



**U.S. Department of the Interior  
Office of Inspector General**

# **AUDIT REPORT**

**OGLALA SIOUX  
RURAL WATER SUPPLY SYSTEM,  
MINI WICONI RURAL  
WATER SUPPLY PROJECT,  
BUREAU OF RECLAMATION**

**REPORT NO. 99-I-627  
JUNE 1999**



# United States Department of the Interior

OFFICE OF INSPECTOR GENERAL  
Washington, D.C. 20230

JUN 29 1999

## Memorandum

To: Assistant Secretary for Water and Science

From: Robert J. Williams   
Assistant Inspector General for Audits

Subject: Audit Report on the Oglala Sioux Rural Water Supply System, Mni Wiconi  
Rural Water Supply Project, Bureau of Reclamation (No. 99-I-627)

This report presents the results of our audit of the cost of constructing the Oglala Sioux Rural Water Supply System, which is part of the Mni Wiconi Rural Water Supply Project located in South Dakota. The objectives of the audit were to (1) **identify** the source of any actual or projected System cost overruns and (2) determine whether the costs incurred by the Oglala Sioux Tribe were expended in accordance with Federal law, regulations, and funding agreements. Our review of the Tribe was performed as part of our audit of the four non-Federal sponsors of the Project, including the Tribe. The results of our review of the other Project sponsors have been presented in separate reports. The audit of the Mni Wiconi Project was undertaken at the request of three members of the Congress.

Based on our review, we found that cost overruns totaling an estimated \$49.7 million will occur in constructing the Oglala Sioux Rural Water Supply System as currently designed. This amount consists of \$16.3 million expended for System components completed or under construction and \$33.4 million for future construction. Furthermore, the Tribe is likely to exceed its percentage allowance for noncontract activities, which we estimate would increase the cost overruns by \$12.9 million, to a total of \$62.6 million. These overruns will occur because the costs for some of the components were underestimated; other components were not included in the Bureau's May 1993 Final Engineering Report; and the Bureau and the Tribe did not ensure that the System was planned, designed, and constructed as described in the Report. As a result, we believe that the System as currently designed cannot be completed within the existing appropriation ceiling.

We also found that the costs incurred by the Tribe under construction contracts for the System (\$34.3 million) and for related noncontract activities, such as design, geotechnical design, archaeology, inspection, and investigation (totaling \$14.4 million), were generally expended in accordance with Federal law, regulations, and funding agreements. However, our review of costs of \$15.6 million incurred by the Tribe for other noncontract activities (contract and easement administration and training) identified expenditures that were not allowable under Office of Management and Budget Circular A-87 or the cooperative

agreements, were not supported by the Tribe's accounting records, or were not in compliance with the provisions of the cooperative agreements or the indirect cost rate agreements. We believe that the questioned expenditures occurred because the Bureau and the Tribe did not clearly establish in the funding agreements the amounts and the types of costs that can be charged to the System or ensure that the indirect cost charges were based on the approved rates. As a result, of the costs of \$660,728 tested for compliance, we classified \$64,919 as cost exceptions because they were not applicable to the System and \$266,228 as unsupported costs because of a lack of documentation showing the relationship of the costs to the System. Also, of the costs of \$486,722 charged to an administrative account established under the 1994 cooperative agreement, we questioned \$366,428 because the expenditures did not meet the terms of the agreement. Further, we classified indirect costs totaling \$456,531 as cost exceptions because the Tribe did not adjust its charges to the System for its indirect costs when the final indirect costs rates were approved.

To address the estimated cost overruns, we recommended that the Bureau (1) request an increase in the authorization ceiling or negotiate with the Tribe to reduce System costs by modifying or eliminating System components, (2) negotiate a requirement in its ongoing and future cooperative agreements to establish a cost accounting system for construction projects, and (3) provide increased monitoring of System expenditures. Regarding the cost compliance issues, we recommended that the Bureau (1) modify the cooperative agreements to identify the type and amounts of allowable costs for contract and easement administration and training and (2) instruct the Tribe to reimburse the System or provide support for the cost exceptions and unsupported costs identified by our review.

In the May 25, 1999, response (Appendix 5) to the draft report from the Commissioner, Bureau of Reclamation, the Bureau concurred with Recommendations A. 1, A.3, B. 1, B.2, B.3, and B.4, and nonconcurred with Recommendation A.2. However, we believe that the actions proposed in the Bureau's response meet the intent of Recommendation A.2. Therefore, based on the response, we consider all of the recommendations resolved but not implemented. Accordingly, the recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation (see Appendix 7).

On May 27, 1999, we received a response from the President of the Oglala Sioux Tribe, which nonconcurred with our findings on cost compliance but did not address our finding on project cost overruns. We have considered the Tribe's comments in preparing our final report and have revised the amount reported as unsupported costs based on additional documentation provided by the Tribe.

Since the report's recommendations are considered resolved, no further response to the Office of Inspector General is required (see Appendix 7).

The legislation, as amended, creating the Office of Inspector General requires semiannual reporting to the Congress on all audit reports issued, the monetary impact of the findings (Appendix 1), actions taken to implement audit recommendations, and identification of each significant recommendation on which corrective action has not been taken.

We appreciate the assistance of Bureau and Tribal personnel in the conduct of our audit.

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# INTRODUCTION

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## BACKGROUND

The Mni Wiconi Project Act of 1988 (Public Law 100-516) authorized and directed the Secretary of the Interior to construct the Mni Wiconi Rural Water Supply Project to provide a safe and adequate municipal, rural, and industrial water supply to both Indian and non-Indian residents of South Dakota. Initially, the Project included the Oglala Sioux Rural Water Supply System, the West River Rural Water System, and the Lyman-Jones Rural Water System. In 1994, the West River and the Lyman-Jones Systems were merged into one system, known as the West River/Lyman-Jones Rural Water System. The Mni Wiconi Act Amendments of 1994 (Public Law 103-434, Title 8) added construction of the Rosebud Sioux and the Lower Brule Sioux Rural Water Systems to serve the respective reservations, thereby increasing the number of Project “sponsors” to four. The amendments also raised the authorized appropriation ceiling for the Project from \$87.5 million to \$263.2 million, subject to cost indexing,<sup>1</sup> and provided that the systems would generally be constructed in accordance with the Project’s Final Engineering Report, dated May 1993. The Report also established the appropriation ceilings for each sponsor’s water system and for the core pipeline system, which is being constructed by the Oglala Sioux Tribe.

The core system, which is estimated to cost \$98.4 million (indexed to October 1999), is shared by the four project sponsors and serves as the main diversion of Missouri River water that is conveyed to each of the sponsor’s respective distribution systems. The Act, as amended, also authorized the Secretary to enter into cooperative agreements with the three tribes, subject to the provisions of the Indian Self-Determination and Education Assistance Act (Public Law 93-638), as amended, to provide funds for planning, designing, constructing, operating, maintaining, and replacing their respective systems. Separate cooperative agreements were authorized for planning, designing, and constructing the West River/Lyman-Jones System, with the Project sponsor responsible for 20 percent of these costs. In addition, the Project sponsor is solely responsible for the cost of operating, maintaining, and replacing the System. The Bureau of Reclamation serves as the oversight agency for the Project, with the authority to enter into cooperative agreements and to provide the technical and administrative oversight needed to complete the planning, design, and construction of the Project. The Bureau’s oversight includes reviewing and approving reports, construction plans, specifications, work schedules, fund requests, and change orders. The Bureau has entered into three cooperative agreements with the Tribe since the Project’s inception (see Appendix 2).

The overall Project includes a water treatment plant, 4,500 miles of pipeline, 60 booster pump stations, and 35 water storage reservoirs. The Project will ultimately serve more than 50,000 people, including more than 40,000 Indians on the three reservations. In its “Master

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<sup>1</sup>Cost indexing is the process of updating the Congressionally authorized appropriation ceiling for changes generally attributable to economic factors, usually inflation. The Project’s indexed appropriation ceiling through October 1999 is estimated to be \$327 million.

Plan,"<sup>2</sup> the Bureau estimated that the total cost to complete the Project would be \$387 million, or \$60 million more than the indexed Project cost of \$327 million. The projected overrun was attributable to the Oglala Sioux and the Lower Brule Sioux Systems. In the "Master Plan," the Bureau also estimated that at current funding levels, the \$327 million would not be fully appropriated until 2006. However, the authorization to appropriate funds for the Project expires in 2003. As of September 30, 1998, the Bureau had allocated Federal funds of \$107.5 million to Project sponsors, including \$4.3 million for Bureau administration and oversight charges to the sponsors.

