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**Comptroller General
of the United States**

**United States Government Accountability Office
Washington, DC 20548**

Decision

Matter of: Department of Homeland Security Inspector General—Federal
Emergency Management Agency Subgrantee’s Claim under the Stafford
Act

File: B-317098

Date: March 13, 2009

DIGEST

The Federal Emergency Management Agency (FEMA) reimbursed a subgrantee receiving Stafford Act funds \$3.8 million for rocks used for emergency repairs and improvements to facilities, notwithstanding that the rocks had originally cost the subgrantee less than \$20,000. The Department of Homeland Security Inspector General subsequently questioned the reimbursement. Given the lack of documentation in the record regarding other pricing methods that may have been more appropriate to the circumstances, that would ensure the subgrantee did not obtain a windfall, and that would show whether the method chosen was consistently applied, we recommend that FEMA reassess its reimbursement. If FEMA finds that the reimbursement in question should be reduced or disallowed, but that recovery actions are barred under the Stafford Act, 42 U.S.C. § 5205(a), FEMA should be alert to opportunities that may be available under 31 U.S.C. § 3716 to offset or withhold funds for claims notwithstanding statutes of limitations.

DECISION

The Inspector General of the Department of Homeland Security (DHS) has requested a decision regarding the reimbursement in July 2000 of \$3.8 million in Stafford Act grant funds provided by the Federal Emergency Management Agency (FEMA) to the state of Arizona for the Wellton-Mohawk Irrigation and Drainage District in Arizona. Letter from Richard L. Skinner, Inspector General, DHS, to Gary Kepplinger, General Counsel, GAO, Sept. 2, 2008 (Skinner Letter). A public assistance award was made to the irrigation and drainage district for emergency repairs and improvements to

facilities damaged by floods.¹ The award provided that the FEMA grant funds would cover 75 percent of the district's costs up to a maximum of \$44,200,000, and the state would cover the remaining 25 percent. *Id.* After an audit of the district's costs, FEMA's Inspector General reported that the district used an incorrect valuation methodology to claim \$5.1 million for the replacement value of rocks used from its own stock that had cost it under \$20,000.² Skinner Letter. Wellton-Mohawk had used a Bureau of Land Management (BLM) average royalty rate method to value its rocks. At issue here is FEMA's use of its appropriations to reimburse the district \$3.8 million, FEMA's share of the \$5.1 million claimed.

As we explain below, FEMA should reassess its reimbursement to Wellton-Mohawk to ensure that it did not amount to a sizable windfall to the subgrantee. Nothing in the record before us addresses whether FEMA, in assessing the reasonableness of its reimbursement to Wellton-Mohawk, considered other pricing methods that may be more appropriate to the circumstances or whether Wellton-Mohawk, up to this time, had consistently applied the BLM average royalty method to value its inventory of rocks, as required by FEMA regulations. The Stafford Act requires FEMA to initiate an administrative action to recover payments within 3 years of the date of transmission of the final expenditure report for a disaster. We recommend that FEMA determine whether the statute of limitations bars recovery of funds from Wellton-Mohawk in this case. Even if recovery actions are barred under the Stafford Act, administrative offset may be available under 31 U.S.C. § 3716, which permits agencies to offset or withhold funds notwithstanding statutes of limitations. If FEMA finds that the reimbursement in question should be reduced or disallowed, FEMA should be alert to opportunities that may be available to offset or withhold other funds payable to the state of Arizona.

BACKGROUND

The Wellton-Mohawk Irrigation and Drainage District (Wellton-Mohawk) in Arizona is located between Painted Rock Dam and Yuma and spans a stretch of the Gila River that flows west toward the Colorado River. *See generally* www.wellton-mohawk.org/history.html; www.usbr.gov/dataweb/html/gila.html#general (last visited Jan. 21, 2009). Wellton-Mohawk provides irrigation water, drainage, and flood protection for farmland and support infrastructure. To quarry riprap, or rocks, needed for ongoing

¹ FEMA, Office of the Inspector General—Audits Div., Memorandum from Robert J. Lastrico, Western District Audit Manager, for Karen E. Armes, Acting Regional Director, Region IX, *Wellton-Mohawk Irrigation & Drainage District, Wellton, Arizona, FEMA Disaster No. 0977-DR-AZ, Public Assistance Identification No. 027-91000, Audit Rep. No. W-08-02*, Jan. 14, 2002, at 7 (Audit Memo).

