



U.S. DEPARTMENT OF THE INTERIOR
OFFICE OF INSPECTOR GENERAL

Report on Grants Administered
by the Office of Insular Affairs





United States Department of the Interior
Office of Inspector General

Eastern Region Audits
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September 30, 2003

Memorandum

To: Deputy Assistant Secretary - Insular Affairs

From: William J. Dolan, Jr. *William J. Dolan, Jr.*
Regional Audit Manager, Eastern Region

Subject: Final Audit Report on the Grant Administration by the Office of Insular Affairs
(No. 2003-I-0071)

This report presents the results of our audit of the Office of Insular Affairs' (OIA) grant administration. We found that OIA had properly processed awards and distributed grant funds. However, we identified needed improvements to the control process used to monitor grants. We made eight recommendations to improve the control process.

In the June 30, 2003, response to our draft report, the Deputy Assistant Secretary for Insular Affairs concurred with five of the report's eight recommendations; partially concurred with one recommendation and non-concurred with two recommendations. We therefore consider five recommendations resolved and implemented. Based on the response, we also revised Recommendations 1, 3, and 6 and now request a response to these revised recommendations.

The legislation, as amended, creating the Office of Inspector General, (5 U.S.C. App. 3) requires semiannual reporting to Congress on all audit reports issued, actions taken to implement audit recommendations, and recommendations that have not been implemented. Therefore, this report will be included in our next semiannual report.

Please provide a response to this report by November 25, 2003. The response should provide the information requested in Appendix 4 and should be addressed to Mr. Roger LaRouche, Assistant Inspector General for Audits, Office of Inspector General (MS 5341-MIB).

We appreciate the cooperation exhibited by the OIA staff and compliment them for taking timely actions to address the issues brought to their attention during our review. If you have any questions regarding this report, please contact me at (703) 487-8011.

Executive Summary

Office of Insular Affairs Grant Administration

OIA Needs to Improve Monitoring of Grants to Insular Areas

The Office of Insular Affairs (OIA) awards over 100 grants totaling about \$51 million to Insular Area governments each year. These grants provide the technical and financial assistance necessary to help these governments¹ develop more dynamic economies and improve the quality of life for their citizens. OIA properly processed grants and distributed grant funds. To more effectively monitor these grants, OIA needs to improve their management framework and control environment. Principal areas that need to be addressed are:

- **A centralized grant-tracking system.** The lack of such a system, to some extent, impeded OIA's ability to track, compile, and summarize essential information on its active grants.
- **Accountability.** OIA did not always obtain the documentation necessary to verify that projects were progressing as expected or impose consequences for grantees that did not meet grant requirements.
- **Management oversight.** Lack of leadership by prior management and oversight allowed OIA staff to bypass the existing control procedures. We found cases in which a document was altered, errors remained uncorrected, and required approvals were not obtained.

Collectively, these and other weaknesses contributed to delayed projects and services, and the waste of Federal monies intended to improve the effectiveness of Insular Area governments.

The financial and program management challenges facing Insular Area governments are formidable, long-standing, and well known. Historically, Governments have experienced difficulty not only in accounting for both Federal and local monies and controlling

¹ Insular governments, for which the Secretary of the Interior has varying responsibilities, include American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands, all of which are U.S. territories; as well as the Republic of the Marshall Islands, the Republic of Palau, and the Federated States of Micronesia, which are sovereign nations linked with the United States through Compacts of Free Association.

expenditure levels, but also in delivering program services. In an April 2002 press release, Secretary of the Interior Norton reiterated the Department's strong commitment to addressing these challenges, when she announced that OIA leadership would be upgraded from a Director to a Deputy Assistant Secretary of the Interior. The position upgrade and the leadership of the new Deputy Assistant Secretary are an important first step. On our part, we are working closely with OIA and Insular Area governments to identify deficiencies and encourage greater accountability by all concerned.

Recommendations

Our report presents eight recommendations to the Deputy Assistant Secretary for Insular Affairs, to improve controls.

Deputy Assistant Secretary Response and Office of Inspector General Reply

The OIA concurred with five of the eight recommendations; partially concurred with one recommendation; and nonconcurred with two recommendations. We consider the five recommendations that OIA concurred with resolved and implemented. The remaining three recommendations were revised and are considered unresolved. We requested that the Deputy Assistant Secretary respond to the revised recommendations.

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Abbreviations	
CNMI	Commonwealth of the Northern Mariana Islands
EPA	Environmental Protection Agency
NBC	National Business Center
OIA	Office of Insular Affairs
U.S.C.	United States Code
VI	U.S. Virgin Islands

Introduction

OIA Mission

The Office of Insular Affairs (OIA) executes the Secretary of the Interior's responsibilities with respect to Insular Area governments. These governments are American Samoa, Guam, the Commonwealth of the Northern Mariana Islands (CNMI), and the U.S. Virgin Islands (VI), all of which are U.S. territories; and the Republic of the Marshall Islands, the Republic of Palau, and the Federated States of Micronesia, which are sovereign nations linked with the United States through Compacts of Free Association.

The Secretary's responsibilities include (1) providing the Insular Areas with financial assistance for government operations and needed infrastructure and (2) funding or arranging technical assistance and advisory services in all areas of government operations. According to OIA's Annual Performance Plan for fiscal year 2003, this assistance is essential because local tax revenues and other Federal programs are insufficient to respond to local issues, such as differing stages of economic and political development and geographic isolation, which are unique to Insular Area governments.

Insular Area Issues

Over the past 20 years, disturbing trends have developed in the ability of Insular Area governments to achieve sound financial management, control expenditures, and operate government programs. Since 1982, in over 450 audits, we have detected and reported deficiencies and recommended corrective actions to various governing entities. Although most of our recommendations were accepted, most have not been implemented. It is therefore critical that the Department, acting through OIA, insist that Insular Area governments be accountable for monies provided through Departmental grants.

The Secretary of the Interior stated the Department's commitment to change in an April 22, 2002, press release appointing attorney David B. Cohen as the new Deputy Assistant Secretary for Insular Affairs of the Department of the Interior. The Secretary said, "The Administration is upgrading this position from Director of the Office of Insular Affairs to Deputy Assistant Secretary of the Interior to demonstrate our strong commitment to resolving the tremendous, long-standing economic and infrastructure challenges facing the Insular Areas."

