

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

**FEMA Should Recover \$10.9 Million of Improper Contracting Costs from Grant Funds Awarded to Columbus Regional Hospital, Columbus, Indiana**



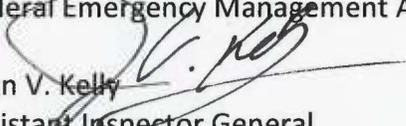


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DEC 4 2013

**MEMORANDUM FOR:** Andrew Velasquez III  
Regional Administrator, Region V  
Federal Emergency Management Agency

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

**SUBJECT:** *FEMA Should Recover \$10.9 Million of Improper Contracting Costs from Grant Funds Awarded to Columbus Regional Hospital, Columbus, Indiana*  
FEMA Disaster Number 1766-DR-IN  
Audit Report Number OIG-14-12-D

We audited Public Assistance grant funds awarded to Columbus Regional Hospital (Hospital) in Columbus, Indiana (Public Assistance Identification Number 005-U0FZF-00). Our audit objective was to determine whether the Hospital accounted for and expended Federal Emergency Management Agency (FEMA) grant funds according to Federal regulations and FEMA guidelines.

The Indiana Department of Homeland Security (IDHS), a FEMA grantee, awarded the Hospital \$94.4 million for damages resulting from severe storms and flooding that occurred May 30, through June 27, 2008. The award provided 75 percent funding for 122 large and 130 small projects.<sup>1</sup> As of January 27, 2013, the cut-off date of our audit, the Hospital had claimed \$71.1 million and IDHS had disbursed \$63.7 million.

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<sup>1</sup> Federal regulations in effect at the time of the disaster set the large project threshold at \$60,900. On June 23, 2008, FEMA reduced the cost share from 90 percent to 75 percent on Category B (Emergency Protective Measures) projects when flood waters receded to a specified level.



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Table 1 shows the gross and net award amounts before and after reductions for insurance.

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

	<b>Gross Award Amount</b>	<b>Insurance Reductions</b>	<b>Net Award Amount</b>
All Projects	\$110,286,824	(\$15,913,494)	\$94,373,330
Audit Scope	\$74,650,556	(\$ 1,372,755)	\$73,277,801

Because of the size of the award and the number of projects, we have divided the audit into two phases. During this first phase, we reviewed the methodology the Hospital used to award \$74.7 million for 11 disaster-related contracts. We are planning a second phase to review the support and eligibility of specific costs the Hospital has claimed.

We conducted this performance audit between March 2013 and September 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, IDHS, and Hospital officials; reviewed contracting documents; and performed other procedures considered necessary to accomplish our objective. We did not assess the adequacy of the Hospital's internal controls applicable to grant activities because it was not necessary to accomplish our audit objective. We did, however, gain an understanding of the Hospital's method of accounting for disaster-related costs and its procurement policies and procedures.

## **BACKGROUND**

Columbus Regional Hospital is a branch of Bartholomew County and is a county non-profit regional healthcare facility providing healthcare services to residents of multiple counties in southeastern Indiana. On June 7, 2008, flood waters inundated the entire basement of the Hospital, which contained much of the Hospital's medical and lab equipment. In addition, standing contaminated water and mud heavily damaged the first floor. Hospital officials closed the facility as a result of the flood and partially



reopened it in October 2008. We determined that exigent circumstances existed until April 2009, when the hospital returned to full capacity.

### **RESULTS OF AUDIT**

Of the 11 contracts we reviewed, totaling \$74.7 million, the Hospital did not follow Federal procurement standards in awarding \$64.8 million for 9 contracts. Two of the nine contracts were non-competitive contracts for non-exigent work, another two were prohibited cost-plus-percentage-of-cost contracts for exigent work, and all nine contracts involved violations of other Federal procurement standards. As a result, open and free competition did not occur, and FEMA has no assurance that costs were reasonable. Therefore, we question \$10.9 million, consisting of \$8.7 million for the two non-competitive contracts for non-exigent work and \$2.2 million for prohibited markups on the two cost-plus contracts for exigent work. We did not question all of the costs for the nine contracts because contractors performed the majority of the work under exigent circumstances to restore the Hospital to its full operating capability.

