



**Homeland  
Security**

July 11, 2005

MEMORANDUM FOR: Gary Jones  
Acting Regional Director, FEMA Region VI

*D. Paige Hamrick*  
for

FROM: Tonda L. Hadley  
Field Office Director

SUBJECT: *Kiamichi Electric Cooperative, Inc.*  
*Wilburton, Oklahoma*  
FEMA Disaster Number DR-1355-OK  
Public Assistance Identification Number 000-006AE-00  
Audit Report Number DD-08-05

The Office of Inspector General (OIG) audited public assistance funds awarded to the Kiamichi Electric Cooperative, Inc. (KEC), located in Wilburton, Oklahoma. The objective of the audit was to determine whether KEC accounted for and expended Federal Emergency Management Agency (FEMA) funds according to federal regulations and FEMA guidelines.

KEC received an award of \$9.65 million from the State of Oklahoma, Oklahoma Department of Civil Emergency Management (ODCEM), a FEMA grantee, for damages caused by an ice storm on December 25, 2000. The award provided 100 percent FEMA funding for six large projects and 75 percent FEMA funding for one large project and five small projects.<sup>1</sup> The audit covered the period December 25, 2000, to September 6, 2001, during which KEC claimed \$9.65 million and ODCEM disbursed \$8.34 million in direct program costs.

We performed the audit under the authority of the Inspector General Act of 1978, as amended, and according to generally accepted government auditing standards. The audit included review of 100 percent of KEC's claimed expenditures, assessment of inventory controls, analysis of weather events and power outages occurring during the damage recovery period, and other auditing procedures considered necessary to accomplish the audit objective.

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<sup>1</sup> Federal regulations in effect at the time of the disaster set the large project threshold at \$50,600.

## RESULTS OF AUDIT

KEC did not account for and expend FEMA funds according to federal regulations and FEMA guidelines. Specifically, KEC did not follow federal procurement standards in awarding \$8,381,786 of contract work. As a result, fair and open competition did not occur and contract costs were excessive. Further, we identified questioned costs totaling \$6,235,687 (\$5,657,548 FEMA share), or 65 percent of the \$9,649,393 claimed as shown in Exhibit A and the following table:

A—Improper contracting after the emergency period	\$4,883,714	
(Less costs also questioned in Findings B through H)	<u>-1,523,289</u>	
Net amount questioned in Finding A		<u>\$3,360,425</u>
B—Unsupported costs		1,247,200
C—Unreasonable contract costs		649,168
D—Duplicate costs		385,812
E—FEMA overpayment		251,479
F—Miscellaneous ineligible contract costs		197,259
G—Overpayment on misclassified costs		105,941
H—Idle/standby contract costs		<u>38,403</u>
Total questioned costs		<u>\$6,235,687</u>

### **Finding A: Improper Contracting During and After the Emergency Period**

KEC did not comply with federal procurement standards or FEMA guidelines in awarding \$8,381,786 for contracted utility and debris removal work. As a result, fair and open competition did not occur and contract costs were excessive. We questioned \$4,883,714 of contract costs claimed for work performed after January 15, 2001, when power was fully restored to all KEC customers. We questioned these costs because (1) after January 15, 2001, exigent circumstances no longer existed to justify KEC's non-compliance with federal procurement standards and (2) not all of the contract work performed after January 15, 2001, appeared to be related to the disaster.

As shown in the table above, we questioned \$1,523,289 of the \$4,883,714 in Findings B through H. Therefore, if FEMA agrees to disallow the costs questioned in Findings B through H, the net amount questioned in Finding A will be \$3,360,425.

