



U.S. Department of Agriculture
Office of Inspector General
Washington, D.C. 20250



DATE: September 14, 2010

REPLY TO
ATTN OF: 08703-0001-SF(3)

TO: Thomas L. Tidwell
Chief
Forest Service

ATTN: Donna M. Carmical
Chief Financial Officer

FROM: Gil H. Harden /s/
Assistant Inspector General
for Audit

SUBJECT: Recovery Act – Review of Wood-to-Energy Projects (3)-State of Washington

The American Recovery and Reinvestment Act of 2009 (Recovery Act) included \$1.15 billion in funds for the Forest Service (FS) to implement projects that directly accomplish its mission of sustaining the nation's forests and grasslands, creating jobs, and promoting U.S. economic recovery. In passing the law, Congress emphasized accountability for and transparency of funds spent through the Recovery Act. To accomplish this, the Office of Management and Budget (OMB) issued guidance in February 2009 that requires Federal agencies to establish internal controls, oversight mechanisms, and other approaches to meet the Recovery Act's accountability objectives. The Director of FS' Acquisition Management is responsible for implementing processes to ensure the agency complies with the Recovery Act and OMB's related guidance. In general, the Recovery Act requires the Department of Agriculture's (USDA) Office of Inspector General (OIG) to oversee FS' (and other agencies') activities to ensure Recovery Act funds are spent in a manner that minimizes the risk of improper use.

The Recovery Act authorized \$500 million for Wildland Fire Management, of which up to \$50 million was made available for wood-to-energy grants. These grants promote increased utilization of biomass¹ from Federal, State, and private lands. As of June 2009, \$49 million was obligated for 23 wood-to-energy grants. In February 2010, as part of USDA OIG's continuing oversight of the Recovery Act activities, we initiated a review of a grant which funded the site preparation and construction of a combined heat and power facility. The grant recipient passed² the funds to a sub-recipient, who owns and operates the project. The grant is administered by the

¹ Biomass is the by-product of restoring and reducing hazardous fuels, including trees and woody plants.

² Code of Federal Regulations, 7 CFR 3016.3, dated January 1, 2001, states that a sub-recipient is accountable to the grant recipient for the use of the funds provided.

FS Pacific Northwest Region and was randomly selected for review using a statistical sample. As of January 2010, the grant recipient received \$3.9 million of the \$4 million grant award. The objective of our review was to determine if the grant recipient complied with applicable laws and regulations pertaining to the Recovery Act. We found that the grant recipient did not maintain the required documentation necessary to support payment requests. Accordingly, we are questioning the entire \$3.9 million disbursed. This report is one in a series of reports pertaining to wood-to-energy grants. The issues below, along with any others identified, will be compiled into a final report at the conclusion of our audit.

Source Documentation Was Not Obtained

The grant recipient submitted three payment requests, totaling \$3.9 million, without source documentation to support expenditures. Instead of requiring source documentation from the sub-recipient, the grant recipient relied on estimated costs provided by the sub-recipient to support payment requests. Without the required documentation, we were unable to verify that expenditures matched payment requests. Due to the lack of documentation, we are questioning the entire \$3.9 million in disbursements.

Federal regulations require that grant recipients and sub-recipients maintain records that adequately identify the source and application of funds provided for financially-assisted activities.³ Also, expenditures must be supported by source documentation, such as cancelled checks, paid bills, payrolls, time and attendance records, and contract and sub-grant award documents.⁴

A grant recipient official informed us that the project was originally submitted as an earmark. In his opinion, he did not have to support actual costs as long as funds were used towards the overall project. An ‘earmark’ is a legislative provision that directs money to a specific project. However, under the Recovery Act, funds directed to a project must be used in accordance with the terms of the grant agreement. Furthermore, the FS Program Manager stated that he relied on the grant recipient coordinator,⁵ instead of the grant recipient, to properly administer the grant and was unaware that the grant recipient was not in compliance with Federal regulations. If FS had properly maintained an ongoing assessment of project activities, as required by the *Forest Service Handbook*,⁶ it would have been able to ensure the grant recipient had the required documentation available.

In addition to the grant recipient not obtaining the required source documentation, we found that pre-award costs were not supported, payment requests were not based on actual work completed, and costs were not within the original scope of the project.

³ Code of Federal Regulations 7 CFR 3016.20(b)(2), dated January 1, 2001.

⁴ Code of Federal Regulations 7 CFR 3016.20(b)(6), dated January 1, 2001.

⁵ The grant recipient coordinator is a National Resource Conservation Service employee who works with the grant recipient as a technical advisor.

⁶ The FS Handbook requires that the Program Manager maintain an ongoing, periodic assessment of current and cumulative project activities for the grants, which includes reviewing and ensuring financial compliance with the terms of the instrument and Federal law (FS Handbook 1509.11 Chapter 15.6).

