

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

**FEMA Should Recover \$258,488 of
Public Assistance Grant Funds Awarded to the
Graton Community Services District, California**





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Department of Homeland Security

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JUN 25 2014

MEMORANDUM FOR: Karen Armes
Acting Regional Administrator, Region IX
Federal Emergency Management Agency

FROM: John V. Kelly
Assistant Inspector General
Office of Emergency Management Oversight

SUBJECT: *FEMA Should Recover \$258,488 of Public Assistance Grant
Funds Awarded to the Graton Community Services District,
California*
FEMA Disaster Number 1628-DR-CA
Audit Report Number OIG-14-109-D

We audited Federal Emergency Management Agency (FEMA) Public Assistance grant funds awarded to the Graton Community Services District of Graton, California (District), Public Assistance Identification Number 097-UGBU4-00. Our audit objective was to determine whether the District accounted for and expended FEMA grant funds according to Federal regulations and FEMA guidelines.

The California Governor's Office of Emergency Services (California), a FEMA grantee, awarded the District \$3.4 million for damages resulting from severe storms, flooding, mudslides, and landslides from December 17, 2005, through January 3, 2006. The award provided 75 percent FEMA funding for one large project and two small projects.¹ The audit covered the period December 17, 2005, to January 8, 2014. We audited all three projects, or 100 percent of the claim, totaling \$4.1 million (see exhibit).² Table 1 shows the gross and net award (before and after FEMA deducted anticipated insurance proceeds) for all projects. As of the date of this report, California was preparing to review the District's final claim.

¹ Federal regulations in effect at the time of the disaster set the large project threshold at \$57,500.

² Although FEMA initially obligates funding based on estimated costs, it funds large projects using a final accounting of actual costs. After reviewing a final claim for reimbursement, FEMA may adjust (obligate/deobligate) the amount of the grant to reflect the actual cost of the eligible work. In the case of the District, FEMA (through California) obligated \$3.4 million, but the District ultimately submitted a (revised) final claim to California amounting to \$4,113,669.



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Table 1. Gross and Net Award Amounts			
Projects	Gross Award Amount	Insurance Reductions	Net Award Amount
All Projects	\$3,407,307	(\$22,387) ³	\$3,384,920

Source: FEMA and District Project Documentation

We conducted this performance audit between September 2013 and March 2014, pursuant to 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 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 by applying the statutes, regulations, and FEMA policies and guidelines in effect at the time of the disaster. We decided to audit this grant, in part, because FEMA officials requested our collaboration to assist them in reviewing its Public Assistance Program subgrants that were ready for closeout.

We interviewed FEMA, California, and District officials; reviewed judgmentally selected project costs (generally based on dollar value); and performed other procedures considered necessary to accomplish our objective. We also notified the Recovery Accountability and Transparency Board of all contracts the subgrantee awarded under the grant to determine whether the contractors were debarred or whether there were any indications of other issues related to those contractors that would indicate fraud, waste, or abuse. We did not assess the adequacy of the District'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 District's method of accounting for disaster-related costs and its procurement policies and procedures.

BACKGROUND

The Graton Community Services District (District), located in Sonoma County, California, currently has one function: the maintenance and operation of a wastewater treatment plant.

Beginning on December 17, 2005, flooding occurred and waters from two nearby creeks soon overtopped the protective levee surrounding the facility and inundated the treatment plant, eroding levee material into three settling ponds and damaging

³ The District actually received \$20,542 in insurance proceeds of the \$22,387 that FEMA originally estimated.



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stationary equipment. FEMA provided grant funding to repair the facility and to build a concrete floodwall surrounding parts of the facility to mitigate the impact of a future event (see figure 1).

Figure 1. Settling Ponds, Graton Sewer Treatment Facility (October 2009)



Source: Graton Community Services District

RESULTS OF AUDIT

The District did not properly account for or expend \$258,488 according to Federal regulations and FEMA guidelines (see table 2). This amount represents about 6 percent of the \$4,113,669 the District claimed.

