OFFICE OF INSPECTOR GENERAL

Capacity Audit of FEMA Grant Funds Awarded to the U.S. Virgin Islands Housing and Finance Authority

Homeland Security

May 4, 2020

OIG-20-29

DHS OIG HIGHLIGHTS

Capacity Audit of FEMA Grant Funds Awarded to the U.S. Virgin Islands Housing and Finance Authority

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Why We Did This Audit

DHS Office of Inspector General contracted with KPMG LLP to conduct an audit to determine whether FEMA ensured that VITEMA and VIHFA established and implemented policies, procedures, and practices to make sure PA grant funds are accounted for and expended according to Federal regulations and FEMA guidance.

What We Recommend

We made seven recommendations to improve VITEMA's and VIHFA's management of PA funds and ensure they are expended according to Federal regulations and FEMA guidance.

For Further Information:
Contact our Office of Public Affairs at (202) 981-6000, or email us at DHS-OIG.OfficePublicAffairs@oig.dhs.gov

What We Found

KPMG found that the Federal Emergency Management Agency (FEMA) did not provide adequate guidance to the Virgin Islands Territorial Emergency Management Agency (VITEMA) and Housing Finance Authority (VIHFA). KPMG also found that VITEMA and VIHFA did not adequately manage FEMA PA funds. Specifically, VIHFA did not have:

- an adequate financial system to verify the completeness and accuracy of costs on a project-by-project basis or enough staff to adequately manage FEMA funding;
- sufficient oversight of contractors and subcontractors and any requirement for supporting documentation for all costs incurred;
- policies and procedures to ensure accurate recording of management costs; and
- adequate procurement policies, procedures, and business practices to comply with Federal procurement regulations.

Also, VITEMA and VIHFA did not always ensure the accuracy of project funding information or promptly notify FEMA about significant project cost overruns.

This occurred because FEMA did not provide the necessary guidance to and oversight of VITEMA and VIHFA to properly manage PA funds. Because of these deficiencies, PA programs are at increased risk of mismanagement and expenditure of funds for unallowable activities.

FEMA's Response

FEMA concurred with all seven recommendations and took or plans to take corrective action. Appendix C includes FEMA's response in its entirety.

OFFICE OF INSPECTOR GENERAL
Department of Homeland Security

Washington, DC 20528 / www.oig.dhs.gov

May 4, 2020

MEMORANDUM FOR: Thomas Von Essen
Regional Administrator, Region II
Federal Emergency Management Agency

FROM: Sondra F. McCauley
Assistant Inspector General for Audits

SUBJECT: *Capacity Audit of FEMA Grant Funds Awarded to the U.S. Virgin Islands Housing and Finance Authority*

Attached for your action is our final report, *Capacity Audit of FEMA Grant Funds Awarded to the U.S. Virgin Islands Housing and Finance Authority.* We incorporated the formal comments provided by your office.

The report contains seven recommendations aimed at improving the USVI Housing Finance Authority. Your office concurred with the seven recommendations. Based on information provided in your response to the draft report, we consider recommendations 5 and 7 resolved and closed. We consider recommendations 1, 2, 3, 4 and 6 resolved and open. Once your office has fully implemented the recommendations, please submit a formal closeout letter to us within 30 days so that we may close the open recommendations. The memorandum should be accompanied by evidence of completion of agreed-upon corrective actions and of the disposition of any monetary amounts. Please send your response or closure request to OIGAuditsFollowup@oig.dhs.gov.

Consistent with our responsibility under the *Inspector General Act*, we will provide copies of our report to congressional committees with oversight and appropriation responsibility over the Department of Homeland Security. We will post the report on our website for public dissemination.

Please call me with any questions at (202) 981-6000, or your staff may contact Maureen Duddy, Deputy Assistant Inspector General for Audits, at (617) 565-8723.

Attachment

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REPORT

ACRONYMS

CFR	Code of Federal Regulations
DRRA	Disaster Recovery Reform Act of 2018
EMMIE	Emergency Management Mission Integrated Environment
FEMA	Federal Emergency Management Agency
PA	Public Assistance
PW	Project Worksheet
SAM	System for Award Management
STEP	Sheltering and Temporary Essential Power
USC	U.S. Code
USVI	U.S. Virgin Islands
VIHFA	Virgin Islands Housing Finance Authority
VITEMA	Virgin Islands Territorial Emergency Management Agency

KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

May 1, 2020

Ms. Sondra F. McCauley
Assistant Inspector General for Audits
Department of Homeland Security Office of Inspector General
395 E Street, SW
Washington, DC 20024

Dear Ms. McCauley,

This report presents the results of our work conducted to address the performance audit objectives relative to the *Capacity Audit of the Federal Emergency Management Agency (FEMA) Grant Funds Awarded to the U.S. Virgin Islands Housing Finance Authority (VIHFA)*. We performed the work during the period of September 26, 2018 to April 30, 2019 and our results are as of April 30, 2019.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards (GAGAS). 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 on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

In addition to GAGAS, we conducted this performance audit in accordance with Consulting Services Standards established by the American Institute of Certified Public Accountants (AICPA). This performance audit did not constitute an audit of financial statements or an attestation level report as defined under GAGAS and the AICPA standards for attestation engagements.

The objective of our performance audit was to determine whether FEMA ensured that U.S. Virgin Islands Territorial Emergency Management Agency (VITEMA) and VIHFA established and implemented policies, procedures, and business practices to account for and expend PA grant funds in accordance with Federal regulations and FEMA guidance. Our audit scope focused on VIHFA's practices for appropriately procuring services, managing funding, and accounting and reporting for FEMA PA grant funds and related expenses. To make this determination, we reviewed the policies, procedures, and business practices at VIHFA and compared them to the relevant Federal Regulations. We listed our full objectives and criteria in Appendix A of this report.

KPMG cautions that projecting the results of our evaluation to future periods is subject to the risks that controls may become inadequate because of changes in or deterioration of conditions or existing controls.

This report is intended solely for the use of the Department of Homeland Security Office of Inspector General and FEMA management, and is not intended to be and should not be relied upon by anyone other than these specified parties.

KPMG LLP

Background

The U.S. Virgin Islands Housing Finance Authority (VIHFA) is a semi-autonomous agency in the U.S. Virgin Islands (USVI). Established in 1981, VIHFA addresses the existing shortage of low- and moderate-income housing in the U.S. Virgin Islands. Specifically, VIHFA ensures that USVI provides all individuals an opportunity to obtain safe, sanitary, and affordable housing by establishing sustainable communities in the Territory. VIHFA uses several methods to provide its services, including tax-exempt mortgage revenue bonds, low income housing tax credits, Community Development Block Grants, and Federal Emergency Management Agency (FEMA) Public Assistance (PA) grants. VIHFA Headquarters is located on the island of St. Thomas, and there is an additional office location on the island of St. Croix.

In September 2017, winds and rain resulting from Hurricanes Irma and Maria damaged or destroyed facilities owned by VIHFA on the islands of St. Thomas, St. John, and St. Croix. Subsequently, the President declared two separate major disasters. On September 7, 2017, FEMA assigned disaster 4335 to Hurricane Irma. On September 20, 2017, FEMA assigned disaster 4340 to Hurricane Maria. These declarations authorized FEMA to support the USVI's response and begin recovery efforts.

