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**Homeland
Security**

September 30, 2009

MEMORANDUM FOR: Tony Russell, Acting Director
FEMA Louisiana Transitional Recovery Office

Tonda L. Hadley

FROM: Tonda L. Hadley, Director
Central Regional Office

SUBJECT: *City of New Orleans Community Correctional Center*
FEMA Disaster Number DR-1603-LA
Public Assistance Identification Number 071-55000-00
Audit Report DD-09-17

We audited public assistance funds awarded to the City of New Orleans, Louisiana (City) under project worksheet (PW) 12090 for environmental mitigation, stabilization, and remediation of the Community Correctional Center (CCC) related to Hurricane Katrina. The audit objective was to determine whether the City accounted for and expended Federal Emergency Management Agency (FEMA) grant funds according to federal regulations and FEMA guidelines.

The City received an award of \$1.13 million from the Governor's Office of Homeland Security and Emergency Preparedness (GOHSEP), a FEMA grantee under PW 12090. We audited \$1.28 million in costs claimed by the City for this project. The audit covered the period March 22, 2006, through December 12, 2006, the last day the City incurred cost for this project.

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. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

We interviewed FEMA, GOHSEP, and City officials; reviewed 100% of cost documentation to support invoices and personnel charges from March 22, 2006, through December 12, 2006; and performed other procedures considered necessary to accomplish our objective. We also reviewed the prime contractor's and the City's documentation supporting the award and administration of relevant contracts. We did not assess the adequacy of the City's controls

applicable to grant 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 and its procurement policies and procedures.

BACKGROUND

CCC is a 13-story prison owned by the City and operated by Orleans Parish Criminal Sheriff's Office (OPCSO). The facility sustained damage from Hurricane Katrina and from inmates rioting in the facility, which lost power and ventilation. PW 12090 is an emergency work project (Category B) written to clean up the facility. FEMA obligated \$1,131,002 and the City requested reimbursement of \$1,288,877 for the period March through December 2006.

RESULTS OF AUDIT

The City did not account for and expend FEMA funds according to federal regulations and FEMA guidelines. City officials did not follow federal procurement standards in awarding and administering contracts for disaster-related work; and the City's claim included \$872,463 of costs that were ineligible. The ineligible costs consisted of \$296,171 in prohibited markups on costs, \$573,992 for work that was not the City's legal responsibility, and \$2,300 in overcharges. The following table summarizes costs claimed by the City:

Subcontractor's lump sum direct billing	\$ 817,040
Prime contractor's direct labor	173,366
Overcharge due to incorrect direct labor rate	2,195
Overcharge due to miscalculation	<u>105</u>
Subtotal direct billing	<u>\$ 992,706</u>
Prime contractor's 5.7% service charge	<u>46,711</u>
Sub total before project management fees	<u>\$1,039,416</u>
Prime contractor's 24% project management fees	<u>249,460</u>
Total of costs claimed	<u>\$1,288,877</u>

Finding A: Contracting

There were two contracts associated with PW 12090. The first contract was between the City and the prime contractor and the second was between the prime contractor and its subcontractor. The City did not follow federal procurement standards in awarding and administering the prime contract for disaster-related work. Federal procurement standards at 44 CFR 13.36 require, among other things:

- Subgrantees maintain a contract administration system that ensures contractors perform according to the terms, conditions, and specifications of their contracts or purchase orders. (13.36(b)(2))
- Subgrantees not use time and material (T&M) type contracts unless a determination is made that 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))
- A cost or price analysis in connection with every procurement action, including contract modifications. (13.36(f)(1))
- Subgrantees not use cost-plus-percentage-of-cost methods of contracting. (13.36(f)(4))

In addition, FEMA's *Public Assistance Guide* (FEMA 322, October 1999), page 40, states that applicants must carefully monitor and document T&M contractor expenses. It also states, "FEMA provides reimbursement for three types of contracts:

- lump sum contracts for work within a prescribed boundary with a clearly defined scope and a total price;
- unit price contracts for work done on an item-by-item basis with cost determined per unit; and
- cost-plus-fixed-fee contracts, which are either lump sum or unit price contracts with a fixed contractor fee added into the price."¹

Prime Contract

The prime contract, awarded competitively in January 2006, was to render environmental mitigation and stabilization services for City facilities damaged in Hurricane Katrina and also to manage projects and project information in critical recovery projects. It was a T&M contract with a not-to-exceed value of \$7.2 million to supply labor ranging from \$40 per hour for a laborer to \$225 per hour for a senior director. The contract stated that all other direct costs would be charged to the project with a 5.7% service charge.