Table 2. Summary of Costs Questioned		
Finding	Subject	Costs Questioned
A	Improper Procurement	\$241,755
B	Duplicate Administrative Costs	13,500
C	Costs Claimed Not Related to the Disaster	3,233
Total		\$258,488

Source: FEMA and District Project Documentation and OIG Analyses

Further, District officials did not recover \$20,542 in insurance proceeds until after we advised them of their oversight. The District did not deduct the proceeds from its initial claim, as FEMA requires (finding D). Also, the District may have included costs that were administrative in nature in its claim for engineering costs, thereby duplicating costs covered by the statutory administrative allowance (finding E). These findings occurred, in part, because California officials did not consistently ensure that District officials were aware of and complied with applicable Federal regulations and FEMA guidelines. Therefore, California should improve its oversight of subgrant activities (finding F).



Finding A: Improper Procurement for the Architectural & Engineering (A&E) Contract

The District awarded four contracts totaling \$3,477,741 to complete the work FEMA authorized. District officials generally complied with Federal procurement standards for three of these contracts, totaling \$3,038,485, but did not comply with those standards in awarding an A&E contract for \$439,256. As a result, full and open competition did not always occur and the District claimed \$241,755 in excessive A&E costs that we question as unreasonable.

Federal procurement standards at 44 Code of Federal Regulation (CFR) 13.36, stipulate that subgrantees must perform the following activities:

- Conduct procurements in a manner providing full and open competition except under certain circumstances. (13.36(c))
- Use noncompetitive proposals only in limited circumstances (such as when the item is only available from one source or FEMA authorizes noncompetitive proposals). (13.36(d)(4)(i))
- Avoid using time-and-material type contracts unless no other contract is suitable and provided the contract includes a ceiling price, which the contractor exceeds at its own risk. (13.36(b)(10))
- Prepare a cost or price analysis in connection with every procurement action, including contract modifications. (13.36(f)(1))
- Maintain a contract administration system that ensures contractors perform in accordance with the terms, conditions, and specifications of their contracts or purchase orders. (13.36 (b)(2))

In addition, Federal cost principles and FEMA guidelines require that costs subgrantees claim must: (1) be reasonable and necessary to accomplish the work; (2) not exceed costs that a prudent person would incur under similar circumstances; and (3) be fair and equitable for the type of work performed.⁴

District officials did not comply with these criteria for the A&E contract. Instead, they awarded a non-competitive, time-and-material contract with no ceiling; did not prepare a cost or price analysis; and did not properly monitor the contractor's performance to ensure cost reasonableness. One week after the disaster occurred, the District accepted and approved a proposal from an engineering contractor that, since December 2004, had been performing work on the District's capital improvements. The District did not seek similar proposals from any other engineering firms or conduct a cost or price

⁴ 2 CFR, Section 225, Appendix A, C.2.; and *Public Assistance Guide* (FEMA 322, October 1999, pp. 33, 39, and 81).



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analysis to determine reasonable costs for the work needed. District officials used a time-and-material contract, but did not determine (or justify) that no other contract type was suitable or include the required ceiling. Time-and-material contracts are riskier than other types, such as fixed-price or costs-plus-fixed-fee contracts, because they require careful monitoring to ensure that the contractor bills only for authorized work that it can properly support with detailed timesheets and invoices.

However, District officials did not create or approve a disaster-related scope of work for the engineering contractor and did not carefully monitor contractor expenses. They have no documentation demonstrating that they signed or otherwise approved—or even required the engineer to maintain—detailed timesheets, planned work assignments, or descriptive invoices. Further, the District’s policy required (Board of Directors) approval of engineering invoices that exceeded \$25,000. However, the District could not provide documentation supporting the Board’s review and authorization of four A&E invoices that exceeded the \$25,000 threshold.

Because the District did not take the required precautions to ensure that the contractor performed only authorized work at reasonable prices, we analyzed the costs to determine eligibility and reasonableness. The District claimed \$439,256 for A&E work, or about 14.5 percent of the \$3,038,485 costs for actual construction work. FEMA’s guidelines on engineering costs (for projects of above-average complexity) indicate that about 6.5 percent of the construction costs are reasonable.⁵ Per these guidelines, the reasonable amount would be approximately \$197,501, or \$241,755 less than what the District claimed.

