

**Clearer Guidance Would
Improve FEMA's Oversight
of the Public Assistance
Alternative Procedures
Pilot Program**





DHS OIG HIGHLIGHTS

Clearer Guidance Would Improve FEMA's Oversight of the Public Assistance Alternative Procedures Pilot Program

October 27, 2015

Why We Did This Audit

FEMA asked us to review letters of undertaking with Hurricane Sandy applicants interested in participating in the Public Assistance Alternative Procedures Pilot Program, as well as the Program Guide. The letters outlined details of permanent work projects that will be completed under the pilot program, valued at more than \$4.6 billion.

What We Recommend

FEMA should implement procedures to gather data to track performance of the pilot program, and revise the *Public Assistance Alternative Procedures Pilot Program Guide for Permanent Work*, to ensure compliance with Federal rules and regulations. FEMA should also ensure that the content of its correspondence to applicants is consistent with that provided in the Guide.

For Further Information:

Contact our Office of Public Affairs at (202) 254-4100, or email us at DHS-OIG.OfficePublicAffairs@oig.dhs.gov

What We Found

The Federal Emergency Management Agency's (FEMA) Program Guide for the Alternative Procedures pilot program and letters of undertaking provide acceptable guidance in most areas to ensure compliance with Federal rules and regulations. However, our review of seven large dollar value projects valued at \$3.9 billion identified weaknesses in five areas of guidance:

1. estimating project costs;
2. responding to Office of Inspector General (OIG) audits;
3. managing cash responsibly;
4. applying insurance proceeds; and
5. obtaining insurance for future losses.

These weaknesses put Federal funds at greater risk of fraud, waste, and abuse. Correcting these weaknesses will better ensure that participants in the pilot program will follow Federal requirements when spending Federal funds. Further, to protect the Federal taxpayer from inflated estimates, FEMA's oversight should include additional steps to assess the accuracy of subgrantee fixed-cost estimates that exceed certain thresholds. In addition, FEMA needs to make other changes to comply with the *Stafford Act* and protect the integrity of the program.

FEMA Response

FEMA concurred with the three recommendations in the report and acted promptly to address a number of issues identified in the report. FEMA intends to address other findings with updates to its guidance and applicant letters.



OFFICE OF INSPECTOR GENERAL
Department of Homeland Security

Washington, DC 20528 / www.oig.dhs.gov

OCT 27 2015

MEMORANDUM FOR: Alex Amparo
Assistant Administrator, Recovery
Federal Emergency Management Agency

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

SUBJECT: *Clearer Guidance Would Improve FEMA's Oversight of the
Public Assistance Alternative Procedures Pilot Program*

Attached for your action is our final report, *Clearer Guidance Would Improve FEMA's Oversight of the Public Assistance Alternative Procedures Pilot Program*. We incorporated the formal comments provided by your office.

The Federal Emergency Management Agency (FEMA) requested we review its letters of undertaking (letters) sent to disaster applicants who were potential candidates for participation in the Public Assistance Alternative Procedures Pilot Program (pilot program.) Our objective was to determine whether the letters properly communicated FEMA guidance and that the guidance was consistent with Federal rules and regulations.

The report contains three recommendations aimed at enhancing the pilot program's overall effectiveness. Your office concurred with the recommendations. Based on information provided in your response to the draft report, we consider the three recommendations open and resolved. Once your office has fully implemented the recommendations, please submit a formal closeout letter to us within 30 days so that we may close the recommendations. The memorandum should be accompanied by evidence of completion of agreed-upon corrective actions.

Please send your closure request to OIGEMOFollowup@oig.dhs.gov.

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

Please call me with any questions, or your staff may contact James Gaughran, Deputy Assistant Inspector General, at (202) 254-4100.



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Background

On January 29, 2013, President Obama signed into law the *Sandy Recovery Improvement Act of 2013* (SRIA), which authorizes FEMA to develop alternative procedures for its Public Assistance Program, which provides disaster relief to states, counties, cities and other local governments, as well as some private nonprofit organizations.¹

In its January 2015 House of Representatives Report to reauthorize FEMA's programs and activities, the Committee on Transportation and Infrastructure explained the intent of SRIA was "to speed up and streamline Hurricane Sandy recovery efforts, reduce costs, and improve the effectiveness of several disaster assistance programs authorized by the *Stafford Act*."² The report specifically identified the Public Assistance, the Individual Assistance, and the Hazard Mitigation Programs. "SRIA grants FEMA greater flexibility in use of Federal funds and in turn allows the agency to reduce the administrative burden and cost to all parties."²

FEMA's Public Assistance grant program is designed to help communities quickly respond to and recover from major disasters or emergencies declared by the President. Under the traditional program, FEMA reimburses Public Assistance applicants only for actual expenditures of eligible costs for each approved large project.³ The most significant difference between the alternative procedures pilot program and the traditional program is that FEMA pays applicants a capped fixed-cost estimate for eligible costs for each approved large project. Appendix C provides additional information on the pilot program.

