



Homeland Security

SEP 29 2006

MEMORANDUM FOR: James W. Stark
Director
Louisiana Transitional Recovery Office

FROM: *Dennis R. White*
for Jack Lankford
Gulf Coast Audit Manager

SUBJECT: *Interim Review of Hurricane Katrina Activities
City of New Orleans, Louisiana
FEMA Disaster No. 1603-DR-LA
Public Assistance Identification Number 071-55000-00
Report Number GC-LA-06-56*

We performed an interim review of emergency protective services and other disaster costs associated with Hurricane Katrina activities for the City of New Orleans, LA (City). The objective of the review was to determine whether the City was properly accounting for disaster-related costs and whether such costs were eligible for funding under FEMA's disaster assistance programs.

As of February 17, 2006, the cut-off date of our review, the City had received an award of \$130.2 million (FEMA share \$128.9 million) from the Louisiana Office of Homeland Security and Emergency Preparedness (LOHSEP), the grantee, for 116 (41 large and 75 small) projects.¹ The projects included debris removal, emergency protective measures, and restoration of facilities damaged as a result of Hurricane Katrina. Our review primarily focused on Project Worksheet 11 (PW 11) that FEMA approved for \$102.3 million for which the City received an expedited payment of \$102.3 million from the LOHSEP, and had charged costs of \$124.8 million. In addition, we reviewed two large contracts for which the work was in progress but FEMA had not approved project worksheets.

Our review consisted of an analysis of the City's accounting system, disaster costs, contracting policies and procedures, and interviews with City officials. The nature and brevity of this assignment precluded the use of our normal audit protocols. Therefore, this review was not conducted according to generally accepted government auditing standards. Had we followed such standards, other matters may have come to our attention.

¹ Federal regulations in effect at the time of the disaster defined a large project as one costing \$55,500 or more, and a small project as one costing less than \$55,500.

This review was conducted in conjunction with the President's Council on Integrity and Efficiency (PCIE) as part of its examination of relief efforts provided by the federal government in the aftermath of Hurricanes Katrina and Rita. As such, a copy of the report has been forwarded to the PCIE Homeland Security Working Group that is coordinating Inspectors' General review of this important subject.

RESULTS OF REVIEW

The City's management of its disaster activities was deficient in three areas: (1) the City's accounting system did not properly allocate costs or document cost eligibility; (2) the City did not comply with federal contracting procedures; and (3) did not remit \$860,110 of interest earned on advances as required.

Inadequate Accounting System.

The City's accounting system did not meet federal requirements that it maintain records for each approved project, that only eligible costs are charged to the project, and that the City identify as expended only those costs that have been paid. Title 44, Code of Federal Regulations, § 206.205, requires a project-by-project accounting of eligible costs. If not corrected, this method of accounting may result in substantial errors in the City's final claim for reimbursement.

The City charged all its disaster-related costs to a single account. The account, established for PW 11, was for emergency protective measures, such as overtime for emergency responders. The City charged other costs, for example \$12.1 million for debris removal, to that account without identifying the projects to which the costs should have been charged. The City Comptroller said their system could not establish an account until FEMA obligated funds for the PW 11 account, and therefore, they charged all expenditures to the only existing account that FEMA had funded. However, allocating expenditures from multiple projects to a single project account could result in duplicate claims.

The City charged \$39.2 million of overtime costs to the PW 11 account without determining whether the costs were eligible for FEMA reimbursement. We noted several examples of ineligible and questionable charges. The City charged overtime costs for accountants and administrative support specialists to the account. Those costs were not eligible because administrative costs were covered by a separate administrative allowance provided to the City. The City charged costs for one employee based on pay for 24 hours each day for 14 consecutive days. Another employee was paid \$207 an hour for overtime although his regular time pay was \$23 per hour. These charges do not appear to be reasonable.

The City treated \$45.4 million as expenditures under the PW 11 account, which in fact had not been paid. This practice could result in errors in the City's accounting for eligible disaster costs.

Contract Award and Administration Deficiencies

The City did not award or administer two of its large disaster contracts according to federal requirements in 44 CFR 13.36. It did not perform cost or price analysis, used an illegal contracting methodology, and did not monitor contractor performance. In addition, both contracts were non-competitive, which increased the risk of unreasonable prices.

