the project costs is not necessary for the construction of a treatment works and therefore is unallowable. 40 C.F.R. § 35.940-2(f) (1977).

[7] See Jackson County Department of Public Works, Docket No. 05-86-AD12 (September 25, 1987); City of Hitchcock, Docket No. 06-86-AD03 (June 30, 1987); and, Bismarck, North Dakota, Docket No. 08-86-AD01 (October 29, 1986). In each of

The contractor demanded $1,839,744[8]. This demand included $163,198[9] for interest. The arbitrator awarded $1,470,000. The arbitration award states simply, "Respondent shall pay claimant the sum of one million four hundred seventy thousand dollars (($1,470,000.00)." The award does not indicate that any portion of this award is for interest. Furthermore, the contract did not permit the award of interest in arbitration. Consequently, we must conclude that the $130,399 disallowed by the DDO is not interest but a substantive part of the arbitration award and that the costs are reasonable and necessary. The DDO's determination to disallow $130,399 should not be sustained.

3. Whether $185,672 for construction costs approved under Change Order 10-3 is allowable.

The DDO disallowed $50,852 plus $134,820 for construction

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these cases the arbitration awards expressly award interest. In the case at hand, the award is silent on whether interest is included.

[8] The contractor provided a detailed breakout of the costs demanded. The DDO determined that all costs, except $130,399 for interest, are grant eligible.

[9] The DDO determined that $130,399 related to unallowable interest. The DDO used the ratio based on total unallowable costs to total costs demanded ($163,198\$1,839,744). Then the DDO applied this ratio to the $1,470,000 arbitration award (.0887069 x $1,470,000 = $130,399).

of a sewer extension in Carmen Creek running from Manhole 144 to Manhole 227. These costs were an addition to Contract 10. The Grantee argues that MDNR and the Corps of Engineers both reviewed and approved the change order for these costs, when the City submitted it. The City argues that these costs should be eligible because the State and Corps approved the change order and the City submitted adequate documentation for its procurement process.

Change Orders approved by a delegated agency do not bind the U.S. EPA to approve claimed costs. Luce County Department of Public Works, Docket No. 05-90-AD04 (September 26, 1990); City of Sun Prairie, Docket No. 05-89-AD10 (September 6,1989); and City of Bloomington, Docket No. 05-88-AD03 (September 23, 1988). A grantee is on express notice that grant awards are subject to final audit. 40 C.F.R. 30.820 (1977). As stated herein, costs incurred are allowable, if they are necessary and reasonable for proper and efficient administration of the grant program. Office Management and Budget Circular No. A-87, (May 9, 1968). However, a grantee must provide adequate documentation to support costs in a manner prescribed by regulation in place at the time a grant is issued. Village of Iuka, Docket No. 05-91-AD04 (September 4,

1991); City of Canton, Ohio, Docket No. 05-85-AD27 (December 5, 1986).

It is important to point out that the auditor does not question the eligibility of Change Order 10-3. The Grantee showed successfully that the work performed under Changer Order 10-3 is grant eligible. However, the Grantee states that Item 1 was identified in the change order as a lump sum cost of $134,820. The change order does not specify the basis for the lump sum. However, the Grantee argues that letters from the City dated December 5, 1979 and March 5, 1980 indicate the City selected the contractor for this item based on competitive bids, and that the final price for the work was then negotiated to incorporate several modifications[10].

The assertion that the City negotiated bids with the contractor does not satisfy its obligation to provide sufficient documentation to support the costs incurred. The Grantee did not provide a breakdown of the costs negotiated with the contractor or any other documentation to allow the Agency to determine whether the costs are allowable. Therefore, the DDO's

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[10] This argument is set forth in the submission from Hinshon Environmental Consulting dated September 7, 1994.

determination to disallow $134,820 related to Change Order 10-3 should be sustained.

As set forth above, the DDO also disallowed $50,852 related to Change Order 10-3. In this instance, however, the Grantee provides detailed documentation which shows a breakdown of the $50,852. This documentation adequately supports the costs incurred. Therefore, the DDO's decision to disallow $50,852 related to Change Order 10-3 should not be sustained.