The Oglala Sioux Rural Water Supply System as authorized includes about 560 miles of pipelines, 30 booster pump stations, and 27 water storage reservoirs and will serve approximately 21,000 people on the Pine Ridge Indian Reservation. The cost of the Oglala System, originally estimated at \$145.3 million in the Final Engineering Report, was indexed in the "Master Plan" to \$175.2 million (October 1999 dollars). As of September 30, 1998, about \$71.8 million (41 percent of the estimated costs) had been allocated, and about \$67.4 million (38 percent of the estimated cost) had been expended.<sup>3</sup>

## **OBJECTIVES AND SCOPE**

The objectives of our audit, which was conducted at the request of three members of the Congress, were to (1) identify the source of any actual or projected cost overruns and (2) determine whether the costs incurred by the Tribe were made in accordance with Federal law, regulations, and funding agreements. Our audit of the Tribe was performed as part of our audit of the four non-Federal sponsors of the Project. The results of the audits of the other three Project sponsors have been presented in separate reports.

To accomplish our audit objectives, we reviewed applicable legislation and Federal, Department of the Interior, and Tribal regulations and policies governing the authorization and management of the System. In addition, we reviewed the Indian Self-Determination and Education Assistance Act, as amended, and documents and financial activities related to the System, such as procurement practices, correspondence, System reports, engineering estimates, bid abstracts, contracts, and invoices. We also reviewed the Tribe's financial statements and compliance reviews of the System performed by the Tribe's contracted accounting firm. Further, we interviewed Bureau program and Tribal personnel to obtain an understanding of the System's financial management and accounting systems; personnel from the engineering firm contracted by the Tribe to plan, design, and manage the System's construction; and members of the public accounting firm that performed the Tribe's annual

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<sup>2</sup>The "Master Plan," dated May 1998, established the construction schedule for each segment of the Project and documented historical and projected costs to enable the Bureau and Project sponsors to track the status of the Project. The "Master Plan" also enabled the Bureau and Project sponsors to estimate the effect of changes in annual appropriations and prices on the construction schedule. The "Master Plan" projected a Project construction ceiling of \$327 million, indexed through October 1999, as presented in Bureau budget documents for fiscal year 2000. The "Master Plan" also included a breakdown of this ceiling for individual Project sponsors. The total estimated Project costs of \$387 million were based on information provided by Project sponsors. The Bureau plans to update the "Master Plan" periodically.

<sup>3</sup>These amounts include \$3.1 million for administration and oversight charges by the Bureau

financial audit and compliance reviews of the System's expenditures. Our audit encompassed construction activities and records from the System's inception in 1991 through September 30, 1998, including the Bureau's cost estimates to complete the System. Our compliance testing of the System's accounting records included the period of January 1995 through September 1998. Our compliance testing did not include accounting periods prior to January 1995 except for our review of the Tribe's indirect cost charges because of the lack of availability of the records at the Tribal offices.

The audit was made, as applicable, 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 that were considered necessary under the circumstances. As part of the audit, we reviewed the Secretary's Annual Statement and Report to the President and the Congress, required by the Federal Managers' Financial Integrity Act for fiscal years 1994 and 1995; the Departmental Reports on Accountability for fiscal years 1996 and 1997, which include information required by the Act; and the Bureau's annual assurance statements on management controls for fiscal years 1997 and 1998. Based on those reviews, we determined that no material weaknesses were reported that directly related to the objectives and scope of our review.

Our analysis of the financial status of the Oglala Sioux Rural Water Supply System was based on expenditures, cost estimates, and other financial and planning data available as of September 30, 1998. As such, our conclusions regarding any actual or projected cost overruns may be affected by subsequent events concerning the cost and design of the System. These events include modifications, additions, and deletions of construction components; revisions of cost estimates based on more current data; increases in the authorized Project ceiling; and efforts by the Bureau and the Tribe to implement cost-saving measures. In this regard, the Bureau issued, in December 1998, the draft "Mni Wiconi Rural Water Supply Project Cost Containment Report," which presents various options for reducing Project costs.

The audit was conducted from August 1998 through March 1999 and included visits to the Bureau of Reclamation's Great Plains Regional Office in Billings, Montana; the Bureau's Dakotas Area Office in Bismarck, North Dakota; the Oglala Sioux's Tribal Office in Pine Ridge, South Dakota; the Oglala Sioux Rural Water Supply System's Administrative Office in Kyle, South Dakota; the offices of the Tribe's engineering firm, in Helena, Montana; and the Tribe's accounting firm in Albuquerque, New Mexico. As part of our audit, we reviewed the Tribe's system of internal controls over its accounting for and management of Federal funds as they relate to the Oglala Sioux Rural Water Supply System. We found that the Tribe had not established the controls needed to ensure that only those segments of the System identified in the Final Engineering Report were constructed and that the percentage allowances for noncontract costs were kept within the percentages established in the Report. These weaknesses are addressed in the Findings and Recommendations section of this report. Our recommendations, if implemented, should improve the internal controls in these areas.

## **PRIOR AUDIT COVERAGE**

Neither the Office of Inspector General nor the General Accounting Office has issued any reports on the Mni Wiconi Rural Water Supply Project during the past 5 years.

## FINDINGS AND RECOMMENDATIONS

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### A. PROJECT COST OVERRUNS

We found that cost overruns totaling an estimated 549.7 million will occur in constructing the Oglala Sioux Rural Water Supply System if construction is completed as currently designed (see Appendix 3). This amount consists of cost overruns of \$16.3 million for System components completed or under construction and \$33.4 million for future construction. Furthermore, the Tribe is likely to exceed its percentage allowance for noncontract activities, which we estimate would increase the cost overruns by \$12.9 million, to a total of \$62.6 million. The Mni Wiconi Project Act of 1988, as amended (Title 8 of Public Law 103-434), established the Mni Wiconi Rural Water Supply Project's May 1993 Final Engineering Report as the criterion for planning, designing, and constructing the Oglala Sioux System. In addition, the cooperative agreements between the Bureau of Reclamation and the Tribe stated that the Bureau was to ensure that the System was planned, designed, and constructed as generally described in the Final Engineering Report. However, cost overruns will occur because the costs for some components were underestimated; other components were not included in the Report; and the Bureau and the Tribe did not ensure that the System was planned, designed, and constructed as described in the Report. As a result, the System as currently designed cannot be completed within the existing appropriation ceiling.

#### Construction Costs

The costs incurred for some construction components of the Oglala Sioux Rural Water Supply System exceeded the estimates in the May 1993 Final Engineering Report because the cost estimates were understated, the components were expanded, and/or the components had been "overlooked" and not included in the Final Engineering Report. These components included buildings; pipelines; and a water treatment plant that will be used to manage, operate, and maintain the System. The Bureau and the Tribe believed that the increased costs were necessary and generally allowable under the Mni Wiconi Project Act, as amended. Therefore, the Bureau approved these additional costs but did not seek increases in the authorized appropriation ceiling to reflect the increased costs associated with these components.

**Underestimated Costs.** During our review, we compared the contracted construction costs with the field cost<sup>4</sup> for the components as outlined in the Final

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<sup>4</sup>As outlined in the Final Engineering Report, field costs were the contract costs for a construction component, including 23.75 percent for appurtenant items and contingencies. The Report defined appurtenant items as "items that were not specifically identified in the cost estimating procedures because the item does not represent a significant cost. [including] such things as valves along the pipeline. miscellaneous electrical wiring in the pump stations. tees, bends, and other necessary. but minor components of the constructed project." The Report defined contingencies as costs incurred for "unforeseen circumstances during construction [such as] an unexpected excavation into rock along the pipeline route where no rock was anticipated or the need to build a stronger foundation at the treatment plant because unusual soil conditions were discovered."

Engineering Report. Based on our review, we found that costs for some components exceeded the costs in the Report by a total of \$8.6 million. The underestimated costs resulted from changes in quantities and prices of materials and/or in the design specifications. For example:

- The cost of the Missouri River water intake for the core system increased by \$1.9 million because the intake site was changed from the Oahe Dam site identified in the Report to Echo Point on the Missouri River below the Dam, which increased the costs for the intake to the water treatment plant and for the building that houses the pumping station.

- The cost of the core system's water treatment plant increased by \$1.5 million because the treatment plant's location, floor plan, and elevation and the requirements for the associated lagoons were not known or defined when the Report was prepared.