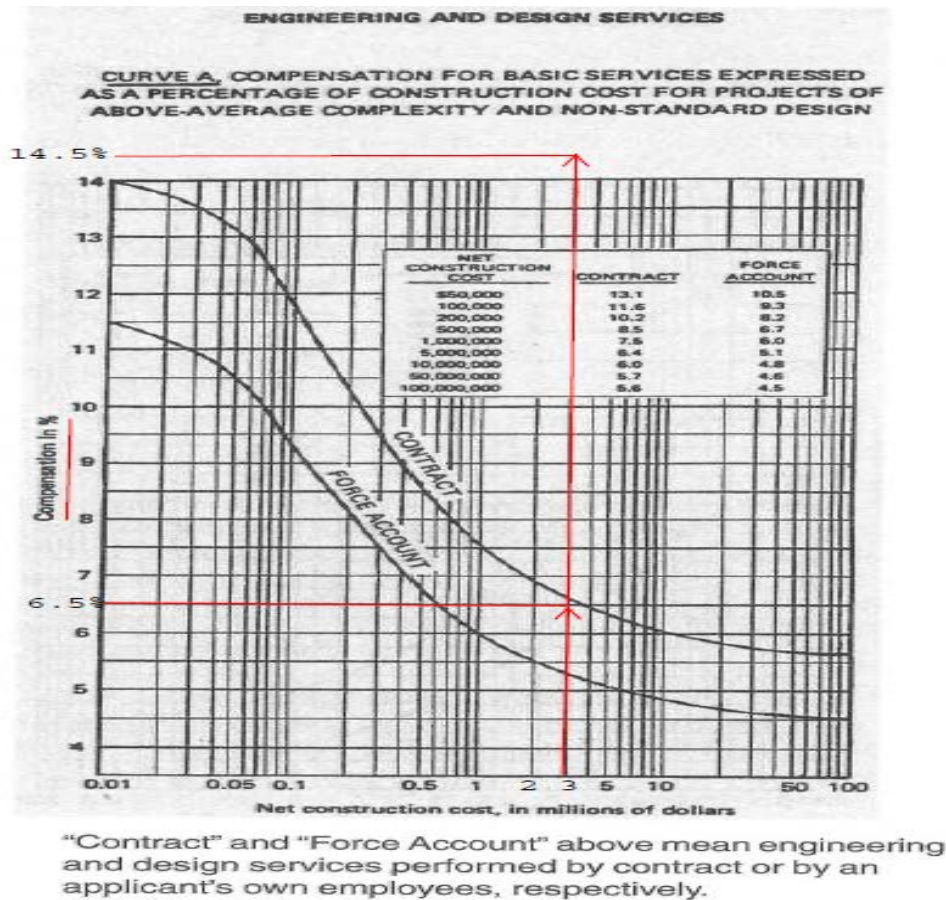
FEMA relies on final inspection and reconciliation to determine the actual costs for reimbursement of engineering services; however, one can estimate the costs during project formulation using a percentage of the construction cost. FEMA derives these percentages from its *Engineering and Design Services Cost Curves*. These curves, which FEMA bases on data developed by the American Society of Civil Engineers, show a correlation between engineering costs and total construction costs. Figure 2 depicts a cost curve.

⁵ To be conservative, we used FEMA’s 6.5 percent guideline for “above-average” complexity, rather than its 5.5 percent guideline for average complexity. However, we would categorize much of the District’s construction work (such as constructing a basic wall) to be of average complexity.



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Figure 2. FEMA's Cost Curve A
Engineering and Design Services for Above-Average Complexity: Eligible vs. Actual



Source: FEMA 322

In addition to being excessive, some of the engineering costs the District claimed appear to be ineligible. FEMA criteria indicate engineering and design services that are generally eligible for reimbursement include preliminary engineering analysis, preliminary design, final design, and construction inspection (FEMA 322, p. 75, October 1999). However, many of the tasks the A&E contractor performed appear to be administrative in nature and, therefore, ineligible (see findings B and E).

In conclusion, District officials did not comply with Federal procurement standards in awarding and administering the A&E contract. As a result, full and open competition did not occur and the District claimed \$241,755 in excessive A&E costs that we question as unreasonable.