4. Whether a $220,000 lump sum settlement between the Grantee and its contractor is allowable.

This amount represents a lump sum settlement between the City and its contractor. The Grantee asserts that the $220,000 settlement resulted from an August 6, 1980 arbitration award. The arbitration proceeded in a two step process. The parties discussed liability and then damages. Following a determination of liability, the parties settled the issue of damages and agreed upon a price. The settlement did not establish the specific cost associated with each item at issue. However, the settlement established the total dollar amount for these items. Additionally, the Grantee provided detailed cost and pricing data showing a total original claim of $264,803.81.

As set forth above, a cost breakdown for a lump sum

settlement amount is necessary to verify the nature of the settlement and how it relates to eligible costs. Grosse Ile Township, 05-92-AD11 (September 1, 1994). The U.S. EPA cannot determine whether calculated lump sum settlement amounts are reasonable, allowable, and allocable to the project, without a breakdown of the costs. Id. Therefore, a grant recipient is not entitled to Federal cost participation for any part of a lump sum award, unless it can demonstrate the breakdown between allowable and unallowable costs. See Grosse Ile Township, Oneida County, Docket No. 02-85-AD11 (December 16, 1986), and City of Parma, Ohio, 05-85-AD11 (June 30, 1987).

Applying the standards for lump sum settlements set forth above, the DDO erred in disallowing this $220,000 lump sum settlement. First, although the lump sum settlement does not provide an individual breakdown of the costs awarded, it provides a description of all items at issue and the total cost of these items. Additionally, detailed cost and pricing data for the items in question adequately supports the total amount of the settlement. Second, as every item that comprises the settlement is eligible for grant funding, the lump sum settlement reasonably segregates eligible from ineligible costs. And lastly, there is no evidence in the record to conclude that the award resulted

from grantee or contractor mismanagement or negligence. Therefore, the DDO's determination disallowing the $220,000 lump sum settlement should be reversed.

E. WHETHER THE GRANTEE IS ENTITLED TO AN OFFSET FOR ONGOING CAPITAL IMPROVEMENT PROJECTS.

In the Grantee's appeal dated April 11, 1997, it argues that costs for current capital improvements should offset any monies owed because these costs likely would have been grant eligible if funds were still available. In support of its argument, the Grantee cites to Orange County, FL, EPA Docket No. 04-91-AD03 (September 27, 1997) and City of Austin, TX, EPA Docket No. 06-92-AD03 (April 26, 1993).

In Orange County, the grantee requested that I/A funds authorized by grant amendment be used to offset money due EPA as a result of audit disallowances. Because the I/A funds were approved, but no longer available, EPA granted the request. Similarly, in City of Austin, an EPA audit revealed $120,000 worth of ineligible project costs, while there existed $4.6 million of unclaimed eligible costs. The Agency accepted the grantee's offset request reasoning that at least $96,000 of the $4.6 million would have been grant eligible.

The above cases reflect scenarios where costs were eligible,

but funding, while approved, was unavailable. Therefore, offsets were allowed to compensate for the lack of funding. The distinguishing factor in these cases is that the funding was approved. In the instant case, a grant amendment concerning the Grantee's ongoing capital improvements has not been approved. Consequently, the Grantee's request for an offset should be denied.

V. CONCLUSION

As set forth above, the DDO disallowed $1,805,865 in costs claimed by the Grantee for Federal participation. In this Subpart L review, the Grantee requested review of $1,353,429 in costs disallowed by the DDO. The Grantee did not dispute $452,436 in costs disallowed. We recommend that $729,690 be reinstated and that $1,076,175 be sustained as unallowable for Federal participation. The Grantee has not paid any of the disputed Federal share. Therefore, $775,224, which constitutes the 75 percent Federal share of $1,076,175 in unallowable disputed costs less the 75 percent share of offsets of $32,879 and $9664, should be refunded to U.S. EPA. The Grantee should pay U.S. EPA interest charges of 5 percent per annum, if payment is not received by U.S. EPA within 30 days of issuance of the FDL.

Respectfully submitted,

Dated: October 16 1997

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