- The cost of the completed portion of the pipeline for the Kadoka-to-Pine Ridge segment of the distribution system increased by \$2 million, primarily because 25,402 additional feet of pipe were needed (\$300,000), pumping station costs were increased (\$400,000) appurtenances and contingencies costs were increased (\$300,000), and the costs of service lines and residential connections were higher than estimated (\$1 million).

- The cost of the Oglala Interim and Slim Butte components under the Prairie Winds Development increased the cost of the distribution system by \$579,880 because the actual composite unit cost of \$5.05 exceeded the unit cost of \$3.15 in the Report for 305,200 feet of pipe.

**Additional or Expanded Components.** Subsequent to the issuance of the Final Engineering Report, the Bureau and the Tribe determined that components needed to manage, operate, and maintain the System had been "overlooked" and that other components needed to be expanded. Based on our review, we identified additional costs of \$7.7 million for components that were not included in the Report or that were expanded. These costs included the following:

- The water distribution system for the Prairie Winds Development,' which consisted of additional residential housing and a casino development in the western area of the Pine Ridge Reservation, added about \$1.1 million to the cost of the System.

- An administrative office building in Kyle and an operation and maintenance building in both Kyle and Pine Ridge were added at a total cost of about \$4 million. System officials

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'The Prairie Winds Development consists of three components: the White Clay/Wakpamni, the West Boundary, and the Pine Ridge to Slim Butte. Only the White Clay/Wakpamni, also referred to as the Oglala Interim component, and the Pine Ridge-to-Slim Butte component were included in the Final Engineering Report. After inclusion of the Report in the Mni Wiconi Act Amendments of 1994, the distribution system for the Prairie Winds Development required additional expansion. Accordingly, the West Boundary Pipeline, also referred to as the Casino Pipeline, was added, and the Pine Ridge-to-Slim Butte component nearly doubled in size.

stated that the exclusion of these buildings from the Report was an “oversight” and that the Bureau agreed to and approved the funding for construction of the buildings

## **Noncontract Costs**

Neither the Bureau nor the Tribe adequately monitored noncontract expenditures to ensure that the percentage allowances for these activities as established in the Report would not be exceeded. This occurred because the Bureau did not require, and the Tribe did not establish, a cost accounting system or structure to monitor the costs incurred for the System in relationship to the Report’s estimates. The Report established an allowance of 39.2 percent for noncontract costs for the System. Table 9<sup>6</sup> of the Report further established percentage allowances for specific activities such as design, geotechnical, archaeological, construction observation, contract administration, and training. Based on our analysis, we concluded that when compared with the percentage allowances in the Report, the expenditures for all activities except for contract administration, easement administration, and training were generally within the expected range, considering that construction of the System was only about 25 percent complete. However, we determined that expenditures for contract administration, easement administration, and training were substantially higher than the percentage allowances and will exceed the estimated amounts for these activities unless they are curtailed significantly. Table 9 of the Report indicates that the costs for contract administration, easement administration, and training should be 13.2 percent, 1.25 percent, and 2 percent, respectively, of the contract costs. To determine whether the expenditures for these activities were within these allowances, we multiplied the Tribe’s overall rate of 14.45 percent<sup>7</sup> by the contract costs incurred through September 30, 1998, and compared this amount (\$4.9 million) with the amount recorded in the Tribe’s accounting records for contract and easement administration and training (\$15.6 million). Based on this comparison, we found that the amount expended was more than three times the amount allotted for these activities.

Bureau and Tribal officials told us that noncontract costs, especially for contract administration, easement administration, and training, were generally higher during the early stages of a project and that they expected these costs to decrease significantly as the System is constructed. Although we agree that the costs for these activities may decrease: we concluded that the expenditures incurred through September 30, 1998 (\$15.6 million), were disproportionately high when compared with the computed allowance (\$4.9 million). Also,

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<sup>6</sup>Table Y presents a summary of the computations used to determine the project cost estimates for the Mni Wiconi Rural Water Supply Project. The noncontract rate of 39.2 percent included an allowance of 1 percent for the Bureau’s oversight responsibilities. Since the Report did not contain a line item for the Bureau’s allocation, the Tribe allocated 1 percent from each of the following cost categories: construction observation, contract administration, investigation and archaeology, and easements.

<sup>7</sup>The 14.15 percent rate consists of 12.2 percent for contract administration, 0.25 percent for easement administration, and 2 percent for training. The percentages for contract administration and easement administration do not include the 1 percent allowance for the Bureau’s oversight responsibilities.

based on the Tribe's expenditures to date, we determined that only \$0.5 million' remains available for these activities if the System's costs are to stay within the allowance percentages established in the Report. Since the amount available is less than the average amounts spent (\$2.8 million) on these activities during the last 3 years,' we concluded that the funds for these activities could be depleted by the end of fiscal year 1999 unless there is a significant reduction in the Tribe's expenditures or additional funds are appropriated,

We identified two factors that contributed to the Tribe's expenditures exceeding the allowance percentages established in the Report First, from the beginning of System construction, the Tribe expended funds for contract administration staff and training that far exceeded the amounts expected based on the construction funding levels. For example, Tribal accounting records showed that the Tribe expended \$4.9 million on contract administration, easement administration, and training, including about \$1 million for public involvement, through September 30, 1994, while construction during this period totaled only \$2.1 million. In addition, the public involvement program, initiated in June 1991 as a short-term measure to inform Tribal members of the System's benefits, is an ongoing program and represents approximately 30 percent of the contract administration and training costs under the latest cooperative agreement. Furthermore, as discussed in the section "Cost Compliance" of this report, a high percentage of the costs tested in these categories were questioned.

## **Estimated Future Costs**

During our review, we received estimates of future costs from the Tribe and the Tribe's contracted engineering firm related to the System's construction. Since the estimates were based mainly on technical analyses, we were not able to confirm that the costs were reasonable and accurate. However, based on the data obtained, we identified estimated future costs of \$33.4 million for components whose costs were underestimated or were not included in the Final Engineering Report (see Appendix 3). For example:

- The engineering firm estimated that additional costs of \$18.2 million may be incurred for the core system construction because pumping stations, reservoirs, and pipelines are more expensive than anticipated in the Report. This amount included \$806,500 for 23,784 linear feet of additional pipe that was not included in the Report.

- Additional costs of \$1.9 million may be incurred because the Tribe raised its Tribal Employment Rights Office tax in August 1998 from 2 percent as included in the Report to 4 percent.

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"We calculated the allowable contract administration, easement administration, and training costs based on rates in Table 9 in the Report: deducted the annual costs expended for these activities; and adjusted the remaining amounts according to the annual composite indices used by the Bureau for the Project.

<sup>9</sup>During 1996, 1997, and 1998, the Tribe expended \$2.9 million, \$2.3 million and \$3.2 million, respectively, for these activities.

- An additional operation and maintenance building will be constructed in Wanblee, South Dakota, at a cost of \$900,000 for the northwest boundary of the System's operation. This component was not included in the Report.

- A water storage reservoir estimated to cost \$750,000 is planned for the Prairie Winds Development to accommodate future growth resulting from the casino operations. The Director of the Water Supply System said that the Tribe has offered to pay for half of the additional costs associated with this reservoir. This water storage reservoir was not included in the Report.

- The Tribe may incur additional estimated costs of \$8.8 million for noncontract activities associated with the additional future increases in contract costs based on the 39.2 percent allowance in the Report.

## **Recommendations**

We recommend that the Commissioner, Bureau of Reclamation:

1. Request additional funding needed to construct the Oglala Sioux Rural Water Supply System as currently planned or negotiate with the Oglala Sioux Tribe to determine which components can be modified or eliminated to stay within the legislatively established construction cost limitation.

2. Negotiate with the Tribe to establish a requirement in the current and future cooperative agreements to establish a cost accounting system for the Oglala Sioux Rural Water Supply System. The accounting system should allow the tracking of expenses and budgets as they relate to the Project in its entirety and to the specific construction and noncontract components, thereby enabling the Bureau to monitor costs effectively.

3. Monitor the costs being incurred by the Oglala Sioux Tribe to ensure that the System is built as generally described in the Final Engineering Report and subsequent cooperative agreements and that the costs associated with the various activities are within the established allowances as negotiated in the cooperative agreements.

## **Bureau of Reclamation Response and Office of Inspector General Reply**

In the May 25, 1999, response (Appendix 5) to the draft report from the Commissioner, Bureau of Reclamation, the Bureau concurred with Recommendations 1 and 3 but did not concur with Recommendation 2. Regarding Recommendation 2, the Bureau stated that instead of requiring the Tribe to establish a cost accounting system, it will negotiate with the Tribe "to provide more detailed schedules in support of fund requests to allow more effective tracking of expenses and budgets." We believe that this proposed action meets the intent of the recommendation to improve the effectiveness of the Bureau's monitoring. As such, we consider all three recommendations resolved but not implemented (see Appendix 7).