FEMA began implementing the pilot program with the issuance of its *Public Assistance Alternative Procedures Pilot Program Guide for Permanent Work* (Guide), dated May 20, 2013. Subsequently, FEMA updated the Guide, as of December 19, 2013, which is the basis for this review.

FEMA's December 28, 2014, Public Assistance Program Alternative Procedures

¹ *The Sandy Recovery Act of 2013* (P.L. 113-2), amends Title IV of the *Robert T. Stafford Disaster Relief and Emergency Assistance Act* (42 U.S.C. 5121 et seq.) (*Stafford Act*). Specifically, the law authorizes alternative procedures for the Public Assistance Program under sections 403(a)(3)(A), 406, 407 and 502(a)(5) of the *Stafford Act*.

² House of Representatives Report 113-732.

³ Repair projects are divided by dollar amount into small and large projects. A small project is any eligible work less than \$68,500, the threshold for small projects for Federal fiscal year 2014 (October 1, 2013–February 25, 2014). Since the *Sandy Recovery Improvement Act of 2013*, the threshold for Simplified Procedures has increased to \$120,000, with annual adjustments according to the Consumer Price Index. The Simplified Procedures threshold is effective for new declarations on or after February 26, 2014.



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90-day Status Report disclosed that 93 subgrantees are participating in the pilot program, which includes 148 fixed-cost estimate projects. At the time of our audit, total project costs for permanent work under the pilot program were valued at \$4.6 billion.

Results of Audit

FEMA's Program Guide for the Alternative Procedures pilot program and its letters provide acceptable guidance in most areas to ensure compliance with Federal rules and regulations. However, we found weaknesses in the following areas:

- estimating project costs;
- responding to OIG audits;
- managing cash responsibly;
- applying insurance proceeds; and
- obtaining insurance for future losses.

Funding disaster assistance projects using the Alternative Procedures methodology enables FEMA to cap its total exposure on grants to communities recovering from presidentially declared disasters, and potentially save the taxpayer significant amounts of money. However, the Alternative Procedures program exposes new risks, and FEMA needs to establish additional internal controls to mitigate potential weaknesses that could materially affect costs.

We audited seven projects, with fixed-cost estimates valued at more than \$3.9 billion of the \$4.6 billion in total costs under the pilot program. Because we initiated this audit early in the implementation of the pilot program, and before some of the applicants had accepted the terms of the projects, FEMA was concerned that the projects available for review at the time were limited in number. As a result, FEMA requested that we include some more recent projects that presented the pilot program under its continued implementation. FEMA provided three additional projects that we included in the seven projects we reviewed.

We initiated this audit early in the decision making process because of the amount of Federal funds associated with these projects. This early participation required frequent meetings with FEMA to discuss our preliminary observations. This open dialog with senior FEMA officials greatly improved both our understanding of what FEMA intended to achieve in the Alternative Procedures pilot program, and the usefulness of our recommendations to strengthen the programs internal controls.



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Estimating Project Costs

Fixed-Cost Estimate Validations

According to the Guide, FEMA will consider applicant cost estimates without developing its own independent estimate for comparison if the estimates: (1) were prepared by a professionally licensed engineer mutually agreed by FEMA and the subgrantee, (2) are properly conducted and certified, and (3) comply with regulations, policy, and guidance. Instead, FEMA developed the following procedures to validate cost estimates submitted by subgrantees:

- a review of the scope of work and cost estimate to verify that only eligible items are included;
- a review of the unit costs to ensure costs are from an approved source of industry standard information;
- a review of the components of the unit costs; and
- a review of the cost estimate for completeness and reasonableness using published sampling techniques.

We do not consider these steps nearly as rigorous as either conducting its own, or having a qualified third party conduct, an independent estimate. However, FEMA officials told us Congress wanted to avoid the dual estimate model since it believed the duplicative efforts to be less effective and efficient than having one estimate prepared by the applicant and validated by FEMA. FEMA officials said the validation process would create a more cooperative and less contentious relationship with the subgrantee.

A FEMA official said the fixed-cost estimates eliminated the risk of end-of-project cost escalation. The official further said FEMA hoped and expected to realize savings for taxpayers through the pilot program by being able to avoid such end-of-project cost escalation.

