



Homeland
Security

January 17, 2006

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

D. Paige Hamrick
for

FROM: Tonda L. Hadley
Field Office Director

SUBJECT: *Western Farmers Electric Cooperative, Anadarko, Oklahoma*
FEMA Disaster Number DR-1401-OK
Public Assistance Identification Number 000-U05EF-00
Audit Report Number DD-06-06

The Office of Inspector General (OIG) audited public assistance funds awarded to Western Farmers Electric Cooperative, (WFEC) Anadarko, Oklahoma. The objective of the audit was to determine whether the WFEC expended and accounted for Federal Emergency Management Agency (FEMA) funds according to federal regulations and FEMA guidelines.

WFEC received an award of \$11.1 million from the Oklahoma Department of Emergency Management (OEM), a FEMA grantee, for damages resulting from a severe winter ice storm beginning on January 30, 2002. The award provided 75 percent FEMA funding for four large projects.¹ The OIG examined the costs for four large projects totaling \$11.1 million, or 100 percent of the total award (see Exhibit). The audit covered the period January 30, 2002, to July 25, 2003, during which WFEC claimed \$11.1 million and OEM disbursed \$8.3 million in direct program costs.

The OIG 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 WFEC's accounting records, judgmental samples of project expenditures generally based on dollar amount or category of cost, and other auditing procedures considered necessary under the circumstances.

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

RESULTS OF AUDIT

WFEC did not expend and account for all FEMA funds according to federal regulations and FEMA guidelines. WFEC did not comply with federal procurement standards or FEMA guidelines in awarding \$7,947,354 of contracted utility and debris removal work. As a result, fair and open competition did not occur and FEMA has no assurance that the contract work was reasonable. Further, we identified questioned costs totaling \$4,112,646 (\$3,084,485 FEMA share), or 37 percent of the \$11,092,047 claimed as shown in the following table:

A—Improper contracting after the emergency period	\$3,480,799	
Less costs also questioned in Findings B, C, and F:		
Finding B	(222,825)	
Finding C	(7,266)	
Finding F	<u>(18,520)</u>	
Net amount questioned in Finding A		<u>\$3,232,188</u>
B—Ineligible Damages to Private Property		549,686
C—Unsupported Costs		234,210
D—Overstated Fringe		37,725
E—Duplicate Administrative Costs		36,080
F—Unallowable Markup		20,387
G—Work not Related to the Disaster		<u>2,370</u>
Total questioned costs		<u><u>\$4,112,646</u></u>

Finding A: Improper Contracting

WFEC did not comply with federal procurement standards or FEMA guidelines in awarding contracts totaling \$7,947,354 for contracted utility and debris removal work. As a result, fair and open competition did not occur and FEMA has no assurance that the contract work was reasonable. We questioned \$3,480,799 of contract costs claimed for work performed after February 28, 2002, when power was fully restored to all WFEC customers. We did not question costs prior to February 28, 2002, because we considered the lack of power to be a threat to public health or safety, which constitutes an exigent circumstance. However, after WFEC fully restored power, the exigent circumstance no longer existed; and WFEC should have complied with 44 CFR 13.36. As shown in the table above, we also questioned \$248,611 (\$222,825+\$7,266+\$18,520) of the \$3,480,799 in Findings B, C, and F. Therefore, if FEMA disallows all of the costs questioned in Findings B, C, and F, the net amount questioned in Finding A will be \$3,232,188, which is the amount we recommend for disallowance.

Procurement standards at 44 CFR 13.36 describe minimum federal procurement standards for subgrantees:

- Conducting all procurement transactions in a manner providing full and open competition (44 CFR 13.36(c)(1)). Noncompetitive procurement may be used only under certain circumstances (44 CFR 13.36(d)(4)(i)), one of which is when the public exigency or

emergency for the requirement will not permit a delay resulting from competitive solicitation. (44 CFR 13.36(d)(4)(i)(B)).