² FEMA's Inspector General completed the audit in January 2002, before FEMA was merged into the newly created DHS by the Homeland Security Act of 2002, Pub. L. No. 107-296, §§ 503, 507, 116 Stat. 2135, 2213–14 (Nov. 25, 2002).

flood control and infrastructure projects, Wellton-Mohawk, in 1982, purchased Antelope Mountain, a 40-acre property, for \$20,000.³

Flooding between January and March 1993 damaged Wellton-Mohawk facilities and its various projects. FEMA Audit Resolution Briefing Paper, IG Audit Report W-08-02, *Wellton Mohawk Irrigation and Drainage District (WMIDD), Wellton, Arizona*, Jan. 14, 2002 (Audit Briefing); Audit Memo at 8. On January 19, 1993, the President declared that a major flood disaster existed in Arizona and ordered federal aid to supplement state and local recovery efforts. *See* White House Announcements, 29 Weekly Comp. Pres. Doc. 73 (Jan. 25, 1993) (Presidential Disaster Declaration).

The Stafford Act⁴ authorizes the President to issue major disaster or emergency declarations and specifies the types of assistance that the President may authorize for disaster relief. 42 U.S.C. §§ 5121–5206 (Stafford Act); *see also* 44 C.F.R. §§ 206.35–206.48 (1996). *See generally* www.fema.gov/media/fact_sheets/declaration_process.shtm (last visited Jan. 21, 2009). If the President issues such a declaration and finds that federal resources are required to supplement state and local resources, the federal government may provide various types of financial and essential assistance for disasters such as floods. *See, e.g.*, 42 U.S.C. §§ 5170b, 5172; 29 Weekly Comp. Pres. Doc. 73.

Each year Congress appropriates funds without fiscal year limitation to the disaster relief fund for FEMA to carry out the Stafford Act. *See, e.g.*, Continuing Appropriations, 1996, Pub. L. No. 104-31, 109 Stat. 278, 279 (Sept. 30, 1995); Department of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1995, Pub. L. No. 103-327, 108 Stat. 2298, 2323 (Sept. 28, 1994). The appropriation is available under section 406 of the Stafford Act to make contributions to state or local government for at least 75 percent of the eligible costs of the repair, restoration, reconstruction, or replacement of a public facility that was damaged or destroyed by a major disaster and other associated expenses incurred by such government. 42 U.S.C. §§ 5172(a)(1), (b)(1). States apply for federal public assistance disaster funds and are responsible for processing subgrants to applicants in accordance with FEMA regulations. 44 C.F.R. § 206.202(a). A subgrantee is accountable to the state grantee for the use of the funds provided. *Id.* § 206.201(l).

Wellton-Mohawk received a public assistance award of \$66.2 million of Stafford Act funds from the Arizona Department of Emergency and Military Affairs (ADEM), a FEMA grantee, for property damaged by the floods and for improvements to

³ While Wellton-Mohawk officials told FEMA that the mountain cost \$20,000, Wellton-Mohawk did not make records available to FEMA to validate the purchase price of the Antelope Mountain property. Audit Memo at 2.

⁴ We refer to provisions of the Stafford Act and FEMA's grant regulations in force on May 10, 1996, when FEMA Region IX awarded grant funds for the channel project.

irrigation, drainage system facilities, and flood control projects. Audit Memo at 8. FEMA agreed that ADEM could subgrant FEMA grant funds to Wellton-Mohawk to cover 75 percent of the \$66.2 million, with the state of Arizona covering the remaining 25 percent. *Id.* at 1.