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District officials agreed that they did not follow Federal contracting procedures for engineering and construction management services. They asked that we consider that they did not have the time or resources for competitive procurement in the aftermath of the disaster. Officials said it would have been less efficient and create considerable delays to their ongoing work to properly procure these services. They also said that California officials never advised them on these requirements. We maintain that the District took more than 6 years to complete the work and should have taken a minimum of time upfront to ensure full and open competition and reasonable costs. Further, full and open competition ensures more than just reasonable costs. It also helps to discourage and prevent favoritism, collusion, fraud, waste, and abuse. Regarding the reasonableness of the claimed engineering costs, District officials said they mistakenly comingled costs and functions in their claim. For example, they acknowledged their claimed costs included engineering services, construction management services, and grant administration charges. They said, when properly segregated, the engineering services fall within FEMA's criteria for reasonableness. They told us that they plan to properly identify and segregate all of their charges and resubmit their claim to California and FEMA.

California officials generally agreed with our finding and reiterated that the District should separately account for and claim the variety of charges related solely to the contracted engineering services. California officials said they would await the District's revised claim.

FEMA officials are withholding comment until after we issue our final report.

Finding B: Duplicate Administrative Costs

The District improperly claimed \$13,500 for the cost of A-133 (\$9,000) and California-required (\$4,500) audits under Project 2776.⁶ These costs are, in effect, duplicate costs because the statutory administrative allowance covers such costs.⁷

According to 44 CFR 206.228, a subgrantee receives an administrative allowance to cover the necessary costs of requesting, obtaining, and administering Federal disaster

⁶ The District expended more than \$500,000 per year in Federal awards and thus was subject to audit requirements commonly referred to as *Single* or *A-133* audits. The Office of Management and Budget requires these audits under its guidelines *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133). Further, California requires that its Special Districts—of which Graton Community Services District is one—have a complete annual audit of their financials. These audits of financial statements and other information become available to the public, the Governor, any potential grantors, and financial institutions, etc.

⁷ Finding E relates to additional costs that we identified that may be administrative in nature and covered by the statutory administrative allowance.



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assistance subgrants. The allowance covers all direct and indirect administrative costs.⁸ Audits are administrative in nature, and therefore subgrantees cannot separately claim the costs for audits because the administrative allowance covers these costs.

California officials previously determined that the \$13,500 the District claimed for the cost of audits was ineligible and deducted the amount from the District's claim. Nevertheless, District officials submitted the same costs again for reimbursement in a subsequent, revised claim.

Therefore, FEMA should disallow \$13,500 as ineligible costs and review all engineering costs the District claimed to ensure they did not include costs for grant administration. District officials agreed with our finding and said California did not make them aware of the requirements pertaining to the statutory administrative allowance. They said they will work with California officials to resubmit their claim and seek reimbursement for these costs from the statutory administrative allowance or elsewhere.

California officials generally agreed with our finding and said they would provide the District additional information on the statutory administrative allowance and collaborate with the District to revise their claim. FEMA officials are withholding comment until after we issue our final report.

Finding C: Costs Claimed Not Related to the Disaster

District officials improperly claimed \$3,233 for Project 2776 for engineering services (surveying consultation and drainage collection) that a contractor performed before the disaster occurred. Federal regulations and FEMA guidelines stipulate that claimed costs must be for work directly related to the declared disaster [44 CFR 206.223; *Public Assistance Guide* (FEMA 322, October 1999, pp. 23, 33, and 71–73)].

The contractor performed the engineering services during December 1–15, 2005, which was before the disaster began on December 17, 2005. Therefore, we question as ineligible the \$3,233 the District claimed in costs for Project 2776 that did not relate to the disaster.⁹

District officials agreed with our finding and said they would revise their claim. California officials agreed with this finding. FEMA officials are withholding comment until after we issue our final report.

⁸ For disasters that occurred after November 13, 2007, FEMA no longer provides this allowance, but allows subgrantees to claim administrative costs that directly relate to specific projects (FEMA Disaster Assistance Policy 9525.9).

⁹ This amount does not include those costs related to the District's claimed preparedness costs incurred immediately before the disaster (e.g., sandbagging). We did not question those costs.



