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**Homeland  
Security**

August 7, 2009

MEMORANDUM FOR: Nancy Ward  
Regional Administrator  
FEMA Region IX

FROM:   
Robert J. Lastrico  
Western Regional Director

SUBJECT: *City of Laguna Beach, California*  
Public Assistance Identification Number 059-39178-00  
FEMA Disaster Number 1585-DR-CA  
Audit Report Number DS-09-10

The Office of Inspector General audited public assistance funds awarded to the City of Laguna Beach, California (City). The objective of the audit was to determine whether the City expended and accounted for Federal Emergency Management Agency (FEMA) funds according to federal regulations and FEMA guidelines.

The City received a public assistance subgrant award of \$33.9 million from the California Office of Emergency Services (now, the California Emergency Management Agency - CalEMA), a FEMA grantee, for debris removal, emergency protective measures, and permanent repairs to facilities damaged by the Bluebird Canyon Landslide that was caused by severe storms in February 2005. Of the \$33.9 million, FEMA provided 75% federal funding for seven large projects<sup>1</sup> with a total award amount of \$33.9 million, and two small projects with a total award amount of \$30,233. The audit covered the period June 1, 2005,<sup>2</sup> through November 7, 2008, and included a review of all seven large projects awarded under the grant (see Exhibit). As of June 25, 2009, CalEMA was in the process but had not completed a review of the City's final claim for the large projects.

We conducted this performance audit under the authority of 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 on our audit objective. The evidence obtained during the audit provides a reasonable basis for our findings and conclusions based on our audit objective. We interviewed FEMA, CalEMA, City officials, and contractors; reviewed judgmentally selected samples of cost documentation to support invoices and personnel charges; and

<sup>1</sup> Federal regulations in effect at the time of the disaster set the large project threshold at \$55,500.

<sup>2</sup> FEMA determined that the Bluebird Canyon Landslide that occurred in June 2005 was directly attributed to the severe storms that occurred in February 2005.

performed other procedures considered necessary to accomplish our objective. We did not assess the adequacy of the City’s internal controls applicable to subgrant activities because it was not necessary to accomplish our audit objective. We did, however, gain an understanding of the City’s method of accounting for disaster related costs.

## RESULTS OF AUDIT

Of the \$33,905,602 the City plans to claim for the seven large projects reviewed, \$1,032,171 does not comply with the criteria required for federal reimbursement (federal share \$774,128). The findings and amounts questioned are shown below.

Finding	Subject	Amount Questioned
A	Disaster Related Work on Private Property	\$ 815,006
B	Costs Cover by FEMA's Statutory Administrative Allowance	171,607
C	Equipment Salvage Value	22,657
D	Project Costs	22,901
Total		\$1,032,171

### **Finding A – Disaster Related Work on Private Property**

The City did not have legal responsibility to install new sewer lines, demolish private property structures and foundations, remove debris, and perform other work for private property owners. The following table identifies the four project worksheets (PWs) that included FEMA funding for work on private property and the questionable claimed costs associated with the work.

Project Worksheet	Disaster Work Authorized	Claimed Costs Submitted to CalEMA
854	New Sewer Line for Private Property Owners	\$207,570
856	Shoring of Two Privately Owned Structures	112,151
857	Structure Removal and Site Clearance	488,448
858	Other Tasks Performed on Private Property	6,837
Total		\$815,006

- PW 854 provided \$207,570 in funding to install a series of sewer lines that did not exist pre-disaster to provide service to private property owners.
- PW 856 provided \$112,151 for the shoring up of two privately owned structures, and PW 857 provided \$488,448 to demolish structures on private properties.<sup>3</sup> This work was performed to expedite the disaster recovery process.
- PW 858 provided \$6,837 in funding for contractors to perform general tasks on private properties [watering trees, replacing locks, meeting with home owners to discuss reconnecting utility services].

<sup>3</sup> The City performed the following tasks on 12 privately owned property sites: demolition of structures, concrete footings and slabs, asbestos removal, and general debris removal.

According to Title 44, *Code of Federal Regulations*, Section 206.223(a)(3) [44 CFR 206.223(a)(3)], an item of work must be the legal responsibility of an eligible applicant in order to qualify for disaster assistance. FEMA's Response and Recovery Directorate Policy 9523.4 (November 1999), *Demolition of Private and Public Facilities*, addresses federal funding eligibility requirements for demolition of private properties that includes applicants meeting legal permission requirements. FEMA's *Public Assistance Policy Digest* (FEMA 321, October 2001, page 31) states that demolition work on private property requires condemnation proceedings in accordance with state and local law.