To support recovery efforts, FEMA provides guidance to all recipients of PA grant funding to help subrecipients ensure their policies, procedures, and practices comply with Federal laws and regulations. In the USVI, FEMA provides funding directly to the recipient, the Territorial Government of the USVI. The U.S. Virgin Islands Territorial Emergency Management Agency (VITEMA) is the central government agency that oversees the funding process and fulfills the responsibilities of the recipient. VITEMA, in turn, provides the funding and additional oversight to each subrecipient of FEMA funding, including VIHFA. Thus, according to Federal regulations,[1] VITEMA is the recipient and VIHFA is the subrecipient of grant funds.

Although VIHFA is the subrecipient of FEMA PA grant funds, both VITEMA and VIHFA are entities that meet the definition of a "State."[2] As such, Federal regulations require that when procuring property and services under a Federal award, VIHFA must follow the same policies and procedures it uses when procuring with non-federal funds.[3]

[1] 2 Code of Federal Regulations (CFR) § 200.86 and 2 CFR § 200.93
[2] 2 CFR § 200.90
[3] 2 CFR § 200.317

USVI government agencies have a complex interrelated structure. The following describes the roles of VITEMA and VIHFA in managing FEMA PA grant funds.

The request for grant funds begins with the creation of a Project Worksheet (PW), a FEMA funding document, by VIHFA. VIHFA personnel draft the initial PW and submit it to VITEMA. VITEMA reviews the worksheet and upon acceptance, submits it to FEMA for approval. Each PW must include a detailed Scope of Work, the estimated project cost, and the funding categorization, as follows:

Figure 1: PA Grant Categories

Category	Description
A	Debris Removal
B	Emergency Protective Measures
C	Roads and Bridges
D	Water Control Facilities
E	Buildings and Equipment
F	Utilities
G	Parks, Recreational, Other

Source: FEMA *Public Assistance Program and Policy Guide*

Categories A and B are considered emergency work projects, while Categories C-G are considered permanent work projects.

VIHFA personnel are responsible for:

- initiating and completing Requests for Proposals to solicit bids from vendors;
- awarding contracts to vendors;
- managing FEMA PWs; and
- managing the related contracts, including approval of invoices, tracking costs incurred against the project budget, such as analyzing progress of the work and related costs, and managing contractor performance.

Once FEMA approves and funds a PW, VITEMA draws down funds to reimburse VIHFA, which then pays the vendors. The reporting of expenditures incurred to date is the responsibility of both VITEMA and VIHFA. Project worksheet development is managed in the FEMA Grants Manager and Grants Portal Tool.[4] In 2019, the Grants Manager and Grants Portal Tool replaced FEMA's previous grants management system, Emergency Management Mission

[4] The Grants Manager and Grants Portal Tool is a web-based, project tracking system with two separate workflows. FEMA PA specialists use the Grants Manager workflow internally, while recipients and subrecipients use the Grants Portal workflow. Although the separate workflows compose one system, users refer to the individual workflows by the names "Grants Manager" and "Grants Portal."

Integrated Environment (EMMIE), however, EMMIE remains the system of record and the system used to obligate PW funds.

To assess the extent to which FEMA provided VITEMA and VIHFA with guidance related to the use of PA grant funds, we reviewed the policies, procedures and business practices in place at VIHFA. Due to the organizational structure of the USVI government, the recipient (VITEMA) managed some of the grants functions that would ordinarily be the responsibility of the subrecipient (VIHFA). In these instances, we reviewed VITEMA's policies, procedures and business practices.

For our detailed audit scope and methodology, see **Appendix A.**

Results of Audit

The following section provides the results of our audit. The objective of the capacity audit was to determine whether FEMA ensured that VITEMA and VIHFA established and implemented policies, procedures, and business practices to account for and expend awarded PA grant funds according to Federal regulations and FEMA guidance.

We found that FEMA did not provide sufficient guidance and assistance to VITEMA such that VITEMA ensured VIHFA established and implemented policies, procedures, and business practices to account for and expend awarded PA grant funds according to Federal regulations and FEMA guidance. The procedures we performed and the results of our audit encompassed the following areas:

- **Accounting for Costs**
- **Procurement Practices**
- **Grants Management**
- **Insurance Policies and Procedures**

Accounting for Costs

VIHFA can improve the policies, procedures, and business practices used to account for FEMA PA grant funds on a project-by-project basis.

To assess VIHFA's capability to account for costs on a project-by-project basis, we reviewed VIHFA's policies and procedures to account for disaster-related expenditures and revenues and discussed them with VIHFA officials. We identified the following:

- VIHFA has an inadequate financial system and could not verify the completeness and accuracy of Excel spreadsheets used to track costs on a project-by-project basis. VIHFA also does not have enough staff to manage adequately FEMA funding. **(Finding I)**

- VIHFA does not have sufficient oversight of contractors and subcontractors hired to work under the FEMA PA grant and does not require supporting documentation for all costs incurred. (**Finding II**).

In addition to our assessment of VIHFA's accounting for non-management costs incurred, we performed procedures related to the accounting of management costs at VITEMA and VIHFA. In June 2018, FEMA issued a new recovery policy, the *Public Assistance Alternative Procedures for Direct Administrative Costs*, which created a new method for FEMA to award PA management costs via a fixed estimate process (hereafter referred to as the pilot program). The USVI opted into this program as the grant recipient on behalf of the grant subrecipients, including VIHFA. The USVI delegated the responsibility for recording and monitoring management costs to VITEMA, as well as the development of related policies and procedures. The USVI also required VITEMA to develop policies and procedures for VIHFA and other subrecipients to ensure management costs are appropriately reported and are not included on permanent work PWs. (See **Appendix B** for further background on FEMA's pilot program and the responsibilities of VITEMA and VIHFA to record and monitor management costs.)

We assessed VITEMA's ability to comply with the requirements of the pilot program and found that VITEMA had not developed policies and procedures for the proper recording of management costs. Although the USVI opted into the pilot program on behalf of VIHFA, VIHFA was unaware of the pilot program. (**Finding III**)

Finding I: Inadequate Financial Management System and Inadequate Number of Staff

Financial Management System

VIHFA does not have a sustainable financial management system. Federal regulations require that recipients and subrecipients utilize a financial management system to administer grants. The financial management system requires specific parameters that allow for documenting various aspects of grant funding.[5]

VIHFA tracks costs incurred for each Federal grant project in an Excel spreadsheet at the project level; however, VIHFA does not have policies, procedures, or business practices to verify the completeness and accuracy of

[5] 2 CFR § 200.302

the Excel spreadsheets. Further, the spreadsheets do not provide a sufficient level of detail for grant funding, such as a listing of all current Federal grants, including contracts awarded on those grants (i.e., Catalog of Federal Domestic Assistance numbers and other pertinent funding information).[6] Without such detail there is an increased risk that VIHFA is not complying with the documentation requirements required by Federal regulations. In addition, each Excel spreadsheet is located solely on one employee's computer hard drive and lacks controls over segregation of duties. As a result, VIHFA does not have policies and procedures to manage version control, audit logs, or to verify the completeness and accuracy of each Excel spreadsheet tracking the costs incurred. This current, manual system creates risks of mistakes, abuse, and misappropriation of grant funds.

VIHFA has identified a need for a new financial management system. At the time of our fieldwork, VIHFA had started drafting plans to develop a new, automated financial management system; however, VIHFA was unable to provide an estimated timeline or implementation date for the new system. According to VIHFA, it plans to design the new system to enhance its grant management functions, but it also indicated it has limited financial resources to implement a new system.

