Office of Inspector General
Office of Emergency Management Oversight

U.S. Department of Homeland Security
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Homeland Security

June 7, 2010

MEMORANDUM FOR: Tony Russell
Regional Administrator
FEMA Region VI

FROM: Robert J. Lastrico
Western Regional Director

SUBJECT: *FEMA's Practices for Evaluating Insurance Coverage for Disaster Damage and Determining Project Eligibility and Costs*
Report DS-10-08

During our audit of *Gulf Coast Recovery: FEMA's Management of the Hazard Mitigation Component of the Public Assistance Program* (Audit Report Number OIG-10-28 of December 10, 2009), we identified reportable conditions outside the scope of that audit. We employed audit procedures related to these conditions to determine whether the Federal Emergency Management Agency (FEMA) effectively managed selected areas of the Public Assistance (PA) Program across the Gulf Coast region. This report summarizes those conditions. We ask that you review, evaluate, and comment on the findings and recommendations contained herein.

We performed audit procedures under the authority of the *Inspector General Act of 1978*, as amended, and according to *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform our work to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our objective. The evidence obtained during this review provides a reasonable basis for our findings and conclusions based on our objective.

We visited FEMA's Gulf Coast Recovery Office (GCRO), Transitional Recovery Offices (TROs), FEMA Regions IV and VI, and several grantees and subgrantees. At each location, we interviewed responsible officials regarding the overall delivery and effectiveness of the PA Program. We also reviewed National Emergency Management Information System documentation, management reports, project worksheets (PWs), and project records. We performed other procedures considered necessary under the circumstances. We did not assess the adequacy of the internal controls applicable to grant activities because it was not necessary to accomplish our audit objective. We did, however, gain an understanding of: (1) the process used by FEMA to review insurance coverage, record insurance recoveries, and maintain supporting insurance-related documentation, (2) FEMA's use of the cost estimating format (CEF) to determine if damaged facilities should be repaired or replaced, and (3) the process used by FEMA to determine project and funding eligibility.

BACKGROUND

In August and September 2005, hurricanes Katrina and Rita battered the Gulf Coast region, caused unprecedented damage, devastated whole communities and neighborhoods, and left hundreds of thousands of people without shelter and employment. In the aftermath of these disasters, FEMA created the GCRO and established TROs in Louisiana, Mississippi, Alabama, and Texas to deliver and administer effective and consistent recovery programs. On April 10, 2009, the Acting FEMA Administrator: (1) announced the dissolution of the GCRO and (2) indicated that the Alabama, Mississippi, and Texas TROs had already transitioned back to their respective FEMA Regional Offices. Subsequently the Louisiana TRO became the Louisiana Recovery Office under the leadership of the Regional Administrator, FEMA Region VI.

RESULTS OF AUDIT

FEMA needs to strengthen procedures and processes for (1) reviewing insurance coverage, recording insurance recoveries, and maintaining related supporting documentation (Louisiana and Texas), (2) applying the CEF methodology and maintaining documentation that supports the assumptions used in CEF calculations (Louisiana), and (3) maintaining documentation to support project eligibility and funding determinations (Texas). Our review questions approximately $21.1 million in PA Program grant funding as follow:

- $15.9 million in disaster repair costs for projects in Texas due to insurance proceeds not being allocated proportionately among all insured risks, and the inclusion of ineligible or excessive costs in the hospital's claimed costs calculations.

- $3.9 million in overstated repair costs in Louisiana caused by the misapplication of a CEF factor.

- $1.3 million in roof replacement costs in Texas because project documentation indicated that the roofs could be repaired to their pre-disaster condition rather than being totally replaced.

Finding A - Insurance Coverage for Disaster Damage

FEMA needs to improve its processes and procedures for reviewing insurance coverage, recording insurance recoveries, and maintaining related supporting documentation. Section 312 of the *Robert T. Stafford Disaster Relief and Emergency Assistance Act*, P.L. 93-288, as amended, prohibits duplication of benefits received from other sources, including from insurance. In addition, Title 44, *Code of Federal Regulations*, Section 206.253(a) [44 CFR 206.253(a)] requires that (a) recipients of federal disaster assistance notify FEMA of any entitlement to insurance settlement or recovery relating to a damaged facility and (b) FEMA reduce the federal contribution of eligible costs by the actual amount of insurance proceeds. Further, FEMA's *Public Assistance Guide* (FEMA 322, October 1999, pages 89 and 94), requires FEMA to identify insurance coverage for disaster damages and reduce the amount of federal assistance by the anticipated or actual insurance proceeds available for the work.