OIA Administration and Budget

OIA consists of three divisions: (1) the Policy Division, (2) the Technical Assistance Division, and (3) the Budget and Grants Management Division. The primary concern of the Policy Division is carrying out OIA's goal to "*help manage Federal-Island relations by promoting appropriate Federal policies.*" The Technical Assistance and the Budget and Grants Management Divisions focus on OIA's goal to "*assist the islands in developing more efficient and effective government by providing financial and technical assistance.*"

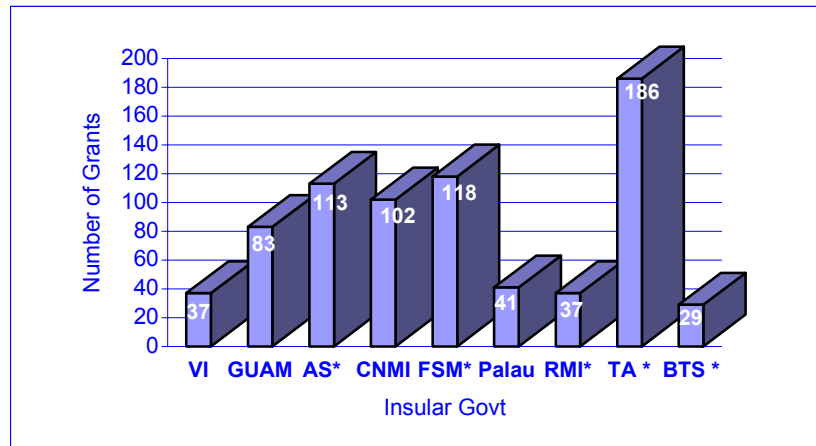
OIA issues two types of grants: non-discretionary and discretionary. Non-discretionary grants are those mandated by Congress, which determines and sets forth the dollar amount and purpose of each of these grants in either the appropriation act or committee reports. Examples include grants for operations, capital improvements, and special programs. Discretionary grants, on the other hand, are awarded by OIA based on applications from Insular Area governments. These grants include technical assistance and operations and maintenance improvement grants.

Four grant managers administer all of the non-discretionary and discretionary grants. Along with managing grants, these grant managers perform other duties such as budget formulation, compact fund negotiations, and Government Performance and Results Act (GPRA) implementation. The grant managers receive assistance from four field representatives located in the CNMI (two representatives), American Samoa, and the Federated States of Micronesia. The field representatives are responsible for reviewing and investigating compliance with grant terms and conditions.

In fiscal year 2002, OIA received a total budget of \$353 million. Congress appropriated the majority of these funds to the Compacts of Free Association² (\$168 million) and fiscal assistance to the U.S. territories (\$106 million). The remaining \$79 million (1) provided operational support to American Samoa (\$23.1 million), (2) funded capital infrastructure programs for the four U.S. territories (\$27.7 million) and technical (\$17 million) and territorial (\$6.7 million) assistance programs to all seven insular governments, and (3) paid the administrative costs of the 32 full-time positions that make up OIA (\$4.5 million).

² Funding to the Compacts of Free Association is not used for grants and represents guaranteed payments and services to the Federated States of Micronesia, the Republic of Palau, and the Republic of the Marshall Islands. OIA sends payments to these governments every 90 days based on a percentage rate and cannot assign any conditions on how the payments are used.

OIA awards approximately 100 discretionary and non-discretionary grants, totaling about \$51 million, to Insular Area governments each year to improve government operations and to provide needed infrastructure. As shown on Figure 1, nearly 750 grants have been awarded since 1997.



***OIA Grants by Insular Area Government
Fiscal Years 1997 - 2002
Figure 1***

*AS is American Samoa; FSM is the Federated States of Micronesia; and RMI is the Republic of the Marshall Islands. Some Technical Assistance (TA) and Brown Tree Snake (BTS) grants serve several Insular Area governments and cannot be delineated by Insular Area.

Objective and Scope

Our objective was to determine whether OIA has adequate administrative controls over awarding, distributing, and monitoring grants. We judgmentally selected and reviewed 47 grants (36 grants from fiscal years 1997 through 2002 and 11 grants over 5 years old). We were not able to statistically select our sample because OIA could not provide an electronic database that combined all OIA grants. We included discretionary and non-discretionary grants in our grant selection, but excluded Compact of Free Association payments.

We also reviewed OIA's Annual Performance Plan for fiscal year 2003³ and found a program activity related to our objective in support of OIA's mission goal to "Assist the islands in developing more efficient and effective government by providing financial and technical assistance." We reviewed this program activity (Program Activity 1 – "Improve Infrastructure") and concluded that OIA's goal was appropriate, accurate, and properly disclosed.

As part of our audit, we evaluated the internal controls over OIA's administration of Insular Area grants and found significant weaknesses in the area of grant monitoring. We also noted OIA's inability to meet its performance goals for accelerating the completion of grant-funded projects. Four of the seven OIA performance goals for fiscal year 2001 addressed this issue. OIA, however, met only one of these goals.⁴

We discussed these weaknesses in the body of the report, and our recommendations, if implemented, should improve internal controls in these areas.

We conducted our audit in accordance with the *Government Auditing Standards*, issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures considered necessary under the circumstances.

Prior Audit Coverage

During the past 5 years, we have not issued any reports on the award, distribution, or monitoring of grants administered by OIA. We have, however, issued a report to the Government of the Virgin Islands which stated that contracts were ineffectively administered by the VI for the construction of health care facilities (see Appendix 1).

³ Under the Government Performance and Results Act of 1993 (5 U.S.C., Section 306 and 31 U.S.C., Sections 1115 and 1116), Federal agencies are required to submit annual performance plans comparing planned accomplishments for mission-related activities with the results actually achieved in that year.

⁴ Two goals measured the timeframe from grant award to completion. OIA achieved the goal of 28 months for its technical assistance grants, but did not achieve this goal for its construction and infrastructure related grants (43 months actual completion time). The two other goals were to complete as many projects each year as started. Neither of these goals was achieved.

Results of Audit

Improvements to Monitoring of Insular Area Grants Needed

OIA properly processed awards and distributed grant funds, but needs to monitor its grants to Insular Area governments more effectively. Specifically, OIA needs to:

- ❑ Establish a centralized grant-tracking system.
- ❑ Examine grants over five years old and determine if funds should be reprogrammed.
- ❑ Ensure that Technical Assistance Division personnel follow internal control procedures.
- ❑ Recover all disallowed costs.
- ❑ Hold both field representatives and grantees accountable for ensuring that project status reports are completed on time.
- ❑ Update and use the OIA Manual.

Deficiencies in these areas occurred primarily because prior OIA management did not always establish the control environment necessary to ensure adequate oversight or establish consequences for grantees that did not adhere to conditions of the grants. As a result, projects were not completed on time, essential services were delayed or not provided, and some Federal monies designed to improve the economies and self-sufficiency of Insular Area governments were wasted. For example, a \$2.7 million grant award to Guam in 1988 and 1989 for a hazardous landfill cleanup project was never started, and a \$1.5 million grant to the Virgin Islands in 1984 for a detention center is only 10 percent complete.