As work was underway on the channel project, Wellton-Mohawk informed ADEM that it would use rock from its Antelope Mountain property for the repairs and improvements to the project. Audit Memo at 8. Wellton-Mohawk proposed to charge ADEM a royalty rate for the replacement value of the rock consumed.⁵

Id. at 2. The rate was determined using a BLM average royalty rate based on fair market value. *Id.* at 3; FEMA, Office of the Inspector General, Memorandum from Nathan S. Bergerbest, Counsel to the Inspector General, for Robert J. Lastrico, Western District Audit Manager, FEMA, *Wellton-Mohawk*, Sept. 18, 2002, at 2. Using that methodology, Wellton-Mohawk valued the rocks at \$5,143,679, and claimed that amount from ADEM. Audit Memo at 2. In April 1994, ADEM agreed to pay Wellton-Mohawk the \$5,143,679. *Id.* at 8. In July 2000, FEMA completed its final inspection report of the project and disbursed \$3.8 million, the federal share of the \$5.1 million. *Id.* at 9. See Final Inspection Report by Lester A. Ferguson, ADEM Reservist, *\$44.2 Million Grant Project*, Declaration No. 0977, Aug. 23, 2000.

FEMA's Inspector General completed an audit of Wellton-Mohawk's FEMA-funded projects in January 2002. Audit Briefing. While the audit found that Wellton-Mohawk generally expended and accounted for public assistance funds according to federal regulations and FEMA guidelines, the audit questioned the costs claimed for rocks used on the channel restoration project. Audit Memo at 2. The Inspector General found that the royalty-based replacement value method resulted in excessive and unreasonable charges by claiming more than the actual cost of the rock used. These charges, the Inspector General found, were unreasonable under FEMA regulations and applicable cost principles because the claimed costs were not ordinary and necessary for Wellton-Mohawk's operation, did not consider the restraints imposed by federal regulations, and unjustifiably increased the cost of the federal award. *Id.* at 4, citing OMB Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, at Attachment A, § C.2, (May 5, 1995), available at 60 Fed. Reg. 26489 (May 17, 1995).

The Inspector General concluded that Wellton-Mohawk should have claimed the actual cost paid for the Antelope Mountain property less the residual value of rock remaining after project completion.⁶ *Id.* Since Wellton-Mohawk could not provide

⁵ The costs of extracting, processing, and delivering rock from Antelope Mountain to the project site were not included in the replacement value of the inventory but were also paid under this grant. Audit Memo at 8–9.

⁶ The report notes that rock from the Antelope Mountain property was still available for other needs after completion of the FEMA- and ADEM-funded projects. Audit Memo at 2–3.

supporting documentation regarding the cost paid for its Antelope Mountain property and the residual value of the remaining rock, the audit recommended that FEMA's Regional Director, in coordination with ADEM, disallow the \$5,143,679 reimbursement for the claimed cost of the rocks. Audit Briefing; Audit Memo at 6. The DHS Inspector General maintains that FEMA had no regulatory authority to disburse funds for costs not incurred and has a legal obligation to recover the federal share, \$3.8 million, of the \$5.1 million awarded to Wellton-Mohawk. Skinner Letter.

FEMA Region IX and FEMA Headquarters disagreed with the Inspector General. FEMA argues that materials drawn from grantee stores or stockrooms may be charged to the grantor agency at costs derived under any recognized method of pricing, consistently applied, and that the BLM pricing methodology that Wellton-Mohawk used is a "recognized method of pricing." Memorandum from Amy Weinhouse, Attorney, for David Trissell, Chief Counsel, *Wellton Mohawk*, Oct. 2, 2007, at 2, *citing* OMB Cir. No. A-87, at Attachment B, § 29 (Weinhouse Memo). *Id.* FEMA concluded that the replacement value awarded for the rock was fair and reasonable compensation for the depleted inventory and that the agency would take no further action on the Inspector General's audit report. FEMA, Region IX, Memorandum from Jeff Griffin, Regional Director, for Robert J. Lastrico, *Wellton-Mohawk*, May 21, 2003, at 1; DHS, Memorandum from Michael D. Brown, Under Secretary, Emergency Preparedness and Response, to Richard L. Skinner, Acting Inspector General, *Wellton Mohawk*, June 23, 2008.