Finding D: Unreported Insurance Recovery

District officials did not recover \$20,542 in insurance proceeds until after we advised them of their oversight. Thus, the District did not deduct such proceeds from its initial claim, as FEMA requires. Federal regulations require FEMA to deduct actual or anticipated insurance recoveries that apply to eligible costs from project awards (44 CFR 206.250(c)). This action prevents subgrantees from receiving duplicate benefits for losses.

FEMA officials correctly deducted \$22,387 in anticipated (estimated) insurance proceeds from the funding they obligated for the District's eligible projects. However, District officials did not actively pursue recovering \$20,542 of insurance proceeds for which they were eligible under their insurance policy in effect at the time of the disaster. Therefore, their initial claim to FEMA included \$20,542 in ineligible costs for which FEMA should not have been liable.

During the course of our audit fieldwork, we brought this issue to the attention of District officials. At first, they could not confirm whether they had filed an insurance claim for damages related to the disaster, but they started looking into the matter. As a result, their insurance provider issued proceeds of \$20,542 related to the disaster damages, which the District subsequently deducted from its revised claim.

This disaster is over 8 years old. Therefore, the District should have long ago pursued its insurance claim and notified California of the actual proceeds. Further, California, as the grantee, should have held the District accountable for pursuing and reporting insurance proceeds in a timely manner.

District and California officials generally agreed with our finding. FEMA officials are withholding comment until after we issue our final report.

Finding E: Costs Covered by Statutory Administrative Allowance

The District included administrative costs in its claim for engineering costs (see finding A). FEMA covers administrative costs through its statutory administrative allowance and so the District cannot claim them separately as direct project expenses. The District agreed to revise and resubmit its claim to FEMA; therefore, we did not verify the total administrative costs improperly included in the District's claim for engineering services.

According to 44 CFR 206.228, a subgrantee receives an administrative allowance to cover the necessary costs of requesting, obtaining, and administering Federal disaster assistance subgrants. The allowance covers all direct and indirect administrative costs,



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including the costs of tasks such as identifying damage, attending briefings, completing forms, providing documentation, assessing damage, collecting cost data, developing estimates, and working with California.¹⁰ The District's claim included many of these costs, for activities it described as—

- estimating costs
- developing FEMA spreadsheets
- preparing applications to FEMA
- analyzing costs
- traveling to and attending FEMA training
- reviewing FEMA flood application requirements
- exchanging emails related to FEMA
- writing cover letters
- discussing FEMA funding
- packaging and mailing letters to FEMA and the State for budget augmentation
- discussing matters with the State

District officials agreed with our finding and said California did not make them aware of the requirements pertaining to the statutory administrative allowance. They also said they included various charges related to the overall administration of the grant in their claim for contracted engineering services (see finding A). They intend to identify and segregate these costs and work with California officials to resubmit their claim and seek reimbursement for these costs from the statutory administrative allowance or elsewhere.

California officials generally agreed with our finding and indicated that they would provide the District additional information on the statutory administrative allowance and collaborate with the District to revise their claim. FEMA officials are withholding comment until after we issue our final report.

Finding F: Grantee Management

The preceding findings in this report occurred, in part, because California officials did not consistently ensure that District officials were aware of and complied with applicable Federal regulations and FEMA guidelines. Further, District officials consistently said they did not receive enough or appropriate guidance from California. Although California officials were involved in the projects and took their role as grantee seriously, they need to improve their procedures for monitoring and managing Federal

¹⁰ For disasters that occurred after November 13, 2007, FEMA no longer provides this allowance, but allows subgrantees to claim administrative costs that directly relate to specific projects (FEMA Disaster Assistance Policy 9525.9).



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grants. Federal regulations at 44 CFR 13.37(a)(2) requires the State (California) to ensure that subgrantees are aware of requirements that Federal regulations impose on them. Further, 44 CFR 13.40(a), requires grantees to manage the day-to-day operations of subgrant activity and monitor subgrant activity to ensure compliance with applicable Federal requirements. California officials could improve in providing sufficient oversight and coordination of subgrant activities, particularly to ensure that subgrantee officials manage Federal grants associated with future disasters effectively and efficiently. District officials agreed with this finding. California officials did not comment on this finding, except to note that the District is a small entity and therefore may not have been fully equipped to process and implement the guidance California provided them. FEMA officials are withholding comment until after we issue our final report.