- Maintaining 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 (44 CFR 13.36(b)(9)).
- Maintaining a contract administration system that ensures contractors perform in accordance with the terms, conditions, and specifications of their contracts or purchase orders (44 CFR 13.36(b)(2)).
- Performing a cost or price analysis in connection with every procurement action, including contract modifications (44 CFR 13.36(f)(1)).
- Using time-and-material-type contracts only when no other contract is suitable and provided that the contract includes a ceiling price that the contractor exceeds at its own risk (44 CFR 13.36(b)(10)).
- Negotiating profit 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 (44 CFR 13.36(f)(2)).

WFEC did not require competitive bids for utility line repairs and debris removal. Instead, they selected contractors based on past work history or from referrals by other electric cooperatives. The selected contractors provided rate sheets; and WFEC awarded the work using time-and-material purchase orders without cost ceilings. Further, WFEC did not analyze the proposed contractor costs for reasonableness and did not negotiate contractor profits as a separate element of costs. WFEC officials stated that they considered the cost of work reasonable if it was \$200,000 or less per mile of utility line. However, we could not evaluate WFEC's measure of reasonableness because it had no support for its determination.

In addition, WFEC did not adequately monitor the work of contractor crews. WFEC stated that they did monitor the number of miles the crews advanced on a daily basis. However, they did not maintain logs or reports that documented contractor activities to compare to contractor invoices. Without proper documentation, WFEC could not verify charges for labor and equipment. FEMA's *Public Assistance Guide* (FEMA 322, October 1999, page 40) states that applicants should avoid time-and-material contracts, but if they are used, applicants must carefully monitor and document contractor expenses and include a cost ceiling provision in the contract.

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. However, we did not question costs solely based on noncompliance with procurement regulations because WFEC incurred the costs for eligible work and we saw no way to determine how much the costs would have been if they had provided full and open competition on the contracts. We considered the period January 30, 2002, when the ice storm occurred, through February 28, 2002, when WFEC fully restored power to all its customers, to be an "emergency period" that constituted exigency because life and property were at stake. Therefore, we questioned only those contract costs incurred after February 28, 2002 when power was restored and the exigent circumstance no longer existed.

Both WFEC and OEM should be aware that, while exigent circumstances may justify the use of non-competitive, time-and-material contracts, they do not justify not following other procurement standards imposed to ensure the reasonableness of contract costs. WFEC should have performed a

cost analysis, negotiated profit as a separate element of costs, set a realistic ceiling price, and monitored contract performance using daily activity logs.

WFEC officials stated that OEM did not instruct them on proper federal procurement standards and told them that they could follow their normal procurement procedures. According to 44 CFR 13.37(a)(2), grantees are responsible for ensuring that subgrantees are aware of requirements imposed upon them by Federal statute and regulation. While 13.36 (b)(1) does state that grantees and subgrantees will use their own procurement procedures, which reflect applicable State and local laws and regulations, it also requires that those procurement procedures conform to applicable Federal law and standards identified in 44 CFR 13.36 (b) through (i). In addition, 13.40(a) states that grantees are responsible for managing the day-to-day operations of grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to assure compliance with applicable federal requirements and the achievement of performance goals.

Further, KPMG, LLP an accounting firm that performed WFEC's A-133 audit (Office of Management and Budget (OMB) Circular A-133), identified WFEC's lack of procurement procedures as an issue in the audit for year ended December 31, 2002. KPMG questioned the entire FEMA share of \$5,960,516² contracting costs in excess of the \$25,000³ small purchase threshold. KPMG, LLP reported that WFEC was unable to provide evidence documenting the performance of a cost or price analysis as required by OMB Circular A-110. Therefore, WFEC was aware of its improper contracting procedures and, in response to the A-133 audit, documented new contracting procedures in September 2003. During our audit, we advised WFEC that its 2003 procedures were not adequate because they did not reflect all of the procurement standards required by federal regulations. In response, WFEC revised its contracting procedures again in June 2004 to include language requiring WFEC staff to follow all requirements listed in 44 CFR 13.36.

Recommendation:

We recommend the Regional Director, FEMA Region VI:

1. 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.
2. Disallow \$3,232,188 of contract costs that WFEC incurred that did not meet minimum federal procurement standards. This amount is net of costs that we also questioned in Findings B, C, and F.