A Centralized Grant Tracking System

OIA's ability to monitor its inventory of grants could be improved by establishing a single grant-tracking system to properly and accurately track progress of all OIA grants. Specifically, this system would include a database that would collect grant data that is not currently captured in the Department's Financial Management System. Although OIA possesses the grant-tracking software program (Filemaker Pro), not all grant managers use this software. Even those grant managers who did use the software program maintained such dissimilar data that comparing and analyzing grant data is extremely difficult. For example, one database included data fields such as: project number, project title, status, date awarded, amount awarded, amount drawn down and project balance while another database only included the project number, government, grant title and amount awarded. Consequently, the task of using and summarizing data for all OIA grants was so time consuming and cumbersome, that managers did

not have the appropriate data available to make informed decisions. In addition, a centralized grant-tracking database would help monitor the large numbers of grants and fund balances.

The grant data was also maintained in separate electronic folders and not one centralized database. This is a problem because OIA management then needs to query each grant manager in order to produce a listing of all grants. The unavailability of one or more of the managers, at any given time, could result in an incomplete compilation of the data.

Although the Technical Assistance Division maintained a database, it only included 4 (project number, territory, project name, and amount awarded) of the 12 attributes for tracking grants required by the OIA Manual.⁵ The Division's non-compliance with the Manual contributed to OIA's inability to adequately monitor technical assistance grants.

In addition to using different systems to track grants, grant managers also did not maintain hard-copy files in a uniform manner. We believe that it would be beneficial for grant managers to maintain their files in a uniform manner so that other grant managers can easily determine the status of a grant.

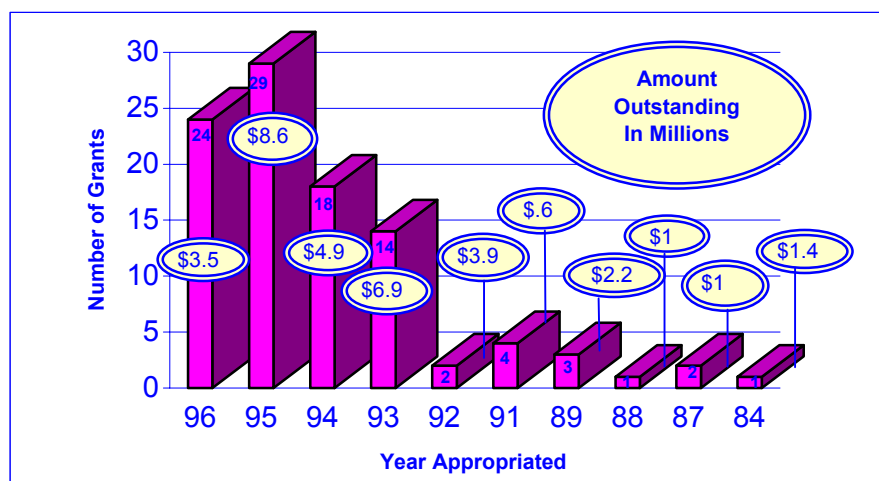
We believe that OIA would benefit from a centralized grant-tracking system which would provide complete information to management and make it easier for grant managers to retrieve grant data, such as, the date a grant was awarded and estimated to be completed to determine the status of drawdowns.

Unexpended Grant Funds

We identified 98⁶ grants that were over 5 years old with \$33 million of remaining balances. We recognize that some grants, such as those for capital improvement projects, can take a number of years to complete; however, as shown in Figure 2, funds for some of these had been appropriated as far back as 1984. A few of these grants, such as those for the Ordot Landfill and the St. Croix Detention Center, have had little or no activity since the grants were awarded in 1988 and 1984 respectively.

⁵ Chapter 4 "Technical Assistance" of the Manual states that a database must include the following: "the date application was received, the project number, the name of the territory, the project name, the amount requested, the category, the subcategory, the status, the amount approved, the document number, the effective date, the FY [Fiscal Year] of obligation and notes or comments concerning the application."

⁶ Of these, 90 were for capital improvement projects, 7 were for operations and maintenance improvement projects, and 1 was for Technical Assistance.



Grant Balances Over 5 Years Old (by Fiscal Year)
Figure 2

We believe OIA should examine the 98 grants over five years old to determine the status of each project and, if appropriate, seek authority to reprogram the funds for those projects which are no longer valid.

Internal Control Weaknesses

We identified internal control weaknesses within the Technical Assistance Division on 7 of the 27 grants reviewed. For example:

- An OIA employee copied an original memorandum transmitting a request for a payment and then changed the copy, thereby allowing the same payment request to be processed twice. It appears that the original transmittal letter for \$15,000 was copied and then subsequently changed to show an additional \$15,000 had been requested. However, we were unable to determine if the change was intentional or unintentional. A Technical Assistance secretary then processed the two transmittal memorandums on the same date to the National Business Center (NBC). Both memorandums referenced the same Request for Reimbursement (SF-270) from the grantee. The grantee found the error, informed OIA of the double payment, and OIA deducted that amount against the next drawdown as a method of reimbursement. Although these payments never exceeded the total grant amount, internal controls were not sufficient to prevent the erroneous payment request.
- An uncorrected clerical error increased a grant obligation. A CNMI grantee requested payment for the remaining balance of its grant of \$66,257. When sending the transmittal memorandum to NBC for payment, OIA accidentally transposed two numbers and asked for

\$66,527. NBC caught the error and informed OIA. Rather than correcting the error, OIA requested NBC to increase the obligation by the difference of \$270. NBC honored this request, but OIA never amended the original grant agreement and then overpaid the grantee by \$270.

- ❑ Five grants administered through the Technical Assistance Division were not properly approved in accordance with OIA's Manual. One grant for \$80,000 was signed only by the OIA Director and did not have the required Division Director (formerly Deputy Assistant Secretary) signature; four grants totaling \$507,000 had some, but not all, required Division Director signatures. In addition, we were unable to determine whether another eight grants were properly approved because OIA could not provide the surname approvals.

Regarding the approval of grant applications, the OIA Manual states that the Technical Assistance Division should prepare a letter and application to be transmitted to the applicant. The Manual, Chapter 4 "Technical Assistance" next states, "The documents are then surnamed by the Deputy Assistant Secretaries and submitted to the Assistant Secretary for signature." OIA indicated during our exit conference that a Division Director might not surname an application because they may not agree with the project and would have written an explanation on the routing slip. However, we did not find any routing slips with explanations in the files.

We believe the surname signature requirement is in place to provide greater management control over deciding what projects are funded. If OIA does not follow written procedures for proper approvals, it could potentially fund inappropriate and unqualified projects. Also, OIA should develop more formal procedures for documenting any disagreement with the awarding of the grant other than a mere written explanation on the routing slip.

Unrecovered Disallowed Costs

On the following two grants, OIA allowed up to three years to lapse without enforcing repayment of disallowed costs.