Inadequate Number of Staff

As of April 30, 2019, VIHFA did not have enough staff to adequately manage the over $222 million in FEMA PA grant funding it had received as of that date. Federal regulations require non-federal entities to maintain effective internal controls over Federal awards.[7]

VIHFA anticipates receiving additional Federal funding of over $1.2 billion by the end of 2019 — from FEMA and the Department of Housing and Urban Development. To manage these Federal funds, VIHFA identified it needed 58 employees. However, as of April 2019, VIHFA's staffing level was at 22 employees (38 percent), with 36 vacancies. These staffing shortfalls increase the risk that VIHFA will not be able to appropriately implement and maintain an internal control environment, as described in 2 CFR §200.303, including proper segregation of duties. Without proper segregation of duties, Federal funding is at risk of waste, fraud and abuse.

Recommendation I: We recommend the FEMA Regional Administrator, Region II, work with VITEMA and VIHFA to:

[6] 2 CFR § 200.302
[7] *2 CFR § 200.303*

a. Request that VIHFA complete the development of the new financial management system and request that VIHFA demonstrate its compliance with Federal regulations; and

b. Verify VIHFA has the appropriate staffing to account for Federal funds, prior to awarding additional funding.

FEMA Comments

Concur. VIHFA implemented an accounting system called SAP Business One. SAP Business One is a complete business management solution. The system allows VIFHA to manage its funds and provide accurate financial information by reconciling its banks accounts, comparing budget versus expenditures, handling accounts payable function, processing checks, and producing purchase orders and invoices. VIHFA now uses SAP Business One for its grant management process, including closeout. All project information is stored in the system allowing quick web-based access. VIHFA can monitor deadlines, track costs, and close projects within the system. Users submit and track Project requests such as scope changes, time extensions, or closeouts in the system. Users may also collect and export Quarterly Report data as required.

Additionally, as of March 2020, VIHFA had 85 employees; 54 in its St. Thomas office and 31 in its St. Croix location. VIHFA has the appropriate staffing to account for Federal funds. FEMA Region II will review the capability of SAP Business One to ensure it is in compliance with 2 CFR 200.302. Estimated Completion Date (ECD): **February 28, 2021.**

OIG Analysis

FEMA's corrective actions are responsive to the recommendation. However, the recommendation will remain resolved and open until we have received and reviewed evidence that: (1) the SAP Business One system allows VIFHA to manage and account for Federal funds; and (2) evidence that FEMA Verified whether VIHFA has the appropriate staff to account for Federal funds before awarding additional funding.

Finding II: Insufficient Policies and Procedures to Review Labor Costs

VIHFA does not have sufficient oversight of contractors and subcontractors working under FEMA PA grants and does not require that contractors provide supporting documentation for all invoiced costs.

During our walkthroughs and reviews of procurement policies, procedures, and business practices, we noted that VIHFA:

- did not have business practices to perform detailed reviews of labor costs and did not collect and maintain supporting documentation of those costs; and
- did not maintain information on the status of FEMA-funded work prior to collecting and reviewing contractor invoices for completed tasks.

We reviewed a sample of invoices, as detailed in the Scope and Methodology section in **Appendix A**. For the two projects reviewed, as of February 2019, the contractors had invoiced VIHFA for approximately $104 million[8] in subcontractor labor costs related to FEMA PA grant funds, of which FEMA has paid approximately $58 million. The projects reviewed included funding for the Sheltering and Temporary Essential Power (STEP) program.

Per Federal regulations, VIHFA must adequately document all costs incurred and allowable for Federal awards.[9] VIHFA is not complying with this Federal requirement because it does not require or use supporting documentation to verify the labor hours invoiced by contractors and subcontractors for payment on Federal projects. For two contracts, VIHFA uses one primary contractor per project. For both projects, the primary contractors used several tiers of subcontractors. On its invoices, the primary contractor bills VIHFA for subcontractor labor costs as a lump sum amount. VIHFA does not request or maintain support for the subcontractor labor costs, including timesheets.

Additionally, VIHFA was unaware of the status of the work for the two projects and could not verify whether the primary contractors performed additional procedures for reviewing and approving subcontractor labor invoices. We obtained and reviewed the contracts for the primary contractors and did not identify any clauses in the contracts stipulating that the primary contractor is required to perform detailed reviews. Without such verification, VIHFA is at increased risk of not complying with Federal regulations and PA grant requirements when procuring goods or services using FEMA PA grant funding.

Insufficient review of subcontractor invoices increases the risk that VIHFA will make improper payments to contractors and subcontractors using Federal funding. On January 16, 2020, the United States Attorney for the District of the Virgin Islands announced that the operator of a construction company pled guilty and received a sentence of 14 months in prison for fraud related to FEMA's Sheltering and Temporary Essential Power (STEP) program. The company submitted fraudulent invoices and timesheets related to a STEP-funded subcontract, requesting payment for work not actually performed.[10]

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[8] As reported by VIHFA invoice logs obtained from VIHFA.
[9] 2 CFR § 200.403(g)
[10] Department of Justice U.S. Attorney's Office news release *Owner of Construction Company Sentenced to Prison for Disaster Fraud in the United States Virgin Islands* dated January 16, 2020

Recommendation II: We recommend that FEMA Regional Administrator, Region II, work with VITEMA and VIHFA to perform a detailed review of the $104 million in subcontractor labor costs and consider disallowing unsupported costs that do not fully comply with Federal regulations.

FEMA Response

Concur. FEMA implemented a manual drawdown review process for reimbursement on October 1, 2019 for all PA projects. Through that process, FEMA is currently reviewing all requests to draw down funding from all PWs, including PWs 100 and 273, and will only approve the drawdown of eligible costs. FEMA is also completing a review of all drawdowns approved by VITEMA prior to FEMA implementing the manual drawdown review process. FEMA will recover any costs found to be ineligible. **ECD: February 28, 2021.**

OIG Analysis

FEMA's corrective action is responsive to the recommendation. However, the recommendation will remain resolved and open until we have received and reviewed evidence that FEMA worked with VITEMA and VIHFA to perform a detailed review of the $104 million in subcontractor labor costs and made a determination about any unsupported costs.

Finding III: Inadequate Policies and Procedures Related to the Accounting of Management Costs

VITEMA officials informed us that they had not established policies and procedures to ensure that VITEMA and VIHFA submit management costs as required by FEMA's *Public Assistance Management Costs Interim Policy – Standard Operating Procedures* (SOP) issued in February 2019. VITEMA had not established policies and procedures related to this requirement because FEMA had not yet developed adequate guidance, including policies and procedures, communicating the requirements of the pilot program. FEMA issued this SOP in February 2019, three months after it issued its new recovery policy. The SOP incorporates *Disaster Recovery Reform Act of 2018* (DRRA) requirements to reimburse direct and indirect administrative costs to the State for distribution to the recipient and subrecipient, up to the established percentages. The SOP sufficiently defines procedures to document and process management cost claims to ensure consistent implementation of the requirements and effective tracking and verification of management cost claims by recipients and subrecipients. Prior to implementation of the SOP, FEMA did not effectively work with VITEMA to reinforce the existing policies and procedures related to management costs, including implementing controls to ensure that costs already submitted for reimbursement as project costs are not also later submitted for reimbursement as management costs.

FEMA's insufficient guidance to VITEMA increases the risk that VITEMA will not have appropriate policies and procedures to ensure both it and VIHFA submit eligible management costs for reimbursement on permanent work PWs, in compliance with Federal regulations. As of February 2019, VITEMA and VIHFA had not submitted any claims for management costs to FEMA because the process was not yet fully developed.

