

Department of Homeland Security Office of Inspector General

Review of Costs Invoiced by the
City of San Jose Relating to the
Terminal B Checked Baggage Screening Project
at the Norman Y. Mineta San Jose International
Airport Under Other Transaction Agreement
Number HSTS04-09-H-REC161



American Recovery and Reinvestment Act of 2009

OIG-12-40

February 2012



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Preface

The Department of Homeland Security (DHS) Office of Inspector General (OIG) was established by the *Homeland Security Act of 2002* (Public Law 107-296) by amendment to the *Inspector General Act of 1978*. This is one of a series of audits, inspections, and special reports prepared as part of our oversight responsibilities for programs, grants, and projects administered by the Department under the *American Recovery and Reinvestment Act of 2009* (Recovery Act).

This report presents the results of our audit of the costs invoiced for reimbursement by the City of San Jose under an agreement funded by the Recovery Act from the Transportation Security Administration. The purpose of the agreement was to finance a portion of the costs of modifications to the Norman Y. Mineta San Jose International Airport to accommodate a checked baggage inspection system.

The recommendations herein have been developed to the best knowledge available to our office, and have been discussed in draft with those responsible for implementation. We trust this report will result in more effective, efficient, and economical operations. We express our appreciation to all of those who contributed to the preparation of this report.


Anne L. Richards

Assistant Inspector General for Audits

Table of Contents/Abbreviations

Executive Summary	1
Background	2
Results of Review	3
Unsupported Owner-Controlled Insurance Program Costs	3
Use of American Iron, Steel, and Manufactured Goods	4
Recommendations	5
Management Comments and OIG Analysis	5

Appendices

Appendix A: Purpose, Scope, and Methodology	6
Appendix B: Management Comments to the Draft Report	8
Appendix C: Major Contributors to this Report	11
Appendix D: Report Distribution	12

Abbreviations

CBIS	Checked Baggage Inspection System
DHS	Department of Homeland Security
OIG	Office of Inspector General
OTA	Other Transaction Agreement
OMB	Office of Management and Budget
TSA	Transportation Security Administration

OIG

*Department of Homeland Security
Office of Inspector General*

Executive Summary

The Transportation Security Administration entered into an Other Transaction Agreement with the City of San Jose to fund a portion of the costs to modify Terminal B at the Norman Y. Mineta San Jose International Airport to incorporate a checked baggage inspection system. Under the agreement, the Transportation Security Administration agreed to reimburse the City of San Jose up to \$20,916,360 for designing, managing, and building the project. At the time of our audit, the Administration had paid the City of San Jose \$14,387,182 on the basis of invoices submitted through March 31, 2011.

We conducted our audit to determine whether invoiced costs were allowable, allocable, and reasonable according to the funding agreement and applicable federal requirements.

We concluded that costs of \$254,092 invoiced for owner-controlled insurance were questionable for reimbursement because they were not adequately supported by the accounting records. Also, we determined that the City of San Jose complied with the requirements for submitting quarterly reports to the federal government and for paying prevailing wages, but could not provide adequate support that it complied with the requirement for buying goods manufactured in America. The report contains two recommendations to address unsupported invoiced costs and to ensure City of San Jose compliance with the requirement to buy American goods. The Administrator concurred with the two recommendations.

Background

On February 17, 2009, Congress enacted the *American Recovery and Reinvestment Act of 2009* (Recovery Act) to preserve and create jobs, promote economic recovery, and invest in transportation, environmental protection, and other infrastructure that will provide long-term economic benefits. The Recovery Act appropriated \$1 billion to the Transportation Security Administration (TSA) for “procurement and installation of checked baggage explosive detection systems and checkpoint explosives detection equipment....” TSA awarded \$574,023,483 of that amount to 25 airport organizations for 29 projects modifying airports to accommodate new baggage-screening equipment.

On March 5, 2009, TSA informed the City of San Jose (City) that the City’s explosive detection system project in Terminal B of the Norman Y. Mineta San Jose International Airport was under consideration for Recovery Act funding. The City had already awarded a design-build contract for the Terminal B area and issued four task orders totaling \$25,023,637 for the baggage-handling system. Subsequently, the City estimated that TSA’s Checked Baggage Inspection System (CBIS) project represented about \$21,257,400 of the total cost. In addition, the City requested \$1,983,000 as schedule impact costs for potential delays in the TSA delivery of the screening equipment (CTX-9800 machines). Negotiations between the City and TSA resulted in the award of Recovery Act funds of \$20,916,360, which represented 90% of the estimated eligible project costs of \$23,240,400 (\$21,257,400 plus \$1,983,000).