- ❑ OIA continued to fund its grant to CNMI for the Beach Road Sewer Project even after requesting repayment of disallowed costs almost 3 years earlier. In September 1999, the project Architectural & Engineering contractor defaulted on the contract, and in February 2000 the grant manager requested repayment of the disallowed costs of

\$204,000 from CNMI. CNMI, however, was reluctant to repay the disallowed costs and requested an independent study, which subsequently supported OIA's position. As of September 2002, and after several letters between the project and OIA grant managers, CNMI had yet to repay OIA. Meanwhile, CNMI has continued to request and receive drawdowns in excess of \$300,000 on the same project. Under the Code of Federal Regulations (43 CFR 12.83 (a)), "If a grantee or subgrantee materially fails to comply with any term of an award...the awarding agency may...temporarily withhold cash payments pending correction of the deficiency by the grantee or subgrantee." OIA, however, has continued to authorize payments requests for the project and did not enforce any repayment.

- ❑ OIA inadvertently released a payment to CNMI after withholding the pending payment because of a lack of supporting documentation. In turn, CNMI released the payment to the contractor in fiscal year 2000, despite repeated OIA requests that CNMI withhold payment. OIA considered the payment to the contractor an unallowable cost and requested an immediate refund in March 2001. As of September 2002, the unallowable costs had yet to be recovered.

OIA staff stressed that forcing a government to repay disallowed costs might create a cash flow problem in areas with depressed local revenues. Therefore, depending on the circumstances, OIA may choose either to work with local governments or to enforce repayment. Although we commend OIA for working with the local governments, we also believe the disallowed grant cost should be recovered expeditiously to demonstrate that misuse of Federal funds is unacceptable.

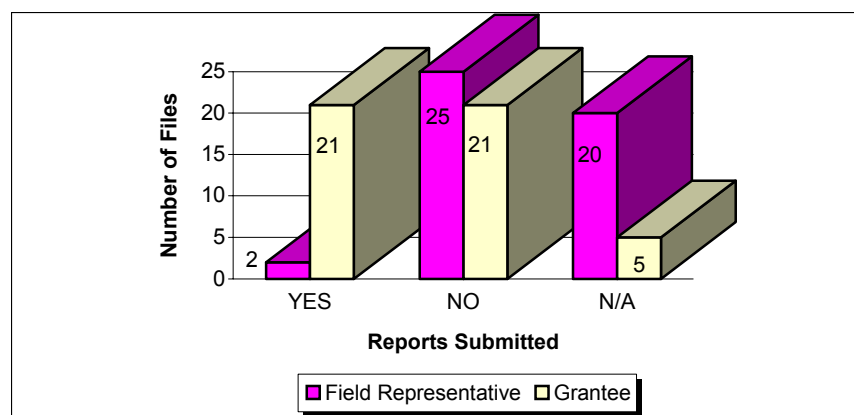
Accountability

Out of the 47 grants reviewed, OIA field representatives and grantees did not always submit the required status or final project reports. Furthermore, OIA did not hold any field representatives or grantees accountable nor were consequences imposed when grantees failed to meet their responsibilities.

Reports on the status of grant projects are critical to OIA's ability to effectively monitor grants. Without such reports, grant managers cannot determine or act on the progress of grant projects. The OIA Manual, Chapter 3, "Grants Management of Nondiscretionary Grants" says, in part, that OIA field representatives shall "submit to the Grants Manager a quarterly

progress report for each grant project using the form entitled ‘Capital Improvement Project Onsite Review’. Information contained on the form will be developed from the onsite inspections and project meetings with government officials.” In addition, grantees are required to submit quarterly or semiannual performance reports 30 days after the reporting period specified in the grant and final performance reports “90 days after the expiration or termination of grant support.”

Of the 47 grants reviewed, 27 required site visits and quarterly progress reports from field representatives, and 42 required quarterly or semiannual reports from the grantee. As shown in Figure 3, however, only two files contained the required information from the field representatives and only 21 files contained the reports required from grantees. Although OIA eliminated field representatives for the VI and Guam as a result of a 1995 reorganization,⁷ grant managers informed us that they made periodic visits to review insular projects. However, we did not locate any documentation of the site visits in the grant files.



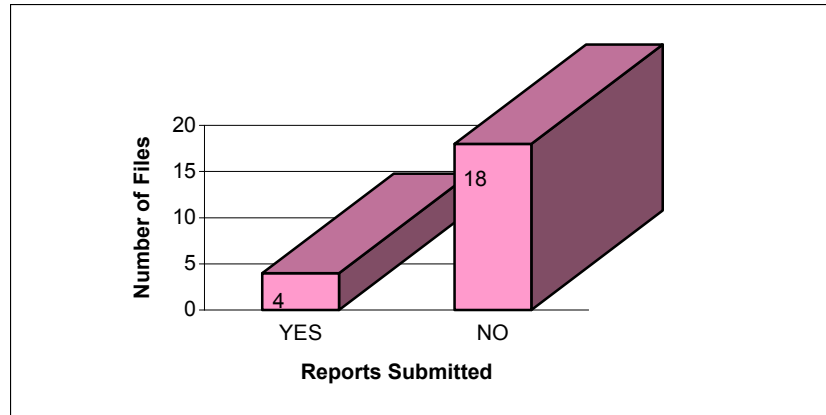
Reports submitted by Field Representatives and Grantees
Figure 3

Of the 47 grants reviewed, 24 had completed projects, 22⁸ of which required final project status reports. As shown on Figure 4, however, only four⁹ grants had the required documentation. One final project status report was not received until 2 years after the project completion date.

⁷ Our audit did not disclose any difference in grantee reporting between locations in which OIA had stationed field representatives versus locations without field representatives.

⁸ One project represented interest accrued and another represented salaries. These projects’ terms and conditions did not require final project status reports.

⁹ Two of the four grants were for actual studies, and we accepted the studies as reasonable notification to OIA of project completion.



Final Project Status Reports
Figure 4

Without the required reports, OIA lacked the information necessary to effectively monitor the grants to ensure that projects were completed as planned and on time. We believe that OIA could improve grant management and grantee accountability by implementing consequences for grantees that do not meet their grant responsibilities. Such consequences could include, for example, initiating the retention of 10 percent of a project's funds until final project status reports are received.

OIA Manual

The OIA Manual has not been updated since December 1991, and OIA staff use it infrequently. We believe that OIA needs to review and revise the Manual as appropriate to (1) include a section for operations and maintenance improvement projects, as indicated in the "Contents" and (2) reflect changes in OIA operations, such as the 1995 reorganization and downsizing. During our exit conference, OIA informed us that they are currently revising the OIA Manual.

Impact

OIA recognizes that project completion is a significant management challenge facing Insular Area governments and that it should focus its efforts on helping the governments meet this challenge. OIA grants are Federal investments designed specifically to improve the economies and effectiveness of Insular Area governments, and the success of this investment is measured by the number of grants completed, proposed, and approved. We believe, therefore, that delayed projects and services to Insular Area citizens and the resulting increased costs equate to the waste and abuse of grant monies, as demonstrated by the following examples.