² KPMG questioned costs of \$5,960,516 is the 75 percent FEMA share of WFEC's total claimed contract cost of \$7,947,354.

³ KPMG used the \$25,000 small purchase threshold cited in OMB circular A-110 (revised 11/19/93, as further amended 9/30/99) for the cut-off amount for requiring contracts to be conducted in a manner providing full and open competition. However, according to 44 CFR 13.36 (d)(1), the correct small purchase threshold for FY 2002 was \$100,000.

Finding B: Ineligible Damages to Private Property

WFEC claimed \$549,686 for damages to private property. However, the entire claimed amount is ineligible because the damages did not pose a threat to public health or safety. FEMA Publication 321, October 2001, *Public Assistance Policy Digest*, page 94, states that if an eligible applicant damages private property while performing eligible work, repairs to that property are not eligible unless the damages result in a health or safety risk. WFEC paid \$291,257 of ineligible costs directly to landowners or leaseholders of the land for repairs resulting from damages caused by work crews gaining access to right-of-ways to repair damaged transmission lines. WFEC paid an additional \$222,825 to contractors who made repairs to private property. WFEC also claimed \$35,604 for materials taken from inventory to build steel gates to replace wire gates on damaged private property or gates that were not wide enough to allow equipment access to right-of-ways to repair electrical transmission lines. Accordingly, we questioned the entire \$549,686 as ineligible damages to private property.

We also identified the following additional issues regarding the eligibility of these costs:

- WFEC paid damages to private property based on estimates rather than actual costs. According to 44 CFR 13.20(b)(2) and (6), subgrantees must maintain accounting records that adequately identify the source and application of funds provided and the accounting records must be supported by such source documentation as cancelled checks, paid bills, payrolls, time and attendance records, contract and subgrant award documents. Further, 44 CFR 206.205(b) states that Grantees shall make an accounting of eligible costs for each approved project.
- The costs included those for plowing, smoothing, fertilizing, and reseeding cropland or pastureland. As stated in 44 CFR 206.221(d), land used for agricultural purposes is not improved property, therefore, it is ineligible for FEMA funding.
- The costs included those for replacing numerous wire gates with steel gates. According to the Stafford Act section 406(e)(1), the cost of repairing, restoring, reconstructing, or replacing a public facility or private nonprofit facility on the basis of the design of such facility as it existed immediately prior to the major disaster and in conformity with current applicable codes, specifications, and standards are eligible costs. Therefore, the costs for replacing wire gates with steel gates is not an eligible expense.
- The costs included estimated lost production costs for crop damages. According to 44 CFR 206.221(d), land used for agricultural purposes is not improved property and is therefore not eligible for FEMA funding.

Recommendation:

We recommend the Regional Director, FEMA Region VI:

3. Disallow \$549,686 of ineligible damages to private property.

Finding C: Unsupported Costs

WFEC did not provide adequate source documentation for \$234,210 of claimed force account and contract costs. The unsupported costs included the following:

- \$185,370 for force account [WFEC] employee per diem expenses claimed without proper documentation such as receipts, expense reports, or signed work logs designating that the employees were working on approved disaster projects when they incurred the per diem expenses.
- \$41,130 for contractor per diem claimed without supporting documentation.
- \$4,400 for freight costs based on an estimate, rather than actual documented costs.
- \$2,866 that WFEC paid to contractors for rock and dirt without supporting documentation.
- \$444 for force account overtime costs claimed for WFEC employees who did not receive payment for the overtime.

According to 44 CFR 13.20(b)(2), a subgrantee must maintain accounting records that adequately identify the source and application of federal funds. Additionally, 44CFR 13.20(b)(6) provides a list of adequate source documentation including cancelled checks, paid bills, payrolls, time and attendance records, and contract award documents that are acceptable accounting records. WFEC did not provide sufficient records to document the above-referenced costs. Accordingly, we questioned the \$234,210 as unsupported costs.

