



# Homeland Security

August 5, 2011

MEMORANDUM FOR: Tony Russell  
Regional Administrator  
FEMA Region VI

FROM: Matt Jadacki   
Assistant Inspector General  
Office of Emergency Management Oversight

SUBJECT: *FEMA Public Assistance Grant Funds Awarded to Saint Mary's Academy, New Orleans, Louisiana*  
FEMA Disaster Number 1603-DR-LA  
Public Assistance Identification Number 071-02E99-00  
Audit Report DD-11-15

We audited public assistance funds awarded to St. Mary's Academy (SMA), in New Orleans, Louisiana. Our audit objective was to determine whether SMA accounted for and expended Federal Emergency Management Agency (FEMA) grant funds according to federal regulations and FEMA guidelines.

SMA received an award of \$56.4 million from the Louisiana Governor's Office of Homeland Security and Emergency Preparedness (GOHSEP), a FEMA grantee, for damages resulting from Hurricane Katrina, which occurred on August 29, 2005. The award provided 100% FEMA funding for 18 large and 19 small projects.<sup>1</sup> The audit covered the period August 29, 2005, through December 09, 2010, the cutoff date of our audit, and included 12 projects totaling \$53.5 million, or 94.8%, of the total award.<sup>2</sup> As of the cutoff date of our audit, SMA had claimed \$46.1 million (net of insurance proceeds).

The table below shows the gross and net award and claimed amounts before and after insurance reductions for all projects and for our audit scope.

	Gross Award Amount	Gross Claim Amount	Insurance Reductions	Net Award Amount	Net Claim Amount
All Projects	\$60,213,247	\$49,911,570	\$(3,807,232)	\$56,406,015	\$46,104,338
Audit Scope	\$56,270,233	\$45,281,614	\$(2,818,788)	\$53,451,445	\$42,462,826

<sup>1</sup> Federal regulations in effect at the time of the disaster set the large project threshold at \$55,500.

<sup>2</sup> We audited the gross amount of \$56.3 million awarded before reductions for insurance.

We conducted this performance audit 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 based upon the statutes, regulations, and FEMA policies and guidelines in effect at the time of the disaster.

We interviewed FEMA, GOHSEP, and SMA officials; reviewed judgmentally selected transactions (generally based on dollar value); and performed other procedures considered necessary to accomplish our objective. We did not assess the adequacy of SMA's internal controls applicable to grant activities because it was not necessary to accomplish our audit objective. We did, however, gain an understanding of SMA's method of accounting for disaster-related costs and its procurement policies and procedures.

## **BACKGROUND**

Before Hurricane Katrina, SMA was a private, historically African-American, nonprofit Catholic girls' school for middle and high school students. After Katrina, it added elementary classes and became coeducational through the middle school grades. SMA is operated by the Sisters of the Holy Family.

Floodwaters from Hurricane Katrina inundated the campus with more than 4 feet of water for more than 2 weeks. As a result, the campus was destroyed, and the facilities were rebuilt primarily with FEMA funding. After Katrina, SMA operated on offsite temporary campuses before moving back to its permanent campus in August 2007 to occupy temporary-use modular classrooms. Construction on permanent, new educational facilities began in 2009 and was substantially completed in March 2011.

## **RESULTS OF AUDIT**

SMA accounted for FEMA grant funds on a project-by-project basis according to federal regulations and FEMA guidelines. However, SMA did not follow federal procurement standards in awarding \$18,843,445 in contracts; claimed \$60,036 of ineligible legal costs and \$55,620 of ineligible contract costs; and did not purchase all required insurance for its new facility, which will cost more than \$33.7 million. Additionally, FEMA had not allocated \$1,523,507 of insurance proceeds to SMA's projects. Therefore, we recommend that FEMA disallow \$18,307,266 for improperly procured contracts, \$60,036 of ineligible legal costs, \$55,620 of ineligible contract costs, \$31,191,581 for the uninsured value of the facility, and \$1,523,507 of insurance proceeds to be allocated to SMA's projects.<sup>3</sup>

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<sup>3</sup> The recommended amounts for disallowance are net of costs questioned in multiple findings (see Exhibit A, Schedule of Questioned Costs).

