Office of Inspector General
Eastern Audit Division

Audit Report

GRANTS MANAGEMENT

Grants Management Practices of Rhode Island Department of Environmental Management

2000-1-00416

September 21, 2000

Inspector General Division Conducting the Audit	Eastern Audit Division Boston, Massachusetts
Region Covered	Region 1
Program Offices Involved	Office of Ecosystem Protection Office of Administration and Resources Management

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MEMORANDUM

SUBJECT: Grant Management Practices of Rhode Island Department of Environmental Management
Audit No. 2000-1-00416

FROM: Ira Brass
Principal Team Leader
Eastern Audit Division

TO: Mindy Lubber
Regional Administrator
EPA New England

Attached is our subject report which contains findings and recommendations that are important to both EPA and the Rhode Island Department of Environmental Management.

This audit report contains findings that describe problems the Office of Inspector General has identified and corrective actions the OIG recommends. This audit report represents the opinion of the OIG and the findings contained in this report do not necessarily represent the final EPA position. Final determinations on matters in this audit report will be made by EPA managers in accordance with established audit resolution procedures.

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. Your response should address all recommendations, and include milestone dates for corrective actions planned, but not completed.

We have no objection to the release of this report to the public.

Should you or your staff have any questions about this report, please contact me at (212) 637-3057 or Steven Weber, Team Leader at (617) 918-1470.

Attachment

EXECUTIVE SUMMARY

INTRODUCTION

EPA accomplishes its mission and goals through grants and cooperative agreements to States. The States were responsible for planning, developing, establishing, improving and maintaining environmental programs as required by law. The purpose of the audit was to determine if the Rhode Island Department of Environmental Management (RIDEM) was managing its Federal grants in accordance with applicable requirements.

OBJECTIVES

The objectives of the audit were to determine if RIDEM was:

- Managing grant funds provided by EPA in accordance with the terms and conditions of the grant.
- Allocating costs associated with Federal and State activities appropriately.
- Drawing funds in accordance with the Cash Management Improvement Act.
- Meeting Federal match requirements.

RESULTS IN BRIEF

RIDEM needs to seize the opportunity to strengthen its administrative processes to achieve effective internal controls and fiscal responsibility. We found that RIDEM's internal controls for financial management of Federal funds were not adequate to ensure that Federal funds were being managed appropriately. RIDEM's approach was to maximize its receipt of Federal funds without equivalent benefit to

EPA programs and activities. Since Fiscal Year (FY) 1996, EPA has provided RIDEM over $16.7 million to help ensure that the State of Rhode Island improves the quality of its air, land and water. Yet control breakdowns raise questions about whether RIDEM is meeting its grant management responsibilities.

Our audit of RIDEM found a variety of internal control weaknesses. We believe RIDEM needs to address and resolve these concerns to operate a better program. Specifically, we found:

Controls Needed For Payroll Costs

RIDEM did not have adequate controls over how payroll costs were charged to Federal grants. Payroll expenses were charged based on a budget rather than on actual hours worked; authorized absences were charged based on estimates or budgets; and RIDEM did not include the cost of leave as part of its fringe benefit rate.

Costs Not Allocated Appropriately

RIDEM's Office of Air Resources did not have a system to assure charges to the Federal grants were allowable, reasonable and allocable. Computers purchased were charged 100 percent to Federal grants even though staff time was planned to be split between eligible and ineligible Federal activities; and the cost of vehicles were allocated to two different Federal grants even though employees used the vehicles to perform activities ineligible for Federal reimbursement. In addition, time and travel costs were not always appropriately charged and EPA did not always benefit from charges made to the Air grant.

Matching Requirements Not Supported

RIDEM lacked documentation to support that it had met the minimum cost sharing requirements to be eligible to receive its FY 1996 Section 105 Air Grant funds. RIDEM had $94,280 (11 percent) in unsupported matching funds out of the FY 1996 match of $891,204.

Cost Transfers Prevalent

RIDEM did not adequately financially manage its grants, resulting in the Assistant Administrator for Financial Management making substantial and frequent costs shifts between State and Federal accounts or between two Federal grants. Because of these actions, RIDEM submitted multiple final Financial Status Reports with different ending balances; had excess Federal funds on hand; made transfers without prior EPA approval; and would have overspent Federal grants.

Title V Revenues Not Properly Maintained

RIDEM did not maintain Title V operating permit fee revenue in accordance with either the terms of the Clean Air Act or Rhode Island's Air Pollution Control Regulations. This resulted in operating fee revenue from FYs 1997, 1998 and 1999 totaling $380,906 being deposited into the State's general revenue account rather than utilized on the Title V program.

RECOMMENDATIONS

We recommend that the Regional Administrator instruct Regional staff to work with RIDEM to develop a corrective action plan for addressing the internal control weaknesses and recommendations we present in Chapters 3 through 7. Regional officials should then regularly meet with RIDEM to review the action plan's implementation progress.

REGION COMMENTS AND ACTIONS

In responding to the draft report, the Regional Administrator generally concurred with our Findings and Recommendations and advised that most of the recommendations were accurately stated and acceptable to both the Region and to RIDEM. Furthermore, the Regional Administrator advised that RIDEM has agreed to develop a detailed corrective action plan in conjunction with the Region's Rhode Island State Program Unit that will address our recommendations. Additionally, the Region has

requested our assistance in reviewing the progress that RIDEM makes towards meeting their proposed corrective action plan.

In regards to Chapter 7, the Region felt that RIDEM currently had in place a system to ensure that Title V fee revenue collected was expended only on Title V activities. Additionally, the Region felt that in FY 1997 EPA's policy did not clearly require that funds collected and not expended on Title V activities during the fiscal year collected be made available in the subsequent fiscal year to carry out the Title V program. Based on discussions during the exit conference and information provided by the OIG General Counsel we have revised our recommendations in this chapter.

OIG EVALUATION

The OIG concurs with the actions the Regional Administrator proposes. The Region's actions in concert with RIDEM, when implemented, will strengthened the administration of the Rhode Island grant program.

However, relating to Chapter 7, we disagree with the Regional assertion that Agency policy was not clear. Our evaluation of this matter can be found in Chapter 7.

ABBREVIATIONS

APC	Air Pollution Control
CAA	Clean Air Act
EPA	Environmental Protection Agency
FSR	Financial Status Report
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
ISDS	Individual Sewage Disposal Systems
NPS	Non Point Source
OAR	Office of Air Resources
OIG	Office of Inspector General
OMB	Office of Management and Budget
OMS	Office of Management Services
OPP	Operating Permits Program
OWR	Office of Water Resources
PPA	Performance Partnership Agreement
PPG	Performance Partnership Grant
RCRA	Resource Conservation and Recovery Act
RIDEM	Rhode Island Department of Environmental Management
RIDOH	Rhode Island Department of Health
RIPDES	Rhode Island Pollution Discharge Elimination System
UIC	Underground Injection Control

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CHAPTER 1
INTRODUCTION

PURPOSE

We initially conducted a survey of the Resource Conservation and Recovery Act (RCRA) grant Financial Status Reports (FSRs), based on concerns regarding RIDEM's submission of three different FSRs for the same RCRA grant. Based on the results of the survey, an audit of RIDEM grants management was conducted. The purpose of the audit was to determine if RIDEM was managing its Federal grants in accordance with applicable requirements. Specifically, our objectives were to determine if RIDEM was:

- Managing grant funds provided by EPA in accordance with the terms and conditions of the grant.
- Allocating costs associated with Federal and State activities appropriately.
- Drawing funds in accordance with the Cash Management Improvement Act.
- Meeting Federal match requirements.

BACKGROUND

RIDEM is comprised of three bureaus; Environmental Protection, Natural Resources, and Policy & Administration.

Each bureau administers the following specific programs:

Environmental Protection	*Natural Resources*	*Policy & Administration*
Air Resources	**Agriculture**	**Human Resources**
Compliance and Inspection	**Coastal Resources**	**Management Services**
Technical & Customer Assistance	**Enforcement**	**Planning & Development**
Waste Management	**Fish & Wildlife**	**Strategic Planning and Policy**
Water Resources	**Forest Environment**	**Legal Services**
Criminal Investigation	**Parks & Recreation**	
	Administrative Adjudication	

In FYs 1996, 1997 and 1998 EPA awarded RIDEM 38 grants totaling $16,755,631. These grants were awarded under 23 separate programs. EPA awarded both categorical grants and Performance Partnership Grants (PPGs) during FYs 1996-1998. A PPG is a single grant made to a State or Tribe from grant funds allocated and otherwise available for existing categorical grant programs. PPGs are voluntary and provide States and Tribes with the option to combine funds from two or more categorical grants into one or more PPGs. Recipients may receive their financial assistance as one or more PPGs, or continue receiving categorical grants.

Our audit dealt primarily with RIDEM's Offices of Management Services, Air Resources, and Water Resources. The services and functions these offices provide RIDEM are detailed below.

The Office of Management Services (OMS) consists of accounting, budgeting, data processing, boat registration, commercial fishing licenses, revenue and receipt tracking, property insurance monitoring, fresh water fishing and hunting licenses, mail distribution, in-house print services, basement record storage, and the technical aspect of telephone operations. In addition to fund accounting, the office handles all purchase requests, debt collection management, travel and conference requests. The office personnel consist of a chief, budget administrator, assistant administrator for financial management, accountants and support staff. The licensing staff consists of an administrator, titling supervisor and support staff. The Information Management Unit consists of two program analysts and a technical support specialist. The OMS supports all divisions and offices of the department. The OMS has fiduciary responsibility with all State and Federal funding as it works closely with all RIDEM officials and Federal and State agencies. The OMS implements the Fiscal Integrity Act which is a set of standards established by the general assembly and assures that audit recommendations are implemented as expediently as possible. In support of the regulatory group, the office staff tracks penalties, billings, and fines and works closely with State collection personnel.