Recommendation III: We recommend the FEMA Regional Administrator, Region II, provide VITEMA and VIHFA with additional guidance to update their policies and procedures to ensure they comply with DRRA and FEMA's *Public Assistance Management Costs Interim Policy – Standard Operating Procedures*.

FEMA Comments

Concur. FEMA issued the Public Assistance Management Costs Interim Policy on November 14, 2018, shortly after the President signed the *Disaster Recovery Reform Act of 2018* (October 5, 2018). Additionally, FEMA issued the *Public Assistance Management Costs Interim Policy – Standard Operating Procedures* (SOP) in February 2019. FEMA Region II will meet with VITEMA and VIHFA to review the SOP and provide guidance needed for VITEMA and VIHFA to have compliant policies and procedures. **ECD: February 28, 2021.**

OIG Analysis

FEMA's corrective action is responsive to the recommendation. However, the recommendation will remain resolved and open until we have received and reviewed evidence that FEMA worked with VITEMA and VIHFA to ensure their compliance with the issued policies and procedures.

Procurement Practices

We reviewed VIHFA's procurement policies and procedures used to purchase services with FEMA PA grant funds. We conducted walkthroughs with procurement personnel from VIHFA to assess their business practices. For the seven contracts we selected for testing, we reviewed procurement records and performed procedures over the basis for contract price, requests for proposals, bid tabulations, and contract selections. In addition, for a sample of invoices, we reviewed documentation in support of contract costs. For our sampling methodology and list of contracts and invoices reviewed, see **Appendix A**.

We determined that VIHFA does not have adequate contracting policies, procedures, and business practices to comply with Federal regulations requiring that costs incurred under a grant award are necessary and reasonable. (**Finding IV**)

Finding IV: Procurement Practices Need Improvement

VIHFA's policies, procedures, and business practices are inadequate in:

- Cost or Price Analysis;
- Use of Cost-Plus-Percentage-of-Cost Contracts;
- Sole Source Procurement;
- Conflict of Interest Provisions; and
- Use of Suspended or Debarred Contractors.

VIHFA is an entity of the "State,"[11] therefore, Federal regulations require that VIHFA follow the same policies and procedures for procurements using FEMA PA grant funding as for procurements using non-Federal funds.[12]

From our walkthroughs over the procurement process and procedures performed over selected procurement contracts, we determined VIHFA does not have adequate contracting policies, procedures, and business practices to comply with Federal regulations[13] requiring that costs incurred under a grant award are necessary and reasonable.

Finding IVa: Cost or Price Analysis

VIHFA procurement policies do not require performance of a cost or price analysis during the contract award process. Federal regulations dictate that costs incurred must be necessary and reasonable for performance of the Federal award.[14] VIHFA must also consider market prices for comparable goods or services for the geographic area.[15]

For two contracts reviewed, valued at over $222 million, for emergency work repairs under the STEP program, VIHFA did not perform an adequate cost or price analysis. Specifically, VIHFA did not ensure price competition — it did not negotiate a fee bid by the contractor as a separate element of the contract cost. VIHFA also did not document considerations of industry profit rates in the surrounding geographical area for similar work. The cost or price analysis

[11] 2 CFR § 200.090
[12] 2 CFR § 200.317
[13] 2 CFR § 403.403
[14] 2 CFR § 200.403 (a)
[15] 2 CFR § 200.404 (c)

performed included estimated costs per unit, but did not include an estimate of cumulative costs for the projects, including the total number of units repaired under the STEP program.

Although Federal regulations do not provide requirements for cost or price analyses for state agencies,[16] the absence of adequate cost or price analyses put VIHFA at higher risk for unallowable costs. Without adequate cost or price analyses during the contracting phase of an award, which is a sound business practice to reduce costs, there is an increased risk that costs incurred are not reasonable and allowable under Federal regulations.

Finding IV b: Use of Cost-Plus-Percentage-of-Cost Contracts

VIHFA awarded two contracts valued at over $222 million containing cost-plus percentage-of-cost clauses. The clauses specify the pass-through of costs to VIHFA with a 10 percent administrative handling fee. These contracts were for emergency work repairs under VIHFA's STEP program.

VIHFA is considered a "State," so while FEMA guidance does not expressly prohibit use of cost-plus-percentage-of-cost procurement, its use increases the risk that costs incurred on the contract may not be necessary and reasonable because it provides little incentive for the contractor to keep costs low. Federal regulations define costs as allowable if they are both necessary and reasonable.[17] To be considered reasonable, costs must follow sound business practices.[18]

Furthermore, we noted these contracts did not include ceiling amounts. Without a contract ceiling there is no incentive for the contractor to control costs because there is no total dollar value restriction to limit costs incurred. This is especially problematic for cost-plus-percentage-of-cost contracts because contractors may continue to incur costs without restriction to maximize their fee and related profit.

Finding IV c: Sole Source Procurement

VIHFA awarded one contract, for approximately $35 million, to a contractor without issuing a Request for Proposal or soliciting a competitive bid because the contractor had bid on similar work for another project. This contract was for emergency work repairs under VIHFA's STEP program.

[16] 2 CFR § 200.404 (c)
[17] 2 CFR § 200.403(a)
[18] 2 CFR § 200.404(b)

Federal regulations also dictate that costs incurred must be necessary and reasonable for the performance of the Federal award.[19] To be considered reasonable, considerations must be made for restraints or requirements imposed by factors such as sound business practices and arm's-length bargaining.[20] VIHFA determined this procurement qualified for a sole-source procurement; however, it did not perform a cost analysis to support the reasonableness of the contract costs.

Costs incurred under contracts awarded without arm's length bargaining are at higher risk for fraud, waste, and abuse; thus, the related costs may be unreasonable and unallowable.

Finding IV d: Conflict of Interest Provisions

Although VIHFA's procurement policies and procedures contain an overarching conflict of interest statement, they do not contain conflict of interest provisions governing the selection, award, and administration of contracts negotiated at arm's-length. We further noted that the overarching conflict of interest statement does not address disciplinary actions for violations of the policy.

Because VIHPA is a "State" entity, Federal regulations do not explicitly require that it maintain written standards of conduct covering conflicts of interest.[21] Although conflict of interest polices are not required for procurements made by VIHFA, costs incurred must be necessary and reasonable for the performance of the Federal award.[22] In determining reasonableness of a given cost, FEMA considers, among other factors, restraints or requirements such as arm's-length bargaining. Without adequate conflict of interest policies, VIHPA may negotiate cost that are not at arm's length,[23] resulting in costs that FEMA considers unreasonable and are therefore unallowable. We determined that VIHFA's conflict of interest policies and procedures do not provide assurance that costs incurred for negotiated contracts are reasonable.

During our testing, we did not identify any instances in which the absence of appropriate conflict of interest policies resulted in an inappropriate contractual agreement containing conflicts of interest. In addition, VIHFA officials informed us that they were unaware of any instances of conflicts of interest for procurement actions.

Finding IV e: Use of Suspended or Debarred Contractors

[19] 2 CFR § 200.403 (a)
[20] 2 CFR § 200.404 (b)
[22] 2 CFR § 200.318
[22] 2 CFR § 200.403(a)
[23] 2 CFR § 200.404(b)

Non-federal entities, including VIHFA, may not award contracts, including sub-awards, to suspended or debarred contractors.[24] Additionally, Federal regulations require that costs incurred must be necessary and reasonable for the performance of the Federal award.[25] VIHFA does not have policies and procedures to perform reviews of subcontractors for suspension or debarment.