The contract required the prime contractor to perform the following tasks related to environmental mitigation and stabilization services for multiple facilities:

- Document all work activities for each building such that all costs can be supported.
- Identify applicable regulations, codes, standards, or any other special considerations.
- Remove and dispose of wet or dried sludge from the facility.
- Perform project management, scheduling, reporting, performance measurement, staffing, subcontractor management, and coordination with any and all applicable agencies or jurisdictions.

¹ At the time of the disaster, FEMA had not yet issued the June 2007 *Public Assistance Guide*, which contains the same wording on pages 52-53.

The “Project and Information Management” part of the contract added the following tasks:

- Collect, analyze, manage, and report project information including status, expected range of magnitude scope/cost, expected schedule, identifiable constraints, logic, potential risks, and known geographical characteristics.
- Provide progress reports, mitigation plans, and alternative approaches as applicable.
- Provide project audit and quality control function for selected projects.

Subcontract

In June 2006, the prime contractor awarded a lump sum contract in the amount of \$791,848 to the lowest bidder. Change orders to this subcontract raised its value to \$817,040. The subcontract documents consisted of a purchase order with vague descriptions of work, a separate work agreement, and a scope of work that included references to the City, OPCS0, and Orleans Parish School Board. None of these documents clearly explained the costs or prices for each of the tasks to be performed.

Contract Award and Administration

For the prime contract, the City could not provide evidence that it had (1) performed a cost or price analysis before awarding the contract to determine the reasonableness of proposed costs; (2) justified using a T&M contract, rather than a more suitable type, such as lump sum or cost plus fixed fee; (3) reviewed invoices to ensure charges complied with contract terms; or (4) monitored contract performance.

T&M contracts present higher risks than unit-price contracts because they provide a disincentive for saving costs—the more hours charged to a project, the greater the contractor’s potential profit. Therefore, the City should have mitigated these higher risks by monitoring and documenting the contractor’s activities while the work was being performed. Without such documentation, the City had no records to compare to the contractor’s invoices for hours worked and FEMA had no assurance that contract costs were reasonable.

Finally, the contract contained a prohibited cost-plus-percentage-of-cost clause that allowed the prime contractor to add 5.7% to direct costs other than labor. The 5.7% markup totaled \$46,711. Further, as shown in the table on page 2 of this report, the prime contractor added a 24% project management fee, totaling \$249,460, on top of all costs, including the 5.7% markup on costs. The contract between the City and the prime contractor did not contain a provision for a 24% project management fee. This fee and the 5.7% service fee are prohibited because they were added as a percentage of costs.

We provided City officials a preliminary draft report and discussed the results of our audit with them on August 20, 2009. Regarding procurement issues, the City provided the following written comments:

The City has not paid [the prime contractor] for the cost associated with the Project Management Fee's that were outlined in the audit for the 24% and the 5.7% fees that were billed to the City. [The] contract states that [the prime contractor] will perform project management and the City will be billed based on the Fee Schedule attached to their contract. The City understands that the issue being raised is that in their contract it is considered a Cost Plus Cost Percentage Contract which is prohibited by federal procurement laws as outlined in 44 CFR 13.36. The City is currently reviewing the contract and will comply with all federal procurement laws as outlined in 44 CFR Part 13 and follow the City's procurement procedures. . . . The City is going to review all project worksheets to assure that all procurement guidelines have been followed and only eligible costs associated with those projects will be paid.

