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May 7, 2004

MEMORANDUM FOR: Karen E. Armes
Acting Regional Director
FEMA Region IX

FROM: *Robert J. Lastrico*
Robert J. Lastrico
Field Office Director
Office of Audits

SUBJECT: *Audit of Santa Clarita Health Care Association
Santa Clarita, California
Public Assistance Identification Number 037-90568
FEMA Disaster Number 1008-DR-CA
Audit Report Number DS-12-04*

The Office of Inspector General (OIG) audited public assistance grant funds awarded to Santa Clarita Health Care Association, Santa Clarita, California (Association). The objective of the audit was to determine whether the Association expended and accounted for Federal Emergency Management Agency (FEMA) funds according to federal regulations and FEMA guidelines.

The Association received an award of \$16 million from the California Office of Emergency Services (OES), a FEMA grantee, for emergency protective measures and permanent repairs to the Association's Henry Mayo Hospital facilities damaged by the Northridge earthquake on January 17, 1994. The award provided 100 percent Federal funding for emergency work until January 25, 1994, and 90 percent FEMA funding thereafter for large and small projects.¹ The award provided funding for seven large projects and two small projects. The audit covered the period January 17, 1994, to May 18, 2001, and included the review of six large projects and two small projects with a total award of \$15.9 million (see Exhibit).

The OIG performed the audit 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. The audit included the review of FEMA, OES, and Association records, and other auditing procedures determined necessary under the circumstances.

¹ Federal regulations in effect at the time of the disaster set the large project threshold at \$42,400.

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RESULTS OF AUDIT

The Association generally expended and accounted for public assistance funds according to federal regulations and FEMA guidelines for one large and two small projects. However, for the five remaining large projects, the Association's claim contained \$2,290,275 in questionable costs (FEMA's share - \$2,061,248). The questioned costs consisted of \$1,525,901 of duplicate benefits, \$353,726 of ineligible project costs, \$311,309 of excessive project management costs, and \$99,339 of unsupported project costs.

Finding A – Duplicate Benefits

The Association's claim for project 92014 included \$1,525,901 in duplicative benefits. Details regarding the duplicate benefits are discussed below.

The Association accepted FEMA's Grant Acceleration Program (GAP) offer of \$19,929,469 under project 92014 and supplemental funding of \$47,000 for architectural and engineering (A&E) services associated with the project. While total funding related to the Hospital's main building totaled \$19,976,469, FEMA's closeout documents showed the Association actually received \$14,566,456. In determining eligible funding, FEMA adjusted total funding by \$5,410,013 for insurance benefits when in fact the Association received \$6,935,914 in benefits. Accordingly, net eligible disaster assistance funding should have been \$13,040,555² instead of \$14,566,456 when considering the \$1,525,901 in insurance benefits not deducted at closeout.

The OIG discussed this issue with FEMA and Association officials. FEMA officials agreed that based on criteria for determining eligible project costs, the Association was overpaid. Association officials disagreed that an overpayment occurred and noted that actual project costs exceeded the GAP offer. They explained that the Association had provided FEMA with adequate documentation pertaining to insurance reimbursements, and that FEMA had not adequately explained federal rules governing the acceptance of a GAP offer.

Despite the Association's assertion that FEMA had not adequately explained federal rules governing the acceptance of a GAP offer, the OIG explained that by FEMA policy, the Association's acceptance of the GAP offer was voluntary, and once accepted, was irrevocable. The OIG explained that by statute and regulation, FEMA's funding for any project, GAP or otherwise, should be reduced by the total amount of insurance reimbursement received. The acceptance of the GAP offer merely provided the Association with a fixed level of funding based on accepted industry cost estimating practices, net of any insurance reimbursements received by the Association.

Section 312(a) of the Robert T. Stafford Disaster Relief and Emergency Assistance Act (Stafford Act) prohibits receipt of federal disaster assistance with respect to any part of a loss covered by insurance. Section 312(b)(3) addresses the issue of partial benefits, stating that the receipt of partial benefits for a disaster shall not preclude provision of additional federal assistance. These provisions are also codified in Title 44, Code of Federal Regulations, Section 206.191 (44 CFR 206.191). Accordingly, the OIG questioned \$1,525,901 as a duplicate benefit.

² GAP funding \$19,929,469 plus A&E costs of \$47,000 less insurance recovery of \$6,935,914.

Finding B – Ineligible Project Costs

The Association's claim under project 92013 and project 05638 included \$353,726 in ineligible project costs.