During the bid evaluation process, VIHFA verifies whether the primary contractor is suspended or debarred per the System for Award Management (SAM). Although VIHFA reviews the primary contractor information in SAM, we found that VIHFA's policies and procedures do not require a review of the SAM for subcontractors. Specifically, VIHFA does not receive a listing of subcontractors proposed upon contract award and does not perform procedures to determine whether the subcontracted entities and individuals have been suspended or debarred. VIHFA uses several tiers of subcontractors in the programs it operates.

Without adequate monitoring of subcontractors used under Federal awards, VIHFA is at a higher risk that costs incurred are not reasonable and therefore unallowable.

Recommendation IV: We recommend that FEMA Regional Administrator, Region II, work with VITEMA and VIHFA to:

a. Review the expenditures related to the cost-plus-percentage-of-cost and non-competitive contracts to determine if the related costs are reasonable and therefore allowable. FEMA should determine if unreasonable and unallowable costs should be recovered.

b. Establish an internal control structure to ensure that business practices provide assurance that costs claimed for FEMA reimbursement meet the Federal criteria for necessary, reasonable, and allowable costs.

c. Develop additional guidance regarding potential consequences of not complying with the procurement issues discussed in the finding: Cost or Price Analysis, Cost-Plus-Percentage-of-Cost Contracts, Sole Source Procurement, Conflict of Interest Provisions, and Use of Suspended or Debarred Contractors.

FEMA Comments

Concur. Through the manual drawdown review process for reimbursement, FEMA will review all requests to draw down funds from PWs 100 and 273 and

[24] 2 CFR § 200.213
[25] 2 CFR § 200.403 (a)

will only approve eligible costs. FEMA will evaluate all costs for reasonableness in accordance with its *Public Assistance Reasonable Cost Evaluation Job Aid* as part of the eligibility review.

FEMA Region II will work with VITEMA and VIHFA to ensure that VIHFA establishes effective internal controls over its management of its PA subgrants to comply with 2 C.F.R. § 200.303. In particular, these will focus on the requirement that all costs claimed for FEMA reimbursement are necessary, reasonable, and allowable. FEMA provided numerous trainings to VITEMA and Territorial agencies on the current procurement standards that apply to state and territorial entities. The training specifically stressed that "cost-plus percentage-of-cost" contracts may be allowed under state law, but are generally discouraged." FEMA will reiterate to VIHFA that although Federal procurement standards for states are limited to the requirements in 2 C.F.R. § 200.317, without establishing controls over the use of "cost-plus-percentage-of-cost" contracts and sole source procurement, such as instituting a cost or price analysis process, VIHFA is at risk of incurring costs that FEMA may find unreasonable and ineligible for reimbursement. FEMA will also reiterate that without sufficient conflict of interest provisions in its procurement and contracting policies and procedures, a similar risk exists. Lastly, FEMA will reinforce that 2 C.F.R. § 200.213 restricts the award of contracts to suspended or debarred contractors. **ECD: February 28, 2021.**

OIG Analysis

FEMA's corrective actions are responsive to the recommendation. However, the recommendation will remain resolved and open until we have received and reviewed evidence that FEMA: (1) reviewed all draw down requests from PWs 100 and 273 and only approved eligible costs; (2) worked with VITEMA and VIHFA to establish internal controls over its management of subgrantees and that only reasonable and allowable costs are submitted for reimbursement; (3) reiterated to VIHFA that percentage-of-cost and sole source contracts may be deemed unreasonable and ineligible for reimbursement; and (4) worked with VIHFA to include a conflict of interest provision in its procurement policies and procedures.

Grants Management

We reviewed VIHFA's policies and procedures related to grants management for FEMA PA grant funding. We conducted walkthroughs with grants management personnel from VIHFA to determine their business practices. We noted that although VIHFA personnel play a key role in grants management, many of the duties are the responsibility of VITEMA. As such, we conducted additional walkthroughs with grants management personnel from VITEMA to understand their business practices. Contractors from multiple firms support both VIHFA and VITEMA in the grants management process. These contractors aid in identifying disaster damage eligible for FEMA funding, preparing PWs, and reviewing cost documentation prior to requesting reimbursements. We found three areas for improvement: cost share categorizations (Finding V), management of project cost overruns (Finding VI), and lack of sufficient access and training related to FEMA's Grants Portal system (Finding VII).

Finding V: Cost Share Categorizations

During our testing of three VIHFA PWs, we identified one PW with an incorrect categorization as permanent work, Category E. FEMA confirmed that the PW[26] related to resuming operations in the VIHFA main office and thus qualified as an emergency work project in Category B. FEMA, VITEMA, and VIHFA did not adequately coordinate to ensure that they assigned the correct Category of work to this PW. For our sampling methodology and PWs reviewed, see **Appendix A**.

The PW categorization directly impacts the State and Federal cost shares for these projects. The Federal cost share for emergency work projects (categories A and B) for Hurricane Irma is 100 percent through August 31, 2018,[27] while the Federal cost share for permanent work projects (categories C through G projects) is 90 percent. Because of the incorrect categorization of the PW, the State erroneously reimbursed VIHFA an additional $7,000, which should have been FEMA's responsibility. As a result, FEMA confirmed it would correct the cost share allocations because this PW qualified for a 100 percent cost share.

Recommendation V: We recommend that FEMA Regional Administrator, Region II, work with VITEMA and VIHFA to ensure that all PA grant funds are assigned the correct category and verify that the State cost-share information is accurate.

FEMA Comments

Concur. FEMA Region II acknowledges the importance of accurate categorization of work and cost-share allocation. A Project Worksheet goes through multiple levels of review and concurrence before it is obligated to assure the accurate categorization. FEMA correctly categorized PW 205 under DR-4335-VI as permanent work, Category E, at 90 percent Federal cost share. The PW approved funding for completed permanent repair work to bring the VIHFA Main Office in Frenchtown Plaza back to its pre-disaster design and function and to replace damaged contents. FEMA requests the OIG consider this recommendation resolved and closed.

[26] PW-00205, related to Disaster 4335
[27] FEMA USVI State Agreement for Disaster 4335, and amendments

OIG Analysis

FEMA's corrective actions taken are responsive to the recommendation. In its response, FEMA noted that VIHFA correctly categorized PW 205 under DR-4335-VI as permanent work and Category E at 90 percent Federal cost share. FEMA further noted that the PW approved funding for completed permanent repair work was to bring the VIHFA Main Office in Frenchtown Plaza back to its pre-disaster design and function and to replace damaged contents. We believe that the actions taken by FEMA met the intent of the recommendation. Therefore, we consider this recommendation resolved and closed.

Finding VI: Mismanagement of Project Cost Overruns

VIHFA did not conform fully to Federal regulations[28] or FEMA guidelines when managing two projects[29] under the STEP program. FEMA awarded two projects for $222 million; however, VIHFA has incurred nearly $296 million of cost overruns. Thus, estimated project costs rose from $222 million to $518 million, an approximate 133 percent increase. For our sampling methodology, contracts, and invoices reviewed, see **Appendix A**.

VIHFA did not notify FEMA of the cost overruns on the two projects prior to incurring the incremental costs. Specifically, in January 2018, VIHFA began identifying cost overruns on the PWs. However, VIHFA did not notify FEMA of cost overruns of $296 million until September 2018, nearly 9 months after incurring a significant amount of the costs. These cost overruns largely related to costs that were not included in the project SOWs. FEMA was reviewing the PW for these additional funds at the time of our audit in February 2019.