## **Finding A: Contracting**

SMA did not follow federal procurement standards in awarding eight contracts totaling \$18,843,445. Federal regulations at 2 CFR 215 require the following, among other things:

- All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition. (2 CFR 215.43)
- Contractors that develop or draft specifications, requirements, statements of work, invitations for bids and/or requests for proposals, shall be excluded from competing for such procurements. (2 CFR 215.43)
- A description, whenever practicable, of technical requirements in terms of functions to be performed or performance required, including the range of acceptable characteristics or minimum acceptable standards (2 CFR 215.44(a)(3)(iii)) and the specific features of “brand name or equal” descriptions that bidders are required to meet when such items are included in the solicitation.” (2 CFR 215.44(a)(3)(iv))
- “Cost-plus-a-percentage-of-cost” methods of contracting shall not be used. (2 CFR 215.44(c))
- Specific provisions shall be included in all contracts and subcontracts. (2 CFR 215.48 and Appendix A)

SMA awarded eight noncompetitive contracts (\$18,843,445), gave unfair competitive advantage to a subcontractor, and paid one contractor on a prohibited cost-plus-percentage-of-cost basis. Additionally, SMA did not include all required provisions in any of its contracts.

### **Open and Free Competition**

*Limited Contractors* – SMA did not publicly advertise eight contracts awarded for \$18,843,445. SMA limited competition by not advertising or otherwise publicizing its procurements to potential qualified bidders. Federal regulations at 2 CFR 215.43 require that 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.

SMA representatives stated that FEMA and GOHSEP personnel told them they only needed to obtain three bids to comply with federal regulations. As a result, SMA did not advertise all procurements. However, SMA officials advertised two subsequent awards totaling \$36.1 million.

*Preparation of Bid Specifications* – SMA also gave unfair competitive advantage to a subcontractor, Southwest Design Build LLC (Southwest), on an \$8.7 million contract, by allowing Southwest to prepare drawings and specifications for the scope of work. Federal regulations (2 CFR 215.43) state that contractors who develop specifications or statements of the work should be excluded from competing for such procurements.

*Identified Subcontractor* – SMA also gave Southwest an additional advantage on the same contract because it identified “Southwest or equal” in its request for bid documents but did not describe the specific technical requirements that would equal Southwest’s product. Specifically, an amendment to the request for bids stated, “The following items are to be provided by

Southwest Design Build LLC **or equal** [emphasis added]: Foundations, elevated walkways w/steps & ramps, railings & gates, overhead metal coverings & supports, modular buildings w/all finishes, all plumbing fixtures & stall dividers, and all lighting fixtures.” SMA provided no further description of the *equal* requirements in the request for bids; therefore, there was insufficient detail for competitors to identify what was meant by “or equal,” as required by 2 CFR 215.44(a)(3)(iii) and (iv). The work associated with Southwest’s scope totaled \$4.9 million, or 56% of the \$8.7 million contract award.

### Prohibited Contract Billings

SMA paid a contractor \$528,303 on a prohibited cost-plus-percentage-of-cost basis for “reimbursables” and change orders under a professional services contract. Federal regulations (2 CFR 215.44(c)) state that the cost-plus-percentage-of-cost contract method shall not be used. This type of billing arrangement provides an incentive for the contractor to incur as much cost as possible. Additionally, SMA’s contract stated that either these costs would be billed to SMA without markup or SMA would pay the costs directly without markup. As a result, the contractor’s billings not only violated federal procurement regulations, but also were not allowed under the terms of the contract. SMA officials said that FEMA and GOHSEP approved the contract terms before the contractor billed the reimbursables; however, SMA has not provided documentation to support this statement.

### Required Clauses

None of SMA’s contracts and subcontracts contained all the contract provisions required by 2 CFR 215.48 and Appendix A. These provisions document the rights and responsibilities of the parties and minimize the risk of misinterpretations and disputes.

FEMA’s practice has been to allow contract costs it considers reasonable, regardless of whether the contract complies with federal procurement regulations. We do not agree with this practice unless lives and property are at stake, because the goals of proper contracting relate to more than just cost. Without open and free competition, FEMA has little assurance that contract costs are reasonable. Open and free competition usually increases the number of bids received and thereby increases the opportunity for obtaining reasonable pricing from the most qualified contractors. Open and free competition also helps to discourage and prevent favoritism, collusion, fraud, waste, and abuse.

Because SMA did not follow federal procurement regulations in awarding its contracts, we question \$18,843,445 of improperly contracted costs. Of this amount, \$536,179 is questioned again in Findings B, C, and D for different reasons. Therefore, the net amount of costs questioned for improperly procured contracts is \$18,307,266 (see Exhibit A, Schedule of Questioned Costs).

### **Finding B: Legal Costs**

SMA’s claim included \$60,036 of ineligible legal fees. SMA’s architect billed monthly retainer fees for legal services as “reimbursables” (costs in addition to the architect’s fee) under its

contract with SMA. According to 44 CFR 206.223 (a)(1), work must be required as a result of the disaster to be eligible for FEMA funding. Further, the *FEMA Public Assistance Guide* (FEMA 322/October 1999, p. 33) states, “Generally costs that can be tied to the performance of eligible work are eligible. Such costs must be reasonable and necessary to accomplish the work.” Because attorney’s retainer fees are not necessary to accomplish the work, we question the \$60,036 of legal fees as ineligible. SMA officials said that FEMA and GOHSEP public assistance staff proposed this billing arrangement; however, SMA has not provided documentation to support this statement. FEMA agreed that these legal costs as characterized would not be eligible.

