



Homeland
Security

May 17, 2005

MEMORANDUM FOR: Gary Jones
Acting Regional Director, FEMA Region VI

D. Paige Hamrick
for

FROM: Tonda L. Hadley
Field Office Director

SUBJECT: *Central Rural Electric Cooperative, Inc.*
Stillwater, Oklahoma
FEMA Disaster Number 1401-DR-OK
Public Assistance Identification Number 000-U05EC-00
Audit Report Number DD-06-05

The Office of Inspector General (OIG) audited public assistance funds awarded to the Central Rural Electric Cooperative (CREC), located in Stillwater, Oklahoma. The objective of the audit was to determine whether CREC accounted for and expended Federal Emergency Management Agency (FEMA) funds according to federal regulations and FEMA guidelines.

CREC received an award of \$5.45 million from the State of Oklahoma, Oklahoma Department of Civil Emergency Management (ODCEM), a FEMA grantee, for damages caused by a severe winter ice storm during the period January 30, 2002, through February 11, 2002. The award provided 75 percent FEMA funding for three large projects¹. We audited all projects under the award (see Exhibit). The audit covered the period January 30, 2002, to May 13, 2004, during which CREC claimed \$5.45 million and ODCEM disbursed \$4.77 million in FEMA funds for direct program costs.

We performed the audit under the authority of the Inspector General Act of 1978, as amended, and according to generally accepted government auditing standards. The audit included tests of CREC's accounting records, judgmental samples generally based on dollar value of expenditures, and other auditing procedures considered necessary to accomplish the audit objective.

¹ Federal regulations in effect at the time of the disaster set the large project threshold at \$52,000.

RESULTS OF AUDIT

CREC did not account for and expend FEMA funds according to federal regulations and FEMA guidelines. Specifically, CREC awarded non-competitive time-and-materials contracts for \$3,239,787 that did not comply with federal procurement standards. As a result, fair and open competition did not occur and FEMA has no assurance that contract costs claimed were reasonable. Further, we questioned \$1,875,324 (\$1,406,493 FEMA share) of the total \$5,449,499 claimed (34.41 percent) for costs related to improperly procured contracts (\$1,802,562) and ineligible materials costs (\$72,762).

Finding A: Improper Contracting During and After the Emergency Period

CREC did not follow federal procurement standards or FEMA guidelines in awarding contracts totaling \$3,239,787 for utility and debris removal work. As a result, fair and open competition did not occur and FEMA has no assurance that contract costs claimed were reasonable. We questioned \$1,802,562 of contract costs claimed for work performed after February 27, 2002, when power was fully restored to all CREC customers. We questioned these costs because exigent circumstances no longer existed to justify CREC's non-compliance with federal procurement standards.

Federal procurement standards at 44 CFR 13.36:

- Require the performance of procurement transactions in a manner providing full and open competition except under certain circumstances. (13.36(c)).
- Allow procurement by noncompetitive proposals only when the award of a contract is infeasible under small purchase procedures [\$100,000 or less], sealed bids, or competitive proposals and certain circumstances apply. One acceptable circumstance is when the public exigency or emergency for the requirement will not permit a delay resulting from competitive solicitation. (13.36(d)(4)(i)).
- Require that sub-grantees maintain records sufficient to detail the significant history of the procurement, including the rationale for the method of procurement, the basis for contractor selection, and basis for the contract price. (13.36(b)(9)).
- Require subgrantees to maintain a contract administration system that ensures contractors perform in accordance with the terms, conditions, and specifications of their contracts or purchase orders. (13.36(b)(2)).
- Prohibit the use of time-and-material-type contracts unless a determination is made that no other contract is suitable and provided that the contract include a ceiling price that the contractor exceeds at its own risk. (13.36(b)(10)).
- Require a cost analysis when adequate price competition is lacking. (13.36(f)(1)).
- Require profit to be negotiated as a separate element of the price for each contract in which there is no price competition and in all cases where cost analysis is performed. (13.36(f)(2)).

To perform disaster work, CREC awarded five large-dollar (over \$100,000) time-and-material contracts totaling \$3,239,787 and procured services from nine small-dollar vendors totaling \$213,846. For the five large-dollar contracts, CREC did not (1) provide evidence of competition, (2) maintain records sufficient to detail its rationale for contractor selection, (3) perform a cost or price

analysis, (4) justify the use of time-and-material type contracts, (5) negotiate profit as a separate element of the price, or (6) provide for a not-to-exceed cost ceiling.

Before the disaster, CREC awarded two of the large-dollar contracts to perform routine and planned non-disaster work. One contract was for work on a unit basis for line-extension construction work, billable as units of productions (electrical pole sub-assemblies), and included supplementary hourly labor and equipment rates for use in the event of an emergency. The other pre-disaster contract was to provide right-of-way clearing, billable in linear feet, and also provided for the use of hourly labor and equipment rates for disaster cleanup and construction. Although CREC provided limited evidence that it may have performed an incomplete price comparison of line extension prices for the line extension construction contract negotiated, we found no evidence that the supplementary hourly labor and equipment rates used in the billing for disaster cleanup and construction were competitively procured. In fact, the emergency rates negotiated in the line extension construction contract did not stipulate the negotiated labor rates, stating only that CREC would pay for construction labor at the “actual rate of pay plus 100 percent of total labor cost.” After the disaster, CREC procured the three other large-dollar contractors without competition at hourly rates for labor and equipment. For these three contractors, CREC used verbal agreements and informal rate sheets rather than written contracts.