ANALYSIS

The question before us involves the use of FEMA disaster relief funds to pay the Wellton-Mohawk Irrigation and Drainage District for the value of rocks used to carry out a disaster restoration project. As we describe above, the Inspector General and FEMA disagree on the applicability of the various grant regulations, and on cost principles and appropriate valuation methods thereunder, and even on the type of grants that were awarded for the channel restoration project.⁷ The record submitted to us in this case does not permit us to resolve these disagreements here. The record does not show, for example, whether Wellton-Mohawk consistently applied the BLM average royalty method to value its inventory of rocks. It does suggest, however, that FEMA may not have considered the implications of a 2004 federal circuit court decision interpreting the Stafford Act, *Public Utility District No. 1 of Snohomish County, Washington v. FEMA*, 371 F.3d 701 (9th Cir. 2004). We recommend that FEMA reassess its reimbursement to Wellton-Mohawk in light of that decision.

In a case similar to the facts before us, the Ninth Circuit Court of Appeals upheld a FEMA order requiring a public utility district to repay portions of Stafford Act

⁷ The various arguments and rebuttals between the Inspector General and FEMA's regional director and headquarters appear in a series of 10 memoranda, including 2 legal memoranda, spanning the period January 14, 2002, through October 2, 2007.

disaster grants. *Public Utility District*, 371 F.3d 701. FEMA had awarded federal disaster relief grants to a public utility district in Washington State after severe winter storms damaged the district's power distribution network. *Id.* at 705. An Inspector General audit found the utility district's claimed "fringe benefit overhead rate" questionable and recommended that FEMA reduce the amounts of the awards and recover portions thereof. *Id.* The utility district's policy was to claim an across-the-board, 36 percent fringe benefit overhead rate for each employee labor hour worked. *Id.* at 704. The district arrived at that rate by taking its total cost of fringe benefits and dividing by the total number of labor hours for a given time period. *Id.* FEMA's Inspector General concluded that the 36 percent rate did not reflect the district's actual expenses for providing fringe benefits for overtime labor because the district's expenses remained constant for fringe benefits, regardless of the number of overtime hours worked by its employees. *Id.* By the utility district's own calculation, the actual fringe benefit overhead rate for overtime labor was about 10 percent, not the 36 percent rate it claimed. *Id.* FEMA adopted the Inspector General's recommendation that the agency demand that the utility district return the fringe benefit overcharge. *Id.* The district appealed FEMA's determination, FEMA rejected the appeal, and the district sued the agency. *Id.* at 706.

The Ninth Circuit agreed with FEMA and the Inspector General that the utility district's claim was unreasonable and not based on actual costs incurred. *Id.* at 709-10. The court noted that Congress's declared intent in enacting the Stafford Act was "to provide an orderly and continuing means of assistance by the Federal Government to State and local governments in carrying out their responsibilities to alleviate the suffering and damage *which result from such disasters.*" *Id.* (emphasis in original), *citing* 42 U.S.C. § 5121(b). Referring to the Stafford Act's declaration of intent, the court found that the utility district's 36 percent rate resulted in a "sizable windfall" in an amount in excess of \$600,000. *Id.* at 710. That this windfall may have resulted from the district's use of an accepted accounting practice for determining fringe benefit overhead costs was of no consequence. *Id.* The court concluded that FEMA had not acted arbitrarily and capriciously by challenging the district's 36 percent fringe benefit rate where that rate resulted in FEMA paying the district amounts having nothing to do with the disasters for which federal relief was given. *Id.* See also B-203681, Sept. 27, 1982 (because grantee overallocated overhead costs to the grant, agency's reimbursement violates the purpose statute, 31 U.S.C. § 1301(a); those costs were not for the purpose of the grant).

In this case, as the Inspector General has pointed out, Wellton-Mohawk charged ADEM and FEMA \$5.1 million for rocks taken from a mountain that, in 1982, had cost Wellton-Mohawk \$20,000. It is not disputed that Wellton-Mohawk is entitled under the grant to the value of the rocks it used from its own inventory.

