

Department of Homeland Security **Office of Inspector General**

FEMA Should Disallow \$4.1 Million of the \$48.5 Million
Public Assistance Grant Awarded to ARK Valley
Electric Cooperative, Kansas





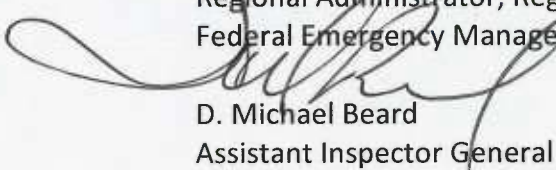
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Department of Homeland Security

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APR 16 2013

MEMORANDUM FOR: Beth Freeman
Regional Administrator, Region VII
Federal Emergency Management Agency

FROM: 
D. Michael Beard
Assistant Inspector General
Office of Emergency Management Oversight

SUBJECT: *FEMA Should Disallow \$4.1 Million of the \$48.5 Million
Public Assistance Grant Awarded to ARK Valley Electric
Cooperative, Kansas*
FEMA Disaster Number 1741-DR-KS
Audit Report Number DD-13-08

We audited Public Assistance grant funds awarded to ARK Valley Electric Cooperative (Cooperative) in Kansas (Public Assistance Identification Number 000-UEBOK-00). Our audit objective was to determine whether the Cooperative accounted for and expended Federal Emergency Management Agency (FEMA) grant funds according to Federal regulations and FEMA guidelines.

The Kansas Division of Emergency Management (KDEM), a FEMA grantee, awarded the Cooperative \$48.5 million for damages resulting from severe winter storms that occurred December 6 through 19, 2007. The award provided 75 percent funding for permanent work (Category F) and emergency protective measures (Category B) for eight projects (one small and seven large).¹ Of the seven large projects, three were improved projects.² The audit covered the period December 6, 2007, to September 16, 2012, the cutoff date of our audit, and included a detailed review of projects totaling \$48.5 million, or 100 percent of the total award (see Exhibit, Schedule of Projects Audited).

We conducted this performance audit between June 2012 and February 2013 pursuant to the *Inspector General Act of 1978*, as amended, and according to generally accepted

¹ Federal regulations in effect at the time of the disaster set the large project threshold at \$60,900.

² An improved project allows a subgrantee to make improvements, but still restores the predisaster function of a damaged facility. Federal funding for such improved projects shall be limited to the Federal share of the approved estimate of eligible costs (44 Code of Federal Regulations (CFR) 206.203(d)(1)).



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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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based upon our audit objective. We conducted this audit according to the statutes, regulations, and FEMA policies and guidelines in effect at the time of the disaster.

We interviewed FEMA, KDEM, and Cooperative officials; reviewed judgmentally selected project costs (generally based on dollar value); and performed other procedures considered necessary to accomplish our objective. We did not assess the adequacy of the Cooperative's internal controls applicable to grant activities because it was not necessary to accomplish our audit objective. However, we did gain an understanding of the Cooperative's methods of accounting for disaster-related costs and its procurement policies and procedures.

RESULTS OF AUDIT

The Cooperative accounted for public assistance funds on a project-by-project basis as required by Federal regulations and FEMA guidelines. However, the Cooperative did not follow Federal procurement standards or use written contracts in awarding \$4.1 million for Architectural and Engineering (A/E) work to three contractors. This occurred because KDEM did not adequately manage the Cooperative's subgrant activity and did not ensure that the Cooperative complied with applicable Federal procurement standards. Therefore, FEMA should disallow \$4.1 million in ineligible contract costs and require KDEM to develop and implement procedures to adequately monitor subgrant activities and to ensure that subgrantees follow Federal procurement standards.

Finding A: The Cooperative Had \$4.1 Million in Verbal Contracts with A/E Firms

We question \$4.1 million because the Cooperative did not follow Federal procurement standards in awarding three contracts for A/E work. Federal Regulations at 2 Code of Federal Regulations (CFR) 215 require that—

- All procurement transactions provide, to the maximum extent practical, open and free competition (2 CFR 215.43).
- All recipients shall establish written procurement procedures (2 CFR 215.44(a)).
- Recipients take positive efforts to utilize small businesses, minority-owned firms, and women's business enterprises whenever possible (2 CFR 215.44(b)).