Procurement standards at 44 CFR 13.36:

- Require the performance of procurement transactions in a manner providing full and open competition except under certain circumstances. (13.36(c))
- Allow procurement by noncompetitive proposals only when the award of a contract is infeasible under small purchase procedures [\$100,000 or less], sealed bids, or competitive proposals and certain circumstances apply. One acceptable circumstance is when the public exigency or emergency for the requirement will not permit a delay resulting from competitive solicitation. (13.36(d)(4)(i))

- Require that subgrantees maintain records sufficient to detail the significant history of the procurement, including the rationale for the method of procurement, the basis for contractor selection, and basis for the contract price. (13.36(b)(9))
- Require subgrantees to maintain a contract administration system that ensures contractors perform in accordance with the terms, conditions, and specifications of their contracts or purchase orders. (13.36 (b)(2))
- Require a cost or price analysis in connection with every procurement action, including contract modifications. (13.36(f)(1))
- Prohibit the use of time-and-material type contracts unless no other contract is suitable and provided that the contract include a ceiling price that the contractor exceeds at its own risk. (13.36(b)(10))
- Require profit to be negotiated as a separate element of the price for each contract in which there is no price competition and in all cases where cost analysis is performed. (13.36(f)(2))

The ice storm occurred on December 25, 2000. KEC used its own employees (force account labor), mutual aid assistance from other power companies, and contractors to restore power to its customers by January 15, 2001. KEC and its contractors worked at extreme emergency levels until sufficient right-of-way (ROW) space was cleared to permit full restoration of power. KEC continued to use these contractors and claimed costs for disaster work through September 5, 2001.

Before the disaster, KEC competitively procured four contractors to perform routine and planned non-disaster work. Of the four contracts, one was a construction contract, three were ROW contracts, and all were at fixed unit prices. Each of the four pre-disaster contracts also included hourly labor and equipment rates for emergency storm work. To perform disaster work, KEC paid these 4 contractors \$4,114,801, another 10 contractors \$4,008,168, and 38 smaller contractors \$242,538. In total, KEC used 52 contractors during the disaster.

Except for the 4 pre-disaster contracts, KEC procured the remaining 48 contractors at hourly rates for labor and equipment without competition. KEC did not (1) maintain records sufficient to detail its rationale for contractor selection, (2) perform a cost or price analysis, (3) justify the use of time-and-material type contracts, or (4) negotiate profit as a separate element of the price. KEC used verbal agreements and informal rate sheets rather than written contracts for eight (five large and three small) of the contractors procured after the disaster. Although some of the contracts had cost ceilings, KEC did not enforce them and did not document its justification for allowing contract costs to exceed the ceilings. For example, one of the pre-disaster contractors had a \$750,000 ceiling and total costs billed were over \$2 million.

KEC officials were unable to provide evidence of contract monitoring, stating that they did not have the resources available to monitor contract performance. FEMA's *Public Assistance Debris Management Guide* (FEMA 325, April 1999), p. 28, states that supervision of time-and-material contracts is "extremely important." Work inspection reports should be prepared each day. These reports should clearly state the amount of work accomplished that day in quantitative terms, such as the number of cubic yards of debris hauled, the type and number of trucks used and the number of hours worked." Without such reports, KEC had no documentation to validate labor and equipment hours billed in contractor invoices. Contract monitoring is essential to ensure that contractors perform in accordance with the terms, conditions, and specifications of their contracts.

FEMA's *Public Assistance Debris Management Guide* (FEMA 325, April 1999), p. 28, states:

- Time-and-Material contracts should be limited to a maximum of 70 hours of actual emergency debris clearance work and should be used only after all available local, tribal and State government equipment has been committed.
- Time-and-Material contracts may be extended for a short period when absolutely necessary, for example, until appropriate Unit Price contracts have been prepared and executed.

In addition, FEMA's *Public Assistance Guide* (FEMA 322, October 1999), p. 40, states:

- FEMA provides reimbursement for three types of contracts: lump sum, unit price, and cost-plus-fixed-fee contracts.
- Time-and-material contracts should be avoided, but may be allowed for work that is necessary immediately after the disaster has occurred when a clear scope of work cannot be developed.
- Applicants must carefully monitor and document contractor expenses.