### **Finding C: Contract Terms**

SMA’s claim included \$55,620 of contract costs that were not billed according to contract terms. SMA’s contract specified billing rates for additional work. When SMA authorized the contractor to perform the additional work, the contractor billed SMA at rates higher than specified in the contract. The contract was not amended for the increased billing rates; however, during the audit, SMA and the contractor provided a statement that they had an understanding that this work could be billed at the higher rates. The amount billed for this work was \$135,083, a \$55,620 increase (70%) to the \$79,463 billing allowed under the contract rates. SMA said that the additional work was on an exigent basis for redesign work that FEMA ordered.

This increase in costs did not fund any significant change in scope of work beyond the redesign, and these costs were billed on a prohibited cost-plus basis (see Finding A), which further increased costs. In addition, around the time when the contractor billed these higher rates, SMA had filed an appeal to FEMA requesting more than a \$1,000,000 increase (32%) for the contractor’s base fee. FEMA subsequently approved the appeal. This increase in the base fee was not a result of a change in the scope of work. After FEMA’s approval, the final base fee (which did not include the billing rate increase discussed above or the cost-plus increase in Finding A) was 47% higher than set forth in the *FEMA Public Assistance Guide* (322/October 1999) for engineering and design services of “above-average complexity.” Therefore, the overall cost of the contractor’s services was unreasonable, and FEMA should not allow any further increase in costs.

Accepting contract prices at rates higher than stipulated in a contract is a waste of federal funds, encourages abuse of the contract process, and invites acts of fraud. Because SMA claimed costs in excess of the terms in the contract, we question \$55,620 as ineligible contract costs. SMA officials said that these funds should be allowed because FEMA and GOHSEP proposed and approved the increased rates.

### **Finding D: Flood Insurance Requirement**

SMA was underinsured for flood losses, with only a \$1.0 million flood policy to cover the SMA campus. Costs to replace SMA’s destroyed facilities will exceed \$33.7 million. Federal regulations require applicants to obtain and maintain flood insurance in the amount of the eligible disaster assistance as a condition of receiving federal assistance that may be available (44 CFR 206.252(d)). SMA officials told us that they were working to get a waiver to the requirement for

obtaining the full amount of insurance. However, if SMA is unable to obtain the waiver or the required amount of insurance, FEMA should disallow the uninsured portion of eligible claimed costs (\$32,715,088 as of December 2010). Of this amount, \$1,523,507 of insurance allocations is also questioned in Finding E; therefore, we question the net amount of \$31,191,581 (see Exhibit A, Schedule of Questioned Costs). SMA officials agreed with this finding.

### **Finding E: Insurance Allocation**

SMA received \$3,807,232 of insurance proceeds for its losses. During the audit, SMA asked FEMA to reduce the insurance allocation to one of its projects by \$1,523,507 until FEMA had processed SMA's requests for increased funding for several projects (primarily claims for contractor change orders). According to 44 CFR 206.253(a), eligible costs must be reduced by the actual amount of insurance proceeds relating to the eligible costs. Therefore, FEMA should allocate \$1,523,507 of insurance proceeds to SMA's projects and disallow those amounts from the projects as ineligible. SMA officials agreed with this finding.

## **RECOMMENDATIONS**

We recommend that the Regional Administrator, FEMA Region VI:

**Recommendation # 1:** Disallow \$18,307,266 (\$18,307,266 federal share) of improperly contracted costs that were ineligible (Finding A).

**Recommendation # 2:** Disallow \$60,036 (\$60,036 federal share) of ineligible legal costs (Finding B).

**Recommendation #3:** Disallow \$55,620 (\$55,620 federal share) of ineligible contract costs that exceeded agreed-upon rates (Finding C).

**Recommendation # 4:** Disallow the ineligible, uninsured portion of SMA's new facility totaling \$31,191,581 (\$31,191,581 federal share) unless SMA obtains and maintains additional flood insurance to cover the full amount of eligible disaster assistance provided for the new facility (Finding D).

**Recommendation #5:** Allocate \$1,523,507 (\$1,523,507 federal share) of insurance proceeds to SMA's projects and disallow those amounts from the projects as ineligible (Finding E).