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- Recipients identify the type of procuring instruments used (e.g., fixed price contracts, cost reimbursable contracts, purchase orders, incentive contracts) (2 CFR 215.44(c)).
- Recipients contract with only responsible contractors that possess the potential ability to perform successfully under the terms and conditions of the proposed procurement (2 CFR 215.44(d)).
- Recipients shall, on request, make pre-award review and procurement documents available for the Federal awarding agency (2 CFR 215.44(e)).
- Some form of cost or price analysis will be made and documented in the procurement files in connection with every procurement action (2 CFR 215.45).

In December 2007, the Cooperative entered into a verbal agreement with an A/E firm to serve as the Cooperative's project manager and assist with the disaster response. Although the Cooperative restored electrical power to its residential customers and critical facilities by January 6, 2008, it retained the A/E firm until July 2011 to provide engineering and design services, conduct field line evaluations of the rebuilt lines, and provide project management for the actual system restoration. The A/E firm also prepared construction bid documents and cost estimates; recommended contractors and product manufacturers; provided contractor and materials procurement oversight and quality control; and substantiated documentation that went to FEMA. For the services provided after January 6, 2008, until July 2011, the A/E firm billed the Cooperative \$2.8 million.

The Cooperative did not have a written contract with this A/E firm and did not award the work through a competitive bid process. Rather, it continued to rely on a verbal agreement it had with this firm for work performed before this disaster. Without a written contract, there was no assurance that the A/E firm was aware of or followed the contracting provisions required by Federal regulations, which include the following—

- Contractual provisions or conditions that allow for administrative, contractual, or legal remedies in instances in which a contractor violates or breaches the contract terms (2 CFR 215.48(a)).
- Suitable provisions for termination, including the manner by which termination will take place and the basis for settlement (2 CFR 215.48(b)).



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- A provision for construction or facility improvements to provide for the recipient to follow its own requirements relating to bid guarantees, performance bonds, and payment bonds if the contract or subcontract is under \$100,000. If the contract or subcontract exceeds \$100,000, the Federal awarding agency may accept the bonding policy and requirements of the recipient provided the Federal awarding agency has made a determination that adequately protects the Federal Government's interest (2 CFR 215.48(c)).
- A provision that states the recipient, the Federal awarding agency, the Comptroller General of the United States, or any of their duly authorized representatives shall have access to any books, documents, papers, and records of the contractor that are directly pertinent to a specific program for the purpose of making audits, examinations, excerpts, and transcriptions (2 CFR 215.48(d)).

Additionally, there was no assurance that the A/E firm was aware of other Federal contract provisions that Federal regulations at 2 CFR 215, Appendix A required it to follow such as those for—

- Equal Employment Opportunity.
- Copeland "Anti-Kickback" Act.
- Contract Work Hours and Safety Standards Act.
- Rights to Inventions Made Under a Contract or Agreement.
- Clean Air Act.
- Byrd Anti-Lobbying Amendment.
- Debarment and Suspension.

While serving as the Cooperative's project manager, the A/E firm facilitated the solicitation and selection of other contractors. Of the contracts this A/E firm facilitated, it properly solicited and awarded all contracts with the exception of two, which were for additional contractors to perform A/E services totaling \$1.3 million.

Because the Cooperative did not competitively bid the services provided by these three contractors and did not perform a price analysis to determine the reasonableness of the contractor's rates, open and free competition did not occur and FEMA has no assurance that the costs were reasonable. A cost or price analysis decreases the likelihood of unreasonably high or low prices, contractor misinterpretations, and errors in pricing relative to the scope of work. Cooperative officials said that they did not announce or competitively bid the contracts because they understood from KDEM officials that competition was not necessary for A/E firms that were already under contract.