We considered the 3-week period after the ice storm occurred on December 25, 2000, to be the "emergency period" because power was not restored to all of KEC's customers until January 15, 2001. We concluded that the lack of power constituted exigent circumstances that warranted the use of non-competitive, time-and-material type contracts because KEC likely did not have time to develop a clear scope of work until all power was restored.

Under 44 CFR 13.43(a)(2), failure to comply with applicable statutes or regulations can result in the disallowance of all or part of the costs of the activity or action not in compliance. Although KEC did not follow other procurement standards during the emergency period (e.g., negotiate profit separately, perform a cost analysis, or monitor contract performance), we did not question contract costs incurred during the 3-week emergency period on the basis of improper procurement procedures. However, we did question the \$4,883,714 of contractor costs incurred after the emergency period because, after KEC restored power to its customers, it should have solicited competitive bids for the remaining disaster work under lump sum, unit price, or cost-plus-fixed-fee contracts. Instead, KEC continued to use the time-and-material contracts, some of which were non-competitive, until September 5, 2001, over 7 months after the power was fully restored on January 15, 2001.

We also questioned these costs because we found substantial evidence that not all of the work performed after January 15, 2001, was related to the disaster. To be eligible for financial assistance, an item of work must be required as the result of the major disaster event (44 CFR 206.223(a)(1)). KEC was unable to provide any documentation to define the scope of work that remained after power was restored. In reviewing contract costs incurred after January 15, 2001, we noticed that many of the ROW invoices were for spring and summer brush removal, rather than ice storm debris removal. We also noticed unexpected patterns in contractors' billings. We expected to see a steady decline of contract work and billings after the power was restored. Instead, we saw spikes.

We determined that these spikes, or surges, in contract costs coincided with spring and summer "storm outages" recorded in KEC's call log. We tracked power outages and the costs billed by KEC's five largest contractors for the period January 16 through September 5, 2001. These five contractors billed about 70 percent of the \$8,381,786 in total contract costs. As shown in Exhibit B,

major construction work and ROW work initially declined after the power was restored but in February inexplicably began to rise and fall, paralleling spring and summer storm activity. These patterns indicate that some, if not all, of the work that occurred after January 15, 2001, resulted from storms other than the ice storm that was declared a major disaster.

Therefore, the \$4,883,714 of contract costs claimed for work performed after January 15, 2001, was ineligible because exigent circumstances no longer existed to justify KEC's non-compliance with federal procurement standards and because not all of the work appeared to relate to the disaster.

Officials from KEC indicated that State officials did not instruct them on proper federal procurement standards in a timely manner. According to 44 CFR 13.37(a)(2), states are responsible for ensuring "that subgrantees are aware of requirements imposed upon them by Federal statute and regulation". Further, 44 CFR 13.40 requires states to monitor subgrant supported activities to assure compliance with applicable federal requirements. KEC's lack of compliance with federal procurement standards clearly demonstrates that State officials did not adequately monitor KEC's subgrant activities.

### ***Recommendations:***

The OIG recommended that the Regional Director, FEMA Region VI:

1. Disallow \$4,883,714 of ineligible contracting costs.
2. Require the Oklahoma Department of Civil Emergency Management to develop, document, and implement procedures for future disasters to: (a) provide subgrantees timely guidance on federal regulations, standards, and guidelines related to procurement and (b) monitor subgrantees to ensure compliance with those federal regulations, standards, and guidelines.

### **Finding B: Unsupported Costs**

We identified \$1,247,200 in unsupported costs for contract labor (\$660,162), materials (\$293,436), contract equipment (\$282,490), math errors (\$6,252), and force account labor (\$4,860). According to 44 CFR 13.20(b)(2), a subgrantee must maintain records that adequately identify the source and application of funds. Additionally, 44 CFR 13.20(b)(6) states, "Accounting records must be supported by such source documentation as cancelled checks, paid bills, payrolls, time and attendance records, contract and subgrant award documents, etc." As discussed below, KEC was unable to provide source documentation to support these costs; therefore, we questioned \$1,247,200 as unsupported. (Note: \$327,615 of the \$1,247,200 was also questioned in Finding A.)