While properly vetted fixed-cost estimates can help FEMA save money, use on multiyear high-cost projects can also increase FEMA's risk of paying for unnecessary contingencies. In a fixed-cost estimate, the subgrantee bears the risk for project overrun. To reduce this risk the subgrantee has an incentive to increase the estimate to cover unforeseen events or project overruns. By conducting independent estimates on high-cost, complex, multiyear projects, FEMA may reduce the risks of subgrantees inappropriately padding their estimates for cost overruns that may not occur.

Currently, FEMA validates each fixed-cost estimate and, if requested by the



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subgrantee, obtains an independent expert panel validation. FEMA has engaged the U.S. Army Corp of Engineers (USACE) to serve as the independent expert panel to conduct validations of subgrantee fixed-cost grant estimates through its Center of Expertise.⁴ FEMA selected the USACE because of its cost-estimating expertise. In addition, FEMA already has a working relationship with USACE; the National Response Framework assigns USACE as the primary agency for Emergency Support Function #3.⁵ However, to date USACE has validated only one project. FEMA ultimately approved that project at slightly more than \$7.6 million, which represents less than 0.2 percent of the amount FEMA obligated to date under the pilot program.

According to their report, USACE received two estimates: the subgrantee's estimate, which was valued at \$7,925,856, and FEMA's estimate, which was prepared in the Cost Estimating Format (CEF) and valued at \$6,048,172. The USACE's estimate was valued at \$6,092,902. The subgrantee's original estimate exceeded the FEMA estimate by \$1.88 million and the USACE estimate by \$1.83 million (see table 1).

Most of the difference between the subgrantee's estimate and the USACE estimate results from adjustments to the:

- base costs for construction work,
- general requirements,
- project management and design costs,
- markups for overhead and profit,
- construction cost contingencies,
- cost escalation allowance, and
- the applicant's reserve for construction.

USACE noted that there were no assumptions provided with the subgrantee's estimate. Therefore, USACE used the same assumptions that FEMA provided with its estimate, which included the assumption that the estimates were reviewed and did not include any ineligible items.

⁴ USACE has organized itself into multiple Centers of Expertise. The USACE Cost Engineering for Civil Works center will perform the independent expert panel validation of subgrantees' fixed-cost grant estimates. The center is located at the Walla Walla District Cost Engineering Branch and includes technical expertise related to cost product development including current regulations and guidance, estimate development, scheduling and cost and schedule risk development.

⁵ Emergency Support Function #3. Under the National Response Framework USACE is the primary agency for public works and engineering. USACE will assist FEMA by coordinating Federal public works and engineering-related support, as well as providing technical assistance, engineering expertise, and construction management to prevent, prepare for, respond to, and/or recover from domestic incidents.



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Table 1: Key Elements from USACE Independent Validation and the Final Agreed Project Estimate

<u>Estimate/Actual</u>	<u>Subgrantee vs Corps of Engineers Estimate</u>	<u>Subgrantee vs FEMA Estimate</u>	<u>Subgrantee vs Agreed Upon Amount</u>
Original Subgrantee estimate	\$7,925,856	\$7,925,856	\$7,925,856
Direct Administrative Costs	\$194,804	\$194,804	\$194,804
Mandatory Flood Insurance Reduction	(\$250,000)	(\$250,000)	(\$250,000)
Hazard Mitigation Proposal	\$1,571,661	\$1,571,661	\$1,571,661
Totals - Subgrantee estimates	\$9,442,321	\$9,442,321	\$9,442,321
Corps of Engineers Estimate	\$6,092,902		
FEMA Estimate		\$6,048,172	
Agreed Upon Amount			\$6,116,868
Direct Administrative Costs	\$194,804	\$194,804	\$194,804
Mandatory Flood Insurance Reduction	(\$250,000)	(\$250,000)	(\$250,000)
Hazard Mitigation Proposal	\$1,571,661	\$1,571,661	\$1,571,661
Totals - Final project estimates	\$7,609,367	\$7,564,637	\$7,633,333
Difference	\$1,832,954	\$1,877,684	\$1,808,988
Percent Difference	19.41%	19.89%	19.16%

Source: Report of Review of Cost Estimates, prepared by U.S. Army Corp of Engineers and project cost details from EMMIE – provided by FEMA.

Ultimately, the subgrantee agreed to a project cost \$1.8 million (or 19.2 percent) less than the original estimate. We acknowledge that using one example to draw inferences across a larger population of data does not necessarily establish a valid relationship. However, this is the only project that FEMA submitted to the independent expert panel’s review process. Still, given the results of the panel’s estimate and the risk that subgrantees will overstate their estimates, FEMA must prudently balance the needs of the applicants while minimizing potential costs to the taxpayers.

