

U.S. Department of Homeland Security
Central Regional Office
Office of Emergency Management Oversight
3900 Karina Street, Room 224
Denton, Texas 76208



Homeland Security

March 31, 2009

MEMORANDUM FOR: Douglas Gore
Acting Regional Administrator
FEMA Region VIII

Tonda L. Hadley

FROM: Tonda L. Hadley, Director
Central Regional Office

SUBJECT: Central Electric Cooperative, Inc.
FEMA Disaster Number 1620-DR-SD
Public Assistance Identification Number 000-U6PMC-00
Audit Report Number DD-09-07

We audited public assistance funds awarded to Central Electric Cooperative, Inc. (CECI), located in Mitchell, South Dakota. Our audit objective was to determine whether CECI accounted for and expended Federal Emergency Management Agency (FEMA) funds according to federal regulations and FEMA guidelines.

CECI received an award of \$5.91 million from the South Dakota Office of Emergency Management (SDOEM), a FEMA grantee, for damages caused by a severe winter ice storm that occurred on November 27, 2005. The award provided 75% FEMA funding for four large projects.¹ We audited the two largest projects under the award totaling \$5.69 million, or 96% of grant expenditures (see Exhibit). The audit covered the period November 27, 2005, to April 30, 2007, during which CECI, as subgrantee, claimed \$5.91 million for direct program costs.

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 reviewed compliance with federal procurement standards for \$3.66 million in contracts awarded for power restoration work. We also reviewed judgmentally selected samples of power restoration costs (selected based on dollar values) and performed other auditing procedures we considered necessary to accomplish the audit objective. We did not assess the adequacy of CECI's internal

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

controls applicable to its grant activities because it was not necessary to accomplish our audit objective. We did, however, gain an understanding of CECI's grant accounting system for disaster-related costs.

RESULTS OF AUDIT

CECI accounted for FEMA funds on a project-by-project basis according to federal regulations.² However, CECI officials did not follow federal procurement standards in awarding and administering \$2.15 million in contracts for disaster-related work and did not adequately support expenses totaling \$191,528 claimed for contract expenses. Finally, SDOEM overpaid CECI \$723,074.

Finding A: Contracting

CECI did not always follow federal procurement standards in awarding and administering contracts for disaster-related work. Federal procurement standards at 44 CFR 13.36 require, among other things:

- Performance of procurement transactions in a manner providing full and open competition except under certain circumstances (13.36(c)(1)). One allowable circumstance is when there is a public exigency or emergency for the requirement that will not permit a delay resulting from competitive solicitation. (13.36(d)(4)(i))
- Subgrantees maintain records sufficient to detail the significant history of the procurement, including the rationale for the method of procurement, the basis of selection of contract type, the basis for contractor selection, and basis for the contract price. (13.36(b)(9))
- 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-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))

In addition, FEMA's *Public Assistance Guide* (FEMA 322, October 1999), page 40, states, "FEMA provides reimbursement for three types of contracts:³

- 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."

² 44 CFR 13.20(b)(2).

³ At the time of the disaster, FEMA had not yet issued the current June 2007 *Public Assistance Guide*.

Contracting During the Emergency Period

CECI did not always follow federal procurement standards during the emergency period. For electric cooperatives, FEMA considers the emergency period to last from the beginning of the disaster until electrical power is restored. Therefore, the emergency period for CECI lasted 18 days from November 27, 2005, when the storm occurred, through December 14, 2005, when CECI restored power to its customers.

When major power outages occur, lives and property are at risk. As a result, CECI used non-competitive, time-and-material (T&M) contracts during the emergency period because there was not enough time to solicit competitive bids or develop clear scopes of work. However, CECI did not follow other requirements that apply even during exigent circumstances.

We reviewed \$1.82 million in contracts awarded during the emergency period. Of these, CECI awarded 16 T&M contracts totaling \$1.29 million without performing a cost or price analysis and did not include ceiling prices in these contracts as required. In addition, CECI did not document its contractor monitoring. CECI officials said their employees often accompanied the contractors, but did not prepare monitoring reports. Without monitoring reports, CECI had no documentation to validate the accuracy of hours billed on invoices.

FEMA's *Public Assistance Guide* (FEMA 322, October 1999), page 40, states that applicants must carefully monitor and document T&M contractor expenses. 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. Subgrantees should take steps to mitigate these higher risks by monitoring and documenting contractor activities.