- For project 92013, the Association claimed \$218,039 in costs not in the project scope and costs not related to the project.
 - Funding for this project was originally approved on September 29, 1995, under Damage Survey Report (DSR) 12603 for an estimated amount of \$256,020. The sites specified in the scope of work included driveways, parking areas, and the campus road. The work consisted of repairing cracks in the asphalt of the parking areas and interior roadways, and replacing concrete curbs, sidewalks, swales, driveways, rest areas, and steps. In November 1998, the Association requested supplemental funding for additional costs incurred due to the altering and installing new substituted parking spaces, and increased costs caused by the delay in the project. The revised estimate for this work identified "approximately 17 percent of the total site work for which substituted work was implemented."

On January 11, 1999, the Association was notified by OES that it had requested costs for work performed outside the original scope approved under DSR 12603. This included a change in the location of parking spaces and installation of new, substituted parking spaces as noted above. OES also informed the Association that, according to 44 CFR 206.203(d), if a subgrantee (the Association) desires to make improvements, but still restore the pre-disaster function of a damaged facility, the Grantee's (OES) approval must be obtained. Federal funding for the improved project is limited to the federal share of the approved estimate of the eligible costs. However, on January 26, 1999, FEMA approved GAP funding under project 92103 granting the Association additional funding of \$185,857.

As noted above, since federal funding for an improved project is limited to the federal share of the approved estimate of the eligible costs, OIG questioned \$185,857.

- In addition, the Association's claim for GAP DSR 92013 included \$32,182 in A&E costs not related to the project. The costs initially pertained to DSR 85170, a project that FEMA had previously determined not eligible, as it included charges for repairs to four for-profit Medical Office Buildings.
- For project 05638, the Association's claim included \$135,687 for costs not related to the disaster. Association costs to repair the Nursing Pavilion (Pavilion) totaled \$761,467 consisting of insurance reimbursements of \$625,780 and a FEMA award of \$135,687. The scope of work for this project consisted of injecting epoxy into stairway steps, epoxy grouting of concrete slab floors, removing and replacing separated exterior wall panels, insulating and painting affected areas, repairing damaged interior walls, ceilings, flooring materials, windows and restroom facilities, and repairing damaged miscellaneous plumbing, electrical, heating and air conditioning, sprinkler system, and miscellaneous doors and drawers. The award also provided funds for engineering, design, permitting, and inspection services.

Included in the Association's costs to repair the Pavilion was \$137,641 for changes in the contract for flooring repairs to the north wing of the facility. However, as discussed below, the

OIG determined that the Association's records did not sufficiently substantiate that the additional work was necessitated by the disaster.

- On January 20, 1994 (3 days after the disaster), the Association's consulting engineers reported that the Pavilion appeared to have performed very well, and there were no signs of structural damage. Also, a May 1994 evaluation of the Pavilion by the Association's A&E consultants did not report any structural damage. The A&E report stated that a crack had occurred in the indoor slab, running from the north wall to the south exterior near the end of both the east and west nursing units. The A&E report recommended repairs to remove the finish flooring material, replace the slab on grade in the area of the cracks, and patch and repair the finish flooring material.
- After the floor repairs were completed, the Association's interior designers recommended in October 1994 that the entire floor covering be replaced. The interior designers noted that the finished work had uneven surfaces that created a hazardous condition, and the material that was replaced did not match the existing flooring material. They also stated that they noted the presence of additional cracks not included in the original repairs. Thus, the Association issued a change order to an existing contract for \$137,641 (\$135,687 covered by FEMA's award) to remove and replace the previously repaired floor. The OIG requested that Association officials provide documentation substantiating the interior designer's assertions, including any support regarding the additional floor cracks not identified in the initial A&E evaluation. The Association did not provide the needed information and explained that the additional floor cracks were inspected by FEMA and OES. However, FEMA, OES, and Association records did not substantiate the Association's assertions that the additional work was a result of the disaster.

According to Federal Regulation 44 CFR 206.223(a)(1), to be eligible, an item of work must be required as the result of a major disaster event. Because the Association did not sufficiently substantiate that the additional work was required as a result of the disaster, the OIG questioned \$135,687 that represents the amount funded by FEMA for the project.

Finding C - Excessive Construction Management Costs

The Association's claim under project 92014 included \$311,309 in construction management costs that the OIG considered excessive. According to the Office of Management and Budget Circular A-87, Attachment A, paragraph C(2), "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."

One of the Association's contractors for this \$19.9 million project billed excessive construction management costs related to a "cost plus a percentage of cost" site work contract. FEMA strictly prohibits this type of contract because there is little, if any, incentive to minimize direct contract costs.³ In that regard, the OIG noted this contractor billed \$433,453 for construction management, or approximately 44.4 percent of the project construction cost of \$977,153. The construction management charges were based on allocations of the contractor's personnel time, including the project manager, assistant project manager, and clerical and executive personnel located both at the contractor's corporate and field offices. Further, this same contractor told the OIG that current rates

³ See 44 CFR 13.36(f)(4).

for similar work were between 8.5 and 12.5 percent of the construction cost. Using the contractor's own estimates for what current construction management costs would be on a similar project result in charges ranging from \$83,058 (\$977,153 times 8.5%) to \$122,144 (\$977,153 times 12.5%). To be conservative, the OIG subtracted the higher estimate of construction management costs (\$122,144) from what the contractor actually billed (\$433,453) to arrive at the questioned cost of \$311,309.