Recipients of Federal funding are required to report deviations from budget or project scope or objectives and request prior approvals from Federal awarding agencies for budget and program plan revisions.[30] FEMA policy requires that states report cost overruns as soon as they identify them. VIHFA indicated it was not aware of the requirement to report cost overruns.

Failure to notify FEMA of project cost overruns may result in delayed payments to contractors. This may result in an increase in the total costs of related services because damaged facilities may deteriorate further if they are not repaired or replaced promptly. Additionally, failure to promptly notify FEMA of project cost overruns has caused delays in payments to contractors, resulting in litigation claims against VIHFA. Such delays may damage VIHFA's reputation with existing and potential contractors and increase the likelihood

[28] 2 CFR § 200.308(b) and 44 CFR § 206.204
[29] PW-00273, PW-00100
[30] 2 CFR § 200.308(b)

that contractors do not bid on future work. Due to delays in notifying FEMA of project cost overruns, VIHFA may place undue pressure on FEMA to fund costs that are not allowable or reasonable.

Recommendation VI: We recommend that FEMA Regional Administrator, Region II, work with VITEMA and VIHFA to:

a. Perform a detailed review of the $296 million in cost overruns and disallow all costs that do not fully comply with Federal regulations.

b. Require that VIHFA adhere to Federal regulations for all future PW requests and modifications.

FEMA Comments

Concur. FEMA implemented a manual drawdown review process for reimbursement on June 20, 2019, for all VIHFA STEP projects. Through that process, FEMA is reviewing all requests to drawdown funding from PWs 100 and 273 and will only approve the drawdown of eligible costs. FEMA Region II will ensure that VITEMA and VIHFA are aware of FEMA regulations and policies regarding requests for scope of work changes. **ECD: February 28, 2021.**

OIG Analysis

FEMA's corrective action is responsive to the recommendation. However, the recommendation will remain resolved and open until we have received and reviewed evidence that FEMA: (1) performed a detailed review of the $296 million in cost overruns and made a determination about its allowability; and (2) ensured that VIHFA adheres to Federal regulations for all PW requests and modifications.

Finding VII: Inadequate Grants Portal Access and Training

We found that neither VITEMA nor VIHFA had fully implemented FEMA's Grants Portal system (Grants Portal). In February 2019, FEMA provided access to the Grants Portal to only two individuals at VITEMA and one employee at VIHFA. VITEMA personnel received minimal training, consisting mainly of a high-level system overview and basic functionality of the Grants Portal. Although FEMA scheduled several trainings on use of the Grants Portal, an insufficient number of personnel from VITEMA and VIHFA attended due to late notice and scheduling difficulties. Furthermore, although FEMA should allow additional VITEMA personnel to access the Grants Portal, it is VITEMA's responsibility to provide access to VIHFA personnel.

Inadequate access to the system and attendance at training could negatively affect VITEMA's and VIHFA's ability to manage the PA program. Specifically, this could prevent VITEMA and VIHFA from ensuring that they have a complete list of projects related to PA grants, funds awarded by FEMA, and a complete and accurate status of drawdowns.

Recommendation VII: We recommend the FEMA Regional Administrator, Region II, coordinate with VITEMA and VIHFA to identify and grant access to individuals whose job responsibilities require FEMA Grants Portal access and ensure all appropriate personnel receive Grants Portal training.

FEMA Comments

Concur. FEMA Region II has provided Grants Portal access and trained all VITEMA and VIHFA personnel identified by each agency to require access. Specifically, FEMA provided training to VITEMA and Territorial applicants on Grants Manager – Basics on August 13, 2018; Grants Manager Portal on January 23, 2019; Grants Portal Overview (specifically for VITEMA) on February 7, 2019; Grants Portal on February 27, 2019; and Grants Portal Applicant Training on June 21, 2019. FEMA will also provide additional Grants Portal training upon request. FEMA requests OIG consider this recommendation resolved and closed.

OIG Analysis

FEMA's corrective action taken is responsive to the recommendation. FEMA noted that it provided Grants Portal access and trained all VITEMA and VIHFA personnel identified by each agency to require access. Additionally, in the future, FEMA will provide Grants Portal training upon request. We believe that the actions taken by FEMA met the intent of the recommendation. Therefore, we consider the recommendation resolved and closed.

Insurance Policies and Procedures

Federal regulations require that subrecipients use insurance proceeds to offset the costs of projects funded by FEMA.[31] Federal regulations further require that subrecipients obtain and maintain insurance on facilities rebuilt using FEMA grant funds.[32]

To determine if VIHFA appropriately used insurance proceeds received from the disasters to offset the costs projects funded by FEMA, we reviewed VIHFA's policies and procedures for use of insurance proceeds and discussed the

[31] 44 CFR § 250(c)
[32] 2 CFR § 200.310

policies and procedures with VIHFA management. In addition, we reviewed all PWs awarded to VIHFA and VIHFA's insurance policy on its office buildings.

We obtained and reviewed VIHFA's insurance policy and verified the policy included coverage for the VIHFA office building on St. Thomas, as well as housing facilities on St. Croix. We verified the policy included a deductible of $1.4 million. The undisputed loss and damage on the insurance claim was $6.1 million. In March 2019, VIHFA received $1 million in insurance proceeds for housing facilities on St. Croix.

VIHFA had policies and procedures in place to assess damages to insured facilities and use insurance proceeds to offset the costs of FEMA projects, if applicable. We reviewed these policies and procedures and did not identify any instances of non-compliance with applicable Federal regulations and FEMA guidelines. In addition, we verified VIHFA officials are aware that obtaining and maintaining insurance on insurable facilities is a condition of current and future FEMA funding. We are not aware of any uninsured VIHFA facilities that sustained damages from Hurricanes Irma and Maria and were repaired using FEMA grant funds.

Appendix A: Objectives, Scope and Methodology

Objectives

The overall objectives of our audit were to determine whether FEMA ensured that VITEMA and VIHFA established and implemented policies, procedures, and practices to make sure that PA grant funds are accounted for and expended according to Federal regulations and FEMA guidance. We also determined whether Federal regulations and FEMA guidance were used to ensure that VIHFA:

a. Has accounting policies and procedures in place that comply with applicable laws and regulations, as required by Sec. 795 of the *Robert T. Stafford Disaster Relief and Emergency Assistance Act of 1988*.

b. Has policies and procedures in place to appropriately procure goods and services with grant funds in compliance with applicable laws and regulations, as required by Sec. 795 of the *Robert T. Stafford Disaster Relief and Emergency Assistance Act of 1988*.

c. Has policies and procedures in place to appropriately manage the accounting of grant funds on a project-by-project basis and ensure costs are allowable, reasonable, and allocable, as required by Sec. 795 of the *Robert T. Stafford Disaster Relief and Emergency Assistance Act of 1988*.

d. Costs incurred related to Category A – G projects are in compliance with contracting criteria for non-federal entities, as described in 2 CFR 200.318 – .326 General Procurement Standards.

We reported identified instances of noncompliance with Federal laws and regulations, as required by Government Auditing Standards, and that warranted the attention of the DHS OIG and DHS management.

