

# Department of Homeland Security **Office of Inspector General**

**FEMA Should Recover \$46.2 Million of Improper Contracting Costs from Federal Funds Awarded to the Administrators of the Tulane Educational Fund, New Orleans, Louisiana**





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Department of Homeland Security

Washington, DC 20528 / [www.oig.dhs.gov](http://www.oig.dhs.gov)

AUG 15 2013

MEMORANDUM FOR: George A. Robinson  
Regional Administrator, Region VI  
Federal Emergency Management Agency

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

SUBJECT: *FEMA Should Recover \$46.2 Million of Improper Contracting Costs From Federal Funds Awarded to the Administrators of the Tulane Educational Fund, New Orleans, Louisiana*  
FEMA Disaster Number 1603-DR-LA  
Audit Report DD-13-11

We audited Public Assistance (PA) grant funds awarded to the Administrators of the Tulane Educational Fund, New Orleans, Louisiana (Tulane) (Public Assistance Identification Number 000-ULVHC-00). Our audit objective was to determine whether Tulane 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 Tulane the gross amount of \$291.9 million for damages resulting from Hurricane Katrina, which occurred on August 29, 2005. As shown in table 1, Tulane's insurance proceeds as of June 2011 and a Small Business Administration (SBA) loan reduced the gross amount to a net award of \$153.1 million.<sup>1</sup>

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<sup>1</sup> The amount of insurance reductions may change because, at the time of our audit, FEMA had not completed its analysis of Tulane's insurance proceeds.



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**Table 1. Gross and Net Award Amounts**

	<b>Gross Award Amount</b>	<b>SBA Loan Reduction</b>	<b>Insurance Reductions</b>	<b>Net Award Amount</b>
All Projects	\$291,896,596	(\$1,500,000)	(\$137,309,505)	\$153,087,091

The award provided 100 percent funding for 497 projects—309 large and 188 small projects.<sup>2</sup> The audit covered the period August 29, 2005, through April 3, 2013, the cutoff date of our audit. Because of the size of the award and number of projects, we have divided this audit into phases. During the first phase, we reviewed FEMA’s allocation of Tulane’s insurance proceeds and issued a Management Advisory Report recommending FEMA complete its analysis of insurance, because Tulane had received insurance proceeds that FEMA had not allocated to Tulane’s projects.<sup>3</sup> In this second phase, we reviewed the methodology Tulane used to award \$230.1 million in disaster-related contracts. We are planning a third phase to review the support and eligibility of specific costs Tulane has claimed.

We conducted this performance audit between June 2011 and April 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. We conducted this audit by applying the statutes, regulations, and FEMA policies and guidelines in effect at the time of the disaster.

We interviewed FEMA and Tulane officials, reviewed contracting documents, and performed other procedures considered necessary to accomplish our objective. We did not assess the adequacy of Tulane’s internal controls applicable to its grant activities because it was not necessary to accomplish our audit objective. We did, however, gain an understanding of Tulane’s methods of accounting for disaster-related costs and its procurement policies and procedures.

<sup>2</sup> Federal regulations in effect at the time of the disaster set the large project threshold at \$55,500.

<sup>3</sup> DD-12-10, *Insurance Allocations To FEMA Public Assistance Grant Funds Awarded to the Administrators of the Tulane Educational Fund, New Orleans, Louisiana*, dated April 19, 2012.



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### BACKGROUND

Tulane is a private university located in New Orleans, Louisiana. It offers undergraduate, graduate, and professional degrees in various disciplines, and has developed significant research programs. Tulane's primary campuses are located in the New Orleans area and it is the city's largest employer. Hurricane Katrina caused significant damages to its facilities and, as a result, Tulane suspended much of its New Orleans-based activities and programs for the 2005 fall semester. Tulane reopened its main campus in January 2006.



Flooding of an intramural field and students' residences on Tulane's main campus. Photo provided by Tulane University.

During the 2005 fall semester, Tulane arranged for students to enroll at other universities throughout the country and relocated most of its medical teaching programs to Houston. Tulane placed great emphasis on reopening its main campus for the 2006 spring semester because it was concerned that its future would be imperiled if it could not quickly restore operations. Approximately 93 percent of its undergraduate students returned for the 2006 spring semester on the main campus. Tulane reopened its medical-related campuses in the summer of 2006.



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After Hurricane Katrina, Tulane established a Disaster Resilience Leadership Academy that offers masters- and PhD-level programs in disaster leadership. Additionally, Tulane has partnered with FEMA to share knowledge and research about disasters, provide reduced tuition for FEMA employees for disaster-related classes, and offer FEMA internships to Tulane students. Tulane also participates with five other universities in a FEMA Disaster Resistant University pilot program with the purpose of defining and addressing issues to improve the ability of university campuses to withstand significant disaster threats.