Recommendation:

We recommend the Regional Director, FEMA Region VI:

4. Disallow \$234,210 of unsupported costs.

Finding D: Overstated Fringe Benefits

WFEC's claim included \$37,725 in overstated fringe benefits. WFEC erroneously applied a higher-than-normal fringe benefit rate to labor costs for its employees, which resulted in an overstatement of \$37,725. OMB Circular A-122 Attachment B, 7. f (2) states that fringe benefits are allowable, but will be distributed to particular awards and other activities in a manner consistent with the pattern of benefits accruing to the individuals or groups of employees whose salaries and wages are chargeable to such awards and other activities. Therefore, we questioned the \$37,725 overstated fringe benefits.

Recommendation:

We recommend the Regional Director, FEMA Region VI:

5. Disallow \$37,725 of overstated fringe benefits.

Finding E: Duplicate Administrative Costs

WFEC's claim included \$36,080 of duplicate administrative costs. The duplicate costs consisted of \$34,741 paid to administrative and management personnel who were not engaged in disaster related field activities and \$1,339 for the use of an airplane to assess damages caused by the disaster. According to 44 CFR 206.228(a)(2)(ii), the subgrantee's administrative allowance covers the necessary costs of requesting, obtaining, and administering federal disaster assistance. Further, FEMA's *Public Assistance Guide* (FEMA 322, October 1999, page 36) explains that costs for force account labor is eligible only if the employees are engaged in disaster related field activities. Accordingly, we questioned the \$36,080 as duplicate costs because reimbursement for the costs of such activities is limited to the subgrantee's administrative allowance.

Recommendation:

We recommend the Regional Director, FEMA Region VI:

6. Disallow \$36,080 of duplicate administrative costs.

Finding F: Unallowable Markups

WFEC's claim included \$20,387 in unallowable markups on contractor billings. Contractors applied a 10 percent markup on pass-through costs from subcontractor billings. In addition, the subcontractor costs contained markups ranging from 10 to 20 percent on various expense items. According to 44 CFR 13.36(f)(4), the cost-plus-a-percentage-of-cost method of contracting shall not be used. Therefore, we questioned the \$20,387 of unallowable markups.

Recommendation:

We recommend the Regional Director, FEMA Region VI:

7. Disallow \$20,387 in unallowable markups on contact costs.

Finding G: Work not Related to the Disaster

WFEC included \$2,370 in their claim for contract work that occurred before the ice storm began on January 30, 2002. According to 44 CFR 206.223(a)(1), to be eligible, work must be required as the result of the major disaster event. Accordingly, we questioned \$2,370 as ineligible work not related to the disaster.

Recommendation:

We recommend the Regional Director, FEMA Region VI:

8. Disallow \$2,370 of ineligible costs for work not related to the disaster.

DISCUSSION WITH MANAGEMENT AND AUDIT FOLLOW-UP

We discussed the results of the audit with officials from FEMA Region VI, ODCEM, and WFEC on November 7, 2005. WFEC officials disagreed with Findings A and C, but agreed with the remaining findings and recommendations.

Please advise us by March 19, 2006, of the actions taken or planned to implement the recommendations, including target completion dates for any planned actions. If you have questions concerning this report, please call Paige Hamrick at (940) 891-8900. Major contributors to this report were Paige Hamrick, Charles Riley, Jerry Meeker, and Jerry Prem.

EXHIBIT

**Schedule of Audited Projects
Western Farmers Electric Cooperative, Inc., Anadarko, Oklahoma
FEMA Disaster Number 1401-OK**

Project Number	Amount Claimed/ Audited	(a) Amount Questioned Finding A	(b) Amounts Questioned Findings B, C, F	(c) Amounts in Findings B, C, F Questioned in A	(d) Net Amount Questioned Finding A (a-c)	Total Amount Questioned (b+d)
595	\$ 3,055,507	\$ 0	\$ 44,821	\$ 0	\$ 0	\$ 44,821
596	7,487,825	3,220,407	549,238	192,529	3,027,878	3,577,116
615	483,001	260,392	274,136	56,082	204,310	478,446
617	<u>65,713</u>	<u>0</u>	<u>12,263</u>	<u>0</u>	<u>0</u>	<u>12,263</u>
Total	<u>\$11,092,047</u>	<u>\$3,480,799</u>	<u>\$880,458</u>	<u>\$248,611</u>	<u>\$3,232,188</u>	<u>\$4,112,646</u>