Ordot Landfill

Despite repeated requests since September 1994 from OIA's grant manager, Guam has not used the \$2.7 million appropriated and granted in 1988 and 1989 to upgrade the Ordot Landfill (Figure 5). After years of inactivity, the Landfill has become a dumping ground and is a recognized health and environmental hazard. In August 2002, the Environmental Protection Agency (EPA) filed a lawsuit¹⁰ to force Guam to close the Landfill.



*Ordot Landfill – Guam
Office of Inspector General Photo – August 2002
Figure 5*

¹⁰ According to the August 8, 2002, *Pacific Daily News*, “The U.S. government filed a lawsuit to force Guam to close the Ordot dump...The lawsuit follows more than 15 years of failed negotiations to push Guam to address the dump’s many environmental hazards...”

In our 1992 report (No. 92-I-590), we informed OIA that the Landfill had not been expanded or upgraded as intended by the grant and continued to operate in violation of Federal and local environmental laws, rules, and regulations. In addition, we reported that Guam had not established the solid waste disposal fees required under the grant. Our report recommended that OIA obtain an agreement with Guam to impose the user fee and if an agreement could not be reached, to cancel the grant. In response to our report, Guam stated that it was “working on ‘an integrated approach’ to the problem that included closure of the Landfill in 6 years and development of a ‘state-of-the-art sanitary landfill operation’ at a different site.” OIA stated that “the Assistant Secretary will request that the Governor of Guam identify funding shortfalls in other Federally approved programs and that if an appropriate project is found, the Landfill funds ‘may be reprogrammed’”. The response also stated that if such a project is not identified by April 1992, the Assistant Secretary will rescind the Landfill grants.”

OIA has not rescinded the grant. Furthermore, we did not find any documentation of onsite reviews by field representatives in the 7 years prior to eliminating the field representative position in Guam in 1995 or by grant managers in the 15 years since initiation of the grant in 1988. However, in September 2000, OIA approved a request from Guam to use the grant funds for purchasing equipment to operate the existing Ordot Landfill. Again, Guam has not yet used the available funds. During the exit conference on our current audit, OIA indicated that they are unable to rescind grant funds without Congressional approval.

St. Croix Detention Center

The VI has used only \$110,000 of the \$1.5 million grant awarded in 1984 to construct a detention center on St. Croix and, as of August 2002, the project has not been completed (Figure 6). On July 6, 2001, the VI project manager sent a project status report to OIA stating that construction for the center, which began in April 2001 was 10 percent complete and scheduled for completion by June 2002. However, the latest request for payment was dated October 16, 2000. In addition, an October 2002 document from the OIA grant manager stated that the building should be completed by December 2002, but as of February 2003 the project was still incomplete.

In our examination of the grant file, we found several quarterly financial status reports from the grantee and documentation of four site visits by the OIA field representative, before the position was eliminated in 1995. However, the June 1994 site visit report did not indicate the completion status of the project. The only data provided in the report was that the field representative assisted a

VI employee in filling out a project description form. Since the elimination of the VI field representative position, grant managers were responsible for visiting the projects. However, we did not find any documented site reviews from the responsible OIA grant manager.



*Unfinished St. Croix Detention Center
Office of Inspector General Photo – August 2002
Figure 6*

St. Croix Health Facilities

A project to construct a health center at St. Croix in the VI has been delayed for over 8 years and has yet to be completed. Construction was originally scheduled to be completed within a 2-year period ending January 1994.

The project reflects a long history of indecision, poor planning, and lack of communication between OIA and the grantee. The project began in January 1992, when Congress appropriated \$4.12 million to construct the St. Croix East District Clinic (Charles Harwood clinic) and \$500,000 to construct a Rehabilitation Center. Between 1994 and 1997, OIA disbursed a total of \$421,300 to the VI for the project. In August 1998, however, OIA reprogrammed the entire \$4.6 million to a new health clinic project in St. Croix. In June 1999, the VI terminated its contract for construction of the new St. Croix health clinic after it had spent \$449,400. In October 2000, OIA approved VI's April 2000 request that the remaining funds of the \$4.12 million be reprogrammed back to the Charles Harwood clinic. We noted that there was a 10-month period from March 1999 to January 2000 when the OIA grant manager was unaware that the VI had initiated a stop work order on the current Charles Harwood clinic.

According to a March 2002 project status report, the project completion date was June 30, 2002. Since June 2002, OIA has approved an extension to September 2002, but the VI has not completed the project and \$449,450 was wasted on the abandoned St. Croix health clinic project.

Rota Health Center

The project to expand the Rota Health Center, initially scheduled for completion by August 1999, has been delayed 3 years and lacks a prospective completion date.

CNMI awarded a contract to Sablan Construction Co. Ltd. to expand the Center but later terminated the contract before the expansion was completed. Project status reports from June 1999 through August 2001, when the contract was terminated, reported that construction of the project was behind schedule. The delay was the result of (1) a change order requested by Sablan Construction to accommodate the Center's desire for further expansion, and (2) Sablan Construction's failure to pay back wages to its workers. An independent study requested by OIA, in March 2002, and performed by the U.S. Army Corps of Engineers estimated that the project was only 60 to 65 percent complete. As discussed on page 9 of this report, OIA denied approval of a CNMI payment request because of a lack of supporting documentation but OIA inadvertently released this payment. Subsequently, OIA requested that CNMI withhold the payment to Sablan Construction. In October 2000; however, CNMI paid Sablan Construction. OIA considers this payment to be an unallowable grant cost and in March 2001 it requested an immediate refund to the Department.

A factor which may have contributed to the health center not being completed was the performance of the construction management firm, Dev & Associates. OIA was aware that Dev & Associates had not successfully completed a previous project as the construction manager but did not object to CNMI's award of the contract for construction management to Dev & Associates. In the June 1999 OIA project status report for the Center, the field representative noted, "OIA did not object even though we had reservations about their ability to perform." According to an OIA grant manager, OIA does not get involved in the award of contracts by Insular Area governments.

As of September 2002, two years after release of the payment, OIA has yet to recover the unallowable costs, the contractor has been disbarred, and the project remains suspended.

Summary

OIA needs to improve its internal controls with a special emphasis on grant management. OIA also needs to ensure that consequences are imposed on any entity observed wasting, defrauding, or abusing grant monies. We believe that our recommendations will help OIA improve its oversight over grants to ensure that monies provided by the Department actually assist Insular areas in moving toward greater self-sufficiency and economic well being.