## **B. COST COMPLIANCE**

We found that costs of \$34.3 million<sup>10</sup> incurred by the Tribe under construction contracts for the Oglala Sioux Rural Water Supply System and of \$14.4 million<sup>11</sup> for related noncontract activities, such as design, geotechnical design, archaeology, inspection, and investigation, were generally expended in accordance with Federal law, regulations, and cooperative agreements. However, based on our review of costs of \$15.6 million incurred by the Tribe for other noncontract activities (contract and easement administration, training, and indirect costs), we identified expenditures that were not allowable under Office of Management and Budget Circular A-87 and the cooperative agreements, were not supported by the Tribe's accounting records, or were not in compliance with the provisions of the cooperative agreements or the indirect cost rate agreements. Cost compliance requirements are established through Office of Management and Budget circulars, the Tribe's Financial Manual, cooperative agreements, and negotiated indirect cost rate agreements. We believe that the questioned expenditures were incurred because the Bureau and the Tribe did not clearly establish in the funding agreements the amounts and the types of costs that could be charged to the System and ensure that the indirect cost charges were based on the approved rates. As a result, of the direct costs of \$660,728 tested, we classified \$64,919 as cost exceptions because they were not applicable to the System and \$266,228 as unsupported costs because of a lack of documentation showing the relationship of the costs to the System. In addition, we questioned \$366,428 of the \$486,722 of direct Tribal administration costs, which consisted of cost exceptions of \$140,349 because, in our opinion, they were not related to the Tribe's administration of nonconstruction contracts and unsupported costs of \$226,079 because we could not readily trace these costs to specific expenditures. Finally, we classified \$456,531 of indirect costs as a cost exception because the Tribe did not adjust its charges to the approved final indirect costs rates.

### **Contract Administration and Training**

We judgmentally tested, based on the dollar significance of transactions, costs of \$660,728, or approximately 34 percent, of the \$1,920,607 expended by the Tribe in seven<sup>12</sup> of its administrative accounts for the period of January 1995 through September 1998. Based on this review, we questioned costs totaling \$334,934, which consisted of cost exceptions of \$64,919 and unsupported costs totaling \$266,228. The 1994 cooperative agreement between the Bureau and the Tribe stipulates that administrative costs incurred by the Tribe be reasonable and allocable to the work performed under the agreement. The agreement also states that Office of Management and Budget Circular A-87 should be used as the criterion for determining the allowability of costs, provided that the circular does not conflict with the terms of the Indian Self-Determination and Education Assistance Act (Public Law 93-638), as amended. In addition, the Tribe's Financial Management System Manual incorporates

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<sup>10</sup>Our review did not include a technical evaluation or a test of reasonableness of the extent of expenditures incurred in these categories, since these issues should be evaluated by the Bureau.

<sup>12</sup>The seven accounts were Administration, Community Involvement/Outreach Training, Travel, Committee/Advisory, Committee/Elderly, and Committee/Steering.

Office of Management and Budget Circular A-87 and recommends that “program directors operating **under** a [Public Law 93-] **638** contract refer to OMB [Office of Management and Budget] Circular A-87 as a general guide in the allowability of costs charged to the contract.”

**Cost Exceptions.** We identified cost exceptions of \$64,919 pertaining to expenditures that are unallowable under Office of Management and Budget Circular A-87, the Tribe’s Financial Manual, and the cooperative agreement as follows:

- Travel costs of \$13,489 incurred for items such as Tribal government activities or incorrect per diem rates. Although the Tribe’s compliance reviews had questioned some of the costs for those trips, such as for an airline ticket, per diem, or lodging, the reviews did not question the entire cost of the trip.

- In our opinion, costs totaling \$5 1,430 were not allocable to the System as follows: \$17,610 for items such as quilts, beadwork, and crafts; \$14,127 for Tribal government; \$10,359 for flowers and funeral services; \$3,114 for gifts and video games; and \$6,220 for miscellaneous items, such as a duplicate payment and expenditures associated with the operation and maintenance agreement.

**Unsupported Costs.** We identified unsupported costs totaling \$266,228 as follows:

- Travel costs of \$36,742 were not supported by documentation such as receipts for costs incurred or travel reports showing that the trip was System related.

- Documentation for costs of \$229,486 was insufficient for us to determine whether the expenditures were allocable to the System. The unsupported costs consisted of \$85,382 for food and grocery purchases; \$61,170 for art purchases; \$65,339 for sponsorship payments; and \$17,595 for unsupported training, meetings, and Tribal payments.

In addition, we noted a general increase in the extent of unsupported expenditures since 1995, specifically in the areas of food/grocery, art, and sponsorship payments, as noted in the following chart:

<b>Description</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>Total</b>
Food, groceries	\$8,504	\$9,652	\$33,122	\$34,104	\$85,382
Art			56,570	4,600	61,170
Sponsorships	6,405	9,522	16,786	32,626	65,339
Total	<u>\$14,909</u>	<u>\$19,174</u>	<u>\$106,478</u>	<u>\$71,330</u>	<u>\$211,891</u>

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“Although Public Law 93-638, as amended, refers to contracts, we believe that the cooperative agreements for the planning, design, and construction of the Water Supply System are under the **purview** of the same guidelines.

Fiscal year 1995 was the last year whereby the Bureau and the Tribe negotiated a funding modification that allocated specific dollars to contract administration activities, including public involvement-type expenditures. We believe that the expenditures listed in the chart occurred because the Bureau and the Tribe did not clearly establish the amounts and the types of eligible costs in the funding agreements.

## **Tribal Office Administration Account**

Of the \$486,722 that was charged to an administrative account established under the 1994 cooperative agreement, we questioned \$366,428. Bureau officials stated that when the agreement was formulated, the Tribe indicated its intent to administer the subcontracts for nonconstruction type activities, such as planning, designs and specifications, and construction management, directly from the Tribal offices and not through the Oglala Sioux Rural Water Supply System “Board and their staff.” Accordingly, the cooperative agreement (No. 4-FC-60-04080) included a provision (Clause IV C.2.) that stated, “The Tribe’s administrative cost for subcontracted nonconstruction items (engineering planning, designs and specifications, construction management) shall not exceed 5 percent of the value of any contract authorized [and that] the Tribe will not assess an administrative fee on the construction contracts authorized by this agreement.” To implement the provision, the Tribe established an account titled “Administration,” with a budget of 5 percent of nonconstruction contract costs to defray the Tribe’s costs for labor, travel, and miscellaneous expenses (office setup) that were directly attributable to its efforts to administer subcontracts and that were not included in the Tribe’s indirect cost rate. Bureau officials told us that their understanding was that the Tribe was to bill the System for these services on an actual cost basis, not on a flat 5 percent rate. However, the System’s Director told us that he believed the Tribe was allowed a 5 percent fee for these services and that the Tribe therefore did not bill for actual costs but instead provided the “Administration” account to the System to charge “general” expenses, which we found were not related to the Tribe’s administration of nonconstruction contracts. For example, based on our review of the charges to the account totaling \$260,643<sup>13</sup> for the 9-month period ending September 30, 1998, we classified costs totaling \$140,349 as cost exceptions. These costs consisted of \$21,940 for quilts, arts and crafts, paintings, sculptures, and beadwork; \$48,945 for public involvement activities, such as sponsorships, honoraria, pow wows, rodeos, and youth activities; \$7,852 for food/groceries and banquets; and \$6 1,612 for travel of project staff that was not related to the Tribe’s administration of nonconsttuction contracts.

We were not able to determine whether the \$226,079 charged to the Administration account for the period prior to January 1998 was related to the System because several adjusting journal entries were not adequately supported in the Tribe’s accounting records. Therefore, costs that were charged to the System were not identifiable. As such, we classified costs of \$226,079 as unsupported.

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<sup>13</sup>The \$260.613 included costs of \$36,171 that we classified as cost exceptions or unsupported costs as part of our judgmental sampling of the seven contract and easement administration and training accounts. The \$36.171 is not included in the cost exceptions of \$140,359.

## **Recommendations**

We recommend that the Commissioner, Bureau of Reclamation,

1. Negotiate a contract modification with the Oglala Sioux Tribe to provide for the types and amounts of allowable costs related to contract administration and training and ensure that Bureau officials incorporate this information in future agreements.