The Office of Air Resources (OAR) is responsible for the preservation, protection and improvement of the State's air resources. This is accomplished mainly through regulating the emission of air pollutants from stationary sources, and more recently, from mobile sources. Planning, air pollutant emission inventory, and air quality monitoring functions are also major activities. Much of OAR's work is related to assuring the State improves its air quality in order to attain the standard on the schedule required by the Federal Clean Air Act. The OAR is working to implement new emission reduction programs and is working with

other states to assure emission reductions in the Region help Rhode Island attain the standard.

The Office of Water Resources (OWR) implements a variety of programs aimed at protecting and restoring the State's surface waters, groundwater and wetlands. The OWR includes 11 major programs: Individual Sewage Disposal Systems (ISDS) and Freshwater Wetlands Permitting; Groundwater and Surface Water Quality Certifications and Underground Injection Control (UIC); Rhode Island Pollutant Discharge Elimination System (RIPDES) and Pretreatment; Wastewater Treatment Facilities (WWTFs) and sludge management; Narragansett Bay Estuary Program; Shell Fishing Area Water Quality Monitoring; Groundwater Protection; Water Quality Classifications and Standards; and Watershed Protection and Restoration (TMDL/Assessment).

SCOPE AND METHODOLOGY

We performed this audit in accordance with Government Auditing Standards (1994 Revision) issued by the Comptroller General of the United States as they apply to performance audits. Our review included tests of the accounting records and other auditing procedures we considered necessary.

We reviewed RIDEM's accounting records including the comptroller's reports, cost schedules prepared by the Assistant Administrator for Financial Management, employees costs cards, invoices and adjustment vouchers. We reviewed costs charged to grants awarded to the OAR and OWR for FYs 1996 through 1998. Our review evaluated RIDEM's controls, procedures, and documentation to assure that grants were adequately managed and associated costs charged to the grant were proper. We did not evaluate RIDEM's performance under the grants.

In order to address our audit objectives we conducted the following audit work:

- Interviewed EPA New England, RIDEM, Rhode Island State Controller, and Rhode Island Department of Health (RIDOH) staff.
- Traced employee cost center reports to Controller's records and to adjustment folders.
- Traced payroll costs to grant summary schedule and Controller's records.
- Traced non-payroll expenditures to supporting documentation, grant summary schedules, and Controller's records.
- Traced grant summary schedules to FSRs.
- Traced Air Grant indirect costs to the supporting documentation.
- Traced equipment purchases to inventory records and specific employees.
- Reviewed controls and accounting of the Title V Operating Permit Fee revenue.

We reviewed management controls and procedures specifically related to our objectives. However, we did not review the internal controls associated with the input and processing of information reported to the State Controller's Office.

Our fieldwork was performed from May 1, 1999 to January 29, 2000. Fieldwork was conducted at EPA New England's Boston, Massachusetts office and RIDEM's Providence, Rhode Island office. We discussed our preliminary conditions with RIDEM's OMS and OAR staff, and provided them position papers on January 26, 2000 to which they responded

on March 31, 2000. We provided the Region a draft report on May 18, 2000. The Region respond to our draft report on June 29, 2000. Their comments have been considered in the preparation of this report.

PRIOR AUDIT COVERAGE

No prior OIG audits have been conducted of RIDEM's Grant Management. The OIG issued audit reports on a Cooperative Agreement between RIDEM and EPA (March 22, 1995) and the RCRA Enforcement Program (January 21, 1999).

CHAPTER 2

WEAK FINANCIAL CONTROLS COMPROMISE THE INTEGRITY OF RHODE ISLAND ENVIRONMENTAL PROGRAMS

While RIDEM strives to enhance the quality of Rhode Island's environment, we found that the internal controls for financial management of Federal funds were not adequate to ensure that program objectives were met and that Federal funds were being managed appropriately. RIDEM did not adequately administer funds in accordance with the grant terms and conditions established between RIDEM and EPA, or in compliance with Federal and State regulations. As a result, EPA has limited assurance that grant funds were utilized in accordance with workplans and established environmental targets negotiated with RIDEM.

RIDEM was not following standard internal control practices that should be used to ensure that grant funds were properly applied and accounted for. Specifically, we found that RIDEM did not:

- Have controls in place to assure that costs charged to the Federal grants were allowable, reasonable and allocable.
- Have documented written procedures to assure consistent charges of costs to Federal grants.
- Segregate the duties of the operating accountant to assure propriety of accounting records.

These deficiencies make RIDEM grant programs vulnerable to fraud, waste, and abuse. This situation raises questions whether RIDEM is meeting its grant management responsibilities. Since FY 1996, EPA

has provided RIDEM over $16.7 million to help ensure that the State of Rhode Island improves the quality of its air, land, and water.

Objectives Of An Internal Control Structure

The management of the State and the Department of Environmental Management are responsible for establishing and maintaining an internal control structure. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management authorization and recorded properly to permit preparation of the financial statements in accordance with generally accepted accounting principles.

The key organization controls include authorization policies, segregation of duties, and clear description of responsibilities and job tasks. Authorization policies should be communicated to all affected parties and monitored for compliance.

Standards Of Financial Management Systems

40 Code of Federal Regulations (CFR) § 31.20 (b) states that the financial management systems of other grantees and subgrantees must meet the following standards:

> Accounting Records - Grantees and subgrantees must maintain records which adequately identify the source and application of funds provided for financially-assisted activities.
>
> Internal Controls - Effective control and accountability must be maintained for all grant and subgrant cash, real property, and other assets. Grantees and subgrantees must adequately safeguard all such property to assure that it is used solely for authorized purposes.

Budget Control - Actual expenditures or outlays must be compared with budgeted amounts for each grant or subgrant.

Allowable Cost - Applicable Office of Management and Budget (OMB) cost principles, agency program regulations and the terms of the grant and subgrant agreements will be followed in determining the reasonableness, allowability, and allocability of costs.

Cash Management - procedures for minimizing the time elapsing between the transfer of funds from the US Treasury and the disbursement by grantees and subgrantees.

RIDEM Control System Weaknesses

We found RIDEM had the following internal control weaknesses in its administration of EPA provided Federal environmental funds.

- RIDEM did not have adequate controls over how payroll costs were charged to Federal grants. **See Chapter 3 for more details.**

- The Office of Air Resources (OAR) did not have a system in place to assure charges to the Federal grants were allowable, reasonable and allocable. **See Chapter 4 for more details.**

- RIDEM lacked documentation to support it had met the minimum cost sharing requirement to be eligible to receive Federal Section 105 Air funds. **See Chapter 5 for more details.**

- RIDEM did not adequately manage its grant funds, resulting in the Assistant Administrator for Financial Management needing to make substantial and frequent shifts of costs between State and Federal accounts or

between two Federal grants. **See Chapter 6 for more details.**

- RIDEM did not maintain Title V operating permit fee revenue in accordance with either the terms of the Clean Air Act or Rhode Island's Air Pollution Control Regulations. **See Chapter 7 for more details.**

RIDEM's inadequate internal controls are indicative of its weak oversight of the program, which also limits EPA's assurance that future funding will be adequately protected. The need for RIDEM to have comprehensive and adequate controls is all the more necessary now since RIDEM is receiving funding under the PPG, which allows greater flexibility in grants management.

RIDEM Comments

In commenting on these matters, State officials agreed with most of our issues and stated that they will take action such as segregating the roles of the operating accountant, establishing written policies, where applicable, and complying with program requirements if possible within the structure of the State of Rhode Island's accounting system. RIDEM also advised that the air permit fee area was out of the Department's control and the General Assembly will not allow RIDEM to create a restricted fund for the retention of these fees.

RIDEM also stated that the Department is somewhat constrained as to what it can do within the State accounting system. The system makes RIDEM dependent on the Controller's statements and his postings and not when an expenditure occurred. RIDEM further advised that in some instances the OIG observations may be too burdensome to implement because of staffing and/or funding, however many of the review positions were accurate representations.

RIDEM's management has expressed a willingness to improve grant management. RIDEM is currently developing systems and allocation plans to enhance financial grant management. Additionally, the Assistant Administrator for Financial Management began to document procedures used to account for Federal grant funds during our audit. At the same time, RIDEM has stated that there are several challenges it must overcome to meet all grant management requirements. We believe that EPA New England could provide RIDEM with the technical expertise to assure that the planned technological improvements will be successful and assist RIDEM to overcome the obstacles to having a high performing grant management program.

CONCLUSION

We believe that the timing is appropriate for EPA New England to expand its partnering efforts with RIDEM. The internal control weaknesses described in this report, the challenges that RIDEM noted in the preceding paragraphs, and the recent change in accounting staff who manage Federal grants present EPA New England the opportunity to provide RIDEM with technical expertise to enhance RIDEM's grant management program. This technical assistance in the form of grantee financial management support would benefit all RIDEM's programs. RIDEM acknowledged that the management weaknesses found in its system can be corrected to address the Federal requirements.