TSA authorized the funding under Other Transaction Agreement (OTA) number HSTS04-09-H-REC161, dated September 28, 2009. The OTA, as amended, runs from April 1, 2009, through June 30, 2011, and requires the City to submit invoices for reimbursement of project costs. Reimbursement for eligible project costs is based on the scope of the agreement; Office of Management and Budget (OMB) Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*; and the TSA publication *Reimbursable and Non-Reimbursable Costs for the Electronic Baggage Screening Program, version 1.0 June 2008*. As of March 31, 2011, the City had invoiced costs of \$14,387,182, which it incurred from April 2009 through March 2011. The costs invoiced by the City represented 90% of the costs incurred.

The agreement also requires the City to comply with OMB Circular A-133, *Audits of States, Local Governments, and Nonprofit Organizations*, and Recovery Act provisions to submit quarterly recipient reports to the federal government; pay prevailing wages as determined by the Secretary

of Labor; and use American¹ iron, steel, and manufactured goods. The objective of this audit was to determine whether costs invoiced by the City were allowable, allocable, and reasonable according to the funding agreement and applicable federal requirements.

Results of Review

We determined that invoiced costs of \$14,133,090 were allowable, allocable, and reasonable. We identified \$254,092 of costs that were questionable for reimbursement because they were not adequately supported by the accounting records. We also concluded that the City complied with the requirements for submitting quarterly reports and for paying prevailing wages. The City could not, however, provide adequate support that it complied with the requirement for buying goods manufactured in America. We are recommending that TSA examine the relevant project documents to ensure that 95% of the project was built with American products.

Unsupported Owner-Controlled Insurance Program Costs

The City invoiced TSA \$332,894 for insurance program costs. We determined that the amount consisted of \$78,802 for the costs of general liability premiums, workers' compensation, builder risk, and broker fees, and \$254,092 for estimated future liability. The City based the estimate on allocations of incurred insurance costs plus projected insurance expenses. The basic guidelines in OMB Circular A-87 say that to be allowable, a cost must be properly documented and be allocable to the federal award, among other things. The circular says that "a cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received." In addition, Article IV of the OTA states that "TSA will reimburse the City on an actual expense basis supported by one or more invoices...." Although we believe that insurance program costs may be allocated to the CBIS project, we classified the \$254,092 as unsupported because the amount was an estimate based on future costs.

After the audit exit conference, the City provided insurance invoices and its analysis of insurance program expenses for our examination. The City's analysis used labor costs and construction costs to allocate the total invoiced insurance program costs to benefiting activities. Using the City's allocation methodology would result in questionable costs of \$127,210. Although the City's cost allocation methodology seemed reasonable, we were not able to validate that the costs supporting the bases used to allocate the insurance costs were applicable to

¹ On October 13, 2009, the Department of Homeland Security (DHS) issued a limited waiver of the "buy American" requirements for each TSA Electronic Baggage Screening Program project. The waiver specifies that at least 95% of the costs of each project will comply with the buy American requirements of Section 1605 of the Recovery Act, and allows up to 5% of total project costs to be used for non-American products.

the period covered by the OTA. Consequently, we retained our classification of the entire \$254,092 as unsupported.

Use of American Iron, Steel, and Manufactured Goods

Section 1605 of the Recovery Act requires the use of American iron, steel, and manufactured goods in the construction of Recovery Act projects. Under DHS' limited waiver of the requirement for TSA's Electronic Baggage Screening Program projects, up to 5% of the total project costs may be used to purchase non-American goods. The OTA includes a list of some 42 individual baggage-handling system components that TSA and the City agreed would be exempt from the buy American requirements. However, the City's support to demonstrate compliance with the buy American requirement was incomplete.

Neither the City nor the contractor obtained any letters from the baggage-handling system subcontractor or the individual vendors regarding the source of the components used for the CBIS project. The contractor did prepare a spreadsheet, dated May 17, 2010, that included a schedule of values for the CBIS project, the names of the subcontractor and vendors who provided the components for the various work activities, and the identification of American and foreign products used. The spreadsheet showed that 5.5% of the estimated materials costs were from non-American sources. However, we could not validate the accuracy of the spreadsheet without letters or other documents from the subcontractor and vendors certifying the source of the materials used on the project.

TSA officials have not examined the City's compliance with the requirement to use American goods. TSA did publish an administrative checklist to aid contracting officials in determining buy American compliance on February 3, 2011. TSA's Director, Security Technology Acquisition Division, told us that TSA is developing procedures to implement the checklist.