OMB Circular A-87,⁸ which FEMA has incorporated by reference into its regulations,⁹ provides, “Withdrawals from general stores or stockrooms should be charged at cost under any recognized method of pricing, consistently applied.” OMB Cir. No. A-87, at Attachment B, § 29 (May 5, 1995). It is undisputed also that, as FEMA has pointed out, the BLM average royalty rate method that Wellton-Mohawk used to value its rocks is one of “any recognized method[s] of pricing.” However, that should not be the end of FEMA’s assessment of Wellton-Mohawk’s cost valuation. When viewed in the context of the Ninth Circuit decision, Wellton-Mohawk’s use of the BLM average royalty rate in these circumstances certainly appears to result in a “sizable windfall” for Wellton-Mohawk: the subgrantee received \$5.1 million as the value of rocks that cost the grantee under \$20,000. Although FEMA accepted the BLM average royalty rate as a recognized method of pricing, it is not apparent from the record that FEMA took the next step; it is important that FEMA, as a steward of public funds, also assess the reasonableness of the pricing method to ensure that use of that method does not result in a “sizable windfall” for the grantee.

OMB Circular A-87 offers guidance in this regard: “A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost.” OMB Cir. No. A-87, at Attachment A, § C.2. Among the factors that OMB advises agencies to consider are arms-length bargaining, sound business practices, “[w]hether the individuals concerned acted with prudence in the circumstances considering their responsibilities to the governmental unit, its employees, the public at large, and the Federal Government,” and “[s]ignificant deviations from the established practices of the governmental unit which may unjustifiably increase the Federal award’s cost.” *Id.* Indeed, while Circular A-87 provides for cost valuation based on “any recognized method of pricing,” it adds to that consideration that the method be “consistently applied.” *Id.* at Attachment B, § 29.

Nothing in the record addresses whether Wellton-Mohawk, up to this time, had consistently applied the BLM average royalty method to value its inventory of rocks. Although FEMA accepted Wellton-Mohawk’s valuation method as a recognized pricing method, nothing in the record establishes that FEMA, in assessing the reasonableness of the cost that Wellton-Mohawk charged, considered other pricing methods that may have been more appropriate to these circumstances. Clearly, Wellton-Mohawk is entitled to be reimbursed for the rocks it provided to its channel restoration project; however, as the Ninth Circuit pointed out, the purpose of the Stafford Act is to alleviate damages suffered from natural disasters, not to enrich local governmental units. It is FEMA’s responsibility to ensure that whatever pricing method Wellton-Mohawk used to price its rocks is reasonable in the circumstances and consistently applied by the grantee.

⁸ OMB Circular A-87 establishes cost principles generally for federal grants to state, local, and tribal governments. OMB Cir. No. A-87, at 1.

⁹ 44 C.F.R. § 13.22(b).

CONCLUSION

We recommend that FEMA reassess its reimbursement to Wellton-Mohawk in view of the Ninth Circuit decision and this decision. We note that the record was silent with regard to the statute of limitations that appears in the Stafford Act. The Act requires FEMA to initiate an administrative action to recover payments within 3 years of transmission of the final expenditure report for the disaster. 42 U.S.C. § 5205(a). FEMA disbursed its reimbursement to Wellton-Mohawk in July 2000, although the record does not clearly establish the date of transmission of the final expenditure report. We recommend that FEMA determine whether the statute of limitations bars recovery of funds from Wellton-Mohawk in this case.

Even if recovery actions are barred under the Stafford Act, administrative offset may be available under 31 U.S.C. § 3716, which permits agencies to offset or withhold funds for claims notwithstanding statutes of limitations. If FEMA finds that the reimbursement in question should be reduced or disallowed, FEMA should be alert to opportunities that may be available to offset or withhold other funds payable to the state of Arizona. *See* 58 Comp. Gen. 501 (1979) (statutes of limitations bar only the applicable remedy and do not discharge the debt or extinguish, or even impair, the government's right or obligation to avail itself of every other lawful means of realizing on the debt or obligation); 44 C.F.R. § 13.52 (collection of amounts due). Agencies have a duty to recover grant funds awarded for an ineligible cost. *See* B-146285, B-164031(1), Apr. 19, 1972. Not to require repayment of funds for an ineligible cost constitutes giving away United States funds without authority of law. *See* 51 Comp. Gen. 162.



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