In technical comments prepared by FEMA following a discussion of our findings regarding the review of project cost estimates, FEMA referenced the SRIA amendment, now codified in Section 428(e)(1)(F) of the *Stafford Act*, which states:

... in determining eligible costs under section 406, the Administrator shall, at the applicant's request, consider properly conducted and certified cost estimates prepared by professionally licensed engineers (mutually agreed upon by the Administrator and the applicant), to the extent that such estimates comply with applicable regulations, policy, and guidance.



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FEMA considers the validation process as the means of complying with this statutory requirement. However, FEMA could do more in carrying out its fiduciary responsibility to protect the taxpayer. We do not interpret this provision as preventing FEMA from executing more rigorous efforts to validate estimates of eligible cost of repairing, restoring, reconstructing, or replacing a facility—especially on high-cost, complex, multiyear projects.

FEMA also asserted that Section 428 directs it to consider applicants' estimates to the extent they are properly prepared by a licensed engineer/architect or certified cost estimator, and comply with applicable requirements. We agree with FEMA that Section 428 directs it to consider properly conducted and certified cost estimates. Such consideration would include steps to ascertain that the cost estimates are a reasonable representation of the costs associated with repairing the facility under question.

FEMA officials asserted that their validation process constitutes sufficient review of the cost components of the fixed-cost estimates. Yet, they have to be aware that the licensed professionals the subgrantees hire to prepare their estimates have a responsibility to their client (that is, the subgrantee—not the Federal taxpayer) to protect them from unanticipated costs—regardless of probability that the unanticipated costs will occur.

We believe that, to protect the Federal taxpayer, a more thorough review of the fixed-cost estimates is necessary, especially for projects that will cost the taxpayers tens, if not hundreds, of millions of dollars. Thus, more complex projects that exceed certain thresholds or have the probability of requiring an extension to the period of performance beyond what is stipulated in 44 CFR § 206.204(c) should receive a more thorough review of the cost estimates and the assumptions used in those estimates.

Overall, FEMA's oversight of the fixed-cost estimates needs improvement for it to gain a fuller understanding of the pricing dynamics and mitigate the associated risk. FEMA should send all fixed-cost estimates received under the pilot program, valued at greater than \$25 million, to the independent expert panel for review. This procedure will provide valuable data on the accuracy of the subgrantee estimates, and for FEMA's evaluation of its validation process, and identify areas for changes or improvements in the pilot program.

Early and proactive intervention has proven to be one of OIG's most effective oversight tools. This pilot program is still in the test and development stage. It is therefore vital that FEMA carefully consider all recommended improvements to create the most effective new method for managing Public Assistance funds.



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FEMA agreed with the limit of \$25 million as a guideline for sending subgrantee fixed-cost estimates to the independent expert panel for review.

FEMA's 50 Percent Rule

The City of New York was required to document repair-or-replace determinations for two projects for damaged equipment; one scope covered electrical conduit and fittings, and the other, boilers. Two letters addressed these scopes of work, both dated December 31, 2013. The applicants had not signed the letters nor agreed to the projects at the time of our work. FEMA provided an additional letter that referenced a "repair versus replacement cost comparison" and cited 44 CFR 206.226(f)(2), which is part of the regulation that is often referred to as the 50 Percent Rule.

One of the most important recovery eligibility decisions FEMA makes following a declared disaster can be whether to fund the repair or replacement of damaged buildings. Generally, FEMA will replace a facility if the estimated cost to repair exceeds 50 percent of the estimated cost to replace. We reviewed this issue, often referred to as the 50 Percent Rule, and reported our findings in OIG-14-123-D, dated August 7, 2014. In that report, we found that applying FEMA's 50 Percent Rule correctly could be difficult and susceptible to error, misinterpretation, and manipulation. The opportunity for fraud, waste, and abuse because of errors in fixed-cost estimates may increase without FEMA's oversight, guidance, and independent review of decisions regarding repair versus replacement. In response to that report and feedback received from stakeholders, on September 14, 2015, FEMA issued a memorandum clarifying existing policy language of Recovery Policy 9524.4 *Repair vs. Replacement of a Facility under 44 CFR § 206.226(f) (The 50 Percent Rule)*.

FEMA expressed concern that our comments regarding the 50 Percent Rule were generalizations that were not based on facts specific to the pilot program. While FEMA agrees that the 50 Percent Rule can apply to pilot program projects just like any other projects it funds, officials asserted in their technical comments following our exit meeting that it is a mischaracterization to present it as an issue of particular concern with the pilot program.