The City's governing statutes contain provisions consistent with FEMA's criteria for establishing legal responsibility for the private property and allow the City to undertake or complete the remedial action prior to a hearing of protest and to recover the abatement costs from property owners [Laguna Beach Municipal Code Sections 7.24.110(d) and 7.24.110(g)]. In addition, the California Emergency Services Act<sup>4</sup> and the California Tort Claims Act<sup>5</sup> provide the authority to: 1) determine that a nuisance exists and 2) take corrective actions to abate.

A review of records supporting the work performed on private properties and discussions with responsible officials identified that the City did not establish legal responsibility as required. The City did not undertake condemnation proceedings and instead entered into a general agreement with 10 home owners to gain access to their properties. The agreement simplified and expedited the disaster recovery process, but did not establish the City's legal responsibility for the work [44 CFR 206.223(a)(3)] and thus, related costs are not eligible for reimbursement under FEMA's Public Assistance program. FEMA's position for an applicant to establish legal responsibility for disaster work is re-affirmed in FEMA's 2007 – Disaster Assistance Policy 9523.13 – *Debris Removal from Private Property*. This policy provides that an applicant's legal responsibility is not established solely by obtaining signed rights-of-entry and hold harmless agreements from property owners.<sup>6</sup> While FEMA Policy 9523.13 (July 2007) was issued after FEMA Disaster No. 1585-DR-CA (February 2005), it provides further explanation on FEMA's long standing position on the issue of legal responsibility for disaster work.<sup>7</sup>

City officials agreed with our conclusion that the actions taken by the City to gain legal responsibility for work on private properties were not consistent with FEMA guidance and local law. Those officials explained that the City would not seek federal reimbursement for the costs incurred to perform work on private properties. Nonetheless, the \$815,006 (\$207,570 + \$112,151 + 488,448 + \$6,837) of repair costs the City incurred under PWs 854, 856, 857, and 858 is questioned pending CalEMA's review of the City's final claim and submission of final costs to FEMA.

### **Finding B – Costs Covered by FEMA's Statutory Administrative Allowance**

The direct costs the City recorded for PWs 854 and 858 included \$171,607 for tasks covered by FEMA's statutory administrative allowance. According to 44 CFR 206.228(a)(2)(ii), the City is reimbursed for direct and indirect costs associated with requesting, obtaining, and administering public assistance based on a statutory administrative allowance. Also FEMA's *Public Assistance*

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<sup>4</sup> California Government Code § 8550 *et seq.*

<sup>5</sup> California Government Code § 810 *et seq.*

<sup>6</sup> FEMA Policy 9523.13 - *Debris Removal from Private Property* - Section VII (B) (1) (b) (ii), effective July 18, 2007

<sup>7</sup> Disaster Assistance Policy 9523.13 superseded Recovery Policies 9523.13 and 9523.14 of October 23, 2005, and all previous guidance on the subject.

*Guide* (FEMA 322, October 1999, page 41) provides that this allowance covers indirect costs incurred to administer public assistance.

- For PWs 854 and 858, the City recorded project management services of \$95,950 and \$58,225, respectively. Project records showed that the charges related to grant management tasks performed by a Community Recovery Coordinator. Grant management tasks do not meet FEMA's definition of project management.<sup>8</sup>
- For PW 858, the City also recorded \$17,432 in administrative costs as direct charges. The costs consisted of \$16,951 paid to an engineering firm to assist the City with a FEMA appeal and \$481 paid to another engineering firm for preparation of letter(s) to FEMA.

Because the charges noted above were covered by FEMA's statutory administrative allowance, we question \$171,607 in costs that the City claimed against PWs 854 and 858. The City agreed that the costs were administrative in nature, covered by FEMA's statutory administrative allowance, and not claimable as direct project charges.

### **Finding C – Equipment Salvage Value**

City accounting records for PW 853 did not include a credit of \$22,657 for the salvage value of FEMA funded equipment that retained a useful value after disaster recovery. According to FEMA's *Public Assistance Policy Digest* (FEMA 321, October 2001, page 45), FEMA may require compensation for the fair market value of equipment purchased with disaster funds and retained by the applicant for other than disaster related services.

The City installed a temporary lift station to provide sewer services to residences. Upon completion of the main sewer line, the City dismantled the temporary lift station and retained useable components for future use. The remaining fair market value of those components was \$22,657, consisting of \$11,596 for submersible pumps with control panels and \$11,061 for electronic components. Because, the City did not deduct the salvage value of these components from its claim, we questioned the \$22,657. The City agreed and said that it will adjust PW 853 costs before submitting the final claim for reimbursement.