TSA should use the checklist to help determine whether the City complied with the buy American requirement for the CBIS project. City officials agreed that the documentation showing compliance with the buy American requirements was incomplete. The officials also advised that the TSA guidelines were not available when the project was constructed.

Recommendations

We recommend that TSA's Contracting Officer:

Recommendation #1: Resolve the \$254,092 of unsupported owner-controlled insurance program costs.

Recommendation #2: Review the iron, steel, and manufactured goods used in the CBIS project to determine whether the City complied with applicable "buy American" requirements.

Management Comments and OIG Analysis

TSA Comments to Recommendation#1:

TSA Concur: TSA said that it will "work with the City to recoup \$254,092 in unsupported future insurance liability. This adjustment will be attained by TSA receiving a future invoice from the City reflective of a \$254,092 reduction in total reimbursable CBIS costs."

OIG Analysis:

The TSA decision sufficiently responds to the recommendation. However, the recommendation will remain open until TSA provides us with a copy of the invoice with the \$254,092 reduction.

TSA Comments to Recommendation#2:

TSA Concur: TSA said that the contracting officials will work with the City to obtain certification from the subcontractor and vendors.

OIG Analysis:

The TSA decision sufficiently responds to the recommendation. However, the recommendation will remain unresolved until TSA provides us with a timeframe for completion of its planned actions and will remain open until TSA provides us with evidence that it has obtained the certification.

Appendix A

Purpose, Scope, and Methodology

The objective of this audit was to determine whether costs invoiced by the City of San Jose are allowable, allocable, and reasonable according to the funding agreement and applicable federal requirements. Our audit covered invoiced costs of \$14,387,182 for the period April 1, 2009, to March 31, 2011. This represents the total amount invoiced as of May 13, 2011.

Our tests and procedures included the following:

- Reviewing TSA project files, the award agreement and modifications, the Recovery Act, and TSA and OMB guidelines
- Interviewing TSA officials to obtain an understanding of the project and project management
- Examining City accounting records supporting amounts invoiced
- Interviewing City officials to obtain an understanding of project management, accounting, procurement, and invoicing
- Inspecting the CBIS project
- Reviewing the audit working papers of the certified public accounting firm that performed the Single Audit of the City for the fiscal year ending June 30, 2010.

The Single Audit of the City was performed by Macias, Gini, & O'Connell LLP and included Recovery Act-funded CBIS project costs totaling \$13,479,872 (about 94% of invoiced costs). The Single Audit report classified the CBIS as a major program and assessed the City as a low risk.² The Single Audit report did not identify any questionable costs related to the CBIS or any deficiencies in internal controls that were identified as material weaknesses.

We also tested City records supporting costs invoiced to determine compliance with OMB Circular A-87 and with other terms and conditions of the agreement. We considered the City's internal controls over the administration of TSA funds in determining our audit procedures.

We conducted this performance audit between April 11 and June 28, 2011, pursuant to the *Inspector General Act of 1978*, as amended, and according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based upon our audit objectives. We believe that the evidence obtained

² A low risk assessment results from the preceding annual Single Audit presenting an unqualified opinion on the entity's financial statements and the schedule of expenditures of federal awards, and reporting no deficiencies in internal controls that were identified as material weaknesses under the requirements of generally accepted government auditing standards. This assessment allows for reduced audit coverage.

Appendix A
Purpose, Scope, and Methodology

provides a reasonable basis for our findings and conclusions based upon our audit objectives.

We appreciate the cooperation of City of San Jose and TSA officials in providing the information and access necessary to accomplish this review.

Appendix B
Management Comments to the Draft Report

U.S. Department of Homeland Security
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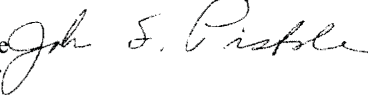
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**Transportation
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INFORMATION

MEMORANDUM FOR: Charles Edwards
Acting Inspector General
U.S. Department of Homeland Security

FROM: John S. Pistole 
Administrator

SUBJECT: Transportation Security Administration's (TSA) Response to the U.S. Department of Homeland Security (DHS) Office of Inspector General's OIG Draft Report titled *Review of Costs Invoiced by the City of San Jose Relating to the Terminal B Checked Baggage Screening Project at the Norman Y. Mineta San Jose International Airport Under Other Transaction Agreement Number HSTS04-09-H-REC161* – FOUO

Purpose

This memorandum constitutes TSA's formal Agency response to the U.S. Department of Homeland Security (DHS), Office of Inspector General (OIG) draft letter report, *Review of Costs Invoiced by the City of San Jose Relating to the Terminal B Checked Baggage Screening Project at the Norman Y. Mineta San Jose International Airport Under Other Transaction Agreement Number HSTS04-09-H-REC161*–FOUO dated October 2011. TSA appreciates the opportunity to review and provide comments to your draft report.

