Office of Inspector General

U.S. Department of Homeland Security
Central Regional Office
Office of Emergency Management Oversight
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Homeland Security

September 20, 2010

MEMORANDUM FOR: Tony Russell, Regional Administrator
FEMA Region VI

FROM: Christopher Dodd for Tonda L. Hadley, Director
Central Regional Office

SUBJECT: *Roman Catholic Church of the Archdiocese of New Orleans Contracting and Emergency Protective Measures*
FEMA Disaster Number 1603-DR-LA
Public Assistance Identification Number 000-UV6IX-00
Audit Report Number DD-10-18

We audited public assistance funds awarded to the Roman Catholic Church of the Archdiocese of New Orleans (Archdiocese) for disaster recovery work related to Hurricane Katrina. Our audit objective was to determine whether the Archdiocese accounted for and expended Federal Emergency Management Agency (FEMA) grant funds according to federal regulations and FEMA guidelines.

The Governor's Office of Homeland Security and Emergency Preparedness (GOHSEP), a FEMA grantee, awarded (obligated) the Archdiocese $318.2 million for damages resulting from Hurricane Katrina. The award provided 100% funding for 156 large and 347 small projects.[1] As of May 1, 2010, the cut-off date of our audit, Category B and Category E projects were in various stages of completion and the Archdiocese had claimed and GOHSEP had disbursed $63.6 million.

Due to the size of this award and the number of projects, we divided the audit into phases. During this first phase, our audit covered the period August 29, 2005, through May 1, 2010. Our audit scope included a review of the Archdiocese's contracting policies and procedures and substantive testing of its claimed costs for Category B (emergency protective measures) work. For eight Category B projects and five Category E (buildings and equipment) projects, we reviewed the associated procurement and contracting actions totaling $49.6 million, or 78% of

[1] Federal regulations in effect at the time of the disaster set the large project threshold at $55,500.

project claims. In addition, we substantively tested the claimed costs for the eight Category B projects totaling $14.2 million, or 72% of the $19.7 million of Category B project awards (see Exhibit).

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 and 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 interviewed FEMA, GOHSEP, and Archdiocese officials; reviewed judgmentally selected transactions (generally based on dollar value) of claimed costs; and performed other procedures considered necessary to accomplish our objectives. We did not assess the adequacy of the Archdiocese's internal controls applicable to grant activities because it was not necessary to accomplish our audit objectives. We did, however, gain an understanding of the Archdiocese's methods of accounting for disaster-related costs and its procurement policies and procedures.

BACKGROUND

The Roman Catholic Archdiocese of New Orleans is a division of the Roman Catholic Church and is the second-oldest diocese in the United States. The Archdiocese encompasses 8 civil parishes in the New Orleans metropolitan area and includes 108 church parishes. In addition to the religious facilities of each church parish, the Archdiocese also owns primarily non-religious facilities including school buildings, elderly and disabled persons housing, and charitable assistance buildings. Hurricane Katrina's high winds and flooding caused extensive damage to many of the Archdiocese's primarily non-religious buildings. Private nonprofit organizations that own or operate private nonprofit facilities not used primarily for religious purposes or instruction are eligible for Public Assistance disaster funding (44 CFR 206.222(b) and 44 CFR 206.221(e)(1)).

RESULTS OF AUDIT

The Archdiocese accounted for disaster costs on a project-by-project basis, as required. However, the Archdiocese did not always follow federal procurement standards, and its claim included $520,952 in ineligible costs for markups on contract costs ($510,328) and costs not incurred ($10,624).

Finding A: Contracting Procedures

The Archdiocese did not consistently comply with federal procurement regulations. These procurement regulations require subgrantees, among other things, to:

- Perform procurement transactions in a manner providing open and free competition (2 CFR 215.43).
- Conduct a cost or price analysis in connection with every procurement action, including contract modifications (2 CFR 215.45).
- Not hire contractors that are debarred, suspended, or otherwise ineligible to participate in federal assistance programs (2 CFR 215.13 and 2 CFR 215.44(d)).

During our review of the Archdiocese's contracting procedures, we noted that the Archdiocese did not:

1. Comply with the requirement for open and free competition because it did not publicize its procurement actions to obtain bids or proposals. We previously discussed this in our interim report, *Roman Catholic Archdiocese of New Orleans, Bidding Process,* DD-10-05, dated February 5, 2010. The Archdiocese also awarded noncompetitive contracts for architectural and engineering services in situations where competitive bids could have been obtained.
2. Include a cost or price analysis in its procurement actions for emergency protective measures.
3. Have processes in place to ensure compliance with the restrictions against using debarred or suspended contractors in federal assistance programs.

The regulations require open and free competition to the extent practicable not only to achieve a reasonable cost, but also to allow all qualified, responsible parties an equal chance to compete for the work. Further, open and free competition helps to discourage and prevent favoritism, collusion, fraud, waste, and abuse. Archdiocese officials said they generally agreed with this finding. As a result of our February 2010 interim report, the Archdiocese took adequate steps to ensure future contracting compliance; therefore, this report does not include additional recommendations related to contracting procedures.

Finding B: Emergency Protective Measures

The Archdiocese claimed $2.9 million in hurricane clean-up costs for St. Ann School in Jefferson Parish, Louisiana that did not comply with federal procurement standards and included $510,328 of ineligible markups on contract costs. In addition, the Archdiocese paid $10,624 less than the amount it claimed for the clean-up work.