The following chapters present the specific areas of internal control weaknesses in RIDEM's grant management with recommendations for improvements. We believe RIDEM and EPA New England working together to strengthen RIDEM's internal controls will result in adequately protecting EPA's grant funds.

percent of employee's time would result in program/activity costs being incorrectly charged to those programs for which time is accounted not where it was spent.

Fringe benefits are allowances and services provided by employers as compensation in addition to regular salaries and wages. Fringe benefits include but are not limited to, the costs of leave, employee insurance, pensions, and unemployment benefit plans. The costs of fringe benefits in the form of regular compensation paid to employees during periods of authorized absences from the job, such as for annual leave, sick leave...and other benefits are allowable if: (a) they are provided under established written policies; (b) the costs are equitably allocated to all related activities, including Federal awards; and (c) the accounting basis (cash or accrual) selected for costing each type of leave is consistently followed by the governmental unit.

RIDEM NEEDS TO CHARGE ACTUAL ACTIVITIES AGAINST AIR GRANT

Our review of costs charged to the Section 105 Air Grants revealed that RIDEM was utilizing an unapproved cost allocation system. When seeking reimbursement for Section 105 Air activities, RIDEM employees did not fill out personnel activity reports or the equivalent that reflected an after-the-fact distribution of the *actual activity* of each employee. In lieu of claiming actual activity, RIDEM was using a cost allocation system that was not reviewed or approved as required. OMB Circular A-87 mandates that charges claimed against the Federal Section 105 Air grant were to be actual expenditures, not proposed or budgeted costs. As a result, EPA has limited assurance that costs claimed for reimbursement under the Section 105 Air Grant were for allowable grant activities. Additionally, the integrity

of the RIDEM Financial Management System and reports generated from their system was brought into question based on this condition.

Employees Charge Time Based On Budget Not Actual Hours

RIDEM employees were directed to fill out their time cards based on an allocation system, not based on actual hours worked on a specific activity. The Chief, Office of Air Resources (OAR) provided each employee on his staff with a percentage for each activity to charge. The percentage was based on the budgeted amount of Federal and State funds available for the Air grant. It was not based on actual activity. This was done to ensure RIDEM did not overspend funds. Additionally, the Assistant Administrator for Financial Management advised that he was unaware that these amounts were estimates and not actual.

During our review of a judgmentally selected sample of cost cards, we found eight of the 18 (45 percent) OAR employees charged their time based on a budget allocation rather than actual.

The following are examples of cost cards charges:

Employee A	Employee B	Employee C
For the 23 weeks reviewed, the employee regularly charged 24.5 hours to the Air Pollution Control and 10.5 hours to the Operating Permit Program, a 70/30 allocation.	For the 14 weeks reviewed, the employee regularly charged 17.5 hours to Air Pollution Control and 17.5 hours to the Operating Permit Program, a 50/50 allocation.	For the 11 weeks reviewed, the employee regularly charged 21 hours to the Air Pollution Control and 14 hours to the Operating Permit Program, 60/40 allocation.

In addition, we found five other employees' cost cards, included in our sample, showing similar types of charging time on a regular allocation rate, such as 50/50, 70/30 and 60/40 basis.

OMB Circular A-87 provides States with minimum standards for their financial management system. A State's financial management system shall provide:

(1) Accurate, current and complete disclosure of the financial results of each program.

(2) Records that identified adequately the source and application of funds for EPA-sponsored activities. These records shall contain information pertaining to Federal awards, authorizations, obligations, unobligated balances, assets, outlays, income and interest.

(3) Written procedures for determining the reasonableness, allocability and allowability of costs in accordance with the provisions of the applicable Federal cost principles and the terms and conditions of the award.

(4) Accounting records, including cost accounting records, that were supported by source documentation.

Without RIDEM having an adequate financial management system in place, EPA has limited assurance that the $3.8 million of Section 105 Air Grant funds awarded during our audit period were utilized in the most effective manner possible in addressing the State's air pollution.

RIDEM's practice of charging costs based on budgetary amounts rather than actual expenditures was in violation of the terms and conditions of its grant agreement with the Agency. The State Auditor General's May 14, 1997 report noted similar weaknesses where employees reported hours for activities that did not correspond with their actual effort. The Auditor General report states: "DEM

contends that expenditures should be charged where they were budgeted regardless of where the costs were actually attributable." The report recommended that all employee time cards accurately reflect hours by activity.

RIDEM officials stated that employees were never directed to fill out their time cards using a certain percentage of time for different cost center jobs. Employees were provided a percentage of time they were expected to spend on activities under different cost centers. Some employees may have interpreted this as an instruction to fill out time cards according to the percentages given. However, the policy directive was to fill out time cards according to activities performed. In any case, staff of the Office of Air Resources have been advised that time cards must be filled out based on actual activity. They have also been advised that the percent of time expected for different cost centers were targets and time cards should not automatically reflect these percentages.

RIDEM's Control Guidance Not Followed By All Employees

RIDEM issued several memos advising employees to charge the actual activity, going back to 1997. Another memo was issued in 1999 with similar instructions and now in 2000 employees are being advised again as to how to charge their time. This is an indication that RIDEM's controls over the charging of payroll expenses were not being adopted by its employees. This further indicates that RIDEM should seek a new control to ensure that employees charge time in accordance with the actual activity worked during the time period.

CHARGING AND ACCOUNTING FOR AUTHORIZED ABSENCE IS NOT ADEQUATE

RIDEM's controls over employees charging authorized absence did not ensure that costs were equitably allocated to all related activities. RIDEM's employees charged leave as a direct cost to the grant the same way they charged time for actual grant work. There were no written procedures for charging leave when employees worked on multiple activities. The common practice for employees was to charge the grant activity where most of the employees' time was previously charged or based on an established budget rate. Since a majority of the employees work on multiple activities, employees must estimate which activities to charge their leave. As a result, there was limited assurance that leave costs were equitably and consistently allocated to all activities.

Leave Costs Are Allowable If Equitably Allocated

OMB Circular A-87 provides that the cost of fringe benefits in the form of regular compensation paid to employees during periods of authorized absences from the job, such as for annual leave, sick leave, holidays, court leave, military leave, and other benefits are allowable if: (a) they are provided under established written leave policies; (b) the costs are equitably allocated to all related, including Federal awards; and, (c) the accounting basis (cash or accrual) selected for costing each type of leave is consistently followed by the governmental unit.

Our review of cost cards showed that employees charged authorized absences in the same manner in which labor was charged. The employees charged the grant and noted next to the hours charged if the hours were vacation, sick, holiday etc. The Office of Air Resources employees charged their leave based on their same budget allocation followed for labor. If the employee charged his/her labor time on a 50/50 basis, the leave costs would follow this same allocation.

The Chief of Office of Air Resources stated that there was no specific protocol on how to split leave time.

Additionally, the Deputy Chief of Water confirmed that there was no policy on how to charge leave for employees who work on multiple activities. The standard practice was for employees to charge either the current activity or estimate where the majority of their previous time was charged.

State Auditor Cites Leave Costs Not Consistently Allocated

The State of Rhode Island's Auditor General Report of RIDEM for the period ending June 30, 1996 contained the following finding:

> Costs for compensated absences (i.e. discharge of vacation, sick or personal time) are not consistently allocated. One group of employees assigns cost center codes to absences based on estimates. Costs for another group are apportioned prorata based on current charges.

In response to the State Auditor General's report on April 9, 1997, RIDEM advised that the Department, subject to funding availability, will continue to explore the procurement and implementation of an automated "image scanning" technology for payroll processing and cost allocation.

RIDEM Concurs Its Leave Policy Conflicts With A-87

On March 31, 2000, we were advised by RIDEM that it was nearing completion of a scanned personnel reporting time card that will allow for improved accountability for Federal versus State time allotment and leave structure. RIDEM further stated that it was aware that its leave policy was in conflict with OMB A-87 and acknowledged that the leave allocation policy must be worked on. RIDEM's position was that any changes must be prospective and that implementation of a tracking allocation not be burdensome. However, RIDEM believed that its administrative controls over leave charging were adequate.

Leave Policy Weakness Is A Chronic Problem

Based on the State Auditor General's finding in 1997 and our review's similar findings, we conclude that RIDEM does not have adequate controls to assure that leave costs are equitably and consistently allocated to all activities. Additionally, RIDEM has been indicating for three years that "scanning image" technology would be implemented to resolve this condition. A chronic condition such as this needs to be addressed before additional time passes. RIDEM also noted that its leave policy was in conflict with OMB A-87 but controls should not be burdensome. We concur that controls should not be burdensome, however, compliance with OMB A-87 is a required grant condition.

The current practice for charging leave may result in Federal grants being inequitably charged for leave expenses because employees charge leave based on estimates or budgets rather than on an approved and equitable allocation plan.

FRINGE BENEFIT COSTS WERE UNDERSTATED

RIDEM did not include authorized leave compensation in its fringe benefit rate, resulting in understating the actual fringe benefit costs associated with the grant. There was no way to distinguish payroll costs charged to a grant as representing compensation for the time devoted and identified specifically to the performance of the grant activities, as opposed to the fringe benefit costs of authorized leave compensation. As a result, RIDEM was not in conformance with OMB Circular A-87 requirements.