2. Instruct the Oglala Sioux Tribe to reimburse the System for the cost exceptions of \$64,919 and to reimburse or provide documentation for the unsupported costs of \$266,228 identified by our review. Also, any supporting documentation provided by the Tribe should be reviewed, and a final determination on the amount of unsupported costs to be reimbursed should be made.

3. Instruct the Oglala Sioux Tribe to bill for the Tribe's administrative cost for subcontracted nonconstruction items (engineering, planning, designs and specifications, and construction management) on an actual cost basis and ensure that the Tribe reimburses or provides support for cost exceptions of \$140,349 and unsupported costs of \$226,079 identified by our review of the Administration account.

4. Instruct the Oglala Sioux Tribe to reimburse the Water Supply System for the indirect cost overcharges totaling \$456,531 and ensure that indirect cost charges for 1996 and subsequent years are adjusted to approved final indirect cost rates based on actual costs.

## **Bureau of Reclamation Response and Office of Inspector General Reply**

In the May 25, 1999, response (Appendix 5) to the draft report from the Commissioner, Bureau of Reclamation, the Bureau concurred with all four recommendations. As such, we consider all recommendations resolved but not implemented (see Appendix 7).

## **Oglala Sioux Tribe Response and Office of Inspector General Reply**

In the May 27, 1999, response (Appendix 6) to the draft report from the President of the Oglala Sioux Tribe, the Tribe generally disagreed with our finding on cost compliance but did not address the finding on project cost overruns. The Tribe included specific comments on our report. These comments and our replies are presented in the paragraphs that follow.

### **Cost Exceptions**

The Tribe stated that the Oglala Sioux Rural Water Supply System "disputes that any repayment to the Bureau of Reclamation is required for cost exceptions" totaling \$64,919, and it provided "supporting documentation" and other information regarding the basis for its changes to the cooperative agreement for community involvement, training, travel, and committee stipends. However, we did not find the "supporting documentation" or the explanations in the Tribe's response sufficient to resolve any of the cost exceptions.

The Tribe also stated that although “the audit report listed check number 2001 as one of the items excepted,” that check was “voided and replaced by check number 2002.”

Regarding the cost exceptions for travel, the Tribe stated that “the program was not charged for this travel and BOR [Bureau of Reclamation] did not pay for any of the costs excepted.” According to the Tribe, program expenditures were reduced for these costs “through adjusting journal entries to the accounting records to transfer such costs to the Tribe’s general fund or program generated revenues. ” The Tribe stated that it provided “copies of the work papers for the adjusting entries.”

**Office of Inspector General Reply.** The documentation provided by the Tribe did not substantiate that the training and travel costs, which included attendance at the National Congress of American Indians and Little Bighorn meetings, were related to the project. Also, although Check No. 2001 in the amount of \$1,574 for training costs had been voided and replaced with Check No. 2002, System expenditures were not properly adjusted. We determined that an adjustment of only \$250 was made to System expenditures, resulting in an overcharge of \$1,324.

Regarding the adjusting journal entries for the travel costs, our review of the journal entries determined that none of the travel costs classified as cost exceptions were included in the journal entries.

**Oglala Sioux Tribe Response.** Regarding the cost exceptions for committee stipend, the Tribe provided documentation with its response to “support that all costs incurred were for the benefit of the program, except costs for \$3,200 which was for contracted services for the operation and maintenance program and was corrected by [an] adjusting journal entry to transfer the costs from the operation and maintenance program to the program.”

**Office of Inspector General Reply.** The cost exceptions we identified included stipend payments for Tribal members attending the Teton Sioux National, the Black Hills Sioux Treaty Council, and the Crazy Horse Planning Commission meetings, for which there was no demonstrated relationship or benefit to the project.

Regarding the operation and maintenance costs included in these charges, the Tribe’s response was not clear on the nature of the adjustment. According to the response, incorrect charges of \$3,200 were corrected by an adjusting journal entry transferring the costs from the operation and maintenance program “to the program.” (Emphasis added.) However, if the transfer was to the program rather than from the program, the exception would be doubled because operation and maintenance costs are not allowed under the cooperative agreement.

### **Unsupported Costs**

**Oglala Sioux Response.** The Tribe provided documentation with its response that, according to the Tribe, would “substantiate that the costs were incurred for the benefit of the program.”

**Office of Inspector General Reply.** The documentation provided by the Tribe was sufficient to support charges for two items totaling \$3,787, and we have revised the audit report accordingly. However, the other documentation was not sufficient to substantiate that the remaining unsupported costs of \$266,228 were related to the project. For example, these costs included \$85,382 for groceries and other food purchases for which the documentation submitted did not identify the specific event for which the purchases were made. Furthermore, grocery and food purchases were made on a frequent basis, often several times a week, and in some cases, it appears that the purchases were for meals for a few individuals. We believe that the Bureau should obtain assurance from the Tribe that all unsupported costs were incurred for the benefit of the Project.

### **Administrative Costs**

**Oglala Sioux Tribe Response.** The Tribe acknowledged that the cooperative agreement permitted it to assess administrative costs of up to 5 percent of nonconstruction contract costs for the management of subcontracts for nonconstruction type activities, but it stated that it allowed the program to use these funds for other activities. Specifically, the Tribe stated:

In an effort to permit the program increased funding for direct services, the Tribe waived the five percent administrative fee and allowed the program to expend a similar amount for general direct services in lieu of the fee. This is generally the explanation for the five percent administrative fee in the audit report. The program does not dispute the audit findings that general direct expenditures were charged to an administrative account.

According to the Tribe, Bureau of Reclamation officials were advised of, and did not object to, this policy.

The Tribe further stated that although it had "waived the administrative cost charges to the program for subcontracted nonconstruction items, [it] did incur costs related to this administration, [which] could have been charged to the program." Specifically, the Tribe identified administration costs totaling \$636,176 for the period January 1, 1995, through September 30, 1998, consisting of \$121,055 for "Contract Management," \$131,503 for "Financial Management," and \$383,618 for "General Management." According to the Tribe, these administrative costs exceeded the 5 percent limitation in each year, which "eliminates the requirement of documenting unsupported expenditures for administration in the audit report."

Further, in response to Recommendation 3 concerning administrative costs, the Tribe stated that the program "agrees to bill for Tribal administrative costs as recommended in the audit report" However, the Tribe requested that "the administrative costs previously incurred as identified in [its response] be accepted as permitted in the cooperative agreement, rather than to require the Tribe to reimburse for any audit exceptions or unsupported costs."

**Office of Inspector General Reply.** We disagree that the use of these funds for “direct services” was proper. The cooperative agreement authorized the use of these funds for the specific purpose of reimbursing the Tribe for costs incurred in administering subcontracts for nonconstruction type activities that were not covered by the Tribe’s indirect cost rate, and there was no documentation in the files indicating that the Bureau had approved the use of these funds for other purposes. In addition, the provision in the cooperative agreement states that the administrative costs “shall not exceed 5 percent of the value of any contract authorized,” indicating that the Tribe was to be reimbursed only for the actual administrative costs incurred. Furthermore, we found that the costs charged to the administrative account were for the same types of expenses such as food and groceries, public involvement, and quilts and paintings that we classified as cost exceptions and unsupported costs in prior sections of our report.

We also disagree that the Tribe has incurred sufficient “costs related to this administration [which] could have been charged to this program. ” The contract management, financial management, and general management costs identified in the Tribe’s response are included in the Tribe’s indirect cost rates; therefore, charging these costs directly to the project would result in a duplicate charge.

### **Indirect Costs**

**Oglala Sioux Tribe Response.** The Tribe disagreed with our recommendation that it should reimburse the Water Supply System for indirect cost overcharges totaling \$456,531, stating the following:

The program disputes that any overcharges occurred in the indirect cost charges during 1991 through 1995. The 1988 amendments (Public Law 100-472) to the Indian Self-Determination and Education Assistance Act precludes the Department of the Interior from such adverse adjustments as recommended in the audit report.

The Tribe also provided a “legal opinion from the leading expert on indirect cost issues” that “strongly supports the program’s position that any repayment of indirect costs would be a violation of law.”<sup>14</sup>

**Office of Inspector General Reply.** We disagree that requiring repayment of the indirect cost overcharges would be a violation of law or, as stated in the legal opinion obtained by the Tribe, contrary to the court’s decision in the **Ramah** Navajo case. Our comments, based on advice from our Office of General Counsel on the specifics of the Tribe’s response, are included in the paragraphs that follow.

We believe that these indirect cost charges were properly questioned pursuant to the terms of the indirect cost rate agreements between the Office of Inspector General and the Oglala

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“We did not include a copy of the legal opinion in our report but considered the opinion in addressing the Tribe’s response.