The first contract was to provide for Program Management and other services on a task order basis to deal with the effects of Hurricane Katrina. This was a time and materials contract with a "not to exceed" (NTE) ceiling established for each task order, and was awarded on a non-competitive basis. We reviewed three task orders under this contract that provided for (1) environmental, health, and safety inspections of houses as stated in Task Order Number 1; (2) management and mitigation of immediate environmental hazards as stated in Task Order Number 3; and (3) stabilization of City-owned buildings across the City as stated in Task Order Number 4. The original NTE value of the three task orders was \$58.5 million, of which about \$7.5 million had been billed. The work was complete on Task Order Number 1. The scope of work was broad and the City did not perform a cost or price analysis, as required by regulations, to ensure that prices were reasonable. In addition, the City did not monitor the work to enable an independent verification of the billing accuracy. These contract deficiencies represent a significant concern, particularly for a non-competitive time and materials contract.

The second contract consisted of amendments to a non-competitive time and materials contract that was awarded prior to the disaster. Amendments 9 and 10 provided for (1) assistance with monitoring of storm drain cleaning and quality assurance; and (2) construction management services for storm drain cleaning. The estimated cost for these two amendments was about \$34.4 million. One problem with the amendments was that they changed the contract type from time and materials to a cost plus percent of cost contract. Amendment 9 provided for 13 percent profit on labor and other direct costs. Such contracts are prohibited by federal regulations because they do not provide incentive to control costs. Contractor profit increases with costs incurred. Another problem was that Amendment 10 allowed the 13 percent profit to be applied to all costs, and applied retroactively to work done under Amendment 9. This change significantly increased the costs on which the 13 percent profit was calculated because it includes \$32.4 million of subcontractor costs. Other concerns about this contract are that: (1) no cost or price analysis was performed as required by regulations; (2) the City did not provide adequate monitoring of the work to enable an independent verification of the billing accuracy; and (3) the amendments to the contract were made without competition.

Cash Management

On September 15, 2005 the City received an expedited payment from FEMA, through the grantee, of \$102.3 million for emergency protective measures. The funds were not immediately expended, and the City earned \$860,110 in interest on the unexpended balance as of December 31, 2005. Federal regulations [44 CFR 13.21(i)] generally require grantees and subgrantees to promptly, but at least quarterly, remit interest earned to FEMA on grant funds advanced.

RECOMMENDATIONS

We recommend that the Director, Louisiana Transitional Recovery Office, in coordination with the grantee and subgrantee:

- (1) Advise the City to transfer all expenditures from PW 11 that are not eligible under this project, including the \$12.1 million for debris removal.
- (2) Ensure that the City sets up an accounting system to charge disaster expenditures to the applicable project or to a suspense account at the time of transaction.
- (3) Advise the City to analyze expenditures for eligibility, including the \$39 million in overtime labor, and allocate only those eligible under FEMA regulations to a disaster account.
- (4) Require the City to comply with cash management practices as to drawdowns or reimbursements for the \$45.4 million encumbrances.
- (5) Require the City to amend any ongoing contracts to ensure compliance with Federal procurement standards, and to comply with these standards for all future contracts.
- (6) Ensure that the City sets up an adequate monitoring system for all contracts to ensure that work performed is within the scope of the contracts and billing accuracy.
- (7) Require the City to implement procedures to remit to FEMA, any interest over \$100 earned on advances, including the \$860,000 earned through December 31, 2005.

DISCUSSION WITH MANAGEMENT AND FOLLOW-UP

We discussed the results of our review with City officials on May 9, 2006 and with FEMA and grantee officials on June 1, 2006. City officials generally concurred with our findings except the issue of whether their system accounted for costs on a project-by-project basis. They said that FEMA had obligated funds to only one project and therefore they were justified to charge all costs to that project, whether applicable or not. FEMA and grantee officials withheld concurrence pending issuance of our report, but stated they had worked with the City to correct some of the deficiencies that may have existed during the audit period, and will continue to assist the City to improve their accounting system.

Please inform us within 30 days of the actions taken to implement the recommendations. Your response should be sent to:

U.S. Department of Homeland Security
Office of Inspector General
One Seine Court, 6th Floor
New Orleans, LA 70114

Should you have any questions concerning this report, please contact me at (510) 377-7383.

cc: Under Secretary for Federal Emergency Management
Acting Under Secretary for Management
General Counsel, DHS
Chief Financial Officer, DHS
Chief Procurement Officer, DHS
Audit Liaison, DHS
Chief Financial Officer, FEMA
Audit Liaisons, FEMA
Deputy Director, Gulf Coast Recovery
Regional Director, FEMA Region IV