We designed our performance audit approach and procedures in accordance with the criteria noted in our audit objectives. During the fieldwork phase of the audit, FEMA and VIHFA indicated that although VIHFA is a subrecipient of FEMA PA grant funds, VIHFA is part of the State government, due to the small size of the USVI and the centralized nature of government operations. The General Procurement Standards per 2 CFR 200.318 - .326 (i.e., objective d.) for non-Federal entities are not applicable to agencies that are part of the State government. Instead, the applicable procurement standards for states are addressed in 2 CFR 200.317 *Procurements by Ses*, 2 CFR 200.403 *Factors Affecting Allowability of Costs*, and 2 CFR 200.404 *Reasonable Costs*. Although we planned and performed our audit procedures using the criteria for non-Federal entities indicated in objective d., we revised the applicable criteria to assess our initial findings under 2 CFR 200.403 *Factors Affecting Allowability of Costs* and 2 CFR 200.404 *Reasonable Cost,* on the basis that VIHFA is part of the State.

Scope and Methodology

We audited the capability of VITEMA and VIHFA to manage FEMA PA grant funds in accordance with applicable laws and regulations, including policies, procedures and practices related to contracting with external vendors. The DHS OIG engaged us to conduct this audit early in the PA process to identify areas where VIHFA may need additional technical assistance or monitoring to ensure compliance with Federal regulations and FEMA guidelines.

We interviewed FEMA, VITEMA, and VIHFA officials and assessed the adequacy of the policies, procedures, and business practices VITEMA and VIHFA used to account for and expend FEMA PA grant funds. We also assessed the policies, procedures, and business practices VITEMA and VIHFA used to procure and monitor contracts for disaster work. We reviewed applicable Federal regulations and FEMA guidelines in order to accomplish our audit objectives.

We conducted fieldwork activities at VITEMA and VIHFA offices in the USVI. We did not perform a detailed assessment of VITEMA's and VIHFA's internal controls over their grant activities because it was not necessary to accomplish our audit objectives. However, we assessed the adequacy of the policies, procedures, and business practices VITEMA and VIHFA used to account for and expend FEMA PA grant funds and to procure for and monitor disaster work.

The scope period of the audit was September 5, 2017, the first day of the incident period for Hurricane Irma, through April 30, 2019. To test costs incurred to date at VIHFA, we obtained a listing of approved PWs from FEMA. Using risk-based criteria, we judgmentally selected three of six PWs[33] for testing, totaling approximately $222 million and 99.99 percent of the total PWs obligated as of December 18, 2018.

We then obtained a listing of the related contracts associated with the PWs from VIHFA and selected all seven contracts for testing. The contracts selected totaled the full amount of the PWs, or approximately $222 million. We noted that two PWs consisted of 99.99 percent of the funding awarded to the VIHFA. These projects related to the Sheltering and Temporary Essential Power program. This program is an emergency work program designed to provide

[33] PWs: PW-00273, PW-00100, and PW-00205

minor emergency repairs in single-family, owner-occupied residencies. The program received extensions to continue operations through March 2019.

Costs incurred at the time of our audit, as reported by FEMA, totaled approximately $122 million. However, we noted inconsistencies between FEMA's reported expenditures and VIHFA's reported expenditures. For full results obtained, see *Procurement Practices* and *Grants Management* sections.

We judgmentally selected $24 million of these costs for testing, to verify invoices and other documentation supported the costs.

We discussed the results of our audit with personnel from FEMA, VITEMA, and VIHFA. We considered their comments when developing our report and incorporated their feedback, as appropriate.

To assess the reliability of the PW obligation and expenditure data provided to us by FEMA, we obtained supporting documentation and interviewed VITEMA and VIHFA personnel. We determined that this data was sufficiently reliable for purposes of this report.

Appendix B: Background on June 2018 FEMA Public Assistance Alternative Procedures for Direct Administrative Costs (pilot program)

Section 324 of the *Robert T. Stafford Disaster Relief and Emergency Assistance Act of 1988* (Stafford Act) authorizes FEMA to provide funds to the recipient and the subrecipient for management costs incurred in the administration of PA programs. In June 2018, FEMA issued a new recovery policy, the *Public Assistance Alternative Procedures for Direct Administrative Costs*, which created a new method for FEMA to award PA management costs via a fixed estimate process (hereafter referred to as "the pilot program").

Under the pilot program, FEMA reimburses management costs using a single "management cost" PW. The "management cost" PW is funded based on a percentage of the total amount of all non-management cost PWs submitted. All recipients and subrecipients must establish their own "management cost" PWs. The intent of the pilot program is to reduce the administrative burden of requiring recipients and subrecipients to submit individual management costs for reimbursement through non-management cost PWs. Instead, the recipient and subrecipient receive the funds provided through the "management cost" PW without having to submit management costs for reimbursement. However, the recipient and subrecipient must also have policies and procedures in place to ensure that they do not submit management cost for reimbursement to non-management cost PWs (i.e., duplication of benefits).

Section 1215 of the DRRA, signed into law in October 2018, expands the definition of management costs to include both direct and indirect administrative costs incurred by the state, local, tribal or territorial government. Previously under the Stafford Act, FEMA reimbursed direct administrative costs directly to subrecipients but reimbursed indirect administrative costs to the State, and the State would determine what portion of these costs to pass through to subrecipients. Under the DRRA, FEMA reimburses direct and indirect administrative costs as "management costs" in an amount up to 12 percent of the total award, of which up to 7 percent may be used by the recipient and up to 5 percent may be used by the subrecipient.

Appendix C: FEMA Region II Comments

U.S. Department of Homeland Security
Washington, DC 20528

FEMA

March 20, 2020

MEMORANDUM FOR: Sandra F. McCauley
Assistant Inspector General for Audits

FROM: *for* Thomas Von Essen TAMMY L LITTRELL Digitally signed by TAMMY L LITTRELL Date: 2020.03.20 18:29:28 -04'00'
Regional Administrator, Region II
Federal Emergency Management Agency

SUBJECT: Management Response to Draft Report: "Capacity Audit of FEMA Grant Funds Awarded to the U.S. Virgin Islands Housing Finance Authority"
(Project No. 19-020-AUD-FEMA)

Thank you for the opportunity to review and comment on this draft report. The U.S. Department of Homeland Security (DHS) Federal Emergency Management Agency (FEMA) appreciates the work of the Office of Inspector General (OIG) in planning and conducting its review and issuing this report.

FEMA appreciates OIG's recognition of the challenges the U.S. Virgin Island's (USVI) government faced in the aftermath of hurricanes Irma and Maria. These included developing policies and procedures for managing federal funds, while also implementing new programs to address the severe damage to homes and a lack of sheltering options.

In partnership with the USVI Territorial Emergency Management Agency (VITEMA) and to further FEMA's mission of helping people before, during and after disasters, DHS and FEMA provided effective and timely recovery assistance to disaster survivors. In 2017, VITEMA addressed immediate staffing challenges by hiring two contractors to assist with grants management and the developing, implementing and oversight of disaster recovery assistance. As a long-term solution, in 2019, the USVI established the Office of Disaster Recovery (ODR) as the primary territorial government agency responsible for monitoring, managing and administering federal funding provided for hurricane Irma and Maria recovery.

On June 20, 2019, FEMA implemented a manual drawdown review process for reimbursement for projects under the Sheltering and Temporary Essential Power (STEP) Pilot Program and on October 1, 2019, FEMA expanded the manual drawdown process for reimbursement to all eligible projects under the Public Assistance (PA) Program. FEMA will continue this manual drawdown process until ODR implements fiscal controls, accounting and project administration procedures at the recipient and sub-recipient levels that demonstrates that it is ready, willing and able to assume the responsibility and access to the federal grant funds. This includes the execution of all phases of the grants management process for both the recipient and sub-recipient in accordance with all applicable federal laws, regulations, and administrative requirements.