- In Louisiana, the State Office of Risk Management (ORM) has responsibility for monitoring and reporting advance recoveries and final settlements on the state's insurance policy. ORM is also responsible for identifying and reporting on insurance recoveries related to FEMA funded projects. Initially, FEMA and the state identified $500 million[1] in potential insurance proceeds to be applied to all state facilities.

As of April 2008, ORM had identified $305 million in insurance recoveries and FEMA had not taken steps to determine the accuracy of the recoveries. In addition, obligations to disaster projects were at the maximum federal share (100%), and FEMA had not reduced project costs to reflect the recoveries. In a March 1, 2010, written response to us, a FEMA Louisiana TRO official explained that ORM had notified FEMA that $311 million in insurance recoveries had been identified and that an additional $189 million remained in litigation with insurance carriers. This official also explained that FEMA had begun allocating insurance recoveries to specific FEMA funded projects and had written 2,682 PW versions (i.e., modifications to the original PWs) to reduce project funding to capture the $311 million in recoveries. The LATRO official noted that FEMA will continue to monitor for additional insurance recoveries, request documentation of current recoveries, and reallocate reductions to other projects by applicants.

- The Memorial Hermann Baptist Hospital (hospital), in Texas[2] did not allocate insurance proceeds proportionally among all insured risks based on documented damages. The hospital had greater than $200 million in insurance coverage when the disaster occurred; however, the policy contained a Limited Named Storm Wind Coverage Endorsement that limited Hurricane Rita coverage to $25 million. The insurance policy covered FEMA eligible and ineligible damages (property damage and business interruption losses, respectively) without specifying limits for each type of loss.

  FEMA's Response and Recovery Directorate Policy Number 9580.3, dated August 23, 2000 (*Insurance Consideration for Applicant*s), provides guidance to disaster applicants for allocating insurance recoveries among FEMA eligible and ineligible damages. This FEMA policy notes that if the insurance policy covers both eligible costs, such as property coverage, and ineligible costs, such as business interruption coverage, then reimbursement for the deductible will be reasonably prorated based on the insurance settlement. Despite this requirement, the hospital allocated insurance proceeds primarily to business interruption losses.

  The hospital confirmed that $22 million of the $25 million in insurance recoveries was allocated to business interruption losses and $3 million to FEMA eligible repair work. As justification for this allocation, hospital officials provided us with documentation from the insurance adjustor and its insurance consultant that explained that since disaster damage costs greatly exceeded insurance recoveries, insurance recoveries should be assigned to as much non-FEMA eligible damages as possible.

  FEMA officials acknowledged that the hospital's methodology for allocating insurance was not consistent with FEMA's policies. FEMA officials continue to monitor claimed costs for permanent restoration of the subgrantee's facilities, and once all projects are completed, the apportionment of insurance proceeds between eligible costs and business interruption costs will be adjusted. Those officials did not opine on the eligibility of the costs the hospital has

[1] Hurricane Katrina - Disaster number 1603-DR-LA.
[2] Hurricane Rita - Disaster number 1606-DR-TX, PW 2471 - $1.2 million, PW 3187 - $6.1 million, and PW 3241 - $5.9 million.

submitted for reimbursement. In regards to the allocation of insurance proceeds, FEMA officials further explained that after repeated requests, the hospital failed to produce supporting explanatory insurance-related documentation and that FEMA had stopped requesting the information pending project close-out. As of April 2008, the estimated reimbursable disaster damages totaled $25.7 million. As of that date, FEMA has reimbursed the applicant $7.4 million with plans to reimburse an additional $15.9 million in disaster costs, for a net reimbursement of $23.3 million for 19 FEMA approved projects. We question FEMA's proposed reimbursement of the additional $15.9 million, as the hospital has not allocated insurance proceeds proportionally among all insured risks.

Additionally, the hospital submitted for federal reimbursement and FEMA accepted costs that do not represent an insurable loss or meet FEMA's eligibility criteria. We identified and communicated to FEMA the following examples of questionable costs.

- The hospital identified the $217,505 "surrender charge on annuity contracts" as an expense to avert business interruption loss. The applicant included the amount in totals allocated to PWs with permanent repair work. FEMA's funding to assist cash flow is limited to reimbursement of eligible costs [44 CFR 13.21] and administrative allowance funding. FEMA does not reimburse subgrantees for investment opportunities lost as a result of a disaster.