### RESULTS OF AUDIT

Tulane did not always follow Federal procurement standards in awarding \$230.1 million in contracts it used for disaster work. As a result, we question \$46.2 million as ineligible contract costs consisting of the following amounts:

- \$35.0 million in excessive and prohibited markups on costs. Tulane awarded \$205.4 million to its primary contractor using a noncompetitive, prohibited cost-plus-percentage-of-cost contract. FEMA approved this contract despite being fully aware of its provisions for markups on costs. We usually question all costs related to noncompetitive contracts; however, in this case, we did not because exigent circumstances existed at the time of the award.
- \$5.5 million in unapplied credits. FEMA needs to ensure that Tulane does not include in its claim a \$3.5 million discount and a \$2.0 million donation that its primary contractor provided.
- \$5.7 million for four noncompetitive contracts Tulane awarded after exigent circumstances ended.

In addition, Tulane did not perform a cost or price analysis on its \$205.4 million primary contract; did not include required provisions in eight contracts; and did not take sufficient steps to ensure the use of small businesses, minority firms, and women's business enterprises. As shown in table 2, Tulane violated five procurement standards included in Federal regulations at 2 CFR Part 215.



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**Table 2. Tulane Contracts**

Contract Award Amount	Questioned Costs <sup>4</sup>	Contract Award Date	Scope of Work	Violations of Procurement Standards 1–5 Listed Below:				
				1	2	3	4	5
\$205,367,469	\$40,498,493	09/16/05	Restoration Contract	X		X	X	X
1,308,570	0	09/16/05	Mold Cleanup					X
2,064,532	0	10/25/05	Elevator Repairs				X	X
158,764	0	11/02/05	Dormitory				X	X
1,994,469	0	11/16/05	Temporary Classrooms				X	X
3,252,776	0	11/21/05	Temporary Residences				X	X
2,432,462	0	06/08/06	HVAC					X
956,224	956,224	07/05/06	Pianos		X		X	X
1,593,222	1,593,222	06/25/07	Fence Repairs		X			X
4,188,277	0	12/23/07	Library Processing				X	X
3,698,764	0	12/23/07	Library Cataloging				X	X
756,110	756,110	01/29/08	Auditorium		X			X
<u>2,371,478</u>	<u>2,371,478</u>	09/18/09	Alumni House		X			X
<b><u>\$230,143,117</u></b>	<b><u>\$46,175,527</u></b>							

Federal regulations at 2 CFR Part 215, in part, require that subgrantees—

1. Do not use the cost-plus-a-percentage-of-cost method of contracting, which is prohibited. (2 CFR Part 215.44(c))
2. Perform procurement transactions in a manner to provide, to the maximum extent practical, open and free competition. (2 CFR Part 215.43)
3. Prepare and document some form of cost or price analysis in connection with every procurement action. (2 CFR Part 215.45)
4. Include required provisions in contracts and subcontracts, such as those relating to termination, compliance with Equal Employment Opportunity and labor laws, and prohibition of “kickbacks.” (2 CFR Part 215.48 and Appendix A)
5. Make positive efforts to utilize small businesses, minority-owned firms, and women’s business enterprises, whenever possible. (2 CFR Part 215.44(b))

<sup>4</sup> The \$40,498,493 questioned from the primary contractor’s billings for restoration includes \$35,003,493 in markups on costs (finding A) plus \$5,495,000 for unapplied credits (finding B). The remaining questioned costs are for the \$5,677,034 Tulane awarded for four contracts after exigent circumstances ended (finding C).



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**Finding A: \$35.0 Million of Excessive and Prohibited Markups on Contract Billings and Costs**

Tulane awarded \$205.4 million to its primary contractor using a noncompetitive, cost-plus-percentage-of-cost contract that included \$35.0 million in excessive and prohibited markups on costs. FEMA approved this contract despite being fully aware of its provisions for markups on costs. As shown in table 3, the contractor added an average of 19.3 percent markups to hourly time-and-materials billings for its own employees. These hourly rates were already “fully burdened,” which means that they included profit and overhead. The primary contractor also added a 21 percent markup on pass-through costs for subcontractors and vendors that already included markups. Therefore, we question \$35,003,493 as excessive, ineligible markups on costs.

