



United States Department of Agriculture
Office of Inspector General
Washington, D.C. 20250



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AUDIT
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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: Grant Recipient Had Inadequate Controls to Account for Its Recovery Act Grants – The Recovery Act - Forest Service (FS) Hazardous Fuels Reduction and Ecosystem Restoration on Non-Federal Lands (10)

The American Recovery and Reinvestment Act of 2009¹ (Recovery Act) provided the Department of Agriculture (USDA) with \$28 billion in funding, \$1.15 billion of which was allotted to the Forest Service (FS) to implement projects that accomplish its mission of sustaining the nation's forests and grasslands, creating jobs, and promoting U.S. economic recovery. FS' Wildland Fire Management (WFM) program was allocated \$200 million² in grant funding for FS to implement activities on State, county, and private lands.³ FS implements this program to operate projects with State, local and Tribal governments, and non-profit organizations that submit grant proposals to FS. FS approved 152 WFM projects on non-Federal lands from May through September 2009, including a project to perform hazardous fuels treatments on non-Federal lands in the Lake Tahoe Basin. FS awarded a \$3.6 million Recovery Act grant to the Nevada Fire Safe Council (the Council) to implement this project.

¹ Public Law 111-5, February 17, 2009.

² This amount excludes \$50 million designated for non-Federal wood to energy grants.

³ These activities include hazardous fuels reduction, forest health, and ecosystem improvements.

Congress, in enacting the Recovery Act, emphasized the need for accountability and transparency in the expenditure of funds. Further, in February 2009, the Office of Management and Budget (OMB) issued initial guidance that required Federal agencies to establish rigorous internal controls, oversight mechanisms, and other approaches to meet the accountability objectives of the Recovery Act.⁴ OMB issued additional guidance in April 2009 to clarify existing requirements and establish additional steps to facilitate accountability and transparency. Moreover, OMB emphasized that, due to the unique implementation risks of the Recovery Act, agencies must take steps, beyond standard practice, to initiate the additional oversight mechanisms.⁵ The USDA's Office of Inspector General (OIG) was charged with overseeing FS and other agencies' activities in order to ensure Recovery Act funds are spent in a manner that minimizes the risk of improper use.

In July 2011, we reviewed a hotline complaint alleging that the Council was not conducting a fair and competitive bidding process when hiring contractors to perform the work related to the Recovery Act grant agreement, and that certain bids were being saved for local fire departments, who were charging excessive prices to perform hazardous fuels treatments on non-Federal lands in the Lake Tahoe Basin. Our review of the complaint concluded that the Council had awarded contracts associated with the Recovery Act grant in a non-competitive manner. However, we are still reviewing the complaint to determine whether excessive prices were charged due to the lack of competition. We will be reporting our final conclusions regarding the complainant's allegations in our final report.

During our review of the hotline complaint, we found that the Council did not properly account for the grant funds FS awarded, including the \$3.6 million Recovery Act grant and also a \$6.2 million non-Recovery Act grant (a total of \$9.8 million in Federal funds).⁶ Funds from these (and other) Federal grants were commingled with the Council's own funds and used to pay unauthorized expenses. Federal regulations prohibit the commingling of Federal grant funds with funds from other sources, and require grant recipients to maintain separate accounting over grant funds to ensure the funds are used for authorized purposes only.⁷ Further, we found that the Council's executive director was handling all aspects of transactions involving the grants (i.e., receiving the funds, depositing the funds, and disbursing the funds), although Federal regulations require key accounting functions to be segregated to reduce the risk of error and fraud.⁸ Additionally, we also found that the Council was routinely requesting reimbursements for expenses it had not yet paid. Finally, we found that the Council had not been audited, as required by Federal regulations, since 2006.⁹

⁴ OMB M-09-10, *Initial Implementing Guidance for the Recovery and Reinvestment Act of 2009*, February 18, 2009.

⁵ OMB M-09-15, Updated OMB M-09-10, *Initial Implementing Guidance for the Recovery and Reinvestment Act of 2009*, April 3, 2009.

⁶ The non-profit was awarded two FS grants: the non-Recovery Act grant for \$6.2 million in February 2009 and the Recovery Act grant for \$3.6 million in July 2009.

⁷ OMB Circular A-110, *Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and other Non-Profit Organizations*, September 30, 1999.

⁸ OMB Circular A-133, *Compliance Supplement*, Part 6, March 2009.