Unsupported Pre-award Costs

On August 21, 2009, the grant recipient submitted a request for reimbursement of \$1,653,515⁷ for pre-award costs, consisting of research and design (\$750,000), equipment (\$779,900), and construction (\$123,615) costs that occurred between April 1, 2009, and August 21, 2009. Federal regulations require that costs be supported by source documentation.⁸ However, we found that the grant recipient was unable to provide us with the required source documentation to support the costs.

In March 2010, we requested source documentation from the recipient to ensure the \$1.65 million reimbursement was in accordance with the terms of the grant agreement. The recipient provided estimates and invoices from the sub-recipient that they relied on as justification to support the costs; however, the grant recipient could not verify that these expenses had been paid. After multiple requests, the recipient was unable to provide source documentation that would provide reasonable assurance that the funds were used for the purposes identified in the grant.

We also had additional concerns regarding the research and design costs for development and testing of the sub-recipient's new technological application of wood burning principles.⁹ The FS grant agreement allows the grant recipient to claim reimbursement for pre-award costs only if these costs were incurred on or after April 1, 2009.¹⁰ The grant coordinator provided a spreadsheet which indicated that 6,090 hours were billed for research and design at a rate of \$90 per hour (\$548,100), and the remaining \$201,900 was used to purchase materials. The spreadsheet did not contain the date of the work completed, justifications for the hourly rate, the types of materials purchased, dates of purchases, number of employees working on the project, or any payment information. Without the required source documentation to determine the number of employees working on research and design, we were unable to verify whether the sub-recipient's labor hours occurred on or after the allowable pre-award cost date of April 1, 2009.

The FS Program Manager stated that to justify the approval of the payment, he only matched the original budget amount submitted by the grant recipient for research and design with the amount requested for the research and design budget category. He did not require documentation from the recipient to support the research and design costs and was unaware of how many labor hours had been charged to research and design. He concurred that the number of labor hours should be questioned to see if they were incurred before the allowable pre-award cost date.

Payment Requests did not Reflect Work Completed

On September 21, 2009, the grant recipient submitted a request for an advance of \$1,656,225,¹¹ and on December 29, 2009, the grant recipient submitted an additional request for reimbursement for \$591,902.¹²

⁷ According to I-WEB Grant and Agreements "Disbursement Details", FS paid this amount to the grant recipient on September 2, 2009.

⁸ Code of Federal Regulations 7 CFR 3016.20(b)(6), dated January 1, 2001.

⁹ Code of Federal Regulations 7 CFR 31.205-25(a)(1), dated January 1, 2001, states the costs of developing and deploying new or improved materials, systems, processes, methods, equipment, tools and techniques that are or are expected to be used in producing products or services, are allowable.

¹⁰ Grant Agreement number 09-DG-11060489-067, Grant Application Section C, dated August 11, 2009.

¹¹ According to I-WEB Grant and Agreements "Disbursement Details", FS paid this amount to grant recipient on September 25, 2009.

In each request, the funds were for construction and other expenses associated with the project. According to Federal regulations, payments are to be based on the actual cash disbursements.¹³ In addition, the grant agreement states that if the recipient receives an advance payment and subsequently requests another payment, then the recipient's request must clearly demonstrate that the previously advanced funds have been fully expended before FS can approve another request for payment.¹⁴ However, we found that the work performed onsite did not match the payment requests, and that the advance payment was not fully expended prior to a subsequent payment request being approved.

To support the two payment requests, the grant recipient used estimates provided by the sub-recipient. The estimates for the construction costs included the installation of a wood-burning system and the pouring of concrete for the installation. When we performed a site visit on March 16, 2010, we found that the construction of the wood-burning system was not completed and the concrete had not been poured. The grant recipient acknowledged that not all the work was completed, due to delays in construction.

We also found that the advance payment was not fully expended prior to FS approving a subsequent reimbursement request. The FS Program Manager stated that to ensure that the advance was fully expended, he called the grant coordinator and received a verbal confirmation that the work was completed. Since the payment approval process was based on the grant coordinator's verification, the FS Program Manager approved the subsequent payment. The incomplete work and non-liquidated advance resulted in excess funds. The grant recipient confirmed that as of March 15, 2010, the sub-recipient had excess Recovery Act funds of \$307,490 in its operating account.

Costs Were Not Within the Original Scope of Project

The project was divided into four-phases. In phase-one, site planning, obtaining permits, construction of a wood-burning system, and the acquisition of biomass fuel were to be completed. The grant agreement explicitly states that the requested Recovery Act funding will be used to complete phase-one of the project;¹⁵ however, we found that the expenditures went beyond the original scope of work outlined in the grant agreement and funds were used to pay for multiple phases of the project.

In November 2009, the sub-recipient purchased a saw mill that was not scheduled to be purchased until a later phase of the project. Instead of using the Recovery Act funds to meet phase-one goals, as intended, the sub-recipient used the funds to get the sawmill operational. The grant recipient submitted the September 21, 2009, advance request and the December 29, 2009, reimbursement requests, even though the expenditures were not within the original scope of the grant. The grant recipient elected not to modify the existing agreement, even though funds were used for other phases of the project.