Fringe Benefits Includes Cost Of Leave

OMB Circular A-87 provides the following:

> Fringe benefits are allowances and services provided by employers to their employees as compensation in addition to regular salaries and wages. Fringe benefits include but are limited to, **the costs of leave,** employee

> insurance, pensions, and unemployment benefit plans. Except as provided elsewhere in these principles, the costs of fringe benefits are allowable to the extent that the benefits are reasonable and are required by law, governmental unit-employee agreement, or an established policy of the governmental unit.

The Assistant Administrator for Financial Management stated that costs for authorized absences were not included as part of the fringe benefit rate. This practice conflicts with A-87's definition of fringe benefit costs. Additionally, the grant application budgets will not provide EPA an accurate picture of labor charges to accomplish grant goals, since the inclusion of fringe benefit costs will distort payroll expenses. The payroll charges include both direct labor and fringe benefit costs. There is no readily accessible way for RIDEM to differentiate direct labor and fringe benefit leave expense from the grants' total payroll expenses.

CONCLUSION

RIDEM needs to address the controls in place over the charging of time and leave on employees cost cards, and the accounting for fringe benefit expense. Our current audit and the State Auditor General's report show that control weaknesses represent a chronic problem for RIDEM. These repeat conditions also demonstrate that RIDEM's actions to correct these weaknesses have not been successful. To ensure that RIDEM is charging grant costs that are equitable, reasonable and in compliance with Federal requirements, we recommend that RIDEM take the following actions to resolve these grant management weaknesses.

RECOMMENDATIONS:

We recommend that you instruct RIDEM to do the following:

3-1. Ensure that employees and supervisors follow RIDEM's policy of charging its payroll costs to actual activities by having Office of Management Service staff perform regularly scheduled quality assurance reviews of selected cost cards for compliance.

3-2. Establish administrative controls over the charging of authorized leave expenses. These controls need to assure that leave costs are equitably and consistently charged to all activities.

3-3. Establish procedures for its employees to follow when charging leave expense on cost cards. These controls should allow for a system that differentiates payroll expenses as direct labor from authorized absence fringe benefit expense; and will allow RIDEM to determine leave costs and make them part of its fringe benefit rate.

3-4. Ensure that its accounting of leave is in compliance with Generally Accepted Accounting Principles (GAAPs) regarding the recording of leave under its chosen accounting basis.

CHAPTER 4

RIDEM DID NOT CHARGE AND ALLOCATE COSTS TO THE APPROPRIATE PROGRAMS

The Office of Air Resources (OAR) did not have a system to allocate costs to allowable and unallowable programs, and Air program staff charged incorrect accounts and cost centers when traveling. Also, RIDEM charged costs to the Air and Water grants that were outside the grant period, and charged the EPA Air grants for expenses incurred to conduct lead inspections although these activities were included in a separate agreement with another Federal department. This occurred because of RIDEM's: (1) philosophy of maximizing Federal grant funds, (2) utilization of Federal funds for equipment and supply purchases, (3) response to State budget cuts, and (4) avoidance of cumbersome State regulations. As a result, computers purchased were charged 100 percent to Federal grants even though staff time was planned to be split between eligible and ineligible Federal activities; and vehicles costs were allocated to two different Federal grants even though employees were to use the vehicles to perform activities ineligible for Federal reimbursement. In addition, time and travel cost was not always appropriately charged and EPA did not always benefit from charges made to the Air grant.

Two major functions administered by the OAR were the Air Pollution Control Program (APC) and the Operating Permits Program (OPP). The APC activities were eligible for Federal reimbursement, while those activities under the OPP were not. OAR must assure that charges to the Federal Air grant were allowable, allocable, and reasonable.

The Implementation Guide for OMB Circular A-87 Section 2.10 clarifies that costs must be allocated to all benefitting activities, including those that are unallowable, as well as donated services. In addition, Section 2.11, paragraph 2-12 requires that where a cost or activity benefits multiple activities or programs, those costs must be allocated in accordance with the relative benefits received by each program or activity. This requirement is the underlying principle of cost allocation.

OMB Circular A-87 Section 11 (h)(1) states that charges to Federal awards for salaries and wages, whether treated as direct or indirect costs, will be based on payrolls documented in accordance with the generally accepted practice of the government unit. In addition, Section 3-24 of the Implementation Guide states that the timeliness of completing time and effort reports depends on the nature of the activities being reported. The Circular also requires that such reports reflect the actual activity of each employee.

CHARGES TO FEDERAL GRANTS NOT ALLOCATED APPROPRIATELY

In July 1998, the OAR purchased 21 computers. Seven were paid with State funds and the other 14 with Federal funds. We were able to locate documentation that showed the individuals to whom 19 computers were assigned. Of the 19 computers, three were assigned to individuals who were assigned 100 percent to the Air Pollution Control Program. The remaining 16 computers were assigned to individuals who, according to OAR's FY 1998 staffing plan, charged or split their time between the Lead Inspection Program, Operating Permits Program, and the Air Pollution Program.

The following schedule shows the 19 computers and the employees' planned program activities for FY 1998:

COMPUTERS ASSIGNED TO STAFF

SERIAL NUMBER	PLANNED TIME BY EMPLOYEE USING COMPUTER
6812BNT5Q645	100% LEAD INSPECTIONS
6818BNT5E088	100% PERMITS
6818BNT53030	40% PERMITS, 60% AIR
6818BNT5D944	30% PERMITS, 70% AIR
6818BNT5E090	30% PERMITS, 70% AIR
6818BNT5E127	100% PERMITS
6753BNT5P171	100% AIR
6818BNT5E031	30% PERMITS, 70% AIR
6818BNT5D546	50% PERMITS
6818BNT5E089	30% PERMITS, 70% AIR
6818BNT5E087	30% PERMITS, 70% AIR
6818BNT5E099	100% AIR
6818BNT5E125	100% PERMITS
6818BNT5D949	100% PERMITS
6752BNT5R518	100% PERMITS
6818BNT5E012	40% PERMITS, 60% AIR
6818BNT5E094	100% AIR
6818BNT5E020	30% PERMITS, 70% AIR
6818BNT5E549	50% PERMITS, 50% AIR

Since these computers were not used solely to carry-out Federally eligible activities, 100 percent of the cost should not have been charged to the Federal grant. The Chief, OAR, conceded that there was no allocation system in place that would allow the

segregation of costs between eligible and ineligible activities.

On March 31, 2000, RIDEM advised that "The purchase of the computers was based on expected percentage of time staff spends on the Federal air grant. It was expected that staff would spend about 66% on the Federal grant. EPA's analysis stated that the use was 50% on the Federal grants. DEM will continue to closely monitor computer purchases to assure actual use is within 10% of A (sic) planned use".

We believe that because RIDEM was aware of the percentage of time employees were expected to work on Federal activities, it could have allocated the computer based on this plan. In addition, even if RIDEM expected staff to spend 66 percent of their time on Federal activities, it failed to explain why it charged the Federal grant 100 percent of the costs.

Vehicles Charged One Hundred Percent To Federal Grants

RIDEM charged the cost of three vehicles to two different Federal Air grants even though the vehicles were used for various eligible and ineligible Federal Air activities. In the justification for the purchase of the vehicles, the RIDEM Associate Director wrote that "Two of the vehicles... will be used in the continued implementation of the State's Air Pollution Control Programs. These programs; currently consisting of major and minor source inspections, operating permits, air toxics, stack testing, and continuous monitoring audits, mobile sources and other related duties...." The memo also stated that the other car would be used for a new fine particulate monitoring program required by OAR's Federal grant which required the installation and maintenance of a new Statewide Air monitoring network. The memo clearly shows that use of the vehicles will benefit more than just the Federal programs, therefore, the cost should have been allocated to all benefitting programs.

The following schedule shows the cost and accounts the vehicles were charged to:

Vehicle Type	Accounts Charged	Amount	Date Paid
1998 Ford Taurus	1752-501 1752-506	$12,152.32 $ 6,835.68	09/14/98
(2) - 1999 Ford Contours	1752 -501 1752-506	$24,974.08 $14,047.95	03/08/99

1752-501 - Federal APC, 1752-506 Federal Ambient Air

The OAR started using a "vehicle sign up form" in January 1999. The form listed the make and number of the vehicle, and the days of the week. It also required employees to sign out, and document the departure and return time. We believe OAR is on the correct path by developing a sign up form. However, they need to go further by expanding the form to gather information on the purpose of the trip and the number of miles driven. This information will allow OAR to allocate future vehicle costs based on actual usage.

We also noted numerous auto maintenance charges to the Federal Air grant. The Chief, OAR stated auto maintenance was charged to whatever account a vehicle was purchased under. We believe auto maintenance charges should be allocated to the programs that use the vehicle not the program that purchased the vehicles.

On March 31, 2000, RIDEM advised that, "The Department contacted three state agencies to obtain information regarding how they allocate the expenses of vehicles purchased with Federal dollars. The system that DOT has in place utilizes a semi-monthly state vehicle distribution sheet. The data is then used to proportion the costs between Federal and state accounts. This procedure is the closest to that

suggested by the EPA. This is a full time responsibility for one FTE. (Full Time Equivalent position)".

Inconsistent Cost Centers And Accounts Charged When Staff Traveled

Air Program staff charged incorrect cost centers and accounts when they traveled. This was caused by RIDEM's practice of maximizing Federal grant funds. As a result, charges made to the grant did not always benefit the Air program, and expenses and salaries charged to the Air grant may not have always been appropriate.