These findings occurred in part because IDHS, as the grantee, did not adequately monitor the Hospital's subgrant activities to ensure compliance with Federal procurement standards. Therefore, FEMA should require IDHS to instruct the Hospital to improve its procurement procedures for future disasters.

#### **Finding A: Improper Contracting**

The Hospital did not follow Federal procurement standards in awarding \$64.8 million for 9 disaster-related contracts, or 87 percent of the \$74.7 million the Hospital awarded for 11 disaster-related contracts. As table 2 below shows, the Hospital awarded two contracts for non-exigent work without adequate competition, awarded another two contracts for exigent work that included prohibited cost-plus-percentage-of-cost payment terms, and did not comply with one or more other Federal procurement standards in awarding all nine contracts. As a result, we question \$10.9 million, consisting of \$8.7 million for the two non-competitive contracts and \$2.2 million for prohibited markups on the two cost-plus contracts.

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

1. Perform procurement transactions in a manner to provide, to the maximum extent practical, open and free competition. (2 CFR 215.43)
2. Do not use the prohibited cost-plus-a-percentage-of-cost method of contracting. (2 CFR 215.44(c))
3. Include required provisions in all of their contracts. (2 CFR 215.48 and Appendix A to Part 215—Contract Provisions)



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4. Make positive efforts to use small businesses, minority-owned firms, and women’s business enterprises, whenever possible. (2 CFR 215.44(b))
5. Prepare and document some form of cost or price analysis in connection with every procurement action. (2 CFR 215.45)
6. Provide a clear and accurate description of the project requirements for the material, product, or service to be procured. (2 CFR 215.44 (a)(3)(i))

**Table 2. Contracting Violations**

Contract Amount	Questioned Amount	Contract Scope of Work	Non-compliance with Procurement Standards 1–6 Listed Above					
			1	2	3	4	5	6
\$ 5,114,305	\$ 5,114,305	Flood Wall	X		X	X		
3,584,720	3,584,720	Project Administration	X		X	X		X
38,916,492	1,675,802	Restoration Work		X	X	X		
5,808,528	557,154	1 <sup>st</sup> Floor Clean-up		X	X	X	X	
3,898,889	0	Basement Clean-up			X	X	X	
3,822,148	0	Architect/Engineer			X	X		
1,372,755	0	Modular Kitchen			X	X	X	X
1,522,314	0	Communications System			X			
751,647	0	Nurse Call System			X	X	X	
<u>\$64,791,798</u>	<u>\$10,931,981</u>							

**Non-Competitive Contracts and Unreasonable Costs**

The Hospital awarded two contracts totaling \$8,699,025 for non-exigent work without open and free competition. In addition, at least one of the contracts included unreasonable prices. Generally, open and free competition means that all responsible sources are allowed to compete for contracts. However, the Hospital did not publicly advertise the two contracts, but rather invited a limited number of preselected contractors to bid.

For one contract (a protective flood wall) totaling \$5,114,305, the Hospital invited five preselected contractors to bid on the work. For a second contract (administrative services) totaling \$3,584,720, the Hospital invited only four preselected contractors to submit bids. In both instances, the hospital limited competition by preselecting contractors to bid rather than advertising or otherwise publicizing its procurement to other potential qualified bidders.



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Further, for the administrative contract, the proposals the Hospital initially received related to processing insurance claims rather than administrative work. The Hospital solicited new proposals because FEMA questioned the scope of work including insurance. The Hospital inserted “FEMA” into the scope of work in its solicitation for the new proposals and the final contract. The Hospital could not provide us pre-award documentation required to determine the proposed scope of the services. Federal regulations at 2 CFR 215.44(a)(3)(i) require a clear and accurate description of the project requirements for the material, product, or service to be procured.