- Replacement of trees damaged by the hurricane [$63,196]. The insurance policy excluded coverage in such circumstances as does FEMA's policy [*Trees, Shrubs, and Other Plantings Associated with Facilities* - Disaster Assistance Policy 9524.5].

- Cost not reduced by the salvage value of vehicles used beyond the disaster recovery period. The hospital acquired three vehicles not included in their vehicle pool pre-disaster at a cost of $90,289. FEMA's governing regulation [44 CFR 13.32] and policy [*Disposition of Equipment, Supplies and Salvageable Materials* - Disaster Assistance Policy 9525.12] require the hospital to apply a credit for the non-disaster related vehicle useful life.

- FEMA needs to improve its procedures for maintaining records collected from disaster applicants for insurance coverage evaluations. For the Texas projects with net reimbursements of $23.3 million (discussed above), FEMA's insurance records were not sufficient for us to adequately assess the status of the insurance claim. FEMA records consisted of only a memorandum from a hospital consultant that identified the deductible allocations for losses incurred. Those records did not include a copy of the insurance policy or correspondence with the hospital related to property coverage. Also, FEMA project records did not include insurance recovery information or provide evidence on how insurance recoveries were evaluated or whether FEMA management reviewed and approved FEMA staff insurance determinations. Instead of being included in FEMA's project files, insurance records were often maintained offsite by the intermittent FEMA employee (insurance specialist) assigned to review the insurance coverage. This de-centralized approach compromised FEMA's ability to collect and monitor the key documents (e.g., insurance policies and loss summary schedules) needed for insurance coverage evaluations. FEMA did not have specific guidance on how and where the records had to be archived.

Finding B – Cost Estimating Format

FEMA obligated $52.3 million under PW 4876 to replace the Orleans Parish Criminal Sheriff's Office housed within the Orleans Parish Correctional Complex. As a result of the disaster (1603-DR-LA), wind and floodwaters damaged the first floors of two concrete and masonry structures. One of the damaged buildings (Templeman III) was a 142,000 square foot (SF), 4-story facility and the other (Templeman IV) was a 17,900 SF, single story facility. In determining funding, FEMA applied incorrect data when using the CEF to determine estimated project costs.

The CEF Guide requires an applicant to establish a timeline to the mid-point of construction for FEMA funded eligible repair work (Part E.1 escalation factor). FEMA records identified that the CEF calculation for Part E, *Cost Escalation Allowance*, incorrectly used 24 months to determine the mid-point of construction[3] instead of the 14 months identified in the project's Part E.1 CEF Notes section. Using the 24 month mid-point of construction factor in lieu of 14 months resulted in a $3,449,376 overestimate of repair costs and was further compounded when CEF Parts F, G, and H factors were applied.[4] These errors resulted in a total overstatement of $3,920,869, as depicted below.

Cost Estimating Format Parts E -H [calculations]				
		Cost Escalation Details		
Part	Description	Shown As	Should Be	Difference
E	Cost Escalation Factor for 24 months/14 months	$8,278,504	$4,829,128	$3,449,376
F – H	Overstatement impact on remaining factors	1,131,776	660,283	471,493
	Totals	$9,410,280	$5,489,411	$3,920,869

The CEF overestimate for Parts E through H ($3.9 million) reduces the repair estimate from $52.3 million to $48.4 million. Thus, FEMA should reduce project funding under PW 4876 by $3.9 million.

Finding C - Project Eligibility and Funding Determinations

For disaster number 1606-DR-TX, Lamar University received over $6.0 million in public assistance grant funding for the replacement of 19 campus building roofs and each roof in a museum complex. We question $1.3 million in funding, including $209,195 in PA hazard mitigation,[5] provided under 16 PWs for roof replacements at 15 of the campus buildings and all the roofs on structures within the museum complex (See Exhibit). FEMA's decision to fund the roof replacements was not supported by, or consistent with, damage descriptions documented in project files.