Our review of the Air grants for FYs 1996, 1997 and 1998 noted many instances where employees who traveled to perform such duties as lead inspections, charged the lead inspections cost center for labor costs, but charged the Air Pollution account instead of the Lead account for travel costs. We also noted many instances where travelers, had no purpose written on their travel voucher and would either charge the Operating Permits Program cost center or split their time between Operating Permits and Air Pollution cost centers. These individuals then charged 100 percent of the travel to the Air Pollution Control Program.

The following schedule shows travel by employees and the accounts and cost centers charged:

Date of Travel	Account Charged	Cost Center Charged	Purpose of Travel
10/11-1012/95	1752-501 APC	Air Pollution Control	Lead Inspections
10/19/95	1752-501 APC	Lead	Lead Inspections
10/24/95	1752-501 APC	Air Pollution Control	Lead Inspections
11/14/95	752-501 APC	Lead	Lead Conference
11/29-30/95	1752-501 APC	Air Pollution Control	Lead Inspections
4/30/96	752-501 APC	Lead	Lead Paint Meeting
10/8-9/96	1752-501 APC	Air Pollution & Operating Permits	NESCUM Conference
11/4/96	1752-501 APC	Air Pollution & Operating Permits	NESCUM Conference
11/12/96	1752-501 APC	Air Pollution & Operating Permits	NEWMOA Conference
9/3-4/97	1752-501 APC	Operating Permits	None
09/25/97	1752-501 APC	Operating Permits	None
10/9/97	1752-501 APC	Air Pollution & Operating Permits	None

The Chief, OAR stated that he reviewed all travel vouchers to assure that the correct accounts were charged. Because of the inconsistency in accounts charged when employees traveled and the time charged on the cost center cards, management needs to develop a system to assure that employees

charge the correct accounts and cost centers when they traveled.

On March 31, 2000, RIDEM advised that, "The Chief of the OAR is responsible for assignment and requesting all out of State travel and the Chief will issue a written policy requiring all travel requirements meet Federal criteria. These breakdowns represent the need for RIDEM to strengthen its internal controls".

OAR travel policy should require that travel accounts charged are consistent with the cost centers charged for the dates of travel.

COSTS CHARGED OUTSIDE THE GRANT PERIOD

Numerous costs charged to the Air grants and the Water Performance Partnership Grants occurred outside the grant periods. This occurred because of RIDEM's policy of recording expenditures on a cash basis and untimely voucher submittals. As a result, costs were incorrectly charged to EPA grants.

Generally Accepted Accounting Principles define the cash basis of accounting as expenses recorded when cash is paid. The accrual basis is defined as recognizing expenses when they occur, regardless of when cash is disbursed.

40 CFR Part 31 Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments § 31.41(b) (2) states that each grantee will report program outlays and program income on a cash or accrual basis. In addition, §31.23 states that where a funding period is specified, a grantee may charge to the award only costs resulting from obligations of the funding period.

RIDEM's Financial Status Reports (FSRs) submitted to EPA stated that the accrual basis for accounting

was used. However, RIDEM procedures for grant accounting states, "Post expenditures directly from Controller's Statement B to accounting worksheet/ledger (Postings will include all paid vouchers)" which is the cash basis of accounting.

We found that RIDEM's Assistant Administrator for Financial Management of Management Services recorded expenditures when they were paid by the Rhode Island Controller rather than when incurred. Also, vouchers were submitted for payment from two days to over three months after the travel dates. In addition, RIDEM policy for local travel was to group travel together on a monthly basis before submission to Management Services for payment. This travel was listed under the title "Sundry Payees".

The EPA grant period was normally from October 1, to September 30 unless a grant extension had been executed. The following are the time periods for the cooperative agreements we reviewed:

Air	FY 1996 - 10/01/95 to 09/30/96
	FY 1997 - 10/01/96 to 09/30/97
	FY 1998 - 10/01/97 to 09/30/98
Water- 106	FY 1996 - 10/01/95 to 09/30/97
	FY 1997 - 10/01/96 to 09/30/00
Water - PPG	FY 1998 -10/01/97 to 09/30/99

The following illustrates Air and Water program staff travel was charged to the wrong grant:

Voucher No.	Date Traveled	Date Voucher Prepared	Date Paid	Account Charged
80734	08/3-8/31/95	09/21/95	10/11/95	FY 96 - Air
81282	09/13/95	09/15/95	10/13/95	FY 96 - Air
82245	8/3-8/31/95	9/21/95	10/18/95	FY 96- Air
32555*	09/15/97	10/14/97	10/21/97	FY 98 - Air
82384	08/2/95	8/4/95	10/19/95	FY 96 - Air
8/12/78	09/13/95	09/15/95	10/13/95	FY 96 - Air
34484*	06/18/97	10/14/97	11/21/97	FY 98 - Air
68639	08/17-24/96	08/28/96	11/1/96	FY 97 - Water
70259	06/8-12/96	06/24/96	11/13/96	FY 97 - Water
73752	09/29-10/1/96	10/3/96	12/2/96	FY 97 - Water
86358	09/18-20/96	11/24/96	1/13/97	FY 97 - Water

* Sundry Payees

We also noted instances in which costs for University of Rhode Island interns and costs for the contract with RIDOH for Air lab services were also billed to the incorrect grant.

On March 31, 2000, RIDEM advised that,"The DEM uses the State accounting system. The Department of Administration opted for a cash based rather than the generally accepted accrual system. The Controller currently does not allow a department to record charges to a grant prior to the Controller's processing payments. This causes delays of up to sixty days. Due to the accounting methods the state has chosen, the department does not concur with the comments. The Department must continue to utilize the State Accounting system. In addition the Federal A-87 gives each state the option of selecting its accounting methods".

RIDEM needs to work with the Controller's office to ensure that recording of grant costs complies with Federal requirements. Activities budgeted under a particular grant must be charged to that grant.

In addition, even though the State may use the cash basis of accounting, RIDEM did not always use the cash basis. We noted instances in which payroll was charged to the Federal grant on an accrual basis. 40 CFR part 31 requires that only one basis of accounting is used at a time not a combination of both. RIDEM needs to improve its internal controls to assure that charges made to the Federal grants represent actual costs for the grant periods.

RIDEM CHARGED EPA FOR ACTIVITIES NOT INCLUDED OR BUDGETED IN THE AIR GRANT

RIDEM charged the FYs 1996 and 1997 EPA Air grants for expenses incurred to conduct lead inspections although these activities were included in a separate agreement with another Federal department. This was caused by RIDEM's general philosophy to maximize the Federal grant. As a result, EPA was charged for activities that did not directly benefit the Air Program.

The Implementation Guide for OMB Circular A-87 Section 2.10 clarifies that costs must be allocated to all benefitting activities, including those that are unallowable, as well as donated services. In addition, Section 2.11, paragraph 2-12 requires that where a cost or activity benefits multiple activities or programs, those costs must be allocated in accordance with the relative benefits received by each program or activity. This requirement is the underlying principle of cost allocation.

OMB Circular A-87 defines a cost being reasonable when the cost is of a type generally recognized as ordinary and necessary for the operation of the

government unit or the performance of the Federal award.

In August 1995, RIDEM entered into an agreement with RIDOH for the period July 17, 1995 to June 30, 1996 in which RIDEM agreed to continue to undertake routine inspections of exterior paint removal (both proactively and in response to citizen complaints) and take appropriate enforcement action when violations were found. The Associate Director, RIDOH stated that they received funds for the lead inspections from the Federal Department of Housing and Urban Development. Lead paint activities were not included in RIDEM's FY 1996 grant application to EPA.

RIDOH supplied RIDEM with $40,000 to pay the salary of up to one full-time equivalent inspector, inspector training costs and other expenses towards fulfilling the responsibilities of the RIDEM compliance program for the Air Pollution Control Regulation No. 24. RIDOH also stipulated that the amount requested should not exceed $40,000 for the full agreement period.

The intent of RIDEM's lead removal program was to protect the public from improper removal of lead based paint by assuring that anyone, including private homeowners, who removes lead based paint does so in a manner that minimizes, to the greatest extent possible, the impact of lead paint in the environment. The program also sought to conduct public outreach to educate persons on the proper lead based paint removal methods.

In FY 1996, RIDEM expended $49,949.62 on payroll and was reimbursed for $40,000 by RIDOH. The additional $9,949.62 was billed to the FY 1996 Air grant. In addition, travel expenses incurred to perform lead inspections were also billed to the Air Grant. The Assistant Administrator for Financial

Management stated that the Chief, OAR directed him to bill any excess lead inspection expenses to the Federal grant. Although the Chief, OAR stated that his agreement with EPA allowed excess lead expenses to be billed to the Federal grant, he could not provide documentation to confirm this statement. However, the EPA project officer for Air stated that he could not recall such an agreement.

Additionally, in FY 1997, RIDEM again entered into an agreement with RIDOH for the period July 1, 1996 to June 30, 1997 to perform lead inspections. This agreement was increased to $43,500. The additional $3,500 was to be used to provide RIDEM's Division of Compliance and Inspection with a computer workstation(s) and software to develop, maintain and transmit data to RIDOH.

RIDEM expended $45,123.40 on payroll and was reimbursed for $40,000 by RIDOH. The additional $5,123.40 was billed to the Federal Air grant. In addition, travel expenses incurred were billed to the FY 1997 Federal Air grant. Also, RIDEM purchased a computer for $4,197 which was billed to the FY 1997 Air grant. The Assistant Administrator for Financial Management stated that they received the invoice too late to bill RIDOH so they instead charged it to the Federal grant. The purchase requisition for the computer was initiated in March 1997, the purchase order in May 1997 and was paid by the Controller on July 23, 1997. We believe that RIDEM had adequate time to bill RIDOH for the computer.