FEMA is committed to providing the U.S. Virgin Islands Housing Finance Authority (VIHFA) support it needs to ensure it can manage its grants effectively. FEMA will monitor ODR as the grant recipient and will provide technical assistance as needed to ensure that ODR has the ability to manage its grants.

The draft report contains seven recommendations, with which the Department concurs. Attached find our detailed response to each recommendation. DHS previously submitted technical comments under a separate cover.

Again, thank you for the opportunity to review and comment on this draft report. Please feel free to contact me if you have any questions. We look forward to working with you again in the future.

Attachment

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Attachment: Management Response to Recommendations Contained in OIG 19-020-AUD-FEMA

OIG recommended that the Regional Administrator, FEMA Region II:

Recommendation 1: Work with VITEMA and VIHFA to:
- Monitor the status of the new financial management system in development at VIHFA and verify its compliance with Federal regulations; and
- Verify VIHFA has the appropriate staffing to account for Federal funds, prior to awarding additional funding.

Response: Concur. VIHFA implemented an accounting system called SAP Business One. SAP Business One is a complete business management solution. The system allows VIFHA to manage its funds and provide accurate financial information by reconciling its banks accounts, comparing budget versus expenditures, handling accounts payable function, processing checks, and producing purchase orders and invoices. VIHFA now uses SAP Business One for its grant management process, including closeout. All project information is stored in the system allowing quick web-based access. VIHFA can monitor deadlines, track costs, and close projects within the system. Project requests such as scope changes, time extensions or closeouts can be submitted and tracked in the system. Quarterly Report data can also be collected and exported as required.

Additionally, as of March 2020, VIHFA has 85 employees; 54 in their St. Thomas office and 31 in their St. Croix location. VIHFA has the appropriate staffing to account for Federal funds.

FEMA Region II will review the capability of SAP Business One to ensure it is in compliance with 2 CFR 200.302. Estimated Completion Date (ECD): February 28, 2021.

Recommendation 2: Work with VITEMA and VIHFA to perform a detailed review of the $65 million in subcontractor labor costs and consider disallowing costs that do not fully comply with Federal regulations.

Response: Concur. FEMA implemented a manual drawdown review process for reimbursement on October 1, 2019 for all PA projects. Through that process, FEMA is currently reviewing all requests to draw down funding from all Project Worksheets (PW), including PWs 100 and 273, and will only approve the draw down of eligible costs. FEMA is also completing a review of all draw downs approved by VITEMA prior to FEMA implementing the manual drawdown review process. Any costs found to be ineligible will be recovered. ECD: February 28, 2021.

Recommendation 3: Provide VITEMA and VIHFA with additional guidance to update their policies and procedures to ensure they comply with DRRA and FEMA's *Public Assistance Management Costs Interim Policy – Standard Operating Procedures*.

Response: Concur. FEMA issued the Public Assistance Management Costs Interim Policy on November 14, 2018, shortly after the President signed the *Disaster Recovery Reform Act of 2018* (October 5, 2018). Additionally, FEMA issued the *Public Assistance Management Costs Interim Policy – Standard Operating Procedures* (SOP) in February 2019.

FEMA Region II will meet with VITEMA and VIHFA to review the SOP and provide guidance needed for VITEMA and VIHFA to have compliant policies and procedures. ECD: February 28, 2021.

Recommendation 4: Work with VITEMA and VIHFA to:

- Review the expenditures related to the cost-plus-percentage-of-cost and non-competitive contracts to determine if the related costs are reasonable and therefore allowable. FEMA should determine if unreasonable and unallowable costs should be recovered.
- Establish an internal control structure to ensure that business practices provide assurance that costs claimed for FEMA reimbursement meet the Federal criteria for necessary, reasonable, and allowable costs.
- Establish controls over the procurement issues discussed in the finding: Cost or Price Analysis, Cost-Plus-Percentage-of-Cost Contracts, Sole Source Procurement, Conflict of Interest Provisions, and Use of Suspended or Debarred Contractors.

Response: Concur. Through the manual drawdown review process for reimbursement, FEMA will review all requests to draw down funds from PWs 100 and 273 and will only approve eligible costs. FEMA will evaluate all costs for reasonableness in accordance with its *Public Assistance Reasonable Cost Evaluation Job Aid* as part of the eligibility review.

FEMA Region II will work with VITEMA and VIHFA to ensure that VIHFA establishes effective internal controls over its management of its PA subgrants that comply with 2 C.F.R. § 200.303. In particular, these will focus on the requirement that all costs claimed for FEMA reimbursement are necessary, reasonable, and allowable. FEMA provided numerous trainings to VITEMA and Territorial agencies on the current procurement standards that apply to state and territorial entities. The training specifically stressed that "cost-plus percentage-of-cost" contracts may be allowed under state law, but are generally discouraged. FEMA will reiterate to VIHFA that although federal procurement standards for states are limited to the requirements in 2 C.F.R. § 200.317, without

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establishing controls over the use of "cost-plus-percentage-of-cost" contracts and sole source procurement, such as instituting a cost or price analysis process, VIHFA is at risk of incurring costs that FEMA may find unreasonable and ineligible for reimbursement. FEMA will also reiterate that without sufficient conflict of interest provisions in its procurement and contracting policies and procedures, a similar risk exits. Lastly, FEMA will reinforce that 2 C.F.R. § 200.213 restricts the award of contracts to suspended or debarred contractors. ECD: February 28, 2021.

Recommendation 5: Work with VITEMA and VIHFA to ensure that all PA grant funds are assigned the correct category and verify that the state cost-share information is accurate.

Response: Concur. FEMA Region II acknowledges the importance of accurate categorization of work and cost-share allocation. A Project Worksheet goes through multiple levels of review and concurrence before it is obligated to assure the accurate categorization. FEMA correctly categorized PW 205 under DR-4335-VI as permanent work, Category E at 90 percent Federal cost share. The PW approved funding for completed permanent repair work to bring the VIHFA Main Office in Frenchtown Plaza back to its pre-disaster design and function and to replace damaged contents.

FEMA requests this recommendation be considered resolved and closed.

Recommendation 6: Work with VITEMA and VIHFA to:

- Perform a detailed review of the $296 million in cost overruns and disallow all costs that do not fully comply with Federal regulations.
- Require that VIHFA adhere to Federal regulations for all future PW requests and modifications.

Response: Concur. FEMA implemented a manual drawdown review process for reimbursement on June 20, 2019, for all VIHFA STEP projects. Through that process, FEMA is reviewing all requests to draw down funding from PWs 100 and 273 and will only approve the draw down of eligible costs. FEMA Region II will ensure that VITEMA and VIHFA are aware of FEMA regulations and policies regarding requests for scope of work changes. ECD: February 28, 2021.

Recommendation 7: Coordinate with VITEMA and VIHFA to identify and grant access to individuals whose job responsibilities require FEMA Grants Portal access and ensure all appropriate personnel receive Grants Portal training.

Response: Concur. FEMA Region II has provided Grants Portal access and trained all VITEMA and VIHFA personnel identified by each agency to require access.

Specifically, FEMA provided training to VITEMA and Territorial applicants on Grants Manager – Basics on August 13, 2018; Grants Manager Portal on January 23, 2019; Grants Portal Overview (specifically for VITEMA) on February 7, 2019; Grants Portal on February 27, 2019; and Grants Portal Applicant Training on June 21, 2019. FEMA will also provide additional Grants Portal training upon request.

FEMA requests this recommendation be considered resolved and closed.

Appendix D: Report Distribution

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