**Table 3. Markups on the Primary Contractor’s Billings**

Description	Amounts Billed Before Markups	Markup Amounts	Markup %	Amounts Billed After Markups	% of Total Billings
Time & Materials Billings	\$ 45,124,626	\$ 8,703,232	19.3%	\$ 53,827,858	26.2%
Subcontractors & Vendors	<u>125,239,350</u>	<u>26,300,261</u>	21.0%	<u>151,539,611</u>	<u>73.8%</u>
Totals	<u>\$170,363,976</u>	<u>\$35,003,493</u>	20.5%	<u>\$205,367,469</u>	<u>100.0%</u>

Federal regulations prohibit cost-plus-percentage-of-cost contracts because they provide no incentive for contractors to control costs—the more contractors charge, the more profit they make. Tulane awarded the \$205.4 million contract in September 2005 for emergency and permanent recovery work. The contract represented about 70 percent of the total award for Tulane’s 497 projects, or \$205.4 million of the total \$291.9 million award. The primary contractor performed most of the work between September 2005 and June 2006.

We did not fault Tulane for awarding this contract without competition because exigent circumstances existed at the time. Generally, we consider circumstances to be exigent when lives or property are at stake, or in this case, when a city or community needs to reopen its schools. As stated in the background section of this report, approximately 93 percent of Tulane’s undergraduate students returned for the 2006 spring semester



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on the main campus and Tulane reopened its medical-related campuses in July 2006. Therefore, we consider the exigent period to have ended in June 2006.

*FEMA Approval of Tulane's Cost-Plus-Percentage-of-Cost Contract With Primary Contractor*

Tulane awarded the cost-plus-percentage-of-cost contract on September 16, 2005. FEMA Louisiana Recovery Office (LRO) staff said that they notified FEMA Headquarters of Tulane's cost-plus-percentage-of-cost contract with its primary contractor in November 2005. FEMA Headquarters subsequently approved the contract in February 2006 based on LRO staff representations that the—

- Costs were reasonable;<sup>5</sup>
- Scope was controlled/limited by the January 2006 completion date of the main campus; and
- Work under the cost-plus-percentage-of-cost contract was substantially complete.

Further, FEMA Headquarters conditioned its approval on the requirement that both the LRO and Tulane take immediate steps to reduce/control the costs of the remaining work. FEMA Headquarters also directly notified Tulane representatives of this requirement.

In January 2007, FEMA added standard language to Tulane's project worksheets that documented FEMA's approval of the cost-plus-percentage-of-cost contract. The following excerpt is from one of Tulane's project worksheets that contains this language.

REFER TO THE FILES OF THE OFFICE OF GENERAL COUNSEL FOR A COPY OF THE AGREEMENT BETWEEN [PRIMARY CONTRACTOR] AND THE ADMINISTRATORS OF THE TULANE EDUCATIONAL FUND, FOR DEMOLITION, RESTORATION, REMEDIATION, AND/OR RECONSTRUCTION SERVICES NECESSITATED BY THE STORM EVENT. THE AGREEMENT IS A COST PLUS A PERCENTAGE OF COST CONTRACT AND INCLUDES A PROPOSED RATE AND MATERIAL SCHEDULE. FEMA COST ESTIMATING SPECIALISTS HAVE ANALYZED THE SCHEDULE AND HAVE DETERMINED THAT CONSTRUCTION WORK THAT UTILIZES THE UNIT RATES PROPOSED BY [PRIMARY CONTRACTOR] WILL RESULT IN FAIR AND REASONABLE CONSTRUCTION COSTS. [PRIMARY CONTRACTOR'S] RATES WERE COMPARED WITH SEVERAL ACCEPTED COST ESTIMATING SOURCES.... FEMA COST ESTIMATING SPECIALISTS FURTHER STATE THAT THE DISASTER-SPECIFIC CIRCUMSTANCES SURROUNDING THIS AGREEMENT

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<sup>5</sup> FEMA's practice has been to allow contract costs it considers reasonable even if an award does not comply with Federal procurement regulations.



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PRECLUDE [PRIMARY CONTRACTOR] FROM OBTAINING UNDUE PROFIT OR CHARGING UNREASONABLE ADMINISTRATIVE COSTS BY SUCH COMMON TRADE PRACTICES AS EXPANDING THE SCOPE OF NECESSARY WORK OR EXTENDING THE TIME ALLOWED TO DO NECESSARY WORK, THUS MAKING THE TERMS AND CONDITIONS OF THE AGREEMENT ACCEPTABLE IN THIS INSTANCE.