While FEMA has acknowledged the challenges associated with implementing the 50 Percent Rule and initiated actions to strengthen its controls over decisions related to this rule, our concern with the implementation of the 50 Percent Rule as it applies to the pilot program remains unchanged. Just as we believe the issue of cost estimating is crucial to the successful rollout of the pilot program, we believe FEMA's involvement in all decisions that involve the 50 Percent Rule is equally important. Since implementation of the 50 Percent Rule is complicated, susceptible to error, misinterpretation, and manipulation,



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FEMA should control and provide oversight for all decisions regarding repair versus replacement. FEMA needs to address the 50 Percent Rule in its Guide and provide procedures that clearly identify: (1) the steps that the subgrantee needs to take when a repair-versus-replacement decision arises, and (2) FEMA's role in the implementation and oversight of this rule.

Responding to OIG Audits

FEMA's letters said that it would only deobligate funding awarded in compliance with the agreement described in the letters if: (a) there was fraud, waste, or abuse, or (b) at the direction of the Department of Homeland Security (DHS) Audit Follow-up and Resolution Official. FEMA continued to use this wording in the three additional letters it provided. This statement is confusing and, if not read carefully, could be misinterpreted to contradict both the Audits and Compliance Reviews paragraph in Part III of the Guide as well as existing laws and regulations. While OIG recognizes that the letters do not preclude DHS OIG audits or FEMA compliance reviews of subgrants awarded through the alternative procedures, the paragraph can be improved to make the point clearer.

A FEMA official said that applicants have expressed concerns that FEMA will deobligate funding after approval of the initial project. The Guide and letters clearly require applicants to follow FEMA and Federal policies and procedures. However, those applicant concerns, coupled with the confusing provision in the letters regarding audits, could result in applicants believing they have an exemption from OIG findings that promote program economy, efficiency, and effectiveness.

We believe the language used is confusing and misleading, and requires clarification. FEMA should follow Federal laws and regulations and advise applicants in its letters that the OIG can audit, and FEMA may deobligate or recover funding based on audit findings. FEMA officials said they are considering changes to their letter of undertaking to clarify the OIG's authority and avoid any potential confusion.

Responsible Cash Management

Under the traditional Public Assistance program, small projects are generally funded based on cost estimates and paid at the time of project approval. For large projects, FEMA initially approves funding using a cost estimate and obligates the Federal share of the funds to the state. Funds are made available to the applicant based on progress and documented actual costs.

We noted in guidance documentation prepared to support the pilot program that FEMA stated the grantee was authorized to disburse the total Federal share of



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the subgrant funds to the subgrantee after FEMA obligates the funds. Under these conditions, the applicant could hold the entire Federal share of the funds from the start of the project and for as long as the project takes to be completed, or longer if there are excess funds.

If an applicant acted in this manner, it would violate the *Cash Management Improvement Act* (CMIA). Regulations under 31 CFR 205.11 require that “A State and a Federal program agency minimize the time elapsing between the transfer of funds from the [Government] and the State’s payout of funds for Federal assistance program purposes...and limit the amount of funds transferred to the minimum required to meet a State’s actual and immediate cash needs.”

FEMA officials assured us there was no intention on their part to circumvent the CMIA and the Treasury-State Agreements. FEMA acted immediately, and updated the Frequently Asked Questions document and removed the language in question.

Applying Insurance Proceeds

FEMA does not adequately address the handling of insurance proceeds in its Guide and the letters. According to 44 CFR 206.250(c) actual and anticipated insurance recoveries shall be deducted from eligible costs. The *Stafford Act*, section 312: *Duplication of Benefits*, states that no entity will receive assistance for a loss for which it has received financial assistance from insurance. FEMA includes a paragraph on insurance in its Guide that states the only situation that will result in an adjustment to the fixed estimate is when actual insurance proceeds are more than the anticipated insurance proceeds. The Guide does not address situations where actual insurance proceeds are less than the anticipated amount. FEMA places a burden on the applicant when the initial insurance reduction to the fixed-cost estimate is more than the actual amount of insurance proceeds eventually received by the subgrantee.

Of the original five letters we reviewed:

- one complied with FEMA policy and stated that FEMA would adjust funding based on the actual insurance proceeds;
- two did not indicate how insurance issues would be handled; and
- two indicated that insurance adjustments may be required before project worksheet finalization and did not indicate how actual insurance proceeds would be handled if they were received after the project worksheet was finalized.

We note that FEMA has addressed the insurance issues in three letters subsequently provided. However, FEMA should revise and reissue the earlier



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letters. In addition, FEMA should revise the Guide to reflect Federal rules and regulations for insurance. All fixed-cost estimates should incorporate actual insurance proceeds received by the applicant.