Background

As part of the American Recovery and Reinvestment Act of 2009 (Recovery Act), TSA was appropriated \$1 billion for "procurement and installation of checked baggage explosive detection systems and checkpoint explosives detection equipment..." TSA has awarded more than \$500 million in Recovery Act funding to airport organizations for modifying facilities to accommodate new baggage-screening equipment through the Electronic Baggage Screening Program (EBSP).

One of these Recovery Act awards was to the City of San Jose (the City) for a Checked Baggage Inspection System (CBIS) project in Terminal B of the Norman Y. Mineta San Jose International Airport (SJC) through an Other Transaction Agreement (OTA) dated September 28, 2009. The City had previously awarded a design-build contract for Terminal B at SJC in which TSA was not involved, that included four task orders totaling \$25,023,637 for the baggage-handling

Appendix B Management Comments to the Draft Report

2

system. Through the OTA, TSA provided Recovery Act funding in the amount of \$20,916,360, which represented 90 percent of the estimated eligible project costs (\$23,240,400). As of March 31, 2011, the City had invoiced costs of \$14,387,182.

Discussion

The results of the audit determined that approximately 1 percent of the costs invoiced by the City were questionable because they were not adequately supported by accounting records. Specifically, the city invoiced \$332,894 for insurance program costs, of which \$78,802 was for general liability premiums, and \$254,092 was for estimated future liability. While the OIG believes that insurance program costs may be allocated to the CBIS project, the \$254,092 is deemed unsupported because it is an estimate based on future costs. As the OIG noted, Article IV of the OTA states that “TSA will reimburse the City on an actual expense basis...” Insurance costs incurred by the City may be allowable under the terms of the OTA but are reimbursable only as they become actual incurred expenses. Since the questioned costs involve future insurance liability, TSA will recoup the \$254,092 in the form of a credit in a future invoice and will instruct the City regarding future reimbursement for only costs as incurred.

The audit also determined that TSA officials did not examine the City’s compliance with the Buy American Act. As the OIG noted, the contractor did prepare a schedule of values, which included the names of subcontractors and vendors who provided the components for the work and identification of the American and foreign products used. While this schedule reflected that 5.5 percent¹ of the estimated material costs were from non-American sources, OIG was unable to validate the information without documentation from the subcontractor and vendors certifying the source of the materials used. In order to verify that the goods used are in fact Buy American Act compliant, TSA will work with the City to obtain certification of the sources of materials used in the CBIS project.

TSA concurs with both of the recommendations made in the subject draft report and will take the actions necessary to resolve these issues.

Recommendation 1: TSA’s Contracting Officer resolve the \$254,092 of unsupported Owner-Controlled Insurance Program costs.

TSA Concurs: As indicated above, TSA will work with the City to recoup \$254,092 in unsupported future insurance liability. This adjustment will be attained by TSA receiving a future invoice from the City reflective of a \$254,092 reduction in total reimbursable CBIS costs. TSA will also instruct the City regarding future reimbursement for only costs as incurred.

Recommendation 2: TSA’s Contracting Officer review the iron, steel and manufactured goods used in the CBIS project to determine whether the city complied with applicable “Buy American” requirements.

¹ DHS has a limited waiver for TSA’s Electronic Baggage Screening Program, which provides that up to 5 percent of the total project costs may be for the purchase of non-American goods.

Appendix B Management Comments to the Draft Report

3

TSA Concurs: In order to verify that the materials used are compliant with Buy American Act requirements, the Contracting Officer will work with the TSA Contracting Officer's Representative (COR) and the City to obtain certification from the subcontractor and vendors.

Additionally, the TSA Office of Acquisition has begun using a checklist to assist acquisition workforce staff in assessing and monitoring Recovery Act recipient compliance with Buy American Act compliance. This checklist was provided to the OIG in TSA's 90-day update to OIG-11-07, Final Report, *Use of American Recovery and Reinvestment Act Funds by the TSA for the Electronic Baggage Screening Program* (November 12, 2010). This checklist has been provided to the OIG as resolution for similar recommendations on other Recovery Act-related audits.

Appendix C
Major Contributors to this Report

Roger LaRouche, Director
Robert Leonard, Audit Manager
Karl Gallagher, Audit Manager
Enrique Leal, Report Referencer

Appendix D
Report Distribution

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Manager, Electronic Baggage Screening Program, TSA
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