## CLASSIFICATION OF MONETARY AMOUNTS

Finding	Questioned Costs	
	Cost Exceptions	Unsupported costs
Cost Compliance		
Contract Administration and Training	\$64,9 19	\$266,228
Tribal Office Administration Account	140,349	226,079
Indirect Costs	456,53 1	
Total	<u>\$661,799</u>	<u>\$492,307</u>

## COSTS CONTRIBUTING TO PROJECTED OVERRUN

Description	Costs Through September 1998			Estimated Future Costs	Total System Increase
	Final Engineering Report Added to	Exceeded	Total Costs		
Administration and operation and maintenance buildings	\$4,000,778		\$4,000,778	\$900,000	\$4,900,778
Surface water intake		\$1,933,611	1,933,611		1,933,611
Water treatment plant		1,486,888	1,486,888		1,486,888
Pipelines, pumping stations, reservoirs for core system		75,210	75,210	18,154,207	18,229,417
Easements payments	163,504		163,504	225,000	388,504
Additional residence connections				100,000	100,000
Prairie Winds Development	1,142,183	579,880	1,722,063	750,000	2,472,063
Constructed/under construction Kadoka to Pine Ridge <sup>1</sup>		2,037,654	2,037,654		2,037,654
Upgrade of existing systems				558,907	558,907
Distribution system expansions due to population increase in Bennet County				1,609,806	1,609,806
Noncontract costs related to above construction	2,186,264	2,448,742	4,635,006	8,423,659	13,458,665
Wastewater study				400,000	400,000
Water trucks prior to operation and maintenance agreement	215,019		215,019		215,019
Increase in TERO by 2 percent <sup>2</sup>				1,872,899	1,872,899
Subtotal	\$7,707,748	\$ 8,561,985	\$16,269,733	\$33,394,478	\$49,664,211
Noncontract costs exceeding percentage allowance <sup>3</sup>		12,954,564	12,954,564		12,954,564
Total	\$7,707,748	\$21,516,549	\$29,224,297	\$33,391,477	\$62,615,775

<sup>1</sup>Consists of the fully constructed Kyle North, Kyle to Sharps I, Kyle to Sharps II, American/Porcupine, and Porcupine East/Manderson South segments and the Sharps to Porcupine segment that is under construction and will be completed in 1999.

<sup>2</sup>The TERO (Tribal Employment Rights Office) tax rate increase of 2 percent was calculated based on construction funding remaining within the existing appropriation ceiling.

<sup>3</sup>We compared the noncontract expenditures calculated by using the percentage allowance per Table 9 in the Final Engineering Report (less the 4 percent allowance for the Bureau) with the costs recorded in the Tribe's financial system to determine the amount exceeding the Repon allowance through September 1998. We recognize that noncontract expenditures are to some extent front loaded. Therefore, the \$12.9 million can be reduced if the System expends funds for the remainder of the construction period at an amount that is lower than the percentage allowance provided for in the Report.

## REVIEW OF SELECTED ACCOUNTS

Accounts	Account Totals	Amounts Reviewed	Questioned Costs			No Exceptions Noted
			cost Exceptions	Unsupported costs	Total	
Administration	\$459,263	\$282,001	\$27,035	\$138,331	\$165,366	\$116,635
Community Involvement	434,546	127,617	20,485	88,498	108,983	18,634
Training	497,737	139,948	3,879	18,109	21,988	117,960
Travel	312,732	72,696	9,318	14,910	24,228	18,468
Elder Committee	16,585	1,725	100	1,425	1,525	200
Advisory Committee	97,125	2,750	200	1,750	1,950	800
Steering Committee	102,619	33,991	3,902	3,205	7,107	26,884
Total	<u>\$1,920,607</u>	<u>\$660,728</u>	<u>\$64,919</u>	<u>\$266,228</u>	<u>\$331,147</u>	<u>\$329,581</u>
Percent of Total Amounts Reviewed		100.00%	9.83%	40.29%	50.12%	49.88%
Percent of Total Accounts						
Total	100.00%	34.40%	3.38%	13.86%	17.24%	17.16%

Accounts	Transactions		Transactions Questioned			No Exceptions Noted
	Total	Reviewed	Exceptions	Unsupported	Total	
Administration	2,641	124	19	60	79	45
Community Involvement	1,318	103	23	69	92	11
Training	715	52	6	17	23	29
Travel	2,014	70	22	19	41	29
Elder Committee	151	6	1	3	4	2
Advisory Committee	701	17	1	10	11	6
Steering Committee	662	33	6	5	11	22
Total	<u>8,202</u>	<u>405</u>	<u>78</u>	<u>183</u>	<u>261</u>	<u>144</u>
Percent of Total Transactions Reviewed		100.00%	19.26%	45.18%	64.44%	35.56%
Percent of Total Transactions	100.00%	4.94%	0.95%	2.23%	3.18%	1.76%



IN REPLY REFER TO:  
D-5010

# United States Department of the Interior

BUREAU OF RECLAMATION  
Washington, D.C. 20240

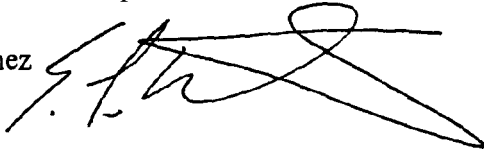
MAY 25 1999

APPENDIX 5

Page 1 of 5

## MEMORANDUM

To: Office of Inspector General  
Attention: Assistant Inspector General for Audits

From: Eluid L. Martinez  
Commissioner 

Subject: Draft Audit Report on "Oglala Sioux Rural Water System,  
**Mni Wiconi** Rural Water Supply Project, Bureau of Reclamation,"  
Assignment No. W-IN-BOR-004-98(A)-R

The Bureau of Reclamation offers the following comments in response to the recommendations in the subject report,

We recommend that the Commissioner, Bureau of Reclamation:

### Recommendation A. 1

Request additional funding needed to construct the Oglala Sioux Rural Water Supply System as currently planned or negotiate with the Oglala Sioux Tribe to determine which components can be modified or eliminated to stay within the legislatively established construction cost limitation.

### Response

Concur. Reclamation intends to finalize the "Mni Wiconi Rural Water System Cost Containment Report" in June 1999. This report provides a wide range of options for addressing additional funding needs. Included in the report is an option which identifies how the cost ceilings for each project sponsor would need to be adjusted if the Congress does not authorize an increase in the construction ceiling. Reclamation will work closely with the South Dakota congressional delegation **and the** project sponsor to identify and request the appropriate funding levels.

The responsible official is the Area Manager, Dakotas Area Office. Target dates are:

June 30, 1999 - Finalize the Mni Wiconi Rural Water System Cost Containment Report.

- August 31, 1999 - Identify additional ceiling request that Reclamation can support and provide the information to the South Dakota congressional delegation.
- September 30, 1999 - Consult with the Oglala Sioux and South Dakota congressional delegation in amending the legislation to increase the cost ceiling.

#### Recommendation A.2

Negotiate with the Tribe to establish a requirement in the current and future cooperative agreements to establish a cost accounting system for the Oglala Sioux Rural Water Supply System. The accounting system should allow tracking of expenses and budgets as they relate to the Project in its entirety and to the specific construction and noncontract components, thereby enabling the Bureau to monitor costs effectively.

#### Response

Nonconcur. Reclamation does not believe Public Law 93-638 or OMB Circular A-102 gives Reclamation the authority to require a "cost accounting system." However, Reclamation believes both the law and the existing cooperative agreements provide the authority to require more detailed information be submitted by the Tribe in support of fund requests. Reclamation will negotiate with the Tribe to provide more detailed schedules in support of fund requests to allow more effective tracking of expenses and budgets as they relate to the Project in its entirety and to the specific construction and noncontract components.

The responsible official is the Area Manager, Dakotas Area Office. More detailed schedules will be required by the Dakotas Area Office commencing with the fund request for the first quarter of fiscal year 2000. The target date for completing the negotiations is September 30, 1999.

#### Recommendation A.3

Monitor the costs being incurred by the Oglala Sioux Tribe to ensure that the System is built as generally described in the Final Engineering Report and in subsequent cooperative agreements and that the costs associated with the various activities are within the established allowances as negotiated in the cooperative agreements.

#### Response

Concur. Reclamation will negotiate with the Tribe to provide more detailed schedules in support of fund requests to allow Reclamation to monitor costs and ensure the system is built as generally described in the Final Engineering Report and in subsequent cooperative agreements.