## **DISCUSSION WITH MANAGEMENT AND AUDIT FOLLOWUP**

We discussed the results of our audit with SMA officials during our audit and included their comments in this report, as appropriate. We also provided written summaries of our findings and recommendations in advance to FEMA, GOHSEP, and SMA officials and discussed them at exit conferences held with FEMA on June 23, 2011, and with GOHSEP and SMA officials on June 29, 2011. FEMA officials stated they would not agree to deobligate the value of any improperly

procured contracts identified in Finding A if the costs are reasonable, and that they needed to further assess Findings B (Legal Costs) and C (Contract Terms). GOHSEP and SMA withheld comments and agreed to work together to resolve the issues.

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 your response is received and evaluated, the recommendations will be considered open and unresolved.

Consistent with our responsibility under the *Inspector General Act*, we are providing copies of our report to appropriate congressional committees with oversight and appropriation responsibility over the Department of Homeland Security. To promote transparency, this report will be posted to our website, with the exception of sensitive information identified by your office. Significant contributors to this report were Tonda Hadley, Paige Hamrick, William Haney, and Rebecca Hetzler.

Should you have questions concerning this report, please contact me at (202) 254-4100 or Tonda Hadley at (214) 436-5200.

cc: Executive Director (Acting), FEMA Louisiana Recovery Office  
Audit Liaison, FEMA Louisiana Recovery Office  
Audit Liaison, FEMA Region VI  
Audit Liaison, FEMA (Job Code G-11-011)  
Audit Liaison, DHS

Schedule of Questioned Costs  
 Saint Mary's Academy  
 FEMA Disaster Number 1603-DR

<b>Project Number</b>	<b>Net Award Amount</b>	<b>Net Claimed Amount</b>	<b>Finding A</b>	<b>Finding B</b>	<b>Finding C</b>	<b>Finding D<sup>4</sup></b>	<b>Finding E</b>	<b>Total Questioned Costs</b>
18696	\$23,005,886	\$18,500,581	\$ 420,523	\$ 0	\$ 0	\$26,673,261	\$1,523,507	\$28,617,291
15985	8,704,967	12,023,493	8,704,967	0	0	0	0	8,704,967
18961	7,222,082	6,304,815	620,278	22,518	0	6,041,827	0	6,684,623
18853	5,311,181	2,665,479	4,699,826	37,518	55,620	0	0	4,792,964
18994	4,601,865	0 <sup>5</sup>	3,328,860	0	0	0	0	3,328,860
18626	3,315,274	1,732,319	0	0	0	0	0	0
17387	1,210,250	1,156,199	1,068,991	0	0	0	0	1,068,991
16249	38,404	38,404	0	0	0	0	0	0
11881	19,212	19,212	0	0	0	0	0	0
16236	14,400	14,400	0	0	0	0	0	0
3253	<u>7,924</u>	<u>7,924</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Subtotals	<u>\$53,451,445</u>	<u>\$42,462,826</u>	<u>\$18,843,445</u>	<u>\$60,036</u>	<u>\$55,620</u>	<u>\$32,715,088</u>	<u>\$1,523,507</u>	<u>\$53,197,696</u>
Less amount also questioned in B			<u>\$ (60,036)</u>					<u>\$ (60,036)</u>
Less amount also questioned in C			<u>\$ (55,620)</u>					<u>\$ (55,620)</u>
Less amount also questioned in D			<u>\$ (420,523)</u>					<u>\$ (420,523)</u>
Less amount also questioned in E						<u>\$(1,523,507)</u>		<u>\$(1,523,507)</u>
Net Questioned Costs <sup>6</sup>			<u>\$18,307,266</u>	<u>\$60,036</u>	<u>\$55,620</u>	<u>\$31,191,581</u>	<u>\$1,523,507</u>	<u>\$51,138,010</u>

<sup>4</sup> The amount questioned in Finding D is based on total contracts that SMA awarded under Project 18696 as of December 2010, which exceeded the original project funding. At that time, FEMA had not determined the total eligible costs for the project.

<sup>5</sup> Amounts claimed are as of December 2010, and GOHSEP had not yet allocated SMA's claims to reflect cost revisions or transfers between projects. Also, amounts claimed are net of insurance proceeds and include costs that, for some projects, are subject to FEMA approval because the claimed amounts exceeded the awarded amounts.

<sup>6</sup> We question improper contracting costs in Finding A and insurance requirements in Finding D in our report that, in some instances, were questioned for more than one reason. As shown in the table above, we questioned \$60,036 in Finding B, \$55,620 in Finding C, and \$420,523 in Finding D that were also questioned in Finding A. Also shown, we questioned \$1,523,507 in Finding E that was also questioned in Finding D. Therefore, if FEMA does not disallow the costs for Findings B, C, and D, FEMA should add them back to the amount recommended for disallowance in Finding A. Similarly, if FEMA does not disallow the costs for Finding E, it should add them back to the amount recommended for disallowance in Finding D.