Obtaining Insurance for Future Losses

FEMA does not identify insurance requirements as a condition of receiving disaster assistance either in its Guide or in the letters. According to 44 CFR 206.252(d) and 253(b)(1), an applicant must obtain and maintain insurance as a condition for receiving Federal assistance. If the applicant does not satisfy this requirement, future damages of a similar type to the facility are ineligible for Federal assistance.

FEMA should clearly state and enforce this requirement to avoid an unacceptable burden on future disaster funds and the taxpayer. We note that FEMA officials have identified this requirement in the three additional letters they provided. However, FEMA should revise the Guide and the earlier letters to reflect Federal rules and regulations requiring applicants to obtain and maintain insurance coverage as a condition of receiving disaster assistance.

Other Issues

Waivers: The letters contained a statement that may cause applicant confusion. The paragraph addressing eligible damages reads:

- a. In accordance with 42 U.S.C. 5189f (f), FEMA has the authority to waive, as necessary, any regulation regarding repair and replacement ... not consistent with this approach and will carry out the proposed alternative procedure as a pilot program....*

While the statement discusses waivers to the pilot program, it may cause applicants to believe that FEMA may waive Federal rules and regulations for them in their particular situation. This is not the case, and FEMA has agreed to either clarify or delete the statement and reissue the letters.

Final project costs: The Guide states that the subgrantee will submit to the Grantee a final report of project costs. FEMA's statement that the report will not be used for reconciliation of the fixed grant to actual costs is confusing as this must occur in order to identify any excess funds available for PA Program-related purposes. FEMA should revise the Guide to eliminate any potential confusion on the purposes of the report.

Additional Guidance Resources: Standard Operating Procedure (SOP) for PA Program Management and Grant Closeout (SOP 9570.14) identifies roles and



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responsibilities for subgrantees, grantees, and FEMA. This SOP is not listed as a resource in the Guide or on FEMA's website. FEMA needs to provide a comprehensive resource listing in the Guide and its website.

Conclusion

FEMA's *Public Assistance Alternative Procedures Pilot Program Guide for Permanent Work* and letters of undertaking to applicants provide acceptable guidance in most areas to ensure compliance with Federal rules and regulations. However, the five areas we discuss in this report represent weaknesses that could materially affect the cost of the pilot program, and put Federal funds at greater risk of fraud, waste, and abuse. FEMA's correction of these weaknesses will better ensure that pilot program participants follow Federal requirements for managing Federal funds. FEMA's oversight of the fixed-cost estimates needs improvement to gain an understanding of the pricing dynamics and mitigate the associated risk. By using the independent expert panel to review more of the fixed-cost estimates received during the pilot, FEMA will gather important feedback on the accuracy of the subgrantee estimates, assess the effectiveness of FEMA's validation process, and identify areas for changes or improvements.

Recommendations

We recommend that FEMA's Assistant Administrator, Recovery:

Recommendation #1: Send all fixed-cost estimates valued greater than \$25 million received under the pilot program to the independent expert panel for its review.

Recommendation #2: Implement changes to the Guide to bring it into compliance with and/or better reflect applicable Federal Rules and Regulations.

Recommendation #3: For applicants whose letters of undertaking have not resulted in finalized agreements signed by all parties, revise the letters to be consistent with the Guide; and make future letters of undertaking consistent with the Guide.

Management Comments and OIG Analysis

We discussed the results of our audit with FEMA personnel responsible for the pilot program, during the review. We provided our draft report to FEMA and discussed the findings at the exit conference held on June 15, 2015. FEMA officials agreed with most of the findings, although they did not agree that the



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section on the 50 Percent Rule should be included in the report. FEMA provided a formal written response on October 5, 2015. This document is included as appendix B. FEMA concurred with all three recommendations.

FEMA responded that it will:

For recommendation 1: issue guidance directing that all fixed-cost estimates valued greater than \$25 million received under the pilot program shall be sent to the independent expert panel for its review.

For recommendation 2: implement changes to the Public Assistance Alternative Procedures guidance to address and/or clarify the application of insurance proceeds, the obtain and maintain insurance requirement, and the final project cost reconciliation and closeout procedures. FEMA disagreed that its Guide does not comply with Federal rules and regulations.

For recommendation 3: revise the letters of undertaking to be consistent with its guidance for applicants whose letters have not been signed by all parties. FEMA will not revise already agreed upon letters of undertaking.

We recognize and understand that FEMA does not want to re-issue letters that have been accepted and signed by applicants. However, we believe that FEMA has an obligation to notify applicants of any rules, regulations, or laws that will apply to them and that were not properly disclosed or clearly identified in the original letters. Correspondence clarifying or explaining the additional information, along with acknowledgement that the applicant received and understood the additional information, will ensure that problems will not surface as the project progresses towards completion.