The prime contractor billed the City for project management on an hourly-rate basis as allowed in its contract. The \$173,366 billed to the City for the prime contractor's labor included costs for "Construction Field Manager" and "Project Manager" personnel that were billed at fully loaded labor rates. Therefore, the 24% added to all costs was ineligible not only because it was a prohibited markup on costs, but also because it represented duplicate billings. The prime contractor charged for project management through its hourly billings and again as a percentage mark up on costs. As a result, we questioned \$296,171 as ineligible costs: \$46,711 for the prohibited 5.7% mark up on costs and \$249,460 for the prohibited 24% markup on costs that also represented duplicate costs.

Finding B: Legal Responsibility for Costs

The City, as the owner of the building, was responsible for the structure and fixtures of the building, whereas OPCSO, as the operating entity, was responsible for its contents and inmates' personal belongings. More than half the work performed at the correctional center related to building contents and inmates' personal belongings and, therefore, was not the City's legal responsibility.

The City's claim documentation was not sufficient to allocate costs billed to specific activities. The subcontractor's purchase order and invoice contained a line item description for \$695,804 that stated, "Complete the stabilization activities at the community correctional facility. Work to be completed per attached prime contractor scope of work. The subcontractor will provide the prime contractor with a contents inventory that provides a photo and description of contents owned by the OPCSO." We interviewed subcontractor personnel who provided a spreadsheet indicating that \$443,596 was bid and billed for performing the contents inventory. Subcontractor personnel said this activity was expensive because each item had to be individually photographed and inventoried. Additional line items on the subcontractor's invoice billed the City \$24,011 for "collecting, packaging and labeling of inmates personal effects" and \$5,833 for mold mitigation of library books and boxing items.

To be eligible for financial assistance, an item of work must be the legal responsibility of the applicant (44 CFR 206.223(a)(3)). Of the \$817,040 billed by the subcontractor, \$473,440 was ineligible because the work was not the City's legal responsibility (\$443,596 + \$24,011 + \$5,833). Further, a proportionate amount (58%) of the \$173,366 costs for the prime

contractor's direct labor to manage the work and the project was not eligible because it was related to ineligible work. Therefore, we questioned \$573,992 for work that was not the City's legal responsibility. The \$573,992 questioned consists of \$473,440 for ineligible subcontract cost and \$100,552 for ineligible prime contract cost (\$173,366 X 58%).

We discussed this matter with City officials who commented that the City took responsibility for the work because, after Hurricane Katrina, there was an urgent need to get the criminal system running again. They also stated that they would work to reconcile this matter.

Finding C: Cost Calculations

The City's claim included \$2,300 in overcharges resulting from the prime contractor's billing errors: \$2,195 for an incorrect billing rate and \$105 for an invoice error. Therefore, we questioned \$2,300 as ineligible overcharges.

RECOMMENDATIONS

We recommend that the Acting Director, FEMA Louisiana Transitional Recovery Office:

1. Require GOHSEP to advise the City not to use cost-plus-percentage-of-cost clauses in future contracts.
2. Disallow \$296,171 as ineligible markups on costs.
3. Disallow \$573,992 for work that was not the City's legal responsibility.
4. Consider writing a separate project worksheet for the Orleans Parish Criminal Sheriff's Office to take responsibility for the work identified as its legal responsibility.
5. Disallow \$2,300 in overcharges by the prime contractor.

DISCUSSION WITH MANAGEMENT AND AUDIT FOLLOW-UP

We discussed the results of our audit with City officials on August 20, 2009, and September 15, 2009, and have included their comments in our report. We discussed the results of our audit with GOHSEP officials on September 10, 2009, and FEMA officials on September 21, 2009. These officials deferred their comments until after the report is issued. Please advise this office by November 30, 2009, of the actions planned or taken to implement the recommendations, including target completion dates for any planned actions. Significant contributors to this report were Judy Martinez, Jeffrey Campora, Bryan Chauvin, and Donna Williams. Should you have questions concerning this report, please contact me at (214) 436-5200, or your staff may contact Judy Martinez, Audit Manager, at (504) 739-7730.

cc: Acting Regional Administrator, FEMA Region VI
Audit Liaison, FEMA Region VI
Audit Liaison, FEMA Louisiana Transitional Recovery Office
Audit Liaison, FEMA (Job Code DG8C13)