In addition, the contractor (a Certified Public Accounting firm) charged unreasonably high hourly rates for the administrative services (ranging from \$300 for staff and \$460 for senior managers and up to \$550 for a partner) and incurred travel costs that it might have avoided if the Hospital had publicly advertised for bids. For example, if the Hospital had publically solicited the work, it may have obtained lower rates from a local firm that would eliminate or reduce travel costs. Hospital officials said they based the selection process on the contractor’s familiarity with hospital accreditation and operating requirements rather than price. We disagree with this selection process because without open and free competition there is no assurance that another contractor would not have been able to perform the same non-technical services at lower rates.

Hospital officials also said they hired the project administrator during the exigent period immediately after the flood to assist the Hospital in responding quickly to FEMA’s requests for information and documentation to formulate its disaster projects. We do not agree with the Hospital’s position because project administration is not exigent work to save lives or property. Therefore, the Hospital should have used open and free competition for the project administration work.

FEMA, in a September 8, 2009, memo provided guidance on implementing Disaster Assistance Policy DAP 9525.9, *Section 324 Management Costs and Direct Administrative Costs* (DAC). This guidance provides an upper-limit reasonable rate of \$265 per hour for a senior consultant and \$224 per hour for a consultant. FEMA also stated in an April 2013 appeal that \$155 per hour for administrative services is a reasonable hourly rate unless the work requires highly technical expertise. For example, a contractor that IDHS used to manage the Hospital’s grant and perform similar administrative services charged only \$147 per hour.

In addition, the services the contractor provided for performing administrative services such as documenting the value of damages, allocating costs, and reconciling billings were not highly technical and therefore did not warrant the \$300 to \$550 hourly rates. Federal regulations at 2 CFR Part 225, Appendix A – General Principles for Determining Allowable Costs, § C.2. define a cost as reasonable if, in its nature and amount, it does not exceed that which a prudent person would incur under similar circumstances.



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Because most of the rates the Hospital's contractor charged for the type services provided exceeded the rates FEMA determined as reasonable, the rates the Hospital claimed appear to be unreasonably high.

Open and free competition also increases the probability of achieving reasonable pricing from the most qualified contractors and allows greater opportunity for small businesses, minority firms, and women's enterprises to compete for federally-funded work. Open and free competition also helps discourage and prevent favoritism, collusion, fraud, waste, and abuse. Because the Hospital awarded noncompetitive contracts for non-existent work, one with unreasonable prices, we question \$8,699,025 of ineligible and unreasonable contracting costs.

### **Prohibited Contracts**

The Hospital awarded two contracts totaling \$44,725,020 using prohibited cost-plus-percentage-of-cost contracts. Federal regulations at 2 CFR 215.44(c) prohibit the use of cost-plus-percentage-of-cost contracts because they provide a disincentive for contractors to control costs—the more contractors charge, the more profit they make.

The Hospital awarded a cost-plus-a-percentage-of-cost contract for the phase 1 rebuilding of the hospital. The contractor added a 4.5 percent mark-up to all subcontractor/vendor costs. The Hospital also used the same type cost-plus contract for emergency clean-up after the flooding, which included a 15 percent mark-up on all costs.

A Hospital representative said that the Hospital has a unique status as a county hospital and that many of the typical sources of mandatory procurement procedures under State and Federal law do not apply to them. The Hospital cited specific Indiana statutes they believe applied to the disaster procurement work. The representative also said that the Hospital did not ignore all procurement guidelines and standards, but rather, as FEMA agreed to and according to existing law, carefully followed all of its own existing procurement standards and guidelines in all of its decisions regarding contracting, bidding, and purchasing. However, the Hospital could not provide any documentation substantiating that it was exempt from following Federal regulations or that FEMA agreed that the Hospital should follow only its own procurement procedures.

