

Department of Homeland Security Office of Inspector General

**Big Rivers Electric Corporation Meets FEMA's
Eligibility Requirements for Participation in the
Public Assistance Program**





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Department of Homeland Security

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SEP 13 2013

MEMORANDUM FOR: Major P. (Phil) May
Regional Administrator, Region IV
Federal Emergency Management Agency

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

FROM: SUBJECT: *Big Rivers Electric Corporation Meets FEMA's Eligibility Requirements for Participation in the Public Assistance Program*
FEMA Disaster Number 1818-DR-KY
Audit Report Number DA-13-28

We audited Big Rivers Electric Corporation's (Big Rivers) eligibility to receive Public Assistance funding from the Federal Emergency Management Agency (FEMA) (FIPS Code 000-UONLE-00). Big Rivers received a Public Assistance award totaling \$1.8 million from the Kentucky Division of Emergency Management (State), a FEMA grantee, for damages resulting from a severe winter storm and flooding, which occurred January 26 to February 13, 2009.

Because the Internal Revenue Service (IRS) revoked Big Rivers' tax-exempt status in 1983, we limited our audit objectives to determining whether Big Rivers (1) met FEMA's eligibility requirements to apply for and receive FEMA assistance under a Public Assistance grant and (2) met FEMA's legal responsibility criteria for disaster-related repairs. We did not audit the eligibility and appropriateness of costs that Big Rivers claimed under the FEMA award.

We conducted this performance audit between March and July 2013 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. To conduct this audit, we applied the statutes, regulations, and FEMA policies and guidelines in effect at the time of the disaster.

We interviewed Big Rivers, State, and FEMA personnel; reviewed applicable Federal regulations and FEMA guidelines; reviewed applicable organization eligibility documents and other relevant information provided by Big Rivers, the State, and FEMA; and performed other procedures considered necessary to accomplish our audit objective. We did not assess the adequacy of Big



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Rivers' internal controls applicable to its grant activities because it was not necessary to accomplish our audit objective.

BACKGROUND

Big Rivers is a generation and transmission cooperative headquartered in Henderson, Kentucky. The three member cooperatives that own Big Rivers (Kenergy Corporation, Jackson Purchase Energy Corporation, and Meade County Rural Electric Cooperative Corporation) distribute retail electric power to more than 112,000 homes, farms, businesses, and industries across 22 counties in western Kentucky. Big Rivers supplies the wholesale power needs of the member cooperatives and markets surplus power to non-member utilities and power markets.

We audited Kenergy Corporation, one of the three cooperatives that own Big Rivers, and issued our report on June 18, 2013.¹ During that audit, it came to our attention that Big Rivers may not be an eligible private, nonprofit applicant, and that it may not have been legally responsible for disaster-related repairs because it had leased its generating facilities to another cooperative.

RESULTS OF AUDIT

Big Rivers qualifies as a nonprofit organization within the Commonwealth of Kentucky, and it met FEMA's legally responsible criteria for disaster-related repairs to its facilities. Therefore, Big Rivers satisfied the eligibility requirements to receive financial assistance under FEMA's Public Assistance program.

Eligible Applicant. Big Rivers meets the requirements to be an eligible applicant under the Public Assistance program. FEMA regulation 44 CFR 206.222 states that the following entities are eligible to apply for FEMA assistance under a State Public Assistance grant:

- State and local governments;
- Private nonprofit organizations or institutions that own or operate a private nonprofit facility as defined in 44 CFR 205[sic].221(e);² and

¹ OIG Report DA-13-20, *FEMA Should Recover \$3.8 Million of Public Assistance Grant Funds Awarded to Kenergy Corporation, Henderson, Kentucky, June 2013*.

² 44 CFR 206.222(b) contains a typographical error. The correct citation should be "206.221(e)," which is the correct citation for the definition of a private nonprofit facility.