¹² According to I-WEB Grant and Agreements "Disbursement Details", FS paid this amount to grant recipient on January 14, 2010.

¹³ Code of Federal Regulations 7 CFR 3016.21(c)-(e), dated January 1, 2001.

¹⁴ Grant Agreement number 09-DG-11060489-067, Section M dated August 11, 2009.

¹⁵ Grant Agreement number 09-DG-11060489-067, Grant Application Section I "Project Description", dated August 11, 2009.

The FS Program Manager was unaware of the acquisition of the saw mill and the deviation from the original plan. He relied on the grant recipient coordinator to properly administer the grant and be forthcoming with any new developments on the project. According to the *Forest Service Handbook*, if the recipient proposes a change of scope to the award, then a written modification request from the grant recipient is required, with a revised budget outlining the changes.¹⁶ The reason for any deviation from the budgeted amount to the actual amount spent should be documented to ensure that the use of funds is transparent. When we discussed these issues with the FS Program Manager, he concurred with our assessments.

According to an FS Washington official, the requirements to verify expenditures before processing payment requests are cited in OMB circulars and are incorporated into every FS grant agreement by reference. Our review of the relevant OMB circulars¹⁷ noted that grant recipients are not required to submit documentation to support its payment requests. However, the FS Program Manager, who is responsible for reviews of payment requests, has the authority to request supporting documentation from a grant recipient to support any expenditure.

We recommend that FS (1) obtain the required documentation from the grant recipient to verify the expenditures match the payment requests; (2) verify that the expenditures charged to the grant are allowable, and, if not, recover the money paid to the grant recipient; (3) recover any excess Recovery Act funds on hand; (4) calculate and recover the interest received on excess Recovery Act funds on hand; and (5) ensure that recipient expenditures are limited to phase-one of the project.

Please provide a written response within 5 days that outlines your corrective action on this matter. If you have any questions, please contact me at (202) 720-6945, or have a member of your staff contact Steve Rickrode, Director, Rural Development and Natural Resources Division, at (202) 690-4483.

¹⁶ FS Handbook 1509.11 Chapter 25.

¹⁷ OMB Circular A-102 Grants and Cooperative Agreements With State and Local Governments (10/07/1994); OMB Circular A-110 Uniform Administrative Requirements for Grants and Other Agreements with Institutions of Higher Education, Hospitals and Other Non-Profit Organizations (11/19/1993).

USDA'S

FOREST SERVICE

RESPONSE TO AUDIT REPORT



File Code: 1430-1

Date: September 30, 2010

Route To:

Subject: Response to Audit Report No. 08703--0001-SF(3) Recovery Act - Review of
Wood-to-Energy Projects (3) - State of Washington

To: Gil H. Harden, Assistant Inspector General for Audit

This letter is in response to the Audit Report No. 08703-0001-SF (3) "Recovery Act – Review of Wood-to-Energy Projects (3) - State of Washington received on September 14, 2010 from the US Department of Agriculture Office of the Inspector General (OIG). The response for each recommendation is the following:

OIG Recommendation #1: Obtain the required documentation from the grant recipient to verify the expenditures match the payment requests.

Forest Service Response: The Forest Service agrees with this recommendation. The FS Program Manager contacted the grant recipient, Upper Columbia RC&D, and requested required documentation. Forest Service will verify the expenditures match the payment request by October 15, 2010.

OIG Recommendation #2: Verify that the expenditures charged to the grant are allowable, and, if not, recover the money paid to the grant recipient.

Forest Service Response: The Forest Service agrees with this recommendation. The FS Program Manager will review all expenditures and verify allowable costs to the grant by October 30, 2010, and will recover funds if appropriate.

OIG Recommendation #3: Recover any excess Recovery Act funds on hand.

Forest Service Response: The Forest Service agrees with this recommendation. The grant recipient does not have any excess funds on hand. However, upon review of expenditures, if Forest Service determines that any funds need to be recovered, the FS will initiate collection by October 30, 2010.

OIG Recommendation #4: Calculate and recover the interest received on excess Recovery Act funds on hand.

Forest Service Response: The Forest Service agrees with this recommendation. Upon review of timeliness of expenditures incurred, if it is found that interest was accrued by the grantee, the FS will initiate collection by October 30, 2010.

OIG Recommendation #5: Ensure that recipient expenditures are limited to phase-one of the project.

Forest Service Response: The Forest Service agrees with this recommendation. A modification to the original grant was approved on June 2010. This modification allows the grant recipient to perform work on all phases (phase 1, 2, 3) of the grant (See Enclosure A).



If you have any additional questions, please contact Donna Carmical, Chief Financial Officer, (202) 205-1321, dcarmical@fs.fed.us.

/s/ Donna M. Carmical
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