The responsible official is the Area Manager, Dakotas Area Office. More detailed schedules will be required by the Dakotas Area Office commencing with the fund request for the first quarter of **fiscal** year 2000. The target date for completing negotiations with the Tribe is September 30, 1999.

#### Recommendation B. 1

Negotiate a contract modification with the Oglala Sioux Tribe to provide for the types and amounts of allowable costs related to contract administration and training and ensure that Bureau officials incorporate this information in **future** agreements.

#### Response

Concur. Reclamation will negotiate a modification to the cooperative agreement with the Oglala Sioux Tribe to establish annual budgets which identify the types and amounts of allowable costs related to contract administration and training. The noncontract **costs** will be based on the noncontract allowances established in the Final Engineering Report, 2-year work plans, and the project master plans. Reclamation will also ensure that **the** requirement for annual budgets establishing allowable contract administration and training costs will be incorporated into **future** cooperative agreements.

The responsible official is the Area Manager, Dakotas Area Office. The target date for negotiating a modification to the cooperative agreement is September 30, 1999.

#### Recommendation B.2

Instruct the Oglala Sioux Tribe to reimburse the System for the cost exceptions of \$64,919 and to reimburse or provide documentation for the unsupported costs of **\$270,015** identified by our review. Also, any supporting documentation provided by the Tribe should be reviewed, and a final determination on the amount of unsupported costs to be reimbursed should be made.

#### Response

Concur. Reclamation will instruct the Tribe to reimburse the System for the cost exceptions of **\$64,919** and request supporting documentation for the unsupported costs of **\$270,015**.

The responsible official is the Area Manager, Dakotas Area Office. The target date to make a final determination on the amount of costs to be transferred to non-System accounts regarding the **\$64,919** in cost exceptions and the unsupported portion of the **\$270,015** is September 30, 1999.

Recommendation B.3

Instruct the Oglala Sioux Tribe to bill for the Tribe's administrative cost for subcontracted nonconstruction items (engineering, planning, designs and specifications, and construction management) on an actual cost basis and ensure that the Tribe reimburses or provides support for cost exceptions of \$140,349 and unsupported costs of \$226,079 identified by our review of the Administration account.

Response

Concur. Reclamation will instruct the Tribe to bill administrative costs for subcontracted nonconstruction items on an actual cost basis and will request that the Tribe provide supporting data for the \$140,349 in cost exceptions and the \$226,079 of unsupported costs. After review of the data, Reclamation will instruct the Tribe to reimburse any cost exceptions or unsupported costs that cannot be validated.

The responsible official is the Area Manager, Dakotas Area Office. The target date to provide a letter to the Tribe is June 30, 1999. The target date to complete reimbursement of any unsupported costs and to ensure administrative costs for subcontracted items are on an actual cost basis is September 30, 1999.

Recommendation B.4

Instruct the Oglala Sioux Tribe to reimburse the Water Supply System for the indirect cost overcharges totaling **\$456,531** and ensure that indirect cost charges for 1996 and subsequent years are adjusted to approved **final** indirect cost rates based on actual costs.

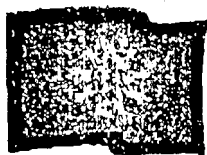
Response

Concur. Reclamation will instruct the Tribe to reimburse the System for indirect cost charges totaling **\$456,531**. Reclamation will also ensure that indirect cost charges for 1996 and subsequent years are adjusted based on approved final indirect cost rates as applied to actual costs for that fiscal year.

The responsible official is the Area Manager, Dakotas Area Office. The Area Manager will instruct the Tribe to reimburse the \$456,531 by June 30, 1999. The target date to ensure that the 1996 indirect costs are adjusted to the approved rate is September 30, 1999. In subsequent years Reclamation will ensure such costs are adjusted as final indirect costs rates are **finalized** and approved by the OIG.

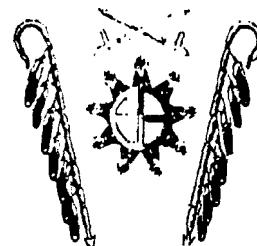
We appreciate the opportunity to comment on the audit recommendations. If you have any questions or require additional information, please contact Luis Maez at (303) 445-2793.

cc: Assistant Secretary - Water and Science, Attention: Laura Brown



# Oglala Sioux Tribe

Box H  
Pine Ridge, South Dakota 57770  
Phone: (605) 867-5821  
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E-mail: harolds@oglala.org



OFFICE OF THE PRESIDENT  
HAROLD D. SALWAY  
"Aká Nujipi"

May 27, 1999

Mr. Robert William, Assistant Inspector General-Audit  
Department of the Interior  
Office of Inspector General  
1849 C Street  
Mail Stop 5341  
Washington, DC 20240

RE: Audit Report Number W-IN-BOR-004-98 (A)-R

Dear Mr. William:

Enclosed is the final response by the Oglala Sioux Rural Water Supply System, to draft audit report number W-IN-BOR-004-98 (A)-R, performed by the United States Department of the Interior, Office of Inspector General.

Respectfully,

*Harold D. Salway*  
Harold D. Salway  
President  
Oglala Sioux Tribe



**Oglala Sioux Tribe**  
**Rural Water Supply System**

Telephone (605) 455-2767  
Fax (605) 455-2731  
P.O. Box 415  
Pine Ridge, South Dakota 57770



May 20, 1999

Mr. Dennis E. Breitzman, Area Manager  
United States Department of the Interior  
Bureau of Reclamation  
Dakotas Area Office  
P.O. Box 1017  
Bismarck, North Dakota 58502

Dear Mr. Breitzman:

This represents the response by the Oglala Sioux Rural Water Supply System (the program) to draft audit report number W-IN-BOR-004-98(A)-R performed by the United States Department of the Interior, Office of Inspector General. The response is limited to Part B, Cost Compliance, of the audit report and the accompanying recommendations pertaining to compliance, accounting, and financial matters. There are five sections of this response, identified as follows:

- Section I – Cost Exceptions
- Section II – Unsupported Costs
- Section III – Administrative Costs
- Section IV – Indirect Costs
- Section V – Response to Audit Recommendations

Supporting documentation and schedules are included in the audit response and are appropriately labeled for the applicable section.

## SECTION I – COST EXCEPTIONS

The audit report identified \$64,919 in cost exceptions pertaining to expenditures considered unallowable either under OMB Circular A-87 or the cooperative agreement with the Bureau of Reclamation. The costs were incurred for administration, community involvement, training, travel, and committee stipends. The program disputes that any repayment to the Bureau of Reclamation is required for cost exceptions. The program's explanation for disputing the cost exceptions in the area of community involvement, training, travel, and committee stipends follows. The program's explanation for disputing the cost exceptions in the area of administration is included in Section III of this response.

Community Involvement. The program annually budgets Bureau of Reclamation agreement funds for an outreach program to disseminate information to the public and to provide an avenue for public comments to the program staff and program Steering Committee. The outreach program was implemented due to the reluctance by the public to accept the program on the reservation. Accordingly, the outreach program was jointly agreed to by both the program and the Bureau of Reclamation as being an effective method of providing interaction with the public and obtaining ideas and perceptions about the program from the Tribal membership. The outreach program is identified in the program budget as public involvement, and often is referred to as community involvement.

Use of federal funds for public involvement is consistent with the intent of the 1994 amendments to Public Law 93-638, the Indian Self-Determination and Education Assistance Act, where Tribes were given broad latitude in the expenditure of 93-638 funds. Under these amendments, Tribes were generally given the flexibility in the expenditure of funds as deemed necessary by the Tribes to achieve program goals and objectives.

Federal policies on the expenditure of program funds were also greatly amended by changes in OMB circular A-87. These changes further support flexibility in the expenditure of such funds. OMB Circular A-87 provides that community involvement expenditures are a form of public relations. The Circular states that public relation expenditures are permitted and include, "activities dedicated to maintaining the image of the

governmental unit or maintaining or promoting understanding and favorable relations with the community or public at large or any segment of the public.”

The Bureau of Reclamation approved the program’s annual budget, including administrative components, with line-item budgets for community involvement. There are no restrictions by type, classification, purpose, or amount written into the BOR agreement as to the expenditure of community involvement funds.

Since OMB Circular A-87 permits public relations expenditures for any segment of the public, community involvement costs are permitted through a broad range of expenditure categories. All of the community involvement costs incurred by the program were for high profile purposes. In other words, the public relation benefits from the expenditures were easily identified.