FEMA provided an estimated completion date of 01/31/2016 for its corrective actions.

Based on the information provided, we consider all three recommendations open and resolved. Once FEMA completes the proposed actions and submits its formal closeout letter, we will review the actions taken to determine if we can close the recommendations.



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Appendix A

Objectives, Scope, and Methodology

The Department of Homeland Security Office of Inspector General was established by the *Homeland Security Act of 2002* (Public Law 107-296) by amendment to the *Inspector General Act of 1978*.

Our objectives were to determine whether (1) FEMA properly communicated guidance for the Public Assistance Alternative Procedures Pilot Program in its communications with applicants interested in the pilot program, and (2) FEMA's *Public Assistance Alternative Procedures Pilot Program Guide for Permanent Work* is consistent with Federal rules and regulations.

We reviewed FEMA's guidance for the pilot program, as defined in the:

- *Public Assistance Alternative Procedures Pilot Program Guide for Permanent Work* (Version 2), dated December 19, 2013;
- *Public Assistance Alternative Procedures Pilot Program Guide for Permanent Work-Frequently Asked Questions*, dated May 20, 2013.
- *Public Assistance Alternative Procedures Pilot Program Guide for Permanent Work-Frequently Asked Questions*, dated December 16, 2013.

We also reviewed applicant correspondence related to the following five letters and one fixed subgrant agreement letter:

- Letter to the City of New York, NY, dated December 31, 2013 – Electrical Conduit and Fittings Replacement;
- Letter to the City of New York, NY, dated December 31, 2013 – Boiler Repair/Replace;
- Letter to the Nassau County Executive, NY, dated January 22, 2014 – Bay Park Treatment Plant Repair/Replace;
- Letter to the Long Island Power Authority, NY, dated February 20, 2014 – Transmission and Distribution Infrastructure Repair;
- Letter to the Metropolitan Transportation Authority, NY, dated April 16, 2014 – Hugh L. Carey Tunnel & Queens Midtown Tunnel Repair/Replace; and
- Fixed Subgrant Agreement Letter from Health and Hospitals Corporation, NY, dated December 19, 2013 – Building and Equipment Repair/Replace.

We also reviewed additional applicant correspondence related to the following three letters provided by FEMA:



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- Letter to New York University, NY, dated July 29, 2014 – NYU Langone Medical Center Repair/Replace;
- Letter to Long Beach City Schools, NY, dated September 5, 2014 – Administration Building Replace;
- Letter to South Nassau Communities Hospital, NY, dated October 15, 2014 – Long Beach Medical Center Repair/Replace.

We interviewed FEMA officials in Washington, DC, and reviewed criteria related to the Public Assistance Program including the *Stafford Act*, the *Sandy Recovery Improvement Act of 2013*, the *Cash Management Improvement Act*, 31 CFR, 44 CFR, and FEMA policies and directives. We did not assess the adequacy of the FEMA's internal controls applicable to alternative procedures because it was not necessary to accomplish our audit objectives.

We conducted this audit between June 2014 and March 2015 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.



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Appendix B
FEMA Comments to the Draft Report

U.S. Department of Homeland Security
Washington, DC 20472



FEMA

October 5, 2015

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

FROM:  David Bibo 
Associate Administrator (Acting)
Office of Policy and Program Analysis

SUBJECT: Management Response to OIG Draft Report:
"Clearer Guidance Would Improve FEMA's Oversight of
the Public Assistance Alternative Procedures Pilot Program"
(OIG Project OIG- 15-50)

Thank you for the opportunity to comment on the Draft Report. The Federal Emergency Management Agency (FEMA) appreciates the work of the Office of Inspector General (OIG) in planning and conducting its review and issuing this report.

FEMA values the OIG's positive recognition that FEMA's Guide for the Public Assistance Alternative Procedures (PAAP) Pilot Program and letters of understanding provide acceptable guidance in most areas to ensure compliance with Federal rules and regulations. FEMA's objectives with the PAAP Pilot Program are to streamline recovery efforts, reduce costs, and improve the effectiveness of the Public Assistance (PA) program. As evidenced by FEMA's request for the OIG to conduct this review, the Agency embraces a proactive approach to mitigating potential risks associated with a new pilot program, recognizes the value of the OIG's assessment early in the implementation process, and seeks to continuously improve upon the PAAP Pilot Program based upon such advice.