Further, CREC could not provide evidence of contract monitoring on any of the five contracts. Although a CREC official stated they assigned a monitor for every four or five contractor crews working, CREC did not maintain logs or records of contractor activity to compare to contractor billings. Therefore, even if contract monitoring occurred, it was not adequate. FEMA’s *Public Assistance Debris Management Guide* (FEMA 325, April 1999), p.28, states that supervision of time-and-material contracts is “extremely important” and that work inspection reports should be prepared each day. These reports should clearly state the amount of work performed that day in quantitative terms, especially the number of hours worked. Without adequate monitoring, CREC had no documentation to validate labor and equipment hours billed in contractor invoices. Contract monitoring is essential to ensure that contractors perform in accordance with the terms, conditions, and specifications of their contracts.

FEMA’s *Public Assistance Debris Management Guide* (FEMA 325, April 1999), p. 28, also states the following:

- Time-and-Material contracts should be limited to a maximum of 70 hours of actual emergency debris clearance work and should be used only after all available local, tribal and State government equipment has been committed.
- Time-and-Material contracts may be extended for a short period when absolutely necessary, for example, until appropriate Unit Price contracts have been prepared and executed.

In addition, FEMA’s *Public Assistance Guide* (FEMA 322, October 1999), p. 40, states:

- FEMA provides reimbursement for three types of contracts, lump sum, unit price, and cost plus fixed fee contracts.
- Time and material contracts should be avoided, but may be allowed for work that is necessary immediately after the disaster has occurred when a clear scope of work cannot be developed.
- Applicants must carefully monitor and document contractor expenses.

We considered the 4-week period after the ice storm occurred on January 30, 2002, to be the “emergency period” because power was not restored to all of CREC’s customers until February 27, 2002. We concluded that the lack of power constituted exigent circumstances that could have warranted the use of non-competitive, time-and-material type contracts because CREC likely did not have time to develop a clear scope of work until all power was restored.

Under 44 CFR 13.43(a)(2), *Remedies for noncompliance*, failure to comply with applicable statutes or regulations can result in the disallowance of all or part of the costs of the activity or action not in compliance. Although CREC did not follow procurement standards during the emergency period that are required even when exigent circumstances exists (e.g., justify the use of time-and-materials rates, negotiate profit separately, perform a cost analysis, or monitor contract performance), we did not question contract costs incurred during the 4-week emergency period on the basis of improper procurement procedures. However, we did question the \$1,802,562 of contractor costs incurred after the emergency period because, after CREC restored power to its customers, it should have solicited competitive bids for the remaining disaster work under lump sum, unit price, or cost plus fixed fee contracts. Instead, CREC continued to use non-competitive time-and-material contracts until May 23, 2003, 15 months after the power was fully restored on February 27, 2002.

Officials from CREC stated that ODCEM did not instruct them on proper federal procurement standards. According to 44 CFR 13.37(a)(2), states are responsible for ensuring that subgrantees are aware of requirements imposed upon them by federal statute and regulation. Further, 44 CFR 13.40(a) requires grantees to monitor subgrant supported activities to assure compliance with applicable federal requirements. CREC’s lack of compliance with federal procurement standards clearly demonstrates that ODCEM did not adequately monitor CREC’s activities under the subgrant.

Recommendations:

We recommend that the Regional Director, FEMA Region VI:

1. Disallow \$1,802,562 of ineligible contracting costs.
2. Require the Oklahoma Department of Civil Emergency Management to develop, document, and implement procedures for future disasters to: (a) provide subgrantees guidance on federal regulations, standards, and guidelines related to procurement and (b) monitor subgrantees to ensure compliance with those federal regulations, standards, and guidelines.

Finding B: Ineligible Materials Costs

CREC claimed \$1,009,255 for materials used in Project 588. Of this amount, \$72,762 was ineligible because CREC valued costs for some of the materials used in a manner inconsistent with its established accounting practices. Office of Management and Budget (OMB) Circular A-122, Attachment A, paragraph A.2(c) and (d), states that to be allowable under an award, costs must be accorded consistent treatment and must be consistent with policies and procedures that apply uniformly to both federally financed and other activities of the organization.

CREC’s established accounting practice was to cost materials at an average unit price developed from cumulative procurement history. CREC used this established practice for the majority of

material costs claimed, but arbitrarily claimed actual costs for some materials even though the average unit purchase price history was available. Therefore, for the materials claimed at actual cost, we questioned the \$72,762 difference between actual cost and average unit price cost.

Recommendation:

We recommend that the Regional Director, FEMA Region VI:

3. Disallow \$72,762 of ineligible material costs.

DISCUSSION WITH MANAGEMENT AND AUDIT FOLLOW-UP

We provided a discussion draft to CREC, ODCEM, and FEMA officials on April 13, 2005, and discussed the results of the audit with these officials on April 20, 2005. We revised the draft report to include comments made during the exit conference.

Please advise this office by August 15, 2005, of the actions taken or planned to implement our recommendations. Please include target completion dates for any planned actions.

If you have any questions concerning this report, please contact me at (940) 891-8900. The major contributors to this report were Paige Hamrick, Stuart Weibel, and Rebecca Rodriguez.

Schedule of Projects
 Central Rural Electric Cooperative, Inc.
 FEMA Disaster Number 1401-DR-OK

| <u>Project Number</u> | <u>Category Of Work</u> | <u>Amount Claimed</u> | <u>Amount Questioned</u> | <u>Finding Reference</u> |
|---------------------------|-----------------------------|---------------------------|------------------------------|------------------------------|
| <u>Large</u> | | | | |
| 588 | F | \$4,727,622 | \$1,472,785 | A, B |
| 585 | A | 587,951 | 402,539 | A |
| 587 | B | <u>133,926</u> | <u>0</u> | |
| Total | | <u>\$5,449,499</u> | <u>\$1,875,324</u> | |