Recommendations

We recommend that the Deputy Assistant Secretary for Insular Affairs:

1. Implement an automated, centralized grant-tracking system.
2. Establish uniform requirements for project file contents.
3. Examine the grants over five years old and seek authority to reprogram funds for those grant projects that are no longer valid.
4. Require grant managers to document their site visits and ensure that field representatives submit site visit reports.
5. Enforce grant agreements that require grantees submit status and final reports.
6. Incorporate into all grant agreements a statement such as “failure to comply with the terms and conditions of this grant award, including reporting requirements, may result in the withholding of grant payments until the deficient situation is corrected.”
7. Provide for periodic reviews of the files by management to ensure compliance with the OIA Manual and/or grant agreements.
8. Complete the revision of the OIA Manual.

Deputy Assistant Secretary, Office of Insular Affairs Response and Office of Inspector General Reply

In the June 30, 2003, response (Appendix 3) to the draft report, OIA concurred with five of the eight recommendations (Recommendations 2, 4, 5, 7, and 8); partially concurred with one recommendation (Recommendation 6); and nonconcurred with two recommendations (Recommendations 1 and 3). The five recommendations that OIA concurred with have been implemented by issuance of the OIA Financial Assistance Manual on March 31, 2003. The response also included detailed comments on the draft report. We considered and included this information, as appropriate, in preparing the final report.

The response disagreed with Recommendation 1, which stated that OIA needs to establish a standardized grant-tracking system. The response stated that OIA already has an automated, standardized grant-tracking system that was instituted in 2000. Therefore, OIA maintained that the statement in the Report that “the four grant managers utilize different grants tracking systems” is incorrect.

During our audit, we found that OIA did use a grant tracking system; however, this system was not centralized. Grant managers may have been using the same software program (Filemaker Pro) to enter data into a database, but not all active grants had been entered into the database. In that regard, when we requested a listing of grants from OIA, we received a separate listing from each of the four different grant managers. Furthermore, the grant managers did not use the same software program or database to compile the listings. Therefore, we believe our previous statement that the grant managers used different grant tracking systems is accurate. The grants monitored by each manager are kept in separate electronic folders because, according to OIA staff, the consolidation of these folders would result in a system breakdown. Since the existing OIA grant-tracking system does not centrally track all grants in one database, we believe that a single centralized database of grants would result in better overall management of grant funds. To clarify this issue, we have made changes to the report and modified the recommendation to state that OIA needs to establish a “centralized” grant-tracking system.

The response also disagreed with Recommendation 3, which is to impose time limitations on funds obligated into grant agreements. OIA states that it has options to seek reprogramming through administrative budget processes or to seek a rescission or re-appropriation through appropriation bills, and that it now includes termination dates on its discretionary grants.

We commend OIA for recently imposing termination dates on its discretionary grants, however most of the 98 grants over 5 years are not discretionary. Therefore, based on OIA's response, we have revised Recommendation 3 to state that OIA should examine the grants over five years old and seek authority to reprogram funds for grant projects that are no longer valid.

Regarding the Ordot Landfill, OIA states that they "strongly disagree with the Report's suggestions that rescinding the grant would have helped alleviate the environmental problems at Ordot." Furthermore, OIA concluded that it was still necessary to keep the money available to help Guam address the landfill problem. According to OIA, the Government of Guam recently stated that they have ordered heavy equipment necessary to improve the landfill. OIA expects the funds to be drawn down shortly.

We do not suggest that rescinding the grant funds would have alleviated the environmental problems at the Landfill. We stated that OIA did not rescind the funds despite the inactivity of grant funds; the repeated requests from its grant manager to use the \$2.7 million that was appropriated in 1988 and 1989; and the fact that OIA, stated in April 1992 that "the Assistant Secretary will rescind the Landfill grants." We believe that if OIA had moved to rescind the funds, the Government of Guam may have used the grant funds to upgrade the Landfill. Finally, we support OIA's recent decision to use the Ordot funds for purchasing equipment to be used at the Landfill.

OIA stated that it agrees with the intent of Recommendation 6 to consider a retention of funds (10%) or termination of funding if the grantee violates the grant agreement. However, it stated "that a ten-percent retention was more of a contract mechanism than grant tool," and that a ten-percent retention is not authorized under the Common Rule. The response also stated that "we do not agree with the implication that OIA is not willing to exercise remedies in appropriate circumstances" and that OIA grant managers are not expected to automatically exercise remedies "simply because OIA technically has a right to do so." Finally, regarding this matter, the response said that grant managers will weigh a number of competing concerns and "decide on a course of action that makes the most sense under the circumstances."

We recognize that at times OIA has terminated grants, recovered disallowed costs and withheld payments; however, we continue to believe that consequences should be imposed for continued non-compliance with grant requirements. In that regard, we agree that the common rule does not provide for withholding payments as the primary purpose of the rule is to provide guidance to grantees on the administrative requirements for using grant funds. However, we note that many of the OIA grant agreements contain terms and conditions which include the statement “Failure to comply with the terms and conditions of this grant award, including reporting requirements may result in the withholding of grant payments until the deficient situation is corrected.” That 21 of 47 grant files we reviewed did not contain required status reports from the grantees suggests that OIA grant managers may not be using all the tools available to them. In any event, based on the response we have revised Recommendation 6 to state that OIA should incorporate into all its grant agreements the aforementioned provision on failure to comply and enforce the provision as appropriate.

In summary, the Deputy Assistant Secretary’s response is sufficient to consider recommendations 2, 4, 5, 7, and 8 resolved and implemented. We are requesting that the Deputy Assistant Secretary respond to the revised recommendations 1, 3, and 6 (see Appendix 4 for Status of Recommendations).

Appendix 1

Prior Audit Coverage

Office of Inspector General Reports

Our report *Grants for the Construction of Health Care Facilities, Department of Health, Government of the Virgin Islands* (No. 2002-I-0043), issued in September 2002, stated that the VI had not effectively administered contracts for the construction of health care facilities or maintained adequate financial accountability for OIA grants. Specifically, the VI spent \$870,700 on construction projects that were not completed. We found that the VI had not followed established competitive procurement procedures in the award of the contract for construction of a new Christiansted Health Clinic. By the time the project was terminated, the VI had already paid the contractor \$449,400 for work on the uncompleted facility. In addition, the VI was required to reimburse OIA for the \$421,300 spent on the previously abandoned project to renovate the Charles Harwood Complex.



United States Department of the Interior

OFFICE OF INSULAR AFFAIRS

1849 C Street, NW

Washington, D.C. 20240

June 30, 2003

Deputy Assistant Secretary

Mr. Roger LaRouche
Assistant Inspector General for Audits
U.S. Department of the Interior
Office of the Inspector General
MS 5341
1849 C Street, NW
Washington, DC 20240

Dear Mr. LaRouche:

This letter responds to the memorandum of May 2, 2003, from the Eastern Regional Audit Manager asking the Office of Insular Affairs (OIA) for comments on the findings and recommendations contained in the subject audit report (the Report). We agree with almost all of the recommendations in the Report. In fact, most of the recommendations were either implemented or incorporated into our official procedures before the date of the Report. Most importantly, we rewrote our standard procedures for the first time in over a decade, and officially adopted the new OIA Financial Assistance Manual (the Manual) on March 31, 2003.