⁹ OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, June 26, 2007, states, "Non-federal entities that expend more than \$500,000 or more in a year in Federal awards shall have a single or program-specific audit conducted in accordance with the provision of this part."

Even though the FS grant agreement stated the Council was subject to a number of specific OMB requirements, the executive director maintained that he was unaware of these requirements. He also attributed the failure to complete the required audits as an oversight. We were able to obtain only limited information from the executive director regarding his grant accounting practices because he left the Council soon after we began our review. Considering the magnitude of the control deficiencies noted during our review, we questioned the Council's ability to properly account for the FS grant funds that it was awarded since 2009. Of the \$9.8 million FS awarded to the Council, it received \$3.6 million of Recovery Act funds and \$2.65 million of non-Recovery Act funds (a total of \$6.25 million) as of the date of this Fast Report. So far, we are questioning \$2.7 million of the Recovery Act-funds the Council received as unallowable. Although subject to the same control deficiencies, we have yet to review the FS non-Recovery Act grant. We are reporting this issue in a Fast Report so that FS is timely notified of the problem and can take immediate action to correct it. This issue, along with other issues identified, will be consolidated into a final report at the conclusion of our fieldwork.

Federal regulations require recipients to properly account for the receipt, obligation and expenditure of Federal grant funds. Federal regulations also require that key accounting functions be segregated among different people to reduce the risk of error and fraud. Finally, Federal regulations require that recipients funded on a reimbursement basis pay their grant-related expenditures before requesting reimbursements from the Federal awarding agency and that non-Federal entities expending more than \$500,000 in Federal funds be audited annually.¹⁰

The following describes in more detail the control deficiencies we found during our review of the recipient's Recovery Act grant:

Council Commingled Recovery Act Grant Funds with Other Funds

Commingling is the act of mixing funding belonging to one grant with the funds belonging to another grant or funding source and is prohibited by OMB.¹¹ Grant recipients are required to maintain records which identify the source and use of funds provided for each grant-funded activity. These records must contain information documenting each grant's authorizations, obligations, unobligated balances, assets, liabilities, expenditures, and income. In addition, OMB issued Circular 09-15 in April 2009, specifically directing grant recipients to separately identify the source and use of Recovery Act funds, and prohibiting grant recipients from comingling Recovery Act funds with other Federal funding.¹² Further, Federal regulations specify that grant recipients must implement effective internal controls to ensure Federal grant

¹⁰ OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, June 26, 2007.

¹¹ Federal regulations have defined commingling as depositing or recording funds in a general account without the ability to identify each specific source of funds for any expenditure. Grant funds can only be consolidated with other Federal, State, local, and private funding sources if there is a clear audit trail linking expenditures to the applicable Federally-awarded funds.

¹² OMB Circular 09-15, *Updated Implementing Guidance for the American Recovery and Reinvestment Act of 2009*, April 3, 2009.

funds are used only for authorized purposes and that expenditures financed with Federal funds are properly charged only to those projects supported by the grant.¹³

The Council did not properly account for its FS Recovery Act grant funds, but, instead, commingled \$2.7 million of the \$3.6 million in FS Recovery Act grant funds it received with funds it received from other sources. Essentially, the Council treated the FS Recovery Act grant funds as simply another income source and used the funds to pay a variety of expenses, rather than separately identifying and tracking the source and use of the FS grant funds as required. As a result, the Council may have used \$2.7 million of the FS Recovery Act grant funds to pay for non-Recovery Act costs, during the 2-year period we reviewed.

Commingled costs cannot be charged to Federal grants because it reduces or eliminates a grant recipient's ability to identify which portion of the commingled costs relate to authorized grant work and which do not. It also results in unallowable costs being charged to FS grants. For example, the Council received \$800,188 from its \$3.6 million FS Recovery Act grant in January 2011. Under OMB rules, the Council was required to use that money solely to pay for authorized expenses incurred while performing Recovery Act grant work. However, the Council only used \$95,578 of the \$800,188 it received in January 2011 to reimburse legitimate grant expenses, and deposited the remaining \$705,611 into an account that commingled funds from both the Recovery Act grant and other Federal grants. Over a 2-year period, the Council deposited \$2.7 million of the FS Recovery Act grant funds it received into the commingled account. The Council did not identify the source of the funds once they were deposited into the account; it simply lumped all the funds together. The Council then used the money in the account to pay various expenses, such as rent, utilities, and other non-FS grant costs, even though none of the costs were authorized by the FS Recovery Act grant. As a result of the Council's commingling practices, it was not readily apparent which portion, if any, of the \$2.7 million was actually used to pay authorized Recovery Act grant expenses. Without the proper support for the expenditures charged to the FS grants, we are questioning the entire \$2.7 million of Recovery Act grant expenses as unallowable.