FEMA acted promptly to address a number of issues identified by the OIG, including updating insurance-related language in FEMA's letter of understanding template, correcting a Frequently Asked Question regarding the Pilot Program, and agreeing to submit projects valued at \$25 million or higher to an independent expert panel for review. FEMA separately addressed the OIG's concern as to the general application of the 50 Percent Rule through its September 14, 2015 issuance of a Policy Clarification Memorandum with respect to Recovery Policy 9524.4 *Repair vs. Replacement of a Facility under 44 CFR § 206.226(f)*. This policy clarification is applicable to all PA projects, including those funded under the Pilot Program for disasters declared after the

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date of the memorandum. FEMA intends to address other findings through updates to its PAAP guidance and to the letters of understanding.

In addition to addressing the OIG's recommendations, FEMA is planning a comprehensive evaluation of the PAAP Pilot Program later this year, including a review of all guidance and related materials, case studies, and interviews, to assess the program and identify other potential improvements.

The Draft Report contained three recommendations with which the FEMA concurs. Specifically:

Recommendation #1: Send all fixed-cost estimates valued greater than \$25 million received under the pilot program to the independent expert panel for its review.

Response: Concur. FEMA's Public Assistance Division will issue guidance directing that all fixed-cost estimates valued greater than \$25 million received under the pilot program shall be sent to the independent expert panel for its review.

FEMA considers this recommendation resolved and open.

Estimated Completion Date (ECD): 01/31/2016

Recommendation #2: Implement changes to the Guide to bring it into compliance with applicable Federal Rules and Regulations.

Response: Concur. FEMA disagrees that its PAAP Guide does not comply with Federal Rules and Regulations but will implement changes to PAAP guidance to address and/or clarify the application of insurance proceeds, the obtain and maintain insurance requirement, and final project cost reconciliation and closeout procedures.

FEMA considers this recommendation resolved and open.

ECD: 01/31/2016

Recommendation #3: For applicants whose letters of understanding have not resulted in finalized projects, revise the letters to be consistent with the Guide; and make future letters of undertaking consistent with the Guide.

Response: Concur. For applicants whose letters of undertaking have not been signed by all parties, FEMA's Public Assistance Division will revise the letters to be consistent with its PAAP guidance. FEMA will not revise already agreed upon letters of undertaking.

FEMA considers this recommendation resolved and open.

ECD: 01/31/2016

Again, thank you for the opportunity to review and comment on this draft report. Technical comments were previously provided under separate cover. We look forward to working with you in the future. Please direct any questions or concerns regarding this response to Gary Mckeon, Director GAO/OIG Audit Liaison Office at 202-646-1308.



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Appendix C

Changes to the Public Assistance Program

FEMA's Public Assistance (PA) Grant Program provides assistance to state, tribal, and local governments, and certain types of private nonprofit organizations so that communities can quickly respond to and recover from major disasters or emergencies declared by the President.

Through the PA program, FEMA provides supplemental disaster assistance for debris removal, emergency protective measures, and the repair, replacement, or restoration of disaster-damaged, publicly owned facilities and the facilities of certain private nonprofit organizations. The PA program also encourages protection of these damaged facilities from future events by providing assistance for hazard mitigation measures during the recovery process.

The *Sandy Recovery Improvement Act of 2013* (SRIA) revised the *Stafford Act* by adding Section 428, which authorizes alternative procedures for the PA program, and authorizes FEMA to implement the alternative procedures through a pilot program. The alternative procedures pertain to debris removal and repair, restoration, and replacement of disaster-damaged public and private nonprofit facilities.

The goals of the alternative procedures are to:

- reduce the costs to the Federal Government of providing public assistance,
- increase flexibility in the administration of such assistance,
- expedite the provision of assistance to an applicant, and
- provide financial incentives and disincentives for timely and cost-effective completion of a project.

Participation in the alternative procedures program is voluntary. To participate in the program, a subgrantee must agree to accept assistance based upon a fixed-cost estimate for eligible work. This element of the alternative procedure varies from the standard procedure described in 44 CFR 206.203(c), which provides funding for the actual cost of completing the eligible work.

The alternative procedures program allows for the following:

- *Consolidation of fixed subgrants* – a subgrantee may combine multiple fixed subgrants into a single subgrant. This feature allows the subgrantee greater flexibility to execute work across multiple facilities or sites in ways that more effectively support its post-disaster recovery needs.



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- *Elimination of the reduction in eligible costs for alternate projects* – under standard procedures, FEMA reduces the eligible cost for alternate projects in accordance with the requirements of section 406(c)(1) and 406(c)(2) of the *Stafford Act*. Under the alternative procedures, FEMA will no longer implement this reduction for subgrants funded under the pilot program.
- *Use of excess funds* – upon completion of the project if the actual cost of the work is less than the fixed-cost estimate, the subgrantee may use the excess funds for approved PA program-related purposes.



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Appendix D
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