### **Finding D – Project Costs**

As discussed below, the City's accounting records for PWs 853, 858 and 860 included \$22,901 in unallowable projects costs.

- Records for PW 853 included \$1,119 in contractor costs that did not benefit the disaster recovery effort. The City initially retained the services of a general construction contractor to restore sewer services, but later determined that the contractor did not have the equipment or capability to accomplish the work. The City paid the first contractor \$1,119 and hired another contractor to perform the work.
- Records for PW 858 included \$19,900 in the following unallowable costs.

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<sup>8</sup> FEMA policy 9525.6, *Project Supervision and Management Costs of Subgrantees*, April 22, 2001

- \$18,374 in duplicative charges. Due to an internal communication error, the City ordered, received, and paid for the same services from two separate vendors.
- \$1,000 in an over payment to a vendor. One vendor provided a series of drilling services to the City at a total invoiced cost of \$50,967. The City paid the invoiced costs but erroneously reflected the cost as \$51,967 in the data used to support claimed costs.
- \$526 in force account labor charges. The City provided security services for a fundraiser held at a school approximately 7 miles from the disaster site.
- Records for PW 860 included an accounting error of \$1,882. An engineering firm performed a service for the City and invoiced \$1,882. The City paid the invoiced cost but erroneously reflected the cost of services as \$3,764 in the data used to support claimed costs.

According to 44 CFR 206.223(a)(1), an item of work must be required as a result of a major disaster to be eligible for financial assistance. In addition, 44 CFR 13.20(b)(1) requires that the City accurately report the results of financially assisted activities. Office of Management and Budget Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, requires that costs charged to grants (federal awards) be allocable to federal awards and comply with any limitations set forth in the terms and conditions of the federal awards, such as grantor guidelines and grant requirements.

Because the costs identified above were not required as a result of the disaster or were not accurately reported or allocable to the projects, we question the \$22,901 as unallowable costs. The City agreed and said it will make necessary adjustments to its claim for PWs 853, 858 and 860.

## **RECOMMENDATIONS**

We recommend that the Regional Administrator, FEMA Region IX, in coordination with CalEMA:

**Recommendation #1.** Disallow \$815,006 in repair costs for work on private properties identified by the City as claimable costs (see Finding A and the attached Exhibit for the applicable PWs).

**Recommendation #2.** Disallow \$171,607 for tasks covered by FEMA’s statutory administrative allowance (see Finding B and the attached Exhibit for the applicable PWs).

**Recommendation #3.** Disallow \$22,657 for a credit not taken by the City for the salvage value of FEMA funded equipment that retained a useful value after disaster recovery (see Finding C and the attached Exhibit for applicable PWs).

**Recommendation #4.** Disallow \$22,901 in unallowable projects costs (see Finding D and the attached Exhibit for applicable PWs).

## **DISCUSSION WITH MANAGEMENT AND AUDIT FOLLOW-UP**

We discussed the results of this audit with City, CalEMA, and FEMA officials on March 25, 2009. The City agreed with the four findings. CalEMA and FEMA generally agreed with our findings or

said they needed additional time to research the issues. Pertinent comments or information provided by those officials are contained at the conclusion of each finding.

Please advise this office by October 7, 2009, of the actions planned or taken to implement our recommendations. Please note that your responses should include target completion dates for actions planned and actual completion dates for actions taken. Should you have any questions concerning this report, please contact me at (510) 637-1482. Key contributors to this assignment were Humberto Melara and Curtis Johnson.

**Schedule of Audited Projects  
City of Laguna Beach, California  
FEMA Disaster Number 1585-DR-CA**

<b>Project Worksheet</b>	<b>Category of Work *</b>	<b>Award Amount</b>	<b>Questioned Cost</b>	<b>Finding Reference</b>
853	B	\$ 379,842	\$ 23,776	C, D
854	C	20,806,426	303,520	A, B
855	F	879,278	0	
856	B	3,804,563	112,151	A
857	A	767,750	488,448	A
858	B	765,442	102,394	A, B, D
860	B	6,502,301	1,882	D
<b>Totals</b>		<b>\$33,905,602</b>	<b>\$1,032,171</b>	

\* Category of Work Descriptions:

- A Debris Removal
- B Emergency Work
- C Roads and Bridges
- F Utilities