

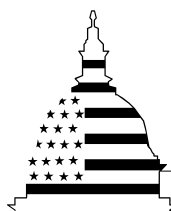
GAO

Report to the Committee on
Appropriations, U.S. Senate, and the
Committee on Appropriations, House of
Representatives

May 2003

FEMA CERRO
GRANDE CLAIMS

Payments Properly
Processed, but
Reported Payments
Somewhat Overstated



G A O

Accountability ★ Integrity ★ Reliability



Highlights of [GAO-03-623](#), a report to the Committee on Appropriations, U.S. Senate, and the Committee on Appropriations, House of Representatives

Why GAO Did This Study

The Cerro Grande Fire Assistance Act mandated that GAO annually audit all claim payments made to compensate the victims of the Cerro Grande Fire in northern New Mexico. For this second report on this topic, GAO determined whether the Federal Emergency Management Agency (FEMA), which is now a part of the Department of Homeland Security, (1) had revised its policies and procedures to address prior GAO recommendations and processed and paid claims consistent with that guidance and (2) properly reported such payments to the Congress.

What GAO Recommends

To improve FEMA's ability to accurately report claims status, including amounts paid, and request additional funding, GAO recommends that the Secretary of Homeland Security require the Emergency Preparedness and Response Directorate to

- reconcile claim amounts approved to amounts paid and correct all identified errors in its payment approval system and
- perform monthly reconciliation of the claims in both systems.

The Department of Homeland Security's Emergency Preparedness and Response Directorate concurred with our recommendations and indicated that it has several actions under way to address them.

www.gao.gov/cgi-bin/getrpt?GAO-03-623.

To view the full report, including the scope and methodology, click on the link above. For more information, contact Linda Calborn at (202) 512-9508 or calbornl@gao.gov.

FEMA CERRO GRANDE CLAIMS

Payments Properly Processed, but Reported Payments Somewhat Overstated

What GAO Found

FEMA implemented corrective actions to address the recommendations from GAO's prior report to strengthen its policies and procedures. GAO found that claims were processed, approved, and paid in accordance with FEMA's established applicable guidelines, providing adequate supporting documentation and evidence of supervisory reviews. However, as discussed below, claimed amounts approved for payment but not paid were not properly tracked in the Office of Cerro Grande Fire Claims' (OCGFC) payment approval system.

FEMA's report to the Congress included somewhat overstated claim payment information. The report used claimed amounts approved by OCGFC for payment, rather than amounts actually paid by FEMA. This occurred because FEMA had not reconciled the approved amounts from its payment approval system to amounts paid per its accounting system and was not aware of the differences, which amounted to about \$12 million, or 3 percent of total reported payments, as of September 7, 2002. FEMA is currently attempting to reconcile the approved amounts with the paid amounts. This difference resulted because approved amounts that were not paid when claims were delayed for appeal or canceled for other reasons were not removed from or adjusted in the payment approval system. As a result, the claim payment information reported to the Congress does not provide a completely accurate picture of OCGFC claim payments. This information was also used by FEMA to determine its request for additional funding. Since FEMA received less than it requested, this error likely did not result in an appropriation in excess of amounts needed to pay claims.

During its review, GAO also noted that FEMA's estimate of its unfunded claims liability increased by \$91 million from September 30, 2001, to October 2, 2002. While FEMA's external auditors found that FEMA used a reasonable methodology to calculate the most recent estimate, they were unable to explain the reason for the increase in the estimate. This occurred because FEMA changed the methodology used but did not provide a crosswalk between the two approaches. In April 2003, FEMA officials stated that they planned to contract for an analysis to be performed to determine the effect that the change in methodology and other factors had on the calculation of the estimated liability.

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Abbreviations

ACIS	Automated Claim Information System
CGFAA	Cerro Grande Fire Assistance Act
DFC	Disaster Finance Center
FEMA	Federal Emergency Management Agency
NOL	Notice of Loss
OCGFC	Office of Cerro Grande Fire Claims

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United States General Accounting Office
Washington, D.C. 20548

May 8, 2003

The Honorable Ted Stevens
Chairman
The Honorable Robert C. Byrd
Ranking Minority Member
Committee on Appropriations
United States Senate

The Honorable C.W. Bill Young
Chairman
The Honorable David R. Obey
Ranking Minority Member
Committee on Appropriations
House of Representatives

On July 13, 2000, the President signed into law the Cerro Grande Fire Assistance Act (CGFAA).¹ CGFAA established the Office of Cerro Grande Fire Claims (OCGFC) and directed the Federal Emergency Management Agency (FEMA)² to expeditiously investigate victims' claims, determine damages, and compensate the victims of the Cerro Grande fire in northern New Mexico. CGFAA also requires FEMA to submit an annual report to the Congress by August 28 that provides information on claims submitted during the year. CGFAA, as amended,³ requires that we audit all claim payments made under the act, including subrogation claims⁴ made by insurance companies, and report the results of our audit within 120 days of the issuance of FEMA's annual report. In this our second report under CGFAA, we determined whether FEMA (1) implemented new policies and procedures to address our prior report's recommendations and processed and paid fire claims in accordance with applicable policies and procedures and (2) properly reported such payments to the Congress.