The EPA project officer for the Air grant was not aware that RIDEM was billing EPA for such services and equipment, and was not aware of an agreement in which EPA would be billed for expenses not covered by RIDOH.

On March 31, 2000, RIDEM advised that the FY 1997 105 Air Grant application describes the lead paint

activities of the then Division of Air Resources. The Department's position is that all charges made to the Air grant for lead paint activities in FY 1997 were proper. There was no such similar description of lead paint activities in the FY 1996 Program narrative. RIDEM further stated that lead paint activities are part of the State's Air Pollution Control Program and are related to protecting human health. Therefore, the Department believes the charges were proper.

Even though RIDEM's FY 1997 grant application included activities to protect the public from improper removal of lead based paint, we believe the FY 1996 or 1997 costs were not proper because they were incurred to fulfill the requirements of an agreement with another Federal department.

The cost incurred by RIDEM was necessary for its agreement with RIDOH not with EPA. The Air grant should not be charged for services and equipment that directly benefit another Federal department not the Air program. Ultimately, the use of Federal Air grant funds supplanted the use of State funds.

CONCLUSION

The need for RIDEM to develop a system to allocate costs to all benefitting programs is imperative because all OAR activities are not eligible for Federal reimbursement. RIDEM's philosophy of maximizing Federal grant funds for program expenses results in unnecessary charges to Federal grants that do not benefit EPA. RIDEM needs to work with EPA New England and the State Controller to ensure that Federal grants are managed in accordance with Federal requirements.

RECOMMENDATIONS

We recommend that you instruct RIDEM management to establish controls and procedures to assure that:

4-1. Costs are allocated to all appropriate programs.

4-2. Vehicle costs are allocated to all benefitting programs.

4-3. Employees consistently charge the appropriate accounts and cost centers when they travel.

4-4. Accounting and charging of costs to Federal grants adhere to OMB Circular A-87, and 40 CFR part 31.

4-5. Charges to the Federal grant are allowable per the grant agreements.

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CHAPTER 5

RIDEM COULD NOT SUPPORT THAT IT MET MATCHING REQUIREMENTS OF THE FISCAL YEAR 1996 AIR GRANT

Our review of RIDEM's FY 1996 Section 105 Air Grant revealed that RIDEM: (1) could not support it had met the minimum cost sharing requirement to be eligible to receive Section 105 Air funds; and (2) did not maintain adequate records to support expenditures claimed as its cost share. RIDEM's Assistant Administrator for Financial Management accepted costs that comprised the matching fund, at face value, without adequate documentation. As a result, there is limited assurance that the State of Rhode Island met its mandated requirement to be eligible for Federal funds. Additionally, Section 105 funds may have supplanted non-Federal funds that would be used to maintain the State's air program.

$94,280 In Matching Funds Were Unsupported

RIDEM had $94,280 (11 percent) in unsupported matching funds out of the FY 1996 match requirement of $891,204. Included in RIDEM's cost share calculation was a $25,380 rent charge from RIDOH, which had an interagency agreement with RIDEM to provide laboratory services. Neither RIDEM nor RIDOH could provide support for this charge. Additionally, RIDEM claimed $68,900 for rental space at 291 Promenade Street in Providence as contributions towards its requirement. To date, RIDEM has not provided us with support for these charges.

To be eligible to receive Federal Section 105 Air Grant assistance, the State of Rhode Island must contribute non-Federal funds in the amount of 40 percent of the total approved allowable budget award. The costs borne by the matching or cost sharing and

in-kind contributions are subject to the OMB Circular A-87 rules governing allowability.

Basic accounting controls for maintaining adequate documentation supporting claimed costs and expenses were not followed for the matching or cost sharing amount. RIDEM's Assistant Administrator for Financial Management relied solely on information provided by RIDOH without proper verification of the charge's validity.

Matching Funds Should Be Fully Documented

Grantees are required to fully document, in the grant application, the specific costs or contributions proposed to meet a matching or cost sharing requirement, the source of the funding or contribution, and how the valuation was determined. Matching or cost sharing costs must be consistent with the applicant's accounting system and any restrictions or limitations in the applicable cost principles.

Internal controls must be designed to protect resources against waste, loss, and misuse. Internal controls are safeguards built into a process or work flow to provide reasonable assurance to management that the system is working as intended and that resources are used in the most effective and efficient manner possible.

Maintenance of effort or matching requirements is generally used to refer to a statutorily specified percentage of program or project costs that must be contributed by a grantee in order to be eligible for Federal funding. This requirement may either be stated as a specified or minimum non-Federal percentage of total allowable costs or a maximum Federal percentage of participation in such costs. Grantees may not use program income or other Federal funds as a source of matching or cost sharing

in determining whether a grantee has met the required matching or cost sharing.

OMS Chief Requests Back-up Documentation

In response to this condition, RIDEM stated that the Chief, OMS contacted the Department of Administration to ascertain that space rental documents were completed and documented. Copies were requested from the Department of Administration and Department of Health.

During our audit we requested the supporting documentation for these expenses on several occasions with no success. The fact that RIDEM's OMS does not have documentation on file is indicative of basic accounting control problems within the Department.

CONCLUSION

EPA has limited assurance that RIDEM met its mandated requirement to provide State funding at the level agreed upon in the assistance agreement. Additionally, if the grantee did not provide the required funding, the State Air Program was under-funded and Federal dollars were used to supplant State funding. This is a violation of the intent of the assistance agreement. Further, the grantee could not support the utilization of certain costs included as match, which in our opinion, is a systemic problem within the grantee's accounting system and its associated internal controls.

RECOMMENDATIONS

We recommend that you instruct RIDEM management staff to implement the following:

5-1. Obtain adequate supporting documentation that supports the claimed matching costs in question.

5-2. Assure that controls over maintaining supporting documentation are reviewed for adequacy and staff are made aware of this basic requirement.

5-3. Should adequate documentation not be located for the $94,280 in unsupported costs, these costs should be considered as questioned, and RIDEM and EPA New England should recalculate the grant award based on the lower matching expense.

CHAPTER 6

RIDEM NEEDS TO ESTABLISH CONTROLS OVER GRANT COST TRANSFERS

RIDEM made substantial and frequent shifts of costs between Federal and State accounts or between two Federal grants. These transfers were necessary because RIDEM was not adequately managing the grants financially. Also, inadequate financial controls allowed RIDEM to make large transfers between accounts without first advising applicable program staff or obtaining prior management approval. As a result, RIDEM's cost accounting system was compromised in order to maximize available funding.

Grantees Are Responsible For Managing Day-to-Day Grant Operations

The Code of Federal Regulations, Part 40 provides as follows:

40 CFR Part 31.20(a)

> A State must expend and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds.

40 CFR Part 31.30(a)

> Grantees and subgrantees are permitted to rebudget within the approved direct cost budget to meet unanticipated requirements and may make limited program changes to the approved project. However, unless waived by the awarding agency, certain types of post-award changes in budgets and projects shall require the prior written approval of the awarding agency.

40 CFR Part 31.40(a)

> Grantees are responsible for managing the day-to-day operations of grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to assure compliance with applicable Federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function or activity.

This chapter will detail several of these questionable transfers.

Grant Adjustment Made Without EPA Approval

Our survey of grant management practices focused on RIDEM's closeout of the 1996 RCRA grant. In closing out this grant, three FSRs were submitted to EPA. Each of the FSRs reported different ending balances (from $98,000 to $14,000). These adjustments caused EPA New England to question the difference.

The adjustment resulted from a transfer of cost from State to Federal accounts. RIDEM effected these transfers in order to avoid having to return unused funds to the Federal Government. Also, these transfers were made without first obtaining EPA approval. RIDEM admitted to this grant violation in response to EPA New England's request for explanation of the different FSR balances.

RIDEM was able to change these costs through a paper adjustment even though the costs were properly charged to the State accounts in accordance with RIDEM's cost accounting system. Proper grant management would have identified the excess grant funds prior to the end of the grant's budget and

project end date; and would have alleviated the need to compromise RIDEM's accounting procedures.

Transfer Results In Excess Federal Funds On Hand

In June 1996, RIDEM transferred $80,000 from the 106 Water Grant to the State water account. RIDEM decided that a transfer of costs was necessary to reduce the grant by $80,000 and charge these costs to the State water account. The $80,000 were comprised of previously recorded payroll costs charged to the Federal grant. The adjustment was done during the last month of the State's fiscal year. The reason provided on the adjustment voucher, "to transfer personnel costs incurred on water resources administration to proper accounts," was not accurate since these payroll costs were originally charged to the proper account.

The Assistant Administrator for Financial Management's ability to make adjustments to grant costs, record the costs, and draw down funds represented a control weakness in RIDEM's grant management. Additionally, the Assistant Administrator for Financial Management's ability to make these changes without having a supervisor's authorization also represented a control weakness. This weakness represents a need for a segregation of duties. A segregation of duties is a basic accounting control which ensures no one employee has absolute authority over fund management. This arbitrary transfer of costs impacted the integrity of RIDEM's cost control system.