We do not agree with FEMA's conclusion that Tulane's primary contractor charged reasonable rates/costs. Our main concerns about the primary contractor's billings are—

- FEMA's basis for cost reasonableness was unsupported and incorrect;
- Markups on time-and-materials rates represented excessive profit because the time-and-materials rates already included overhead and profit;
- Markups on subcontract/vendor costs represented duplicate costs and excessive profit because the primary contractor charged hourly rates for managing subcontracts/vendors;
- Tulane did not realize that the primary contractor's hourly rates already included overhead and profit and already included costs for managing subcontractors and vendors; and
- Tulane's cost control activities were inadequate.

FEMA's Basis for Cost Reasonableness Was Unsupported and Incorrect

FEMA Headquarters based its approval of the contract on the LRO's assertion that the costs were reasonable, but neither FEMA Headquarters nor the LRO maintained documentation of the rationale they used to make this determination. Further, FEMA's basis for the determination was incorrect. FEMA asserted that the contract costs were reasonable because (1) the unit rates were reasonable based on cost estimating formats, (2) the January 2006 deadline to complete work on the main campus served to reduce costs because the time limit did not allow the contractor to increase costs, and (3) the cost-plus-percentage-of-cost work was substantially complete at that time.

- (1) Unit Rates – FEMA's statement that the rates were reasonable applied only to the time-and-materials rates stated in the contract. LRO's assertion of reasonableness did not address the subcontractor/vendor costs; the 19.3 percent (average) markups added to time-and-materials rates, which already included overhead and profit; or the 21 percent markups on subcontractor/vendor costs.
- (2) January 2006 Deadline and Substantial Uncompleted Work – Contrary to FEMA's assertion that a tight deadline served to limit costs, deadlines can increase the



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potential for incurring excessive costs. The contractor would have less opportunity to plan its work and be more inclined to incur excessive costs by hiring extra staff, working additional overtime, and purchasing extra materials to ensure meeting the deadline.

- (3) Completed Work – The primary contractor’s work was not substantially complete in January 2006. In fact, as of February 2006, the primary contractor had billed only \$138.0 million of the \$205.4 million ultimately billed. Further, the primary contractor continued to work on Tulane projects under the cost-plus-percentage-of-cost contract until 2008, even though FEMA Headquarters understood the cost-plus-percentage-of-cost contract terms would be discontinued or substantially modified to reduce costs. Therefore, FEMA should have notified Tulane that it would not fund any costs under the cost-plus-percentage-of-cost contract after February 2006.

#### Markups on Time-and-Materials Rates Represented Excessive Profit

The markups on the primary contractor’s time-and-materials rates were not only prohibited, they also represented excessive profit because the time-and-materials rates already included sufficient overhead and profit. The contract included hourly rates based on the primary contractor’s National Price List for all the types of work. However, these were not the rates that workers received. These rates were fully burdened hourly rates that included the employee’s actual pay, labor burden (taxes and fringe benefits such as insurance, retirement, and vacation pay), overhead, and profit. In June 2012, we asked Tulane to provide us with the composition of the primary contractor’s national labor rates. However, Tulane informed us that the primary contractor had not provided a breakdown of these rates to them; as of the date of this report, Tulane had still not provided this information.

Examples of the primary contractor’s rates listed in the contract were \$26.50 per hour for laborers, \$36.00 per hour for drywall/painters, \$41.00 per hour for supervisors, and \$42.00 per hour for carpenters. Based on average wages for construction, we estimate that these rates were about double what employees received, which leaves half (or 100 percent markup to the employees’ wages) for labor burden, overhead, and profit. We estimate that the primary contractor hourly rates included a 50 percent markup to the wage rate for labor burden and 50 percent markup to the wage rate for overhead and profit. We consider a markup of 50 percent of the wage rate for overhead and profit to be generous, especially considering that the contractor’s risk was very low—Tulane reimbursed for all costs incurred. Therefore, the primary contractor’s additional 21 percent markup on the contracted rates represents unreasonable, excessive profits.



Markups on Subcontractor/Vendor Costs Represented Duplicate Costs and Excessive Profit

The 21 percent markup that the primary contractor added to subcontractor/vendor costs represented duplicate costs and excessive profit because the primary contractor had already charged Tulane for managing subcontractors/vendors through its hourly rates. The primary contractor's scope of work included construction work, but its main function was to manage and oversee subcontractors and vendors. The contract listed hourly rates for different types of work that included project managers, supervisors, administrative staff, and project auditors. We found no evidence that the primary contractor incurred any significant additional costs to manage and oversee the subcontractors and vendors that were not covered by the billing rates. Therefore, the markups on subcontractors and vendors represented duplicate costs and excessive profit. In addition, the primary contractor (1) allowed two general contractors to add additional markups on subcontractor costs, resulting in a 46.4 percent total markup for managing the subcontractors and vendors; and (2) allowed some subcontractors to apply excessive markups.