The OIG discussed this issue with the Association's contractor and FEMA officials. The contractor stated that besides the construction work noted on the billings, contractor personnel (1) managed the construction project, including design analysis, project planning, and project phasing, (2) conducted damage assessments, and (3) prepared documents to obtain disaster funding.⁴ Neither the Association nor the contractor provided documentation to justify the excessive construction management costs, and contractor billings did not specifically identify the project tasks performed. FEMA officials generally agreed with the contractor's assertion regarding the construction management rates applicable to work performed under this project (8.5% to 12.5%). The OIG contacted the Engineering Operations Manager for Reed Construction Data/R.S. Means, an industry leader in construction cost estimating, and learned that there are no industry standards for project or construction management costs. However, this company's 2004 Facilities Cost Data Book gives a range of 2.5 percent to 10 percent for construction management costs depending on the size of the project.

As noted in finding A, project 92014 was a GAP project with a fixed level of funding based on estimated eligible disaster damage costs. FEMA's policy for GAP projects⁵ requires that funds provided as part of a GAP award can only be used on eligible disaster work. While the Association received insurance proceeds of \$6.9 million, FEMA, OES, and Association project records did not include documentation showing how FEMA funds and insurance benefits were allocated among the various project cost items. Also, project records did not include documentation showing the \$433,453 in construction management costs was reasonable and within an acceptable range of such costs when estimating construction work. Therefore, the OIG questioned excessive construction management costs of \$311,309.

Finding D – Unsupported Project Costs

The Association's claim for projects 01032 and 48030 included \$99,339 in costs not supported with documentation showing the charges were disaster related.

- For project 01032, FEMA funded \$115,399 for the structural and non-structural repairs of the Association's Modular building. Project cost records only supported \$39,857 of the amount awarded. Thus, the remaining \$75,542 was not sufficiently supported with documentation proving that the claimed costs were incurred for disaster related work.
- For project 48030, FEMA funded \$40,000 for repairs to a suite in the Human Resources Department (\$26,000) and for the replacement of copier machines (\$14,000). However, project cost records only supported \$16,203. Once again, the remaining \$23,797 was not sufficiently supported with documentation proving that the claimed costs were incurred for disaster related work.

⁴ Tasks relating to damage assessments and efforts to obtain disaster funding are paid under FEMA's statutory Administrative Allowance [44 CFR 206.228 (2)(D)(ii)].

⁵ Grant Acceleration Program (GAP) Guide for Northridge Earthquake Disaster dated June 2, 1999.

According to 44 CFR 13.20(b), the Association is required to maintain accounting records that identify how FEMA funds are used. Since the costs identified above were not supported, the \$99,339 was questioned.

RECOMMENDATION

The OIG recommends that the Acting Regional Director, FEMA Region IX, in coordination with OES, disallow questioned costs of \$2,290,275.

DISCUSSION WITH MANAGEMENT AND AUDIT FOLLOW-UP

The OIG discussed the results of this audit with Association and OES officials on March 2, 2004. Association officials did not agree with the findings. The OIG also notified FEMA Region IX officials of the audit results on April 8, 2004.

Please advise this office by July 6, 2004, of actions taken to implement our recommendation. Should you have any questions concerning this report, please contact me at (510) 627-7011. Key contributors to this assignment were Ravi Anand and Humberto Melara.

Exhibit

Schedule of Audited Projects
 Santa Clarita Health Care Association
 Public Assistance Identification Number 037-90568
 FEMA Disaster Number 1008-DR-CA

<u>Project Number</u>	<u>Amount Awarded</u>	<u>Amount Questioned</u>	<u>Finding Reference</u>
<u>Large Projects</u>			
01032	\$ 208,882	\$ 75,542	D
05638	135,687	135,687	B
12613	409,151	0	
48030	88,976	23,797	D
92013	474,059	218,039	B
92014	<u>14,566,456</u>	<u>1,837,210</u>	A,C
Subtotal	\$15,883,211	\$2,290,275	
<u>Small Projects</u>			
69133	24,467	0	
69139	<u>24,467</u>	<u>0</u>	
Subtotal	48,934	0	
Totals	<u>\$15,932,145</u>	<u>\$2,290,275</u>	

Finding Reference Legend:

- A - Duplicate Benefits
- B - Ineligible Project Costs
- C - Excessive Construction Management Costs
- D - Unsupported Project Costs