Transfer Made Without Prior EPA Approval

In order to close out the FY 1996 106 water grant, budget overruns made it necessary for RIDEM to move additional costs from one grant to another. The Assistant Administrator for Financial Management with the approval of the Chief of the Office of Water transferred $72,052 from the surface water account to the groundwater account. RIDEM completed this adjustment on March 12, 1997. On March 13, 1997 RIDEM sent EPA the FSR showing all grant funds

were expended. A letter accompanying the FSR explained that RIDEM had transferred $72,052 in eligible surface water 106 program costs to the groundwater set aside portion of the grant. RIDEM's cost reprogramming was completed prior to its advising EPA of the transfer. RIDEM acknowledged that utilizing 106 funding originally set aside for groundwater purposes to support other 106 eligible activities pertaining to surface water constituted a change in the workplan subject to pre-approval.

$300,000 Transferred To Avoid Overspending Grant

Another adjustment took place on November 6, 1997. The Assistant Administrator for Financial Management advised OWR that the 106 water portion of the PPG had overspent Federal expenditures by approximately $300,000. This resulted in numerous transfers having to be made to different accounts such as State Water Program ($26,000), Indirect Account ($100,000), Air and Water Restricted Account ($95,350), 1996 Water Quality Management ($15,894), and various water accounts such as NPS, NPDES, and Water Quality.

RIDEM's reasons for the adjustments were to adjust a grant that was being overspent, to utilize funding that would otherwise be returned to the funding agency, and to use old funding sources to close these grants. These cost transfers usually occurred at the State or Federal fiscal year ending dates, or when RIDEM needed to close a grant out.

Examples of adjustments made were as follows:

Date	Grant Reduced	Amount	Grant Increased
September 1995	1995 106 Grant	$104,711	205G Grant
June 1996	1996 106 Grant	80,000	State Water Program
March 1997	1996 Surface Water	72,052	Groundwater Set-aside
May 1997	RCRA State Match	69,547	1996 RCRA
January 1998	1997 PPG-106	12,149	1997 PPG-NPS
May 1998	1997 PPG-106	15,718	1997 PPG-Water Quality
January 1998	1997 PPG-106	100,000	Indirect Account
January 1998	1997 PPG-106	26,000	State Water
January 1998	1997 PPG-106	15,894	1996 Water Quality Mgt.
June 1998	1997 PPG-106	95,350	Air & Water Restricted Account
June 1999	1998 PPG	29,707	1995 NPS
June 1999	1995 NPS	31,033	1996 NPS
June 1999	1996 NPS	18,049	1995 NPS

RIDEM used arbitrary adjustments with inadequate explanations in order to transfer costs to maximize Federal or other available funding. This happened because RIDEM was not adequately performing day-to-day grant financial management to prevent grants from either being over or under charged. Additionally, RIDEM was not complying with Federal grant requirements to obtain EPA approval prior to adjusting grants.

These adjustments compromised the integrity of RIDEM's cost accounting system. RIDEM's ability to move payroll costs previously charged, paid and accurately recorded under the cost system to a Federal grant or to a State account via a paper transfer resulted in inaccurate back-up cost cards for

transfer resulted in inaccurate back-up cost cards for these affected employees. The cost cards may reflect the employees charged time to a Federal grant but were actually paid from a State account. This practice allowed RIDEM to utilize all Federal and State funds available through the use of arbitrary cost-shifting adjustments.

Adjustments Result In Excess Federal Drawdowns

The draw down of Federal grant funds was also impacted by these adjustments. RIDEM's practice was to draw down funds to reimburse incurred expenses. We reviewed two instances where grant funds were drawn down on incurred expenses. However, after drawing down the Federal funds, RIDEM moved costs to another grant/account resulting in having excess Federal funds on hand. The grant 1751-501 (1996 106 water grant) had approximately $70,000 in excess funds due to RIDEM reducing the grant by $80,000 through an adjustment of costs (i.e. reducing the costs previously charged to the grant). These excess funds were on hand for less than three months. The grant 1720-515 (1996 NPS) had excess Federal funds of approximately $37,000 on hand for a 12 month period. RIDEM followed procedures for drawing down funds but adjustments to incurred costs after funds were drawn resulted in RIDEM having excess Federal funds on hand.

RIDEM Asserts That EPA Approved Most Grant Adjustments

In answering our position paper on transfers RIDEM provided the following response:

> DEM disagrees with the position paper. The EPA position paper lists a number of adjustments that were made and appears to state that the adjustments made were not authorized. In the case of the June 1999 adjustments for the FY 95 NPS grant, the three adjustments correspond to actions taken at the time to close the FY 95 NPS grant. DEM specifically sought and received permission

from EPA Region 1 to execute the changes. They reflect a portion of the reprogramming that DEM has pursued as part of a two-year strategy to fully expend and close out older grants.

These June 1999 adjustments were made based on a June 30, 1999 memorandum from the Deputy Director Office of Water to the Assistant Administrator for Financial Management. This was the last day before the FSR was due to be submitted to EPA. This memo contained nine adjustments totaling approximately $113,605 out of the original grant award of $643,000. The memo noted that RIDEM received EPA verbal approval of these adjustments.

One of these adjustments necessitated the transfer of $23,101 in expenses from the 1995 NPS grant to the 1996 NPS grant. This transfer was required because RIDEM charged $23,101 in June 1999 to the 1995 NPS grant after its end date of March 31, 1999. The Office of Water advised OMS that these costs were ineligible and had OMS transfer these costs to the active 1996 NPS grant. It is questionable whether costs that are ineligible under one grant can be reprogrammed to another grant and considered eligible.

Having a grant opened four years after the grant period should have ended; making numerous adjustments 90 days after the grant ending date and on the date the FSR was due; and transferring ineligible costs under one grant to an open and active grant were examples of RIDEM's ineffective grant management controls.

CONCLUSION

The frequent, tardy and inadequately explained transfers, particularly where they involve projects with significant overruns or unexpended fund balances, raised questions about the propriety of the transfers themselves as well as the overall reliability of the grantee's cost accounting system and internal controls. RIDEM lacked effective, day-to-day grant management practices. As a result, RIDEM's cost accounting system was often compromised in order to transfer costs and RIDEM did not always follow grant requirements by obtaining EPA's approval of transfers when required.

RECOMMENDATIONS:

We recommend that you instruct RIDEM to do the following:

6-1. Require that RIDEM's project managers, budget manager, and accountant meet at least monthly to review grants status.

6-2. Ensure that adjustment vouchers provide an accurate reason for any transfer and require the Director of OMS approve all adjustment vouchers.

6-3. Require that all drawdowns from EPA be authorized by the Director of OMS.

6-4. Institute adequate controls to ensure adjustments do not compromise RIDEM's cost controls and that adjustments receive prior EPA approval, when necessary.

CHAPTER 7

CONTROLS OVER TITLE V OPERATING FEE REVENUE NEED TO BE ENHANCED

RIDEM did not maintain Title V operating permit fee revenue in accordance with the terms of the Clean Air Act. The Rhode Island legislature converted RIDEM's previously restricted accounts for operating permit fee revenue to general revenue accounts in order to maintain oversight of these accounts. As a result, unused operating fee revenue totaling $380,906 was deposited into the State's general revenue account rather than in a RIDEM restricted operating fee revenue account.

Permit Fee Revenue To Be Used Solely To Administer Title V Program

The Clean Air Act Section 502 Permit Program provides the following:

> Any fee required to be collected by a State, local or interstate agency under this subsection shall be utilized solely to cover all reasonable (direct and indirect) costs required to support the permit program as set forth in subparagraph (A).

On July 21, 1994, the Assistant Administrator for Air and Radiation issued a memorandum to the Regional Administrators regarding permit fee revenue. This memorandum provided the following definition on permit fee revenue:

> Any fee required to be collected under Title V must be utilized solely to cover the reasonable (direct and indirect) costs of the Title V program.

RI Legislature Converts Restricted Accounts To General Fund

The Rhode Island (RI) Legislature converted all restricted accounts to general revenue accounts through Article 40 of the FY 1996 Budget Bill. The State Assembly intended to maintain oversight on these former accounts. This action changed the way operating permit fee revenue was previously held in a restricted account. Staff turnover, bureaucratic problems involved in hiring new people, and some operating costs not accurately charged to the operating permit program resulted in significant amounts of unused operating permit fee revenue in FYs 1997 and 1998.

A summary of Title V operating fee revenue and expenses was as follows:

FY	Fees Received	Title V Expenses	Fee Revenue not used to run Program
1997	$ 674,981	$ 423,784	$ 251,197
1998	774,634	535,556	239,078
1999	630,986	740,355	(109,369)
Totals	$2,080,601	$1,699,695	$ 380,906

$380,906 In Unused Permit Fees Not Used On Title V Activities

For FYs 1997, 1998, and 1999 RIDEM collected a total of $2,080,601 in permit fee revenue, while expenses totaled $1,699,695. There were no unused fees generated in FY 1999 because payroll expenses increased due to hiring staff and fees to ratepayers in 1999 were reduced based on the unused fees generated in FY 1998. The legislature appropriated $2,234,989 during this period to administer the program. Of this amount RIDEM returned $535,294 to the State Controller since the funds were not

expended on operating permit activities. As a result, $380,906 in Title V operating fees were not used on Title V activities during these three years.