As you know, the Secretary of the Interior has given me a mandate to improve accountability for the funds that the Department of the Interior provides to the insular areas. The Manual incorporates several new policies that are designed to promote our commitment to improved accountability. For example, we will now take the following factors into account when deciding whether or not to award a discretionary grant to an insular area:

- the extent to which the applicant has properly functioning internal controls in place, including the presence of a qualified auditor and a properly staffed and funded public auditor's office with strong safeguards to its independence;
- the extent to which the applicant has been responsive to any follow-up inquiries that OIA may have regarding audits, including inquiries regarding questioned costs and recommendations to improve internal controls;
- the extent to which the applicant has complied with all reporting requirements and other requirements applicable to past and ongoing grants;

- the extent to which the applicant is in compliance with any memoranda of agreement, memoranda of understanding or other agreements to which it may be party with OIA or the Department of the Interior; and
- the extent to which the insular government is exercising prudent financial management.

We recently held a comprehensive training session on the Manual for the entire staff. OIA management has stressed that the staff is expected to become familiar with and follow the Manual.

Additionally, in conjunction with the U.S. government's renewal of financial assistance to the Republic of the Marshall Islands and the Federated States of Micronesia, OIA has taken the lead in designing a completely new accountability system that will apply to the over \$150 million per year that will be provided to those countries through OIA under the amended Compacts of Free Association.

We appreciate that the Report acknowledged the commitment of the Secretary and the current leadership of OIA to improving accountability. I would also like to acknowledge the excellent job that the very talented and dedicated career staff at OIA has been doing to ensure that grants are being managed effectively.

To appreciate how good a job my staff has done in spite of very difficult circumstances, one has to be familiar with the history of the Department of the Interior's efforts to protect its investment in the islands over the past several years. Until the early 1980's, the Office of Territorial and International Affairs (OTIA), OIA's predecessor, had approximately 60 Federal comptroller employees whose primary responsibilities were to oversee and monitor the use of Federal funds in the insular areas. In 1982, OTIA transferred more than 50 of those positions to the Office of the Inspector General. The remainder became the core staff of OTIA's new technical assistance program. The Office of the Inspector General meanwhile has, like the rest of the Federal government, had to make tough decisions regarding the allocation of scarce resources. As a result, only a small fraction of the oversight manpower that was transferred from OTIA in 1982 remains assigned to monitor Federal grants to the insular areas.

When OTIA was reorganized out of existence in 1995, the Department of the Interior's capacity to protect Federal funds in the insular areas was again diminished. In that reorganization, the position of Assistant Secretary for Territorial and International Affairs was abolished along with approximately 40 percent of the combined positions in the former OTIA and the Office of the Assistant Secretary. The abolished positions included field staff in the two most populous of the four U.S. territories under our jurisdiction, Guam and the U.S. Virgin Islands.

Faced with a substantially diminished capacity to do a job that has not gotten any smaller, we have no choice but to work smarter and to constantly re-evaluate our policies to ensure they are working. We intend to revise the Manual whenever we think of ways to

improve our performance. We therefore welcome any suggestions that the Office of the Inspector General may have, and have already incorporated some of those suggestions into the Manual. The following is a response to the specific findings and recommendations contained in the Report.

Recommendation 1: Establish and implement an automated, standardized grant-tracking system. OIA in fact already has an automated, standardized grant-tracking system. The system was instituted in 2000, and grants awarded since that time have been recorded under the new system. The statement in the Report that “the four grant managers utilize different grants tracking systems” is therefore incorrect. OIA staff has also gradually input older grants into the system. In addition to the standardized system, grants managers use a variety of other tools to help track and report on their workload.

However, OIA’s standardized grant tracking system may be superseded in the future by a standardized system which may be implemented for the entire Department of the Interior. The Department of the Interior has created a Federal Assistance Working Group charged with developing standardized systems and processes for grants management. The working group is still in progress and has not yet made final decisions regarding uniform, standardized systems and processes for grants management.

Recommendation 2: Establish uniform requirements for project file contents. OIA agrees with this recommendation and has implemented it. Uniform requirements are established in Part VI, Section F of the Manual. New grant staff hired in March have already begun going through grant files and organizing them in accordance with the Manual.

Recommendation 3: Seek legislation authorizing OIA to impose time limitations of funds obligated into grant agreements. OIA does not agree with this recommendation. While many OIA grants are directed in appropriations acts or accompanying legislative history, OIA has options to seek reprogramming through administrative budget processes or to seek a rescission or re-appropriation through appropriation bills. OIA now places termination dates on its discretionary grants. The actual decision to terminate a grant is seldom a simple management decision. It is more often a policy decision, which must be considered with reference to several complex factors.

The Report bases its recommendation on examples of two grants that have been inactive for many years yet remain obligated, even though no funds have been disbursed in excess of work actually performed. One is a juvenile detention center in the Virgin Islands that dates back to the early 1980s. The Report failed to mention that originally there were two directed appropriations for construction of two detention facilities. Using the methods mentioned above, one project was terminated and funds were successfully directed to other project uses. The second project was allowed to continue at the request of four successive administrations in the Virgin Islands and was approved by as many different Administrations at OIA. This project was started but has not been completed due to a contractor dispute, which OIA was recently apprised of. Specifically, OIA received a copy of a letter sent to the Virgin Islands Office of Management and Budget

stating that the contractual agreement between the Government of the Virgin Islands and the contractor for this project was terminated due to irreconcilable issues. OIA has again reached a point where a decision must be made whether to terminate this grant or try to renew it. Given current priorities, the Virgin Islands government may want to reprogram this money and direct its use towards other valuable projects, including meeting court-ordered improvements to its wastewater system.

The second example is a directed appropriation of \$2.7 million for Ordot Landfill on Guam. The Report states, "After years of inactivity, the Landfill has become a dumping ground and is a recognized health and environmental hazard. In August 2002, the Environmental Protection Agency (EPA) filed a lawsuit to force Guam to close the Landfill. Despite this history, however, OIA has not rescinded the \$2.7 million grant."

We would first note that OIA does not have the authority to rescind the grant, but would have to seek the approval of Congress to have the grant rescinded. More to the point, though, we strongly disagree with the Report's suggestion that rescinding the grant would have helped to alleviate the environmental problems at Ordot. In fact, we believe that following the Report's suggestion would have made the rather dangerous problem at Ordot worse, not better. OIA has also been frustrated by the amount of time that it has taken for Guam to use this grant. Most of the delay was caused because Congress, at the request of OIA, required that Guam implement tipping fees before it could use this money. OIA requested Congress to impose this condition because the \$2.7 million that we were able to provide was only a small fraction of the cost required to close or otherwise address the problems of the landfill. In November 2002, five months after I took office, I personally reviewed this case with the newly elected governor and lieutenant governor of Guam. I concluded that it was still necessary to keep the money available to help Guam address the problem. I am confident that I made the right decision: the Government of Guam recently informed us that on the basis of this grant, they have ordered heavy equipment that is necessary to improve the operation of the landfill. We expect the funds to be drawn down shortly.