- (1) The primary contractor allowed two general contractors to add an additional 21 percent markup on the subcontractors they used. The primary contractor basically served as a project manager for these two general contractors. The general contractors marked up their subcontract cost to the primary contractor by 21 percent, and the primary contractor added its 21 percent markup to the general contractors' billings. Thus, Tulane paid markups of 46.4 percent (1.21 times 1.21 equals 1.46) to manage the subcontractors who were performing the actual work.
- (2) The primary contractor allowed some of the subcontractors to apply extremely excessive markups. For example, one subcontractor marked up costs for fuel and freight by 30 percent and 15 percent, respectively, and the primary contractor then marked up the same costs an additional 21 percent. The resulting cumulative markups for fuel and freight were 57.3 percent and 39.2 percent (1.30 times 1.21 equals 1.57; and 1.15 times 1.21 equals 1.39), respectively.

Generally, fees on construction work are tied to the risk associated with performing the work and collecting the amounts billed. However, in this case, the primary contractor incurred no risk because—



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- All costs were reimbursable;
- There was little to no performance risk because Tulane and the primary contractor jointly determined the scope of work on the cost-plus-percentage-of-cost contract; and
- There was little to no collection risk because payments were secured by insurance proceeds and Tulane contractual guarantees, and FEMA funded most of the costs that insurance did not cover.

### Tulane Did Not Realize That the Primary Contractor's Hourly Rates Already Included Overhead and Profit and Already Included Costs for Managing Subcontractors and Vendors

Early in our audit, we explained to Tulane officials that the 21 percent markup on the contractor's hourly billings and subcontractor and vendor costs represented excessive profits, as discussed in this report. Tulane officials did not agree, stating that the primary contractor's hourly rates represented its actual cost and did not include indirect costs or profit. They said the primary contractor had told them that the hourly rates in the contract represented the contractor's National Rate and Material Schedule (or standard commercial rates). In fact, a primary contractor's representative provided a declaration to Tulane in March 2012 stating that the rates were unburdened.

Because we thought the rates included overhead and profit, we requested that Tulane provide us the composition of the primary contractor's rates (the cost). Tulane stated that they requested this from the primary contractor, but did not receive it. In August 2012, Tulane informed us that they had learned that the rates were burdened (not cost) and that the primary contractor had recently explained that the rates included necessary administrative costs.

### Tulane's Cost Control Activities Were Inadequate

Tulane overcame a number of major obstacles and difficulties to complete a large amount of work in a short period of time to ensure that its main campus would open in January 2006. To do so, it developed a contract progress monitoring system that was instrumental in ensuring the contractor met the January 2006 deadline. However, Tulane's focus was timely construction, rather than cost control. Although Tulane and the primary contractor took steps to reduce costs, there was no reliable administration system to control costs (i.e., to ensure that the contractor purchased only necessary materials and paid for only necessary labor).



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FEMA Headquarters conditioned its approval of the cost-plus-percentage-of-cost contract in February 2006 with the understanding that FEMA and Tulane were to control any future or remaining contract costs. The approving official indicated his concerns to LRO and Tulane officials regarding the contractor's incentive to inflate the costs of the cost-plus-percentage-of-cost contract to increase profits.

The FEMA approving official informed Tulane that LRO staff would work with Tulane to resolve the issue of controlling future contract costs. He also stated in September 2006 that he had not agreed to the contractor performing work after February 2006 on a cost-plus basis. However, neither FEMA nor Tulane took any significant actions to control the contractor's costs or to change the contract terms after February 2006 pursuant to FEMA Headquarters' approval conditions. In fact, as noted above, the contractor continued to perform work under the cost-plus-percentage-of-cost until 2008 and billed Tulane an additional \$67.0 million after February 2006.

Tulane monitored the primary contractor's construction progress. However, there is little evidence that Tulane staff or independent representatives knowledgeable in construction costs monitored the reasonableness or checked the validity of the costs that the primary contractor billed to Tulane.

Tulane contracted with an outside accounting firm to verify that the primary contractor had support for its invoice amounts and that billings were not duplicated. However, according to the accounting firm, "All documentation was accepted as presented" and there were only a few instances in which Tulane or an independent party reviewed these invoices for work performed before the accounting firm processed them. The primary contractor and its subcontractors billed a substantial portion of the project costs on a cost-plus-percentage-of-cost or time-and-materials basis, which require supporting documents, such as timesheets and invoices that an independent third party (that would not benefit from higher costs) should have reviewed before processing. Further, the accounting firm did not verify whether the primary contractor actually paid subcontractors' submitted costs.