The PWs for roof replacements typically contained the same boilerplate damage assessment descriptions as follows: "Heavy winds lifted and ripped the rubber roof membrane. More than 75% of the roof and several sections of coping were damaged." While these damage descriptions were used to justify the roof replacements, other information in the PWs themselves or in project records conflicted with the asserted 75% level of damage. In some instances, the PWs indicated that repairs

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[3] CEF Part E allows the subgrantee to adjust estimated construction costs for inflation during the design and construction stage.
[4] Plan Review and Construction Permit Costs, Applicant's Reserve for Construction, and Applicant's Project Management and Design Costs, respectively.
[5] These PA hazard mitigation costs were not previously questioned in Audit Report OIG-10-28.

were feasible and less costly than replacements. In addition, formal bid proposals in project records indicated that some roof areas requiring disaster repairs were less than 75% damaged. In other instances, the interior damages to structural components, i.e. ceilings, walls, and contents did not support claims of extensive roof failures.

The following three examples identify the type of information that conflicted with FEMA's decision to fund the roof replacements.

- PW 1749 - *Gladys City/Boomtown Museum*. This PW provided $150,700 for new roofs and $75,000 for PA funded hazard mitigation work. The museum consisted of 16 wood frame buildings (14 one-story and 2 two-story buildings), and other structures. Exterior damage due to heavy winds included several blown off tin and shingle roofs. Documents identifying the disaster damage described a two-fold solution for repairing the museum to pre-disaster condition: (1) replace some roofs and (2) refasten the existing corrugated tin roofs with heavy-duty screws and neoprene washers. While less costly disaster repair options were available, the scope of work in the formal bid solicitation required re-roofing metal roofs on 14 existing buildings.

- PW 815 - *Energy Management Facility Building.* This PW provided $82,500 to replace a 6,250 SF roof. The PW used boilerplate language that 75% of the roof area was disaster damaged. The PW did not specify or describe any other related damage. The formal bid solicitation placed by the University's architects and engineers described needed repairs to only 1,838 SF of roof or only 29% of the total roof area. Despite the fact that less than a third of the roof was damaged, FEMA funded replacement of the 6,250 SF roof.

- PW 1792 - *Maimie McFaddin Ward Building*. This PW provided $330,000 in PA and PA hazard mitigation funding to replace a 25,000 SF roof. The PW again used boilerplate language (75% disaster damage to the roof) as justification for the roof replacement. However, other disaster-related repairs resulting from the roof breach and described in the PW were not significant and were inconsistent with a major breech of the roof. Those repairs included damaged ceiling tiles in numerous rooms ($4,220), damaged wallpaper in one room ($1,200), and miscellaneous small projects ($1,800).

According to 44 CFR 206.223, an item of work must be required as a result of a major disaster to be eligible for financial assistance. In addition, 44 CFR 206.203 provides that if a subgrantee desires to make improvements, but still restore the pre-disaster function of a damaged facility, the grantee's approval must be obtained. Also, federal funding for improved projects is limited to the federal share of the approved estimate of these eligible costs. Thus, the funding required in excess of costs to repair the damage element to pre-disaster condition is the responsibility of Lamar University.

As illustrated above, the scopes of work stated in the 16 PWs we reviewed did not accurately reflect actual roof damages to Lamar University buildings and structures. In most cases, roof replacements were not needed to restore disaster-damaged roofs to their pre-disaster condition. From a regulatory perspective, replacing a roof when repairing it would have been more cost effective is tantamount to an improved project as described in 44 CFR 206.203, with federal funding limited to the federal share of the repair estimate. However, it may no longer be feasible to re-estimate roof damage since the disaster occurred in November 2005. As such, we are proposing an alternative approach to determine reasonable costs as described in Office of Management and Budget Circular A-87, *Cost*

Principles for State, Local, and Indian Tribal Governments.[6] We propose that FEMA accept: (a) the 75% roof damage cited in 14 PWs, (b) the 50% roof damage identified in PW 843, and (c) the 29% actual roof damage cited in PW 815 for the Energy Management Facility Building, and apply these percentages to the estimated costs of roof replacements stated in the PWs. As illustrated in the attached exhibit, this would result in a disallowance of $1,313,363 - an amount reflective of the cost of replacing undamaged portions of the roofs.