We further determined that the Council's commingling activities were exacerbated by the fact that it routinely, and inappropriately, requested FS Recovery Act grant "reimbursements" for expenses it had not yet paid. The Council was subject to the requirements of OMB Circular A-133, which specified that grant recipients can only be reimbursed for costs they have already paid.¹⁴ On every reimbursement request we reviewed, the Council certified that it had already paid the expenses for which it was claiming reimbursement when, in fact, it had not. Upon receiving these "reimbursements," rather than immediately utilizing the funds to pay for authorized Recovery Act grant expenses, the Council's executive director deposited the Recovery Act grant funds into the commingled account and used them to pay unauthorized expenses associated with other, non-FS grants.

¹³ 7 CFR Part 3015, *Uniform Federal Assistance Regulations*, October 18, 2007.

¹⁴ OMB Circular A-133, *Compliance Supplement*, Section 3-C-1, March 2011, states, "When entities are funded on a reimbursement basis, program costs must be paid for by entity funds before reimbursement is requested from the Federal Government."

We discussed the commingling with the Council's Board of Directors, who asserted that they had no knowledge of the commingling because the Council's executive director, who no longer works for the Council, had been solely responsible for managing the Council's finances. The Board acknowledged that commingling Federal funds was not acceptable and expressed their intention of immediately strengthening their internal accounting controls to correct the deficiency.

Council's Key Accounting Duties Not Properly Segregated

OMB requires that non-Federal entities receiving Federal awards establish and maintain internal controls designed to reasonably ensure compliance with Federal laws, regulations, and program compliance requirements.¹⁵ A fundamental element of internal control is the segregation of key duties, so that one single individual does not have the ability to make accounting errors (either intentionally or unintentionally) and to also cover them up. The absence of properly segregated duties is commonly cited as the primary factor that allows fraud to occur.

The Council did not properly segregate key accounting duties and responsibilities among different people to reduce the risk of error or fraud, but instead allowed a single individual, the executive director, to control virtually all aspects of its various internal accounting functions. As a result, the Council's use of Federal funds, including FS Recovery Act grant funds, was subject to an increased risk for fraud and abuse. Although nothing has come to our attention at this time to indicate that fraud actually occurred, our review of the Council's financial accounting practices is still ongoing.

During our review of the Council, we determined that the executive director had the ability to perform most of the organization's key accounting functions, with little or no separation of duties, or independent verification and oversight. For example, the Council's executive director had the authority to:

- Access blank checks, sign the checks, and record the checks.
- Initiate purchases for goods and services, valued up to \$25,000; approve the purchases; and receive the goods and services without any other person verifying the purchase amounts were accurate, allowable, and represented legitimate purchases.
- Deposit and remove Federal funds from grant accounts without any higher level authority knowing the amounts were being removed or for what purpose.
- Control the Council's payroll function, giving the executive director the ability to adjust salary amounts or overtime without any higher level oversight or approval.

¹⁵ 2 CFR Part 215, *Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations*, September 30, 1999, and OMB Circular A-133, Part 6, *Internal Controls*, March 2011.

- Prepare, review, and approve Federal grant reimbursement requests, which gave the executive director the ability to submit incorrect, mischaracterized, inflated or false expenses.
- Resolve any discrepancies that occurred between the Council's records and those of its independent bookkeeping service.

When we asked the Council's Board of Directors why key duties had not been properly segregated, they explained that the organization had grown considerably in size and complexity over the last several years and that the Council's financial procedures had not kept pace with those changes. The Board agreed that it was their responsibility to implement effective internal controls and stated their intention to immediately update the organization's policies and procedures to include separation of key functions and responsibilities. The Board also stated their intention of hiring an independent accounting firm to assist in the future management of the Council's Federal grants. The Council's plans to segregate duties should improve its oversight of future Federal grant transactions.