Additionally, Tulane did not have an administrative system to verify that the amounts billed represented actual, necessary, and supported costs. Tulane could not demonstrate that it had an independent, effective method to ensure that contractors actually received and used the billed materials for campus disaster repairs or to ensure that charged labor costs were for actual hours worked on disaster-related repairs.

Instead, Tulane officials said that the companies billed hours based on sign-in sheets that the companies' employees completed. Generally, neither Tulane nor an



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independent monitoring contractor performed on-site procedures to verify or audit the hours charged before document review and processing by an outside accounting firm.<sup>6</sup> Also, the outside accounting firm requested but was not provided information regarding the primary contractor's payroll records related to time charged to Tulane.

Further, subcontractor invoices generally did not contain marks, such as initials, to indicate that anyone reviewed and approved them. In addition, Tulane submitted invoices from its primary contractor that were not supported by invoices from vendors or subcontractors.<sup>7</sup> For example, Tulane did not provide invoices for \$12.2 million from the primary contractor for work that a subcontractor performed on one project. Not having a consistent methodology of independent reviews to ensure that costs billed were supported and represented actual disaster activity increased the likelihood for fraud and abuse.

Most of the cost control deficiencies noted above probably could have been addressed if—

- Tulane had hired an independent project management firm to oversee the costs;
- The primary contractor had provided the independent accounting firm access to its Tulane-related labor records; and
- The independent accounting firm had performed certain other normal accounts payable review procedures such as reviewing for invoice approvals.

However, Tulane did not take these actions. Instead, Tulane's primary project management focus was to open the main campus by January 2006, with cost control being a lesser concern. Further, because Tulane compensated its primary contractor and most of the subcontractors on a cost-plus-percentage-of-cost basis, they had no incentive to control costs in achieving the January 2006 opening.

After learning of the cost-plus-percentage-of-cost contract in November 2005, FEMA should have immediately notified Tulane that these contract terms are prohibited by Federal regulations. Further, FEMA should have informed Tulane that unless it quickly entered into an allowable contractual arrangement, such as a cost-plus contract with a fixed fee, it would not receive additional Federal disaster funding. We disagree with FEMA that the costs were reasonable.

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<sup>6</sup> Tulane officials said that insurance company auditors did some testing and verification of labor hours and presented their findings to Tulane, but we were not able to evaluate the scope of this work because Tulane officials said they do not have access to the documentation.

<sup>7</sup> As stated above, during a third audit phase, we plan to review the support and eligibility of specific costs Tulane has claimed.



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When grantees award cost-plus-percentage-of-cost contracts and do not adequately monitor the costs incurred, FEMA cannot accurately determine reasonable costs. Under a cost-plus-percentage-of-cost contract, the contractor has no incentive to control costs. The fact that FEMA Headquarters approved a prohibited cost-plus-percentage-of-cost contract based on incorrect assertions is troubling in and of itself. Also troubling is the fact that the LRO and Tulane took no actions to control costs after FEMA Headquarters instructed them to do so as a condition of its approval of the cost-plus-percentage-of-cost contract. Clearly, FEMA Headquarters should not have approved any part of a cost-plus-percentage-of-cost contract.

Tulane stated that during the immediate aftermath of Hurricane Katrina, Tulane's operations, including its procurement functions, were severely disrupted and most of its personnel were not in New Orleans. Tulane contacted other universities and relied on their advice and the advice of their insurance companies to obtain a contractor to assist the university in opening the campus quickly.

### **Finding B: \$5.5 Million in Unapplied Donations and Credits**

In developing its claims, Tulane did not account for a \$3.5 million discount and a \$2.0 million donation—both received from its primary contractor. As a result, Tulane would have claimed \$5.5 million more than it paid its primary contractor. According to 2 CFR Part 220, Appendix A, Section C.1 and C.5, to be allowable, costs must be net of applicable credits.

Tulane's primary contractor billed Tulane \$205.4 million in cost-plus-percentage-of-cost charges under the terms of its contract. However, pursuant to a settlement agreement with the contractor, Tulane paid the contractor \$5.5 million less than the amounts billed, or \$199.9 million. This difference is comprised of a \$2,000,000 contribution from the contractor to Tulane and a \$3,495,000 settlement discount. Neither of these credits was reflected on any of the primary contractor's 21 invoices.