On the contrary, FEMA said in a letter dated September 26, 2008, that 44 CFR 13 did not apply to the Hospital, but rather the Office of Management and Budget Circular A-110 (2 CFR 215) applied to hospitals and other non-profit entities. Further, in an October 7, 2008, letter to FEMA, Hospital officials agreed to follow the procurement standards in 2 CFR 215.40 through 48 for two contracts, even though the Hospital did not agree that these regulations applied to them. According to Federal regulations at 2 CFR 215.0 the provisions of Part 215 apply to grants and agreements with institutions of higher



education, hospitals, and other non-profit organizations and that recipients (IDHS in this case) shall apply the provisions to subrecipients (the Hospital in this case). The Hospital is not exempt from Federal regulations and should have complied with the procurement standards in 2 CFR Part 215. It is not the Hospital's prerogative to pick and choose which parts of Federal regulations apply to it.

Although both contracts are entirely ineligible, we did not question all of the costs for the two contracts because contractors performed the majority of the work under exigent circumstances to restore the Hospital to its full operating capability. However, because the Hospital should have known better than to use a cost-plus-percentage-of-costs contract and because such contracts are so egregious, we believe that FEMA should at least disallow the mark-ups on costs. Therefore, we question as ineligible the \$2,232,956 in mark-ups on costs (\$1,675,802 plus \$557,154).

### **Other Contracting Violations**

The Hospital did not comply with other Federal procurement standards in awarding nine contracts we reviewed totaling \$64,791,798. The Hospital did not: (1) include required provisions in any of the nine contracts; (2) make efforts to ensure the use of small businesses, minority-owned firms, and women's business enterprises to the fullest extent practicable on eight of the contracts; (3) perform cost or price analyses on four of the contracts; and (4) document the project requirements in their solicitations for two of the contracts. We did not question additional costs for these other contracting violations because seven of the nine contracts were for exigent work to fully restore the Hospital, and we have already questioned costs for the two non-emergency contracts above.

#### *Required Provisions*

The Hospital did not include all required provisions in nine of its contracts totaling \$64,791,798. Federal regulations at 2 CFR 215.48 and Appendix A to 2 CFR Part 215—Contract Provisions 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.

#### *Small, Minority, and Women-Owned Businesses*

The Hospital did not make efforts on eight contracts totaling \$63,269,484 to ensure the use of small businesses, minority-owned firms, and women's business enterprises whenever possible. Although the Hospital awarded four of the eight contracts to small businesses, the Hospital made no intentional effort in awarding the contracts to small businesses. Federal regulations at 2 CFR 215.44(b) require subgrantees to take specific



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steps to ensure the use of small businesses, minority-owned firms, and women's business enterprises whenever possible. These steps include using the services and assistance of the Small Business Administration and the Minority Business Development Agency of the Department of Commerce to solicit and use these firms.

### *Cost or Price Analysis*

The Hospital awarded \$11,831,819 for four contracts without performing a cost or price analysis. The contracts included two contracts totaling \$9,707,417 million to clean up the hospital's basement and first floor, a contract for \$1,372,755 million to lease modular kitchens, and a \$751,647 contract to repair a damaged nurse call system. Federal regulations at 2 CFR 215.45 require some form of cost or price analysis and documentation in the procurement files in connection with every procurement action. The absence of a cost or price analysis increases the likelihood of unreasonable contract costs and misinterpretations or errors in pricing relative to scopes of work.

Regarding the lease on the modular kitchens, Hospital officials said that it was their only alternative. Hospital officials said they contacted three companies, and only one was responsive to their needs. Regardless, even when only one source is available all procurements require a cost or price analysis. Regarding the damaged nurse call system, Hospital officials said that they used the contractor who installed the prior nurse call system because he was familiar with the system. Although the use of a contractor familiar with a system may be a selection factor that a subgrantee considers in awarding a contract, it does not preclude the subgrantee from performing the required cost or price analysis.

### *Pre-Award Documentation*

The Hospital did not have documentation defining the scope of work for two contracts totaling \$4,957,475. On one \$3,584,720 contract, the Hospital discussed requests for proposals with four potential contractors for project administrative services. The initial proposals that contractors submitted indicated that the work related to insurance settlements rather than project administration. On the other contract, the Hospital leased modular kitchens for \$1,372,755 and did not provide documentation defining the scope of work. Federal Regulations at 2 CFR 215.44(a)(3)(i) and (ii) require that solicitations provide for a clear and accurate description of the technical requirements for the material, product, or service to be procured; requirements that the bidder/offeror must fulfill; and all other factors the subgrantee will use in evaluating bids or proposals.