Council Did Not Obtain Required A-133 Audits

As a condition of receiving Federal awards, non-Federal entities agree to comply with laws, regulations, and the provisions of contract and grant agreements, and to maintain internal controls that provide reasonable assurance of compliance with these requirements. Audits are a primary tool Federal agencies use to ensure that grant funds are used properly. OMB Circular A-133 and other Federal issuances require that all non-Federal entities that expend \$500,000 or more of Federal grant funds in any given year obtain an annual audit.¹⁶ Under OMB Circular A-133, grant recipients are required to hire independent auditors to review and test their organization's internal controls and financial processes to ensure the recipients are complying with all Federal requirements and properly accounting for Federal grant funds.

We determined that the Council annually expended millions of dollars of Federal grant funds, but did not conduct required annual audits of its financial activities from 2007 through 2010. As a result, the Council did not detect the control weaknesses that existed in its organization over the 4-year period or ensure that the FS grant funds it received were properly accounted for in its accounting records.

Because A-133 audits are a critically important control to ensure the proper use of Federal grant funds, failure to obtain the required audits triggers significant Federal sanctions. "In cases of continued inability or unwillingness to have an audit conducted in accordance with this part, Federal agencies and pass-through entities shall take appropriate action using sanctions such as:

- Withholding a percentage of Federal awards until the audit is completed satisfactorily;

¹⁶ OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*, OMB Circular A-133, *Compliance Supplement*, the Single Audit Act Amendments of 1996, and *Government Auditing Standards*.

- Withholding or disallowing overhead costs;
- Suspending Federal awards until the audit is conducted; or
- Terminating the Federal award.”¹⁷

The Council’s failure to obtain the required A-133 audits means that there was no independent review to ensure its financial activities were accurate and verifiable and that Federal grant funds would be properly spent in accordance with Federal requirements. Without A-133 audits, the Council’s non-compliance with financial and Federal accounting practices went undetected and uncorrected for four years.

According to the Council’s written policies and procedures, the Board of Directors was responsible for contracting for annual A-133 audits. When we questioned the Council’s Board about the organization’s lack of A-133 audits, Board members stated that they had delegated the responsibility for obtaining A-133 audits to the Council’s executive director. They also stated that the executive director had maintained each year that the audits were not being performed because an accounting firm could not be hired at an acceptable price. Members of the Board further stated that they continued to apply for additional Federal grant funds, without informing FS about their non-compliance, because the Board of Directors did not understand the significance of the annual audit requirement. At the time of our audit, the Council’s Board of Directors had just engaged an audit firm to perform the required A-133 audits, due to the Board’s concerns about potential financial mismanagement. However, as of this date, the A-133 audit has not been completed.

On October 14, 2011, we discussed with the Council’s Board of Directors the internal control deficiencies identified during our audit. The Board informed us that it planned on taking a number of steps to address the problems we identified, such as replacing the Council’s executive director with an interim director, developing new business and accounting procedures, and using an accounting firm to assist in the development of financial controls and provide management for all of their grants.

Although a step in the right direction, considering the magnitude of the control deficiencies noted during our review, we are recommending that FS recover from the Council the \$2.7 million in Recovery Act grant funds that were unsupported. We are also recommending that FS withhold from the Council any future grant fund reimbursements until the Council can provide FS with documentation showing that it has implemented sufficient internal controls and grant administration policies and procedures to properly account for all grant funds in accordance with OMB and grant requirements. For the remaining grant funds the Council has received from FS, we are recommending that FS obtain from the Council documentation showing that the grant funds were adequately accounted for and used for their intended purpose. In those instances where FS determines the charges to the remaining grants were not adequately supported, we are recommending that FS disallow the costs and recover any reimbursements

¹⁷ OMB Circular A-133, Subpart B, Section 225.

already made to the Council. Further, prior to awarding the Council any additional FS grants, we are recommending that FS require the Council to complete the required A-133 audit and provide evidence to FS that the audit has been completed and all deficiencies corrected.

We discussed our concerns with FS officials on October 27, 2011. According to FS, it plans to send a letter to the Nevada Fire Safe Council, stating that it will withhold payments to the Council on any invoice received until their financial records are reconciled with all their vendors and that invoices submitted are in compliance with the terms of the grant agreement—both from a financial and programmatic perspective. The letter will also state that the Nevada Fire Safe Council must have completed the required A-133 audit before they can receive any future grant or agreement from the FS.