¹Pub. L. 106-246, Div. C, Title I, 114 Stat. 511, 583 (2000).

²As of March 2003, FEMA became part of the Emergency Preparedness and Response Directorate of the Department of Homeland Security.

³Pub. L. 107-73, Title IV, § 428, 115 Stat. 651, 697 (2001).

⁴A subrogation claim is the right of one who has paid an obligation that another should have paid to be indemnified by the other. In this case, insurance companies and possibly others paid claims that the federal government is responsible for paying.

We did not review any subrogated claim payments as part of this audit because as of January 15, 2003, the end of our fieldwork, no subrogated claims payments had been made.⁵ However, FEMA did report to the Congress that as of September 7, 2002, insurance companies had submitted 4,553 subrogated claims totaling approximately \$103 million.⁶ FEMA also reported that as soon as 95 percent of all nonsubrogee claims have been paid, and when funds become available,⁷ payments for subrogation claims will be made to insurers expeditiously. We will review payments made for subrogated claims as part of our next audit.

Results in Brief

FEMA revised its policies and procedures to address our prior report's recommendations and processed and paid fire claims in accordance with its applicable policies and procedures. In response to our prior audit report, issued in July 2001,⁸ FEMA implemented corrective actions to address our recommendations to (1) document all steps and procedures performed by claims reviewers to determine the validity of a claim and the amount recommended for payment, (2) incorporate all existing informal guidance into a set of formal policies and procedures, and (3) establish standardized policies and procedures to address claims for which no policy had existed. Based on the results of our statistical testing, we found that claims were processed, approved, and paid in accordance with FEMA's revised policies and procedures. However, as discussed below, we found that claimed amounts approved but not yet paid were not properly tracked in OCGFC's payment approval system.

FEMA's second annual report to the Congress, dated December 16, 2002, included somewhat overstated claim payment information. FEMA's report

⁵CGFAA specifies that nonsubrogee claims, to the maximum extent practicable, be paid before subrogee claims.

⁶OCGFC stated that the amount represents either the amount of claims processed and approved by the claims reviewer or, if not processed, the amount submitted by the claimants.

⁷In its transmittal letter dated December 16, 2002, which accompanied its annual report to the Congress, FEMA stated that an additional \$155 million, including \$5 million in administrative costs, was needed. In February 2003, FEMA was appropriated an additional \$90 million, of which \$5 million is available for administrative purposes.

⁸U.S. General Accounting Office, *Federal Emergency Management Agency: Weaknesses Exist in the Cerro Grande Fire Assistance Claim Validation Process*, [GAO-01-848](#) (Washington, D.C.: July 13, 2001).

was based on claimed amounts approved for payment, as reported in its payment approval system, rather than amounts actually paid, as reported in FEMA's accounting system. FEMA officials said they believed the amounts to be the same, but had not reconciled the data and were not aware of a \$12 million difference between the two systems, which was almost 3 percent of amounts reported paid. FEMA is currently attempting to reconcile the approved claim amounts with the amounts actually reported as paid. We found that the primary reason for the difference was overstatements of claimed amounts approved for payment in OCGFC's payment approval system. This overstatement was caused by approved claim amounts that were being appealed, replaced by other claims, or otherwise not paid that were not removed from or adjusted in the payment approval system. As a result, the claim payment information reported to the Congress does not provide a completely accurate picture of Cerro Grande claim payment activity for the year. In addition, the erroneous approved claims data were used to determine FEMA's request for additional appropriated funding. Because \$90 million, rather than the \$155 million FEMA stated it needed, was appropriated to FEMA, it does not appear that the errors resulted in an appropriation in excess of the amount needed to pay claims.

In reviewing FEMA's fiscal year 2002 financial statements, we also noted that FEMA's estimate of its unfunded claims liability increased significantly compared to the prior year—from \$36.5 million as of September 30, 2001, to \$127.5 million as of October 2, 2002.⁹ While FEMA's external auditors found that FEMA used a reasonable methodology to calculate the current year liability, they were unable to explain the reason for the differences in the two estimates since FEMA changed the methodology but did not provide a crosswalk between the two approaches. The auditors noted this lack of analysis of the change in methodology as a weakness in their report on internal controls for fiscal year 2002. In April 2003, FEMA officials stated that FEMA would award a contract to perform an analysis to determine the dollar impact on the liability estimate due to changes in methodology, assumptions, systems, data, or other factors, from fiscal years 2002 through 2001.