- **\$660,162 for contract labor.** KEC did not obtain and retain adequate supporting documentation for \$660,162 of contractor labor and subsistence (meals and lodging) expenses. Both KEC and the OIG contacted the contractors in an attempt to obtain the missing records. Two major contractors failed to provide any records related to the work performed. Others provided incomplete records. Collectively, the lack of documentation left \$660,162 of the KEC claim for labor and subsistence unsupported.
- **\$293,436 for materials.** KEC's claim for materials contained (1) an "estimated work order" for \$198,090 that was not supported and (2) an inventory "adjustment" of \$95,346 to cover unsupported shortages in the KEC physical inventory.

- **\$282,490 for contract equipment.** Without supporting documentation for the contract labor charges discussed above, KEC was unable to support \$282,490 in related contract equipment charges.
- **\$6,252 in math errors.** KEC math errors on Projects 613, 2619, and 3583 created a \$6,252 overcharge to the claim.
- **\$4,860 for force account labor.** KEC claimed \$4,860 in excessive fringe benefit rates on its force account labor costs. KEC claimed 2 percent for Medicare instead of 1.45 percent and 7 percent for Social Security instead of 6.2 percent.

***Recommendation:***

The OIG recommended that the Regional Director, FEMA Region VI:

3. Disallow \$1,247,200 of unsupported costs (\$327,615 of which was also questioned in Finding A).

**Finding C: Unreasonable Contract Costs**

We questioned \$649,168 in unreasonable contract costs claimed for equipment (\$141,243), labor (\$478,405), and inflated contractor and sub-contractor rates (\$29,520). The Office of Management and Budget (OMB) Circular A-87, *Cost Principles for State, Local, and Indian Tribal Government*, requires that allowable costs under federal awards be reasonable (Attachment A, paragraph C.1.a.). The Circular also defines a reasonable cost to be one that, in nature and amount, does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost (Attachment A, paragraph C.2.). Because KEC had renewed its regular construction and ROW contracts the same month the ice storm occurred, we used the hourly labor and equipment “storm rates” identified in the contracts as our standard for “reasonable” rates during the disaster. However, KEC acted imprudently in allowing contractors to charge rates above established contract rates and/or reasonable storm rates. (Note: Of the \$649,168 questioned, \$513,275 was also questioned in Finding A.)

***Recommendation:***

The OIG recommended that the Regional Director, FEMA Region VI:

4. Disallow \$649,168 of unreasonable contract costs (\$513,275 of which was also questioned in Finding A).

**Finding D: Duplicate Costs**

We questioned \$385,812 of duplicate costs for contract labor (\$205,422), contract equipment (\$178,978), materials (\$1,044), and force account labor (\$368). In compiling its claim, KEC erroneously entered various check payments under more than one project. KEC agreed that it had claimed \$385,812 twice for the same costs. (Note: Of the \$385,812 questioned, \$214,694 was also questioned in Finding A.)

***Recommendation:***

The OIG recommended that the Regional Director, FEMA Region VI:

5. Disallow \$385,812 of duplicate costs (\$214,694 of which was also questioned in Finding A).

**Finding E: FEMA Overpayment**

We identified a FEMA overpayment totaling \$251,479, which represented 25 percent of \$1,005,917 erroneously funded at 100 percent rather than the 75 percent authorized FEMA cost share. ODCM granted KEC a 60-day extension, beginning July 6, 2001, for disaster debris removal (Category A) under Project 3583. During the initial 6-month period after the disaster was declared (December 25, 2000, to July 6, 2001), FEMA funded debris removal at 100 percent. However, the terms of the 60-day extension specified that debris removal after July 6, 2001, would be funded at 75 percent. FEMA erroneously funded \$1,005,917 claimed for debris removal after July 6, 2001, at 100 percent, rather than the 75 percent authorized. Therefore, we questioned \$251,479 received by KEC as an overpayment (\$1,005,917 x 25 percent). (Note: All of the \$251,479 questioned was also questioned in Finding A.)