RECOMMENDATIONS

We recommend that the Acting Regional Administrator, FEMA Region IX:

Recommendation #1: Disallow \$241,755 (Federal share \$181,316) of ineligible contract costs that do not comply with Federal procurement regulations and are excessive and unreasonable according to FEMA guidelines, unless the District can provide proper documentation to support these costs (finding A).

Recommendation #2: Review the items of work for all engineering costs the District claimed and disallow (or reallocate) those costs that are not eligible engineering services (findings A and E).

Recommendation #3: Disallow \$13,500 (Federal share \$10,125) in ineligible project costs that the statutory administrative allowance covers (finding B).

Recommendation #4: Disallow \$3,233 (Federal share \$2,425) in ineligible costs that are not related to the disaster (finding C).

Recommendation #5: Ensure the District and California accurately reflect in its final claim the \$20,542 in proceeds the District received from its insurance provider (finding D).

Recommendation #6: Advise California to instruct its subgrantees to pursue all insurance proceeds for which they are entitled and deduct such proceeds from their final claims (finding D).

Recommendation #7: Review all costs claimed as engineering to determine actual engineering costs versus those costs eligible under the statutory administrative



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allowance, and instruct the District and California to claim all applicable costs under that allowance and exclude all other costs that are not direct project costs from the District's final claim (finding E).

Recommendation #8: Direct California to improve its oversight and coordination of Federal grant funding to ensure that its subgrantees comply with Federal regulations and FEMA guidelines governing proper procurement, reasonable costs, insurance, and the statutory administrative allowance (findings A to F).

DISCUSSION WITH MANAGEMENT AND AUDIT FOLLOWUP

We discussed these findings with District officials during the course of this audit and included their comments in this report, as appropriate. We also provided a written summary of our findings and recommendations in advance to FEMA on March 12, 2014, and to California and District officials on March 17, 2014. We discussed the findings and recommendations at an exit conference with California and District officials on March 19, 2014, and FEMA officials on March 26, 2014.

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 the contact information of responsible parties and any other supporting documentation necessary to inform us about the current status of the recommendations. Until we receive and evaluate 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 Humberto Melara, Director; Devin Polster, Audit Manager; and Montul Long, Auditor.

Please call me with any questions at (202) 254-4100, or your staff may contact Humberto Melara, Director, Western Regional Office, at (510) 637-1463.



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Exhibit

Schedule of Projects Audited and Costs Questioned

Project / FEMA Category of Work	Project Award Amount (Net of Insurance) ¹¹	Costs Claimed	Insurance Recovery ¹² (Finding D)	Questioned Costs			Total
				Improper Procurement (Finding A)	Duplicate Administrative Costs (Finding B)	Costs Claimed Not Related to the Disaster (Finding C)	
2776 / F	\$3,361,649	\$4,082,381	\$17,185	\$241,755	\$13,500	\$3,233	\$258,488
*1538 / B	18,174	**19,726					
*2166 / E	5,097	**11,562	3,357				
Total	\$3,384,920	\$4,113,669	\$20,542	\$241,755	\$13,500	\$3,233	\$258,488

Source: FEMA and District Project Documentation and OIG Analyses

* Small Project

** California denied the District’s overrun request for Project 2166 because District officials did not submit a Net Small Project Overrun request within the regulatory 60-day mandatory timeframe. It is unclear whether California will likewise deny the additional costs the District claimed for Project 1358, based on the overrun recorded in their updated claim. California’s review is forthcoming. (A Net Small Project Overrun occurs when the applicant (District) incurs costs greater than the total amount approved for *all* small projects.)

¹¹ FEMA estimated the District’s insurance proceeds to be \$22,387.

¹² The District deducted the insurance proceeds from the *total* costs of all projects (large and small) combined in its final claim to California and FEMA. Therefore, we accounted for insurance recoveries for each project on a prorated basis according to FEMA’s initial anticipated insurance proceeds allocations. The District actually received \$20,542 in insurance proceeds of the \$22,387 that FEMA originally estimated.



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