As discussed above, the Archdiocese did not consistently comply with federal contracting regulations. Regarding St. Ann School, the Archdiocese did not comply with other important contracting requirements designed to help control costs and strengthen accountability over federal funds. Specifically, the Archdiocese did not comply with the following federal procurement regulations and FEMA guidelines:

- The subgrantee must maintain records in sufficient detail to reflect the significant history of the procurement, including the basis for the contractor selection and the basis for the contract price (2 CFR 215.46).

- While the form of contract used is determined by the subgrantee (2 CFR 215.44(c)), FEMA guidance advises subgrantees to avoid using time and material contracts (Public Assistance Policy Digest, FEMA 321, October 2001, page 20). FEMA guidance also requires that contractor expenses be carefully monitored and that the contract include a ceiling price that the contractor exceeds at its own risk (Public Assistance Guide, FEMA 322, October 1999, page 40.)
- The subgrantee is prohibited from using a cost-plus-percentage-of-cost contract arrangement (2 CFR 215.44(c)).

In the immediate aftermath of Hurricane Katrina, the Archdiocese, through a local parish, awarded a non-competitive clean-up contract to a parishioner of St. Ann Church. The local parish justified the non-competitive contract based on emergency circumstances. However, the Archdiocese did not develop records showing how it established hourly contract rates or contract terms. The Archdiocese also used this time-and-material contract without determining that no other contract type was suitable and did not establish a ceiling price for the contract. As there was no price competition, the Archdiocese should have also negotiated profit as a separate element of the contract price.

In addition, the billings for St. Ann School included markups on contract costs that were not only strictly prohibited by federal regulation, but also were not part of the (unsigned) contract or its attached fee schedule. The contractor's billings included a 1% administrative fee on all time-and-material charges and a 20% overhead and profit markup applied to all invoice amounts. Cost-plus-percentage-of-cost contracts are prohibited as a matter of federal policy because they create a disincentive to control costs; the more contractors charge, the more profit contractors make. Also, contractors should not be allowed to bill for charges outside the terms and conditions of their contracts. Finally, when time-and-material contracts are competitive, the rates are set at amounts sufficient to cover contractor administrative and overhead costs as well as profit. As a matter of accepted business practice, unless a contract specifies otherwise, properly competed time-and-material contract rates are assumed to be fully-loaded rates that cover all costs, including administrative and overhead costs and profit.

Because the St. Ann School required a $2.45 million cost increase (519%) over the original $472,047 estimate, FEMA conducted a cost reasonableness analysis using the Cost Estimating Format program. Because FEMA's estimate was only 7% less than actual costs the Archdiocese incurred, FEMA decided the actual costs were reasonable. However, FEMA's estimate was not accurate because it included $178,402 for Architectural and Engineering Design Costs and Applicant Project Management Costs, both of which had nothing to do with the contractor's work. Had FEMA more accurately estimated these costs, FEMA would have calculated a lower reasonable cost, 14.5% less than actual cost incurred.

For good reason, the federal government does not reimburse grant recipients for cost-plus-percentage-of-cost contracts. However, in this specific case, these markups on costs are also not allowable because they are not mentioned in the contract and, even if they were, administrative, overhead, and profit fees were already included in the contract's hourly rates. Therefore, we question $510,328 as ineligible. Archdiocese officials said that, although they understood the federal regulation, the costs should still be allowed because FEMA performed a reasonableness

analysis that determined the overall costs were reasonable. We disagree because, in this case, the reasonableness of costs is irrelevant. The markups on costs are prohibited by federal regulation. Therefore, these costs should be disallowed regardless of their amount.

Finally, the Archdiocese paid $10,624 less than the amount it claimed under the grant. Archdiocese officials acknowledged that the $10,624 was not incurred. Because a cost is not allowable under federal grants unless it is actually incurred, we also question $10,624 as ineligible.

RECOMMENDATIONS

We recommend the Regional Administrator, FEMA Region VI:

Recommendation #1: Disallow $510,328 ($510,328 federal share) in disaster funds currently obligated for project 5298 (Finding B).

Recommendation #2: Disallow $10,624 ($10,624 federal share) in disaster funds which were not incurred for project 5298 (Finding B).

DISCUSSION WITH MANAGEMENT AND AUDIT FOLLOW-UP

We discussed the results of our audit with Archdiocese officials during our audit and included their comments in this report, as appropriate. We also provided written summaries of our findings and recommendations in advance to FEMA, GOHSEP and Archdiocese officials and discussed them at exit conferences held with FEMA on August 11, 2010, and with GOHSEP and the Archdiocese on July 12, 2010. These officials, while generally agreeing with the findings, reserved further comments on the recommendations until after we issue our final report. Please advise this office by November 20, 2010, of the actions planned or taken to implement the recommendations, including target completion dates for any planned actions. Significant contributors to this report were Christopher Dodd, John Polledo, and Natalie Lick. Should you have questions concerning this report, please contact me, or your staff may contact Christopher Dodd, Audit Manager, at (214) 436-5200.

cc: Interim Director, Louisiana Recovery Office
Audit Liaison, FEMA Louisiana Recovery Office
Audit Liaison, FEMA (Job Code G-10-005)
Audit Liaison, FEMA Region VI

EXHIBIT

Schedule of Questioned Costs
Roman Catholic Church of the Archdiocese of New Orleans
FEMA Disaster Number 1603-DR-LA

Project Number	Project Amount	Costs Questioned
1382	$ 3,730,490	$ 0
5298	2,920,851	520,952
5442	4,826,768	0
6140	1,238,835	0
6743	315,000	0
7349	441,421	0
9118	397,100	0
17001	330,400	0
Totals	**$14,200,865**	**$520,952**