***Recommendation:***

The OIG recommended that the Regional Director, FEMA Region VI:

6. Recover the \$251,479 FEMA overpayment (all of which was questioned in Finding A).

**Finding F: Miscellaneous Ineligible Contract Costs**

We questioned \$197,259 of miscellaneous ineligible contract costs as discussed below (Note: \$138,809 of these costs was also questioned in Finding A):

- **\$120,922** for work not related to the ice storm. We identified \$108,491 of ROW maintenance costs for defoliant spraying, brush removal, and mowing; and \$12,431 of new utility construction work. According to 44 CFR 206.223(a)(1), to be eligible for financial assistance, an item of work must be required as the result of the major disaster event. Normal ROW maintenance and new line construction do not qualify as disaster-related costs.
- **\$29,325** for ineligible fuel and equipment maintenance. KEC's contractors charged \$29,325 for fuel and maintenance costs that should have been included in their equipment rates. The FEMA *Schedule of Equipment Rates* (January 2001) states that equipment rates cover all costs of ownership and operating equipment, including depreciation, maintenance, field repairs, fuel, lubricants, tires, OSHA equipment, and other costs incident to operation. Although this rule applies specifically to force account equipment, contractors should be held to the same standard. Further, FEMA's *Public Assistance Debris Management Guide* (FEMA 325, April 1999), supports our position by stating that time-and-material contracts should clearly state that the "price for the equipment applies only when the equipment is operating and the hourly rate includes the operator, fuel, maintenance, and repair." Although this guidance was written for debris contractors, it should apply to other types of work.

- **\$39,146** for ineligible utility contractor travel. KEC claimed travel costs for its utility contractor's crews and equipment. KEC's pre-disaster contract with this contractor did not authorize travel expenses. To be eligible for FEMA reimbursement, the costs must be the legal responsibility of the eligible applicant (44 CFR 206.223(a)(3)). KEC had an enforceable contract at the time of the disaster; therefore, KEC had no legal responsibility to pay additional costs for the contractor's performance.
- **\$7,866** for contractor liability claims. KEC included four contractor liability claims in a small Project Worksheet. Two of the liability claims involved work performed by KEC contractors with pre-disaster contracts that clearly required liability insurance coverage. KEC's insurance carrier (the St. Paul Companies) rejected both claims stating that KEC was not liable for the damages because the contractors had performed the work. Both KEC's insurance and the contractor's insurance provider denied a third claim because the contractor was not responsible for the damage. The damage occurred as a result of conditions in the owner's property. The fourth claim appeared to be an insured liability claim against KEC's own work. However, KEC could not provide any evidence that it submitted the claim to its insurance carrier for payment. Without an insurance decision on the fourth claim, we could not determine the eligibility of the cost. As stated above, to be eligible for FEMA reimbursement, the costs must be the legal responsibility of the eligible applicant (44 CFR 206.223(a)(3)). KEC and its contractors had liability insurance in force at the time of the damage. KEC's insurance stated that KEC was not liable for three of the four claims; and KEC failed to submit the fourth claim. Therefore, these claims were not eligible for FEMA reimbursement.

***Recommendation:***

The OIG recommended that the Regional Director, FEMA Region VI:

7. Disallow \$197,259 of ineligible contract costs (\$138,809 of which was also questioned in Finding A).

**Finding G: Overpayment on Misclassified Costs**

KEC misclassified \$423,765 of Category F (permanent utility work) costs as Category A (debris removal). The award provided 75 percent FEMA funding for Category F projects and, until July 6, 2001, 100 percent FEMA funding for Category A projects. Therefore, FEMA funded \$423,765 at 100 percent, rather than the 75 percent authorized for Category F projects. Accordingly, we questioned 25 percent of the \$423,765, or \$105,941 as an overpayment. (Note: \$73,959 of the \$105,941 questioned was also questioned in Finding A.)