The Tulane staff who worked with FEMA to develop the values of projects said they had focused only on the amounts to be billed for each project and had developed a database of all the invoices the primary contractor submitted, which were exclusive of the settlement agreement.

When we discussed this matter with Tulane staff, they immediately agreed that Tulane should not claim and be reimbursed for more than the \$199.9 million that Tulane actually paid the primary contractor. Tulane officials also said they were confident that



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the credits would have been identified during the finalization of its cost submissions and Tulane would have then reduced its overall FEMA claim by the amount of these credits.

**Finding C: Noncompetitive Contracts Awarded After Exigent Circumstances Ended**

Tulane awarded four noncompetitive contracts totaling \$5,677,034 after exigent circumstances no longer existed. We consider the exigency to have ended in June 2006 just before Tulane opened its Medical School campus to students. Federal regulations at 2 CFR Part 215.43 require all procurement transactions be conducted in a manner to provide, to the maximum extent practical, open and free competition, which means that all responsible sources are allowed to compete for contracts. However, rather than publicly advertising these four contracts, Tulane invited only preselected contractors to bid on them.

Because methods of publicly advertising were available before the contract award dates, Tulane should have used open and free competition under non-exigent circumstances to allow all responsible sources to compete as Federal procurement regulations require. Open and free competition also helps to discourage and prevent favoritism, collusion, fraud, waste, and abuse. Additionally, without public solicitation there is no assurance that Tulane (1) allowed all potential responsible sources to compete for federally funded projects, (2) awarded contracts based on the best prices available, or (3) awarded contracts to the most qualified companies. Further, without public notice, all responsible small businesses, minority-owned firms, and women's business enterprises cannot compete for contract awards (see finding D).

One of the noncompetitive awards Tulane made after the exigent period was to replace 21 damaged pianos. Eighteen of the pianos were between 49 and 86 years old and two others were 27 and 36 years old. The FEMA PA Guide (FEMA 322, October 1999, p.57) states that used equipment should be replaced with used items of the same age, capacity, and condition. Replacement of used items with new items is permitted when a used item is not available within a reasonable time or distance.

Tulane submitted, and FEMA approved, a project to buy 21 new (instead of used) replacement pianos on the basis that the pianos would be purchased in time to support the January 2006 opening of the campus. FEMA approved the project because time was a factor. However, Tulane did not purchase the pianos until July 2006. The delay provided Tulane with ample time to evaluate other sourcing options for new and used pianos.



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Further, Tulane purchased all of the 21 new pianos from the sole locally authorized distributor of a well known piano manufacturer and negotiated pricing directly with the manufacturer. This purchase also covered the purchase of four pianos from different manufacturers. As a result, Tulane did not compete or source the award by attempting to purchase used pianos or sourcing from different manufacturers. Therefore, we question this sole-source, noncompetitive contract because Tulane awarded it after exigent circumstances ended, and Tulane could have obtained pianos from other sources at competitive prices.

Because Tulane awarded four contracts without open and free competition after the exigent period ended, we question the \$5,677,034 as ineligible contract costs.

#### **Finding D: Other Violations of Federal Procurement Standards**

Tulane did not always comply with other procurement standards in awarding the 13 contracts totaling \$230.1 million of disaster-related work (see table 2). First, Tulane did not perform a cost or price analysis on its \$205,367,469 primary contract. Federal regulations at 2 CFR Part 215.45 require subgrantees to perform a cost or price analysis on all procurements. Therefore, this contract had an increased likelihood of unreasonable contract costs and misinterpretations or errors in pricing relative to scopes of work.

Second, Tulane did not include all required provisions in eight of its contracts totaling \$221,681,275. Federal regulations at 2 CFR Part 215.48 and Appendix A set forth the required provisions for contracts and subcontracts, such as Equal Employment Opportunity compliance, compliance with labor laws, and prohibition of “kickbacks.” These provisions document the rights and responsibilities of the parties and minimize the risk of misinterpretations and disputes. Tulane representatives stated that, because of the exigent circumstances, they were not able to use their standard federally funded contract templates, but told us that they have since returned to their established practice of including the standard provisions in their federally funded contracts.

Third, Tulane did not take sufficient steps to ensure the use of small businesses, minority firms, and women’s business enterprises whenever possible for any of its awards. Tulane officials said that before Hurricane Katrina, it had an active and formal program to ensure that it used such firms; however, to reopen its campuses in a timely manner, it did not use this program to make disaster awards during the exigent period. Even though Tulane did not take sufficient steps, it did award three contracts totaling \$8.6 million to these types of entities. Tulane representatives said that after Hurricane



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Katrina they re-activated their program and will ensure that they use small businesses, minority-owned firms, and women's business enterprises whenever possible.