Recommendation 4: Require grant managers to document their site visits and ensure that field representatives submit site visit reports. OIA agrees with this recommendation. A site visit format and checklist were included as Appendix D to the Manual. Part VI, Section E (Grant Monitoring) of the Manual imposes responsibility for site visits on field representatives, as well as grant managers and program specialists. OIA does question the relevance of the finding that OIA had failed to document any site reviews of the Ordot project. OIA did not conduct onsite reviews of the project because the project had not been initiated. There was no site to review. That does not mean, however, that OIA was neglecting the situation. The grant file on Ordot contains numerous letters and memoranda between the grant manager at OIA and program officials on Guam and between political officials in OIA and Guam trying to resolve management, political and financial problems that were preventing initiation of the project.

Recommendation 5: Enforce grant agreements that require grantees to submit status and final reports. OIA agrees with this recommendation. Part VI, Section (D)(2) of the Manual states that prior to approving drawdown of funds under a grant, the grant manager will “verify that all grant reporting requirements have been met for each grant including timely submission of SF-269, SF-272 and narrative status reports.” In the past, grants managers often have exercised judgment not to withhold payments based on a delinquent report. OIA policy now requires full documentation of any such judgment. In addition to changes in the Manual, OIA has taken several other steps to ensure timely reporting. First, OIA has added additional grant staff to its office to help maintain grant files and ensure compliance of terms and conditions. Second, OIA is increasing its site visits and requiring documentation as was described under Recommendation 4. The site visit format and checklist require the inspecting official to ascertain the status of reports and follow up on delinquencies. Finally, OIA is developing a competitive process for allocating capital improvement grants to U.S. territories. One criterion upon which allocation decisions will be based is the applicant’s history of performance in meeting reporting requirements.

Recommendation 6: Consider retention of funds (10%) or termination of funding if the grantee violates the grant agreement. OIA agrees with the intent of this recommendation. In the meeting with auditors on the preliminary draft, this issue was discussed and OIA expressed concern that a ten-percent retention was more of a contract mechanism than grant tool. There are clear differences between extensive Federal Procurement Regulations and standard grant regulations, commonly known as the “Common Rule.” A ten-percent retention is not authorized under the Common Rule.

The Report suggests that OIA should have initiated legislative action to rescind certain grants. As noted above, we do not agree with the Report’s suggestions as they relate to the specific grants that were cited in the Report. We also do not agree with the implication that OIA is not willing to exercise remedies in appropriate circumstances. I do not expect my grant managers to automatically exercise remedies simply because OIA technically has the right to do so. I expect my grant managers to exercise their professional judgment and recommend how we can use whatever tools we have available in an appropriate manner to further our goals and objectives. That will usually require us to weigh a number of competing concerns, and decide on a course of action that makes the most sense under the circumstances.

OIA has a documented history of many instances when it has terminated grants, recovered disallowed costs and withheld payments in order to achieve compliance with grant terms and conditions. Several representative examples of enforcement actions are listed below:

1. In April 1998, OIA terminated operations and maintenance improvement program (OMIP) grants to the Virgin Islands totaling \$392,500 and grants totaling \$216,644 to the CNMI due to non-performance.

2. In March 1999, OIA suspended payments for a CNMI elementary school project because the work completed did not equate to the payments requested by the contractor and because of news reports indicating the contractor was in financial distress.
3. In February 2000, OIA recovered \$94,697 disallowed for abandoned construction at Tinian High School in the CNMI.
4. In June 2001, OIA terminated \$1,350,000 of CIP grants to the Virgin Islands due to non-performance, and awarded a new grant to the Roy Lester Schneider Hospital for the same amount.
5. In June 2001, OIA terminated a \$235,000 OMIP grant to Guam due to non-performance.
6. In June 2002, OIA disallowed and recovered \$41,600 for the cost of vehicles which had been inappropriately charged to a school construction account.
7. In June 2002, OIA disallowed costs and recovered \$35,000 from the Federated States of Micronesia associated with a Chuuk road drainage project.
8. In February 2003, OIA notified the CNMI that payments were suspended on a wastewater treatment plan until a detailed status report was filed explaining why the project was behind schedule.
9. In February 2003, OIA notified the CNMI that payments were suspended on projects managed by the Commonwealth Utilities Commission and the Public School System until narrative status reports were received.
10. In April 2003, OIA withheld payment of \$568,182 on Guam's island-wide road project until financial and narrative status reports were received.

Recommendation 7: Provide for periodic reviews of the files by management to ensure compliance with the OIA Manual and/or grant agreements.


OIA agrees with this recommendation and will provide for periodic reviews of the files by management to ensure compliance with the Manual.

Recommendation 8: Complete the Revision of the OIA Manual: As noted above, OIA adopted the Manual on March 31, 2003, culminating an effort of several months to review and update our procedures. However, the Department of the Interior, as required by Public Law 106-107, has undertaken a major effort to standardize grant requirements, not only within the Department of the Interior but among all Federal agencies. When this

effort is completed it may require significant changes to the Manual or possibly result in standardized policies that will supercede parts of the Manual.

Please feel free to contact me if you have any questions or comments.

Sincerely,


for

David B. Cohen

Appendix 3

Status of Recommendations

<u>Recommendation</u>	<u>Status</u>	<u>Action Required</u>
2, 4, 5, 7 and 8	Resolved and Implemented.	No further response to the Office of Inspector General is necessary.
1, 3 and 6	Unresolved	Provide a response to the revised recommendations that states concurrence or nonconcurrence with the recommendations. If concurrence, provide a corrective action plan that includes the target date and title of the official responsible for implementation of the recommendations.

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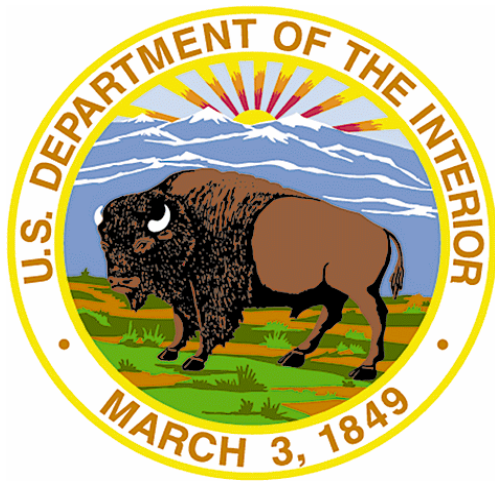
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