Enhanced Controls Over Title V Revenue Are Needed

40 CFR Part 70 provides that the revenue from operating permit fees be used solely to cover the costs of meeting the various functions of the permitting program. RIDEM management should utilize these unused fees to maintain Title V program activities. RIDEM should also establish an accounting control to reconcile Title V operating permit revenue received and expenses incurred to operate the Title V Program. This reconciliation should detail how any unused fees will be used. This reconciliation should utilize the RIDEM official books and records, and be provided to EPA Region 1 on an annual basis.

RIDEM Advises Fees Are Out Of Its Control

In response to our position paper, RIDEM officials stated that the air permit fees are out of RIDEM's control. In FY 1996, the RI General Assembly converted most restricted accounts to general revenue through legislation. One of the accounts was the Title V operating permit fee account. In FY 1997, the program ended with a $251,197 balance, which stayed in the general fund. In FY 1998, the program ended with a balance of $239,078, however, the unused fees were taken into account to reduce the ratepayer assessment in FY 1999. In the fall of 1997, the Department met with the House Finance Committee with the intention of returning the Operating Permits Program back to a restricted account. The Department agrees with EPA that a restricted receipt account system is good and will continue to pursue the legislature for approval.

CONCLUSION

We concur that RIDEM took the 1998 unused fee revenue of $239,078 into account to calculate the 1999 rate, but some of these unused funds remained in the general fund as did the 1997 used fees. Also, as required by the Title V requirements, fee revenue can only be used to support the Title V Program. The Title V Program requires that permit fee revenue is to be used solely to support Title V activities. By allowing the fees to remain in the general fund RIDEM is not administering the program in compliance with requirements.

RECOMMENDATIONS

We recommend that you instruct RIDEM to do the following:

7-1. Provide Region 1 with a plan on how these $380,906 in unused revenue will be utilized to maintain the Title V program in accordance with program requirements.

7-2. Perform an annual reconciliation of Title V Operating Permit Fee revenue and Title V program expenses utilizing the RIDEM official books and records. This reconciliation should also show how any unused revenue will be utilized.

REGIONAL RESPONSE

Region 1 in response to our draft report did not agree with our conclusions relating to Title V. The Region was satisfied that RIDEM has in place a system to account for excess fees since FY 1998 and adds that RIDEM should provide an annual accounting of fees in its Annual Report. The Region contended that during Fiscal Year 1997, EPA's policy did not clearly require funds collected in excess of program support requirements be used to support Title V activities.

Additionally, they also believed it was not appropriate to hold RIDEM to EPA's subsequent policy that all collected fees be expended on Title V activities. Additionally, the Region felt that there is no Federal mandate that required Rhode Island to maintain a restrictive account to ensure Title V revenues were only available for Title V activities.

OIG EVALUATION

We disagree with Region regarding the $251,197 in FY 1997 Title V unused revenue. We found that Agency policy was very clear relating to the use of Title V revenue. Agency policy, the Clean Air Act and CFRs all contain language that the revenue received will be used **solely** for the Title V activities. A July 21, 1994 memorandum from the Assistant Administrator for Air and Radiation to all the Agency Regional Administrators clearly sets EPA policy regarding Title V revenues. It states: "Any fee required under Title V must be utilized solely to cover reasonable (direct and indirect) costs of the Title V program." In addition, a June 2, 1994 memorandum from the Associate General Counsel Grants and Intergovernmental Division to the Agency's General Counsel stated: "Title V requires that any such permit fees collected by the state be utilized solely to cover all reasonable costs...EPA regulations likewise require that States demonstrate that Title V permit fees are used solely to cover the costs of the permitting program."

Additionally, RIDEM's Air Pollution Control Regulations for Operating Permit Fees provides that: "The Department will deposit all fees required by this regulation in the Clean Air Operating Permit Fee Fund. The fund shall be non-lapsing and shall be dedicated solely for use by the Department in administering the operating permit program...." RIDEM's own program regulations clearly required that fees be used only for its Title V activities. The Regions monitoring of the RIDEM FY 1997 operating

permit program cited provisions of the Clean Air Act stating that "any fee required to be collected by a state ... agency ... be utilized solely to cover all reasonable (direct and indirect) costs required to support the permit program." This monitoring report found excess fee revenue at the end of FY 1997 which was necessary to support the FY 1997 and 1998 programs spent on non-Title V activities.

Regarding the State of Rhode Island Legislature's decision to abolish the restricted account previously utilized to account and control Title V fee revenue, we concur that there is no Federal requirement to mandate the Rhode Island Legislature to re-establish the restricted account. However, both RIDEM and EPA Region 1 concur that such a restricted account would be good for the program's administration. The RIDEM regulations currently provide for such a restricted account. This account would alleviate the need for the Air Program and the Office of Management Services to conduct the planned annual reconciliations.

In lieu of a restricted account, we concur that an annual accounting of fees and diligent oversight by the Region would be desirable. It is important to note, based on our review of fee revenue received and expenses incurred for FYs 1997,1998 and 1999 there was $380,906 in fee revenue which has not been used on Title V activities. RIDEM should reconcile the fee revenue initially in order to establish a base for its future reconciliations. This fee revenue needs to accounted for and utilized solely on the Title V Program.

APPENDIX 1

REGIONAL RESPONSE

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
REGION 1
1 CONGRESS STREET, SUITE 1100
BOSTON, MASSACHUSETTS 02114-2023

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OFFICE OF THE
REGIONAL ADMINISTRATOR

MEMORANDUM

DATE: June 29, 2000

SUBJ: Grant Management Practices of Rhode Island
Department of Environmental Management
Audit No. 1999-222

FROM: Mindy S. Lubber
Regional Administrator

TO: Paul D. McKechnie
Divisional Inspector General
Eastern Audit Division

This is in response to your memorandum of May 18, 2000. We appreciate the opportunity to review the subject draft report concerning the Grants Management Practices of the Rhode Island Department of Environmental Management (RIDEM). Your memorandum requested a review of the draft report that addressed its factual accuracy and any policy implication of the recommendations. You also asked that we include plans for taking corrective actions as recommended with specific milestone dates.

My staff has reviewed the report and met with the RIDEM on June 8, 2000. During our meeting, it became evident that most of the recommendations were accurately stated and acceptable to both EPA and the RIDEM. The RIDEM has agreed to draft a detailed corrective action plan in conjunction with our RI State Program Unit that will address each of the recommendations listed in Chapters 3-6 in the draft. It is our intention to incorporate specific Milestone dates into the plan. We expect to receive a draft plan from the RIDEM by July 31, 2000. We also expect to finalize the plan and begin its implementation before September 1, 2000.

As part of our monitoring process, we would like your help in reviewing the progress that the RIDEM is making in meeting the objectives of our proposed corrective action plan.

Your recommendation in Chapter 3 outlined the need to establish administrative control over leave expenses. Our Grants Office will provide the RIDEM with referrals to other similar state agencies in New England to identify the best method for allocating authorized leave to ensure equitable charging to EPA grants.

Help us serve you better. If you need to call us regarding this correspondence in the future, please reference 01-0000310.

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During our discussions regarding the recommendations outlined in Chapter 5, the RIDEM feels that they will be able to provide the supporting documents needed to resolve Recommendation 5-1 that deals with a shortfall in the matching requirements for the section 105 grant. Hopefully this information will negate the need for any grant reductions for the FY 96 grant period.

Concerning your recommendations in Chapter 7, no state is mandated under the Clean Air Act (CAA) to have a separate fund to account for Title V fees. Therefore, there is no legal requirement to mandate that the Rhode Island Legislature establish a restricted account for receipt of operating permit fee revenue. We can recommend to Rhode Island that a separate account is desirable as a policy matter, but we cannot require it. Since the beginning of 1998, we believe that the RIDEM has had in place a system in which the amount of Title V fees collected is expended on Title V activities. The RIDEM has stated to us that if it does not expend all Title V monies in a given year, those unexpended monies are included in the budget allocation for the following year and the Title V fees charged are correspondingly reduced. Therefore, it appears as if RIDEM has put in place an adequate process to manage the Title V program.

It is a requirement of the CAA that the Title V program generate sufficient funds to support itself. In FY 97, EPA's policy did not clearly require funds collected in excess of program support requirements be used to support Title V activities for the next fiscal year. Subsequently, EPA's interpretation of section 502(b)(3) of Title V of the CAA clarified that revenue generated from the operating permit program be used only for Title V activities, even revenue in excess of program costs. Because EPA policy on use of excess Title V fees was not yet set in 1997, it is not appropriate for FY 97 to hold RIDEM to EPA's subsequent position that all collected fees must be expended on Title V activities.

Since FY 98, RIDEM claims that it has used the unexpended funds to reduce fees required to adequately support the Title V program in the following year. Consequently, the operating permit budget consists of fees collected at a reduced amount plus unexpended funds. We believe this is an appropriate approach but will recommend that RIDEM provide each year an adequate accounting of the fees received and expended. RIDEM could provide this accounting in its annual report of the Operating Permit Program or some other mechanism, so long as the accounting is made available to EPA NE and the public. This will ensure, in the future, RIDEM is requiring all fees collected be used on the Title V program and that any excess permit fee revenue not be applied elsewhere.

If you have any questions regarding our response, please call George Mollineaux our Audit Coordinator at 617-918-1936.

cc: Fred Vincent, Associate Director, Bureau of Policy and Administration, RIDEM
Robert Mendoza, Rhode Island State Program Manager, EPA NE

Help us serve you better. If you need to call us regarding this correspondence in the future, please reference 01-0000310.

APPENDIX 2

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