We agree that exigent circumstances may preclude the use of open and free competition and the steps necessary to use these types of businesses whenever possible. However, for the four contracts awarded after the exigent period ended in June 2006, Tulane should have complied with Federal regulations requiring subgrantees to take all necessary affirmative steps to ensure that they use these businesses when possible (2 CFR 215.44(b)). We questioned the costs related to these four contracts in finding C.

Additionally, Tulane and the primary contractor awarded three contracts or subcontracts to vendors who had previously or later made contributions to Tulane, one of the most significant of which was a \$2.0 million donation from the primary contractor.<sup>8</sup> Also, Tulane awarded several other disaster contracts to entities with relationships with Tulane, including previously used contractors, alumni, and members of various Tulane boards. Tulane representatives said that it made these awards in a manner consistent with its internal policies, and were not aware of the open and free competition requirements.

Certain of these awards could potentially represent real or apparent organizational conflicts of interest under 2 CFR Part 215.43, which states that recipients shall be alert to organizational conflicts of interest as well as noncompetitive practices among contractors that may restrict or eliminate competition or otherwise restrain trade. Further, 2 CFR Part 215.42 states, in part:

No employee, officer, or agent shall participate in the selection, award, or administration of a contract supported by Federal funds if a real or apparent conflict of interest would be involved. Such a conflict would arise when the employee, officer, or agent, any member of his or her immediate family, his or her partner, or an organization which employs or is about to employ any of the parties indicated herein, has a financial or other interest in the firm selected for an award. The officers, employees, and agents of the recipient shall neither solicit nor accept gratuities, favors,

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<sup>8</sup> As of March 2012, the primary contractor, a subcontractor and the owner of another subcontractor were members of the Paul Tulane Society. Tulane awards membership in this society to individuals and organizations that have made gifts of \$1 million or more to the university.



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or anything of monetary value from contractors, or parties to subagreements.

Tulane officials said they do not have any evidence to indicate that there were any conflicts of interest associated with its disaster awards.

**RECOMMENDATIONS**

We recommend that the Regional Administrator, FEMA Region VI:

**Recommendation #1:** Disallow \$35,003,493 as ineligible for prohibited and excessive markups on contract costs, unless FEMA grants an exemption for all or part of the costs as provided for in 2 CFR 215.4 and Section 705(c) of the *Robert T. Stafford Disaster Relief and Emergency Assistance Act*, as amended (finding A).

**Recommendation #2:** Ensure Tulane is not reimbursed the \$5,495,000 of ineligible costs for unapplied credits to contract costs. By avoiding these costs, FEMA can put these funds to better use (finding B).

**Recommendation #3:** Disallow \$5,677,034 as ineligible for four noncompetitive contracts, unless FEMA grants an exemption for all or part of the costs as provided for in 2 CFR 215.4 and Section 705(c) of the *Robert T. Stafford Disaster Relief and Emergency Assistance Act*, as amended (finding C).

**Recommendation #4:** Ensure that GOHSEP instructs Tulane on Federal procurement standards listed at 2 CFR Part 215 (findings A, C, and D).



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### DISCUSSION WITH MANAGEMENT AND AUDIT FOLLOWUP

We discussed the results of our audit with Tulane officials during our audit and included their comments in this report, as appropriate. We also provided a draft report in advance to FEMA, GOHSEP, and Tulane officials and discussed it at exit conferences held with FEMA on September 9, 2012, and February 20, 2013, and with FEMA, GOHSEP, and Tulane officials on March 28, 2013. FEMA officials generally agreed with our findings, but will need to further review some of the details. GOHSEP representatives disagreed with finding B and did not offer any other comments. Tulane disagreed with all the report findings and recommendations and said that they will discuss finding A with FEMA.

Within 90 days of the date of this memorandum, please provide our office with a written response that includes your (1) agreement or disagreement, (2) corrective action plan, and (3) target completion date for each recommendation. Also, please include responsible parties and any other supporting documentation necessary to inform us about the current status of the recommendation. Until we receive and evaluate your response, we will consider the recommendations to be open and unresolved.

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 Tonda Hadley, Director; Paige Hamrick, Audit Manager; William Haney, Auditor-in-Charge; Rebecca Hetzler, Senior Auditor; and Tim Scott, Senior Program Analyst.

Please call me with any questions at (202) 254-4100 or your staff may contact Tonda Hadley, Director, Central Regional Office, at (214) 436-5200.



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