Hospital officials said that exigent circumstances immediately following the flood would have made it difficult to make some of the contract requirements a condition in acquiring bids. Hospital officials also believed that because FEMA wrote the project



worksheets after discussing contracting issues with them that FEMA approved the projects.

Exigent circumstances do not negate the necessity to follow Federal regulations even when doing so is difficult. Federal regulations require a cost or price analysis and contract provisions for all contracts regardless of exigent circumstances. FEMA initially develops project worksheets to estimate disaster damages and obligate project funding; the project worksheet is not FEMA's approval of procurement procedures.

**Finding B: Grant Management Issues**

Some of the problems we identified in this report occurred because IDHS did not take a more proactive role in the Hospital's contracting activities. Federal regulations at 44 CFR 13.40(a) require grantees to manage the day-to-day operations of subgrant-supported activities and to monitor subgrant-supported activities to ensure compliance with applicable Federal requirements. IDHS was aware of the contract violations because its employees reviewed the Hospital's contracts; however, IDHS did not assist the hospital in bringing the contracts into compliance with Federal regulations. Hospital officials erroneously believed that Federal regulations did not apply to them and that FEMA's approval of the hospital's projects meant that FEMA approved the contracts. Because it is IDHS' responsibility to manage and monitor the Hospital's projects, IDHS should have taken actions to ensure that the Hospital complied with Federal regulations.

**RECOMMENDATIONS**

We recommend that the Regional Administrator, FEMA Region V:

**Recommendation #1:** Disallow \$10,931,981 (\$8,242,875 Federal share) as ineligible 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:** Direct IDHS to instruct the Hospital to comply with Federal procurement regulations in future disasters by—

- Not using prohibited cost-plus-percentage-of-cost contracts;
- Performing all procurements using open and free competition to the maximum extent practicable;
- Including required provisions in its contracts;
- Making positive efforts to use small businesses, minority-owned firms, and women's business enterprises whenever possible;



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- Performing a cost or price analysis on all procurements; and
- Documenting the project requirements in its solicitations (finding B).

### DISCUSSION WITH MANAGEMENT AND AUDIT FOLLOWUP

We discussed the results of our audit with Hospital officials during our audit and included their comments in this report, as appropriate. We also provided a draft report in advance to FEMA on September 5, 2013, and IDHS and Hospital officials on September 10, 2013, and discussed it at exit conferences held with FEMA officials on September 12, 2013, and with IDHS and Hospital officials on September 18, 2013. FEMA officials generally agreed with our findings but withheld comment until they receive the final report. IDHS and Hospital officials generally disagreed with our findings and recommendations.

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 the contact information for responsible parties and any other supporting documentation necessary to inform us about the current status of the recommendation. Until we receive 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 Christopher Dodd, Acting Director; Paige Hamrick, Audit Manager; William Lough, Auditor-in-Charge; and Jacob Farias, Auditor.

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



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Exhibit

## Schedule of Questioned Costs

Project Number	Category of Work	Net Award Amount	Questioned Costs (Finding A)
2066	E	\$62,278,273	\$7,718,277
2014	B	3,123,960	244,902
2013	B	3,092,243	113,479
1530	B	2,846,394	474,079
2073	E	1,082,763	51,238
2184	B	26,691	26,691
2348	E	1,059,102	22,124
1904	B	946,997	26,872
2210	B	4,906	4,906
2206	B	1,931	1,931
All Other Projects		<u>19,910,070</u>	<u>2,247,482</u>
Total		<u>\$94,373,330</u>	<u>\$10,931,981</u>



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Public Assistance Coordinator, Indiana Department of Homeland Security

**State**

Legislative Post Auditor, State of Indiana

**Subgrantee**

Attorney, Columbus Regional Hospital, Columbus, Indiana

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