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- Indian tribes or authorized tribal organizations and Alaska Native villages or organizations, but not Alaska Native Corporations, the ownership of which is vested in private individuals.

Further, 44 CFR 206.221(f) defines a private nonprofit organization as any nongovernmental agency or entity that currently has—

- an effective ruling letter from the U.S. Internal Revenue Service (IRS), granting tax exemption under sections 501(c), (d), or (e) of the IRS Code of 1954; or
- satisfactory evidence from the State that the nonrevenue producing organization or entity is a nonprofit one organized or doing business under State law.

Big Rivers' 2009 annual report raised a question concerning its nonprofit status that could affect its eligibility for FEMA public assistance funding. According to the annual report, the Corporation is a member-owned, private not-for-profit, generating and transmission cooperative. However, the IRS revoked Big Rivers' tax-exempt status in 1983. Note 7 (Income Taxes) on page 38 of Big Rivers' 2009 audited financial statements states—

Big Rivers was formed as a tax-exempt cooperative organization described in the IRS Code Section 501 (c) (12). To retain tax-exempt status under this section, at least 85% of the Big Rivers' receipts must be generated from transactions with Big Rivers' members. In 1983, sales to nonmembers resulted in Big Rivers failing to meet the 85% requirement. Until Big Rivers can meet the 85% member income requirement, Big Rivers is a taxable cooperative.

On March 12, 2013, we discussed the organization's nonprofit status with Big Rivers' officials. At the meeting, Big Rivers' officials said that, although the utility had lost its IRS tax-exempt status, it remained a non-profit organization under Commonwealth of Kentucky laws. The officials provided us with the organization's tax returns and other documentation to support their assertions. We reviewed the documentation and determined that Big Rivers, in fact, did meet FEMA's requirements as an eligible non-profit organization. Under Kentucky law, with certain exceptions, an organization can qualify and operate as a non-profit electric cooperative, provided it does no more than 49 percent of its business with nonmembers of the cooperative. In 2009, the year in which Big Rivers received Public Assistance funding, only 13 percent of its gross receipts came from non-members. Therefore, under Kentucky law, Big Rivers qualified and operated as a nonprofit electric cooperative in 2009. This status made Big Rivers eligible to apply for and receive a FEMA Public Assistance grant.



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Legal Responsibility. Big Rivers also met FEMA's legal responsibility criteria for disaster-related repairs to its facilities. Federal regulation 44 CFR 206.223(a)(3) states that an item of work must be the legal responsibility of an eligible applicant to be eligible for FEMA assistance. In July 1998, Big Rivers leased its generation facilities to Western Kentucky Energy Corporation. While the lease terms ran through 2023, the two entities mutually terminated the lease on July 17, 2009 (more than five months after the disaster), through an early termination agreement referred to as the "Unwind Transaction."

On March 12, 2013, we met with Big Rivers' officials to discuss whether Western Kentucky Energy Corporation or Big Rivers had the legal responsibility for damages caused to the facilities. At the meeting, Big Rivers' officials said that, although Big Rivers had leased the facilities in 1998, it had retained ownership of the generation facilities both during and at the end of the lease term. They provided us with documentation to support their assertion. We reviewed the documentation and concluded that Big Rivers met FEMA's legal responsibility criteria for the disaster-related repairs to the facilities. Therefore, the costs are eligible for FEMA reimbursement provided they meet other FEMA eligibility and allowability requirements.

DISCUSSION WITH MANAGEMENT AND AUDIT FOLLOWUP

We discussed the results of our review with Big Rivers, FEMA, and State officials on July 23, 2013. Because the audit did not identify issues requiring further action from FEMA, we consider this audit closed.

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 David Kimble, Director; Felipe Pubillones, Audit Manager; Mary Stoneham, Auditor-in-Charge; and Angelica Esquerdo, Auditor.

Please call me with any questions at (202) 254-4100, or your staff may contact David Kimble, Director, Eastern Regional Office, at (404) 832-6702.



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