***Recommendation:***

The OIG recommended that the Regional Director, FEMA Region VI:

8. Recover the \$105,941 FEMA overpayment (\$73,959 of which was also questioned in Finding A).



## **Finding H: Idle/Standby Contract Costs**

We questioned \$38,403 claimed for idle and standby contract costs for equipment (\$30,883) and labor (\$7,520). Contractors used “haul trucks” to transport other equipment to and from job sites. Although the trucks were idle for most of any given day, some contractors billed hourly labor and equipment rates during idle and standby periods. FEMA's *Public Assistance Debris Management Guide* (FEMA 325, April 1999), states that a time-and-material contract should clearly state the “price for the equipment applies only when the equipment is operating.” Although FEMA wrote this guidance for debris contractors, it should apply to all types of work. (Note: \$3,458 of the \$38,403 questioned was also questioned in Finding A.)

### ***Recommendation:***

The OIG recommended that the Regional Director, FEMA Region VI:

9. Disallow \$38,403 of ineligible contract costs for standby and idle equipment (\$3,458 of which was also questioned in Finding A).

## **DISCUSSION WITH MANAGEMENT AND MANAGEMENT RESPONSE**

We discussed the results of the audit with FEMA Region VI on November 22, 2004. We provided a discussion draft of the report to FEMA, ODCM, and KEC on November 29, 2004, and held a joint exit conference on January 4, 2005. The draft report was revised to include some comments made during the exit conference.

Please advise this office by October 11, 2005, of the actions taken or planned to implement our recommendations. Please include target completion dates for any planned actions.

If you have questions concerning this report, please call me at (940) 891-8900. Major contributors to this report were Paige Hamrick, Stuart Weibel, Rita Dear, and Jerry Meeker.

**Schedule of Projects**  
**Kiamichi Electric Cooperative, Inc.**  
**FEMA Disaster Number DR-1355-OK**

Project Number	Cat.	Amount Awarded/ Claimed	(a) Amount Questioned Finding A	(b) Amount Questioned Findings B-H	(c) Amount in Findings B-H Questioned in A	(d) Net Questioned Finding A (a-c)	Total Amount Questioned (b+d)
613	A	\$ 831,782	\$ 17,820	\$ 351,322	\$ 5,602	\$ 12,218	\$ 363,540
988	A	105,097	80,266	27,136	12,133	68,133	95,269
2619	A	695,768	690,799	273,503	271,242	419,557	693,060
3355	A	709,467	709,467	152,119	152,119	557,348	709,467
3550	A	1,054,802	1,054,802	198,655	198,655	856,147	1,054,802
3583	A	1,006,994	1,006,994	507,901	507,901	499,093	1,006,994
1021	F	<u>5,176,815</u>	<u>1,323,566</u>	<u>1,356,760</u>	<u>375,637</u>	<u>947,929</u>	<u>2,304,689</u>
Subtotal		<u>\$9,580,725</u>	<u>\$4,883,714</u>	<u>\$2,867,396</u>	<u>\$1,523,289</u>	<u>\$3,360,425</u>	<u>\$6,227,821</u>
614	B	\$ 48,684	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
1237	C	2,080	0	0	0	0	0
1239	C	0	0	0	0	0	0
1913	E	10,038	0	0	0	0	0
3600	F	<u>7,866</u>	<u>0</u>	<u>7,866</u>	<u>0</u>	<u>0</u>	<u>7,866</u>
Subtotal		<u>\$ 68,668</u>	<u>\$ 0</u>	<u>\$ 7,866</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 7,866</u>
TOTAL		<u>\$9,649,393</u>	<u>\$4,883,714</u>	<u>\$2,875,262</u>	<u>\$1,523,289</u>	<u>\$3,360,425</u>	<u>\$6,235,687</u>

**Major Contractors' Dollars with Outages  
December 25, 2000 Through August 31, 2001**

Exhibit B