CECI followed federal procurement standards in awarding the remaining \$534,985 of contracts awarded during the emergency period, which were mostly mutual aid agreements. Although CECI did not always follow procurement standards, we do not question the associated costs because they appear reasonable compared to costs billed subsequently under competitively awarded contracts.

Contracting After the Emergency Period

When CECI restored power, CECI correctly stopped using T&M contracts and switched to unit-price contracts, which pose less risk than T&M contracts. However, CECI did not always follow other federal procurement standards after the emergency period. We reviewed \$1.83 million in contracts awarded for work performed after the emergency period. CECI could not provide evidence of competition for contracts totaling \$870,088. CECI officials said that they contacted four repair service contractors to bid on these unit-price contracts and that they received bids from two contractors, one of which could not start work right away. However, CECI officials were unable to provide documentation of this informal competition. Subsequently, in April 2006, CECI properly documented the competitive awards of unit-price contracts with total costs of \$963,101. Although CECI did not always follow procurement standards, we do not question the associated costs because they appear reasonable compared to costs billed under the contracts awarded competitively in April 2006.

Finding B: Documentation for Claimed Costs

CECI did not provide adequate documentation to support \$191,528 claimed for the following T&M contract expenses:

- \$152,814 for contractor labor.
- \$37,320 for fuel and other vehicle or equipment-related charges.
- \$1,394 for food and lodging.

A few of the invoices for these expenses listed the names and hours billed for the contract employees who performed the work, but the majority of invoices listed only lump sums for billed expenses, such as labor hours and fuel. None of the invoices provided locations or details for the work performed, timesheets to support labor hours, receipts and details of food and lodging expenses, or records to tie billed labor hours to fuel and other vehicle or equipment-related charges.

Federal regulations require subgrantees to maintain records that adequately identify the source and application of funds (44 CFR 13.20(b)(2)) and to support accounting records “by such source documentation as cancelled checks, paid bills, payrolls, time and attendance records, contract and subgrant award documents, etc.” (44 CFR 13.20(b)(6)). CECI did not obtain such documentation for the \$191,528 claimed for T&M contract expenses. Further, as discussed previously, CECI did not document its contractor monitoring and, therefore, had no records to validate the accuracy of the hours and other expenses billed on invoices. Therefore, we question \$191,528 as unsupported costs.

During our audit fieldwork, CECI officials said that they were unable to provide the source documentation to support the \$191,528 claimed. However, after we provided CECI our draft report, CECI officials sent additional supporting documentation for these costs. We will review these documents as part of our audit follow-up process.

Finding C: Reconciliation of FEMA Funds

SDOEM overpaid CECI \$723,074. According to an SDOEM official, this occurred as the result of an error the state made in reconciling Project Worksheet 233. After we brought the overpayment to their attention, SDOEM officials recovered the funds from CECI; therefore, we make no recommendation regarding the overpayment and no action is required by FEMA.

RECOMMENDATION

We recommend the Acting Regional Administrator, FEMA Region VIII:

1. Disallow \$191,528 (\$143,646 FEMA share) of unsupported costs.

DISCUSSION WITH MANAGEMENT AND AUDIT FOLLOW-UP

We discussed the results of our audit with FEMA, SDOEM, and CECI officials on February 13, 2009. FEMA, SDOEM and CECI officials generally agreed with our findings and recommendations as discussed in this report.

Please advise this office by June 30, 2009, of the actions planned or taken, including target completion dates for any planned actions, to implement our recommendations. Should you have questions concerning this report, please contact me or Chris Dodd, Audit Manager, at (940) 891-8900.

cc: Audit Liaison, FEMA (Job Code DG8C06)
Audit Liaison, FEMA Region VIII

EXHIBIT

Schedule of Audited Projects
Central Electric Cooperative, Inc.
FEMA Disaster Number 1620-DR-SD

<u>Project Number</u>	<u>Award Amount</u>	<u>Claimed Amount</u>	<u>Questioned Costs</u>
233	\$4,781,238	\$4,781,238	\$191,528
239	<u>908,860</u>	<u>908,860</u>	<u>0</u>
Totals	<u>\$5,690,098</u>	<u>\$5,690,098</u>	<u>\$191,528</u>