RECOMMENDATIONS

We recommend that the Regional Administrator, FEMA Region VI:

Recommendation #1. Take action to: (a) determine the accuracy of the $311 million in insurance recoveries recorded by the Louisiana Office of Risk Management, (b) determine the accuracy of the allocation of these insurance recoveries to individual projects, (c) collect up to $189 million in insurance recoveries depending on the outcome of current litigation, and (d) allocate future insurance recoveries to individual disaster projects in a timely manner. (Finding A)

Recommendation #2. Withhold $15.9 million in funding to Memorial Herman Baptist Hospital for 19 projects (disaster number 1606-DR-TX) until the hospital provides FEMA adequate documentation showing that insurance proceeds were allocated proportionally among all insured risks based on eligible documented damages. (Finding A)

Recommendation #3. Advise FEMA's Assistant Administrator for Recovery of needed improvements to existing policies for records retention that will strengthen the control of documents obtained during evaluations of insurance coverage. (Finding A)

Recommendation #4. Reduce project funding by $3.9 million for PW 4876 since the Part E.1 escalation factor mid-point of construction was not properly computed. (Finding B)

Recommendation #5. Disallow the $1.3 million in funding for projects associated with total roof replacement for Lamar University. (Finding C)

DISCUSSION WITH MANAGEMENT AND AUDIT FOLLOW-UP

During the fieldwork phase of our audit *Gulf Coast Recovery: FEMA's Management of the Hazard Mitigation Component of the Public Assistance Program*, the issues in this report were discussed with FEMA and subgrantee officials in Louisiana and Texas. In some cases, we were provided additional information which was reviewed, and when appropriate, we modified our conclusions based on that information. Also, we have included in this report, comments received from FEMA and state officials as they pertain to the issues.

Please provide written responses to our findings and recommendations and advise this office by August 6, 2010, of 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 questions concerning this report, please call me at (510)

[6] Attachment A, Section C.2. says that a cost is reasonable if, in its nature and amount, it 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.

637-1482, or your staff may contact Humberto Melara, Supervisory Auditor, at (510) 637-1463. Key contributors to this assignment were Humberto Melara, Curtis Johnson, Arona Maiava, Carlos Feliciano, and Montul Long.

cc: Interim Director, Louisiana Recovery Office, FEMA Region VI
Audit Liaison, FEMA Region VI
Audit Liaison, FEMA (Job Code: DP7W05/G-10-032-EMO-FEMA)
Central Regional Director, OEMO, DHS OIG

Exhibit

Lamar University Questioned Costs for Roof Replacements

Identification		Roof % Damaged	Total PW Obligated			Questioned Roof Cost	
PW	Facility	Cited in PW		Roof Related	Other work	%	Amount
815	Energy Management Facility	75(1)		$82,500	$ 00	71	$58,575
842	Art Building	75		118,008	1,043	25	29,502
843	Setzer-Student Center	50		274,995	28,989	50	137,498
844	Biology Building (2)	75		265,320	28,901	25	66,330
845	Brooks-Shiver Student Housing (3)	75		550,004	44,446	25	137,501
847	Galloway Building	75		549,991	26,100	25	137,498
853	Wimberly Building	75		192,456	11,063	25	48,114
854	Music Building	75		228,795	5,927	25	57,199
855	Lucas-Engineering Building	75		330,000	10,582	25	82,500
856	Health & Human Performance Complex	75		396,990	13,665	25	99,248
1317	Cherry-Engineering Building	75		597,696	74,119	25	149,424
1327	Dining Hall/Fitness Center	75		274,995	83,290	25	68,749
1749	Gladys City/Boomtown Museum	(4)		225,700	945,589	25	56,425
1786	Social & Behavior Sciences	(4)		184,000	2,527	25	46,200
1792	Maimie McFaddin Ward Building	75		330,000	34,239	25	82,500
1794	Geology Building	75		224,400	36,710	25	56,100
	Totals			$4,825,850	$1,347,190		$1,313,363
					(5)		

Notes:

(1) The solicitation of bids to perform the repair work noted the required repair area as being 1,838 square feet or 29% of the total roof area. (PW 815)

(2) Two large windows blown out on the second floor west side of the building are noted on work orders as the possible entry points for water that caused $10,592 in carpet damage on the second floor of the building. (PW 844)

(3) The “Other” obligated column includes nine roof fans replaced at a cost of $38,113; therefore, other than apparatus on the roof, all other damages totaled $6,333. (PW 845)

(4) The PWs do not state the percentage of roof damaged although total roofs were replaced. We are recommending a 25% disallowance based on the limited damages incurred to the interior of the structures. (PWs 1749 and 1786)

(5) The total obligated cost for all “Other” repairs is $1,347,190. The total for “Other” repairs excluding the Gladys City/Boomtown Museum complex is only $401,601. We included roof fans in the “Other” category because the force of the wind dislodged those apparatus; however, the removal of that claimed cost, as in the case of Brooks-Shiver Student Housing (PW 845), reveals limited interior damages typically reflective of the roofs being breeched or extensively damaged.