The audit report categorized community involvement costs by identifying certain costs as exceptions, without an explanation as to the difference in the costs incurred that were not excepted. This places the auditor in a position of making arbitrary decisions on the classification of community involvement expenditures, which diminishes the expenditure latitude given to Tribes through the self-determination process: While such audit decisions may be relevant on non 93-638 programs, it is inconsistent with the flexibility provided to Tribes in the expenditure of funds in the 1994 amendments. Accordingly, the program strongly disputes any cost exceptions in the expenditure of community involvement funds.

~~The~~ Training audit report listed cost exceptions of \$3,879 for training. Documentation is attached to support that all costs incurred were for the benefit of the program in full compliance with the BOR agreement. It is noted that the audit report listed check number 2001 as one of the items excepted. Check number 2001 was voided and replaced by check number 2002. All applicable documentation to support the costs related to check 2002 are attached. See supporting documentation entitled Section I – Training.

~~The~~ Travel audit report listed cost exceptions of \$9,318 for travel.

The program does not dispute the lack of documentation resulting in the audit exceptions. However, the program was not charged for this travel and BOR did not pay for any of the costs excepted, therefore no funds should be repaid to BOR for the exceptions.

The program maintains a detailed list of outstanding travel advances and periodically reduces the program expenditures by the amount of outstanding advances and other costs not associated with the program, such as travel by elected officials. These reductions are made through adjusting journal entries to the accounting records to transfer such costs to the Tribe's general fund or program generated revenues. Program expenditures were reduced by \$22,351 on July 11, 1998, to reflect outstanding advances through June 30, 1998. Similar reductions of \$44,000 and \$18,014 were made on July 10, 1997, and February 28, 1997, to reflect correction of outstanding travel advances through December 31, 1996. The audit report did not include travel cost exceptions for 1995, therefore no adjusting entries are attached for 1995. These adjusting journal entries to the accounting records corrected the overcharges to the program due to 1) failure to reconcile travel advances, 2) travel that was unrelated to the program, and 3) travel for elected officials and other employees and administrators that were not directly involved with the program. Such entries not only corrected the cost exceptions included in the audit report, but also corrected additional program charges that should not have originally been expended by the program. Copies of the work papers for the adjusting entries are attached. See supporting documentation entitled Section I – Travel.

Committee Stipends. The audit report listed cost exceptions of \$4,202 for committee stipends and related costs. Documentation is attached to support that all costs incurred were for the benefit of the program, except costs associated with check number 21160 for \$3,200 which was for contracted services for the operation and maintenance program and was corrected by adjusting journal entry to transfer the costs from the operation and maintenance program to the program. See supporting documentation entitled Section I – Committee Stipends.

## SECTION II – UNSUPPORTED COSTS

The audit report identified \$270,015 in cost exceptions pertaining to expenditures considered to need additional documentation to substantiate that the costs were incurred for the benefit of the program. The costs were

incurred for administration, community involvement, training, travel, and committee stipends. All required supporting documentation has been included with this response, except in the area of administration which is included in Section III of this response.

Community Involvement. Community involvement expenditures for sponsorships and related activities require a completed activity statement with explanation or accounts payable voucher. Documentation for these costs is attached. See supporting documentation entitled Section II – Community Involvement 1995 and 1996 and Section II – Community Involvement 1997 and 1998.

Documentation to substantiate that all training costs were for the benefit of the program is attached, except for check number 21379 for \$2,647 which was miscoded to training and was for supplies. An accounting adjusting entry was made to correct this error. See supporting documentation entitled Section II – Training.

Travel accounting adjusting entries referred to in Section I, Cost Exceptions, Travel, in this response answers the documentation questioned for travel. Accordingly, no additional documentation is attached.

Committee Stipends Documentation to substantiate that all committee stipends were for the benefit of the program is attached. See supporting documentation entitled Section II – Committee Stipends.

## SECTION III – ADMINISTRATIVE COSTS

The cooperative agreement permitted the Oglala Sioux Tribe to assess

administrative costs for the management performed directly by the Tribe for subcontracts for nonconstruction type activities. The maximum amount to be charged to the program for this administrative effort was restricted by the agreement to five percent of nonconstruction contract costs.

In an effort to permit the program increased funding for direct services, the Tribe waived the five percent administrative fee and allowed the program to expend a similar amount for general direct services in lieu of the fee. This is generally the explanation for the five percent administrative fee in the audit report. The program does not dispute the audit findings that general direct expenditures were charged to an administrative account.

However, in response to the adverse audit findings in this matter, the program raises two issues. First, on two occasions (the first in 1997 and the second in 1998) in meetings with BOR officials in Bismarck, North Dakota, the program staff advised BOR of the program policy of charging general direct expenditures in lieu of the five percent administrative fee. At no time has BOR officials objected to this process.

Second, even though the Tribe waived the administrative cost charges to the program for subcontracted nonconstruction items, the Tribe did incur costs related to this administration. All of these costs were incurred by the Tribe's general fund and according to the cooperative agreement could have been charged to the program. A breakdown of these costs incurred by the Tribe by year follows.

	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998*</u>
Contract Management	\$ 32,597	\$ 3 1,879	\$ 34,079	\$ 22,500
Financial Management	34,515	35,233	35,307	26,448
General Management	<u>87,076</u>	<u>106,477</u>	<u>126,315</u>	<u>63,750</u>
	<u>\$ 154,188</u>	<u>\$ 173,589</u>	<u>\$ 195,701</u>	<u>\$ 112,689</u>

\* Administrative costs for the period 1/1/98 – 9/30/98.

The program respectfully requests that the administrative costs incurred by the Tribe be charged to the cooperative agreement, in lieu of the

direct expenditures previously charged, up to the five percent limitation. In each of the years 1995 through 1998 the administrative costs incurred exceeded the five percent limitation. This eliminates the requirement of documenting unsupported expenditures for administration in the audit report.

#### SECTION IV – INDIRECT COSTS

The audit report questions \$456,531 in indirect cost charges to the program for the years 1991-1995 and recommends that the Oglala Sioux Tribe reimburse the program that amount. The amount questioned is the difference between the amount calculated by applying the Tribe's provisional indirect cost rate to the program's direct cost base and the amount calculated by applying the Tribe's final indirect cost rate to the program's direct cost base for each year. In all five years, the final indirect cost rate was less than the provisional indirect cost rate.

The program disputes that any overcharges occurred in the indirect cost charges during 1991 through 1995. The 1988 amendments (Public Law 100-472) to the Indian Self-Determination and Education Assistance Act precludes the Department of Interior from such adverse adjustments as recommended in the audit report.

The program requested a legal opinion from the leading legal expert on indirect cost issues (Mr. Michael P. Gross) regarding this matter and a copy of that opinion is attached as supporting documentation to Section IV. That opinion strongly supports the program's position that any repayment of indirect costs would be a violation of law.

#### SECTION II – RESPONSE TO AUDIT RECOMMENDATIONS

1. Modification to Cooperative Agreement. The program will negotiate a modification to the cooperative agreement to provide for the types and amounts of allowable costs related to contract administration and training as recommended in the audit report.

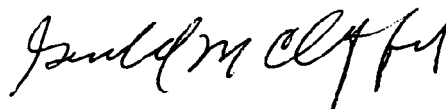
2. Reimbursement For Cost Exceptions and Documentation of Unsupported Costs. The program disputes that any cost exceptions occurred and therefore disputes that any funds should be repaid to BOR. The

program has attached documentation to support questioned costs incurred.

3. Administrative Costs. The program agrees to bill for Tribal administrative costs as recommended in the audit report and respectfully requests that the administrative costs previously incurred as identified in Section III be accepted as permitted in the cooperative agreement, rather than to require the Tribe to reimburse for any audit exceptions or unsupported costs.

4. Indirect Costs. The program disputes that any indirect cost overcharges occurred.

Respectfully yours, -

A handwritten signature in black ink, appearing to read "Gerald Clifford", written in a cursive style.

Gerald Clifford

[NOTE: DOCUMENTS REFERRED TO IN THIS LETTER NOT INCLUDED  
BY OFFICE OF INSPECTOR GENERAL.]

## STATUS OF AUDIT REPORT RECOMMENDATIONS

Finding/Recommendation Reference	Status	Action Required
A.1, A.2, and A.3	Resolved; not implemented.	No further response to the Office of Inspector General is required. The recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.
B.1, B.2, B.3, and B.4	Resolved; not implemented.	No further response to the Office of Inspector General is required. The recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.

**ILLEGAL OR WASTEFUL ACTIVITIES  
SHOULD BE REPORTED TO  
THE OFFICE OF INSPECTOR GENERAL**

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