We recommend that FS:

1. Recover from the Nevada Fire Safe Council the \$2.7 million in Recovery Act grant funds that were unsupported.
2. Withhold from the Nevada Fire Safe Council any future grant fund reimbursements until the Council can provide FS with documentation showing that it has implemented sufficient internal controls and grant administration policies and procedures to properly account for all grant funds in accordance with OMB and grant requirements.
3. For the remaining FS grant funds the Nevada Fire Safe Council has received, obtain documentation from the Nevada Fire Safe Council showing that the grants funds were adequately accounted for and used for their intended purpose.
4. In those instances where FS determines the charges to the remaining grants were not adequately supported, disallow the costs and recover any reimbursements already made to the Nevada Fire Safe Council.
5. Prior to awarding the Nevada Fire Safe Council any additional FS grants, require it to complete the required A-133 audit and provide evidence to FS that the audit has been completed and all deficiencies corrected.

Please provide a written response within 5 days outlining your proposed corrective action for this issue. If you have any questions, please contact me at (202) 720-6945, or have a member of your staff contact Joseph Mickiewicz, Director, Food, Nutrition, Marketing, and Development Division, at (202) 720-5907.

USDA'S

FOREST SERVICE'S

RESPONSE TO AUDIT REPORT



File Code: 1430

Date: January 18, 2012

Route To:

Subject: Response to ARRA Fast Report No. 08703-5-SF (10), Grant Recipient Had Inadequate Controls to Account for Its Recovery Act Grants – The Recovery Act – Forest Service (FS) Hazardous Fuels Reduction and Ecosystem Restoration on Non-Federal Lands (10)

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

This letter is in response to Office of General (OIG) Fast Report No. 08703-5-SF (10) regarding the grant awarded to the Nevada Fire Safe Council received on January 4, 2012. The Forest Service generally concurs with the recommendations and the response for each is as follows:

OIG Recommendation #1: Recover from the Nevada Fire Safe Council the \$2.7 million in Recovery Act grant funds that were unsupported.

Forest Service Response: The FS is currently working with the Nevada Fire Safe Council (NVFSC) to resolve the potential issue of \$2.7 million used for expenses that are unsupported. The FS is requesting the NVFSC provide additional information to the Agency by February 29, 2012. The agency will perform a review and will manage any issues identified as applicable by the OMB Circulars and federal cost accounting principles. These actions will be completed by May 31, 2012.

OIG Recommendation #2: Withhold from the Nevada Fire Safe Council any future grant fund reimbursements until the Council can provide FS with documentation showing that it has implemented sufficient internal controls and grant administration policies and procedures to properly account for all grant funds in accordance with OMB and grant requirements.

Forest Service Response: The FS will postpone further grant reimbursements and grant awards to NVFSC until it provides assurances and documentation to the FS that it is able to fully comply with OMB cost requirements and Federal regulations, except where there is documentation that funds are being delivered to a third party, such as a contract vendor, and the costs comply with OMB requirements and federal regulations. In such instances, the agency will continue reimbursements and awards because there is minimal risk of inappropriate reimbursement to the NVFSC. Supporting documentation of compliance is due to the FS by February 29, 2012. The FS has corresponded and been in discussions with the Acting Executive Director of the NVFSC on the need to address governance and capacity for long-term viability as a Council and as a partner to achieve mutual restoration objectives. These actions will be completed by April 30, 2012 and will be ongoing until the grant is completed.



OIG Recommendation #3: For the remaining FS grant funds the Nevada Fire Safe Council has received, obtain documentation from the Nevada Fire Safe Council showing that the grant funds were adequately accounted for and used for their intended purpose.

Forest Service Response: Through the review to be conducted by the FS referenced in Recommendation 1, the Agency will have information to review the payments requested against all Recovery Act and Non-Recovery Act funds. These actions will be completed by April 30, 2012.

OIG Recommendation #4: In those instances where FS determines the charges to the remaining grants were not adequately supported, disallow the costs and recover any reimbursements already made to the Nevada Fire Safe Council.

Forest Service Response: Based on the results from the review conducted by the FS referenced review in Recommendation 1, the Agency will take appropriate action in accordance with applicable OMB circulars. The FS will also enhance reviews on future reimbursement requests, these procedures will be in place before February 29, 2012.

OIG Recommendation #5: Prior to awarding the Nevada Fire Safe Council any additional FS grants, require it to complete the required A-133 audit and provide evidence to FS that the audit has been completed and all deficiencies corrected.

Forest Service Response: The Forest Service will issue a letter to the NVFSC informing them the receipt of future Forest Service grants will be subject to providing satisfactory evidence of completion of the required A-133 audit with all deficiencies corrected.

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

/s/ Donna M. Carmical
DONNA M. CARMICAL
Chief Financial Officer