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Finding B: Grant Management

KDEM did not adequately manage the Cooperative's subgrant activity and did not ensure that the Cooperative complied with applicable Federal procurement standards. KDEM officials stated that they do not review the procurement methods or Federal procurement standards used in awarding contracts. One KDEM official stated that KDEM's general policy is to inform applicants of the applicable rules and regulations, including contracting regulations.

In its FEMA/State Agreement, KDEM, as the grantee, agreed to "comply with the requirements of laws and regulations found in the Stafford Act and 44 CFR." Further, according to 44 CFR 13.37(a)(2), the grantee is required to ensure that subgrantees are aware of requirements imposed on them by Federal regulations; and 44 CFR 13.40(a) requires the grantee to manage the day-to-day operations of subgrant activity and monitor subgrant activity to ensure compliance with applicable Federal requirements.

KDEM was responsible for ensuring compliance with applicable Federal regulations and the FEMA/State Agreement. Therefore, FEMA should require KDEM to develop and implement procedures to adequately monitor subgrant activities and to ensure subgrantees follow Federal procurement standards.

RECOMMENDATIONS

We recommend that the Regional Administrator, FEMA Region VII:

Recommendation #1: Disallow \$4.1 million (\$3 million Federal share) of improperly procured contract costs as ineligible, unless FEMA grants an exemption for all or part of the costs as provided for in 2 CFR 215.4 and Section 705(c) of the *Robert T. Stafford Disaster Relief and Emergency Assistance Act* (Public Law 93-288, as amended) (finding A).

Recommendation #2: Require KDEM to develop and implement procedures to monitor subgrant activities adequately and to ensure that subgrantees follow Federal procurement standards (finding B).



DISCUSSION WITH MANAGEMENT AND AUDIT FOLLOWUP

We discussed the results of our audit with FEMA, KDEM, and Cooperative officials during our audit and included their comments in this report, as appropriate. We also provided a draft report in advance to these officials and discussed it at exit conferences held with FEMA on January 30, 2013, and with KDEM and the Cooperative on February 1, 2013. FEMA and Cooperative officials generally agreed with our findings and recommendations, however, they both disagreed with recommendation 1. KDEM officials disagreed with all findings and recommendation 1, but agreed with recommendation 2. FEMA, KDEM, and Cooperative officials disagreed with recommendation 1, stating that the rates were reasonable even though the contract was verbal. However, because the Cooperative did not competitively bid the services provided by three contractors and did not perform a price analysis, there is no assurance that the costs were reasonable.

Within 90 days of the date of this memorandum, please provide our office with a written response that includes your (1) agreement or disagreement, (2) corrective action plan, and (3) target completion date for each recommendation. Also, please include responsible parties and any other supporting documentation necessary to inform us about the current status of the recommendation. Until we receive your response, we will consider the recommendations open and unresolved.

Consistent with our responsibility under the *Inspector General Act*, we will provide copies of our report to appropriate congressional committees with oversight and appropriation responsibility over the Department of Homeland Security. We will post the report on our website for public dissemination.

Major contributors to this report are Tonda Hadley, Director; Moises Dugan, Audit Manager; Lori Smith, Auditor-in-Charge; and Patricia Epperly, Auditor.

Please call me with any questions at (202) 254-4100, or your staff may contact Tonda Hadley, Director, Central Regional Office, at (214) 436-5200.



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EXHIBIT

Schedule of Projects Audited

Project Number	Category of Work*	Award Amount	Questioned Costs
584	B	\$ 10,434	\$ 0
745	F	7,660,346	72,264
1219	F	10,922,510	1,158,746
1220	F	14,023,613	1,511,745
1222	F	13,944,515	1,306,308
1267	F	422,868	1,024
1268	F	961,201	2,214
1269	F	<u>577,662</u>	<u>4,698</u>
Totals		<u>\$48,523,149</u>	<u>\$4,056,999</u>

*FEMA classifies disaster-related work by type: debris removal (Category A), emergency protective measures (Category B), and permanent work (Categories C through G).



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APPENDIX

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