⁹In January 2003, FEMA's auditor used the correct payment data, plus other adjustments, and proposed an adjustment to the October 2, 2002, unfunded liability, with which FEMA's management concurred. This resulted in a reduction of \$21.7 million.

We are making two recommendations that, if properly implemented, will improve FEMA's ability to track claims it approves and pays and help ensure the accuracy of amounts approved and paid in its systems, in reports to the Congress, and in amounts used to request additional funding. In commenting on a draft of the report, the Acting Director of the Recovery Division of the Department of Homeland Security's Emergency Preparedness and Response Directorate agreed with our recommendations and outlined several corrective actions that it is currently undertaking to address these issues.

Background

On May 4, 2000, the National Park Service initiated a prescribed burn on federal land at Bandelier National Monument, New Mexico, in an effort to reduce the threat of wildfires in the area. The plan was to burn up to 900 acres. On May 5, 2000, the prescribed burn exceeded the capabilities of the National Park Service, spread to other federal and nonfederal land, and was characterized as a wildfire. On May 13, 2000, the President issued a major disaster declaration, and subsequently, the Secretary of the Interior and the National Park Service assumed responsibility for the fire and the loss of federal, state, local, tribal, and private property. The fire, known as the Cerro Grande fire, burned approximately 48,000 acres in four counties and two Indian pueblos, destroyed over 200 residential structures, and forced the evacuation of more than 18,000 residents.

On July 13, 2000, the President signed CGFAA into law. Under CGFAA, each claimant is entitled to be compensated by the United States government for certain injuries and damages that resulted from the Cerro Grande fire. The Congress appropriated \$455 million to FEMA for the payment of such claims and \$45 million for the administration of the Cerro Grande program. In March 2002, FEMA requested, but did not receive, additional appropriated funding of \$80 million to cover excess claims and administrative costs. In December 2002, FEMA revised its estimate and requested additional appropriated funding of \$155 million, including \$5 million for administrative costs. The revised estimate was based on more complete claim information since the final date to submit claims passed on August 28, 2002. In February 2003, FEMA was appropriated an additional \$90 million, of which \$5 million may be made available for administrative purposes.

CGFAA requires that FEMA submit an annual report to the Congress that provides information about claims submitted under the act. This annual report is to include the amounts claimed, a description of the nature of the claims, and the status or disposition of the claims, including the amounts paid. FEMA's report is to be issued annually by August 28. CGFAA, as amended, requires that we conduct annual audits on the payment of all claims made and report the results of the audits to the Congress within 120 days of FEMA's issuance of its annual report. The act also requires that our report include a review of all subrogation claims for which insurance companies have been paid. On January 8, 2003, FEMA notified us that it had issued the annual report to the Congress through a transmittal letter dated December 16, 2002,¹⁰ and FEMA provided us a copy of the annual report on January 9, 2003. We are publishing our report within 120 days of FEMA's notification of its issuance.

CGFAA required that FEMA promulgate and publish implementing regulations for the Cerro Grande program within 45 days of enactment of the law. On August 28, 2000, FEMA published *Disaster Assistance: Cerro Grande Fire Assistance; Interim Final Rule* in the *Federal Register* (Interim Final Rules).¹¹ FEMA modified the Interim Rule with a set of implementing policies and procedures on November 13, 2000. FEMA updated these policies and procedures in January and March 2001. After reviewing public comments on the interim rule, FEMA finalized and published *Disaster Assistance: Cerro Grande Fire Assistance Final Rule* (Final Rule) on March 21, 2001.¹² Since our prior report, FEMA revised and implemented policies and procedures, which are discussed later in this report.

The claims payment process is initiated when an injured party submits a Notice of Loss (NOL)¹³ to OCGFC. After the NOL is received, claim reviewers contact the claimant to discuss the claim, explain the claims process, and determine the best means to substantiate the loss or damages.

¹⁰In its fiscal year 2002 financial statement audit, FEMA's external auditors reported the late submission of the annual report as an instance of noncompliance with CGFAA in their report on compliance with laws and regulations.

¹¹65 FR 52260, 44 C.F.R. Part 295 (2000).

¹²66 FR 15948, 44 C.F.R. Part 295 (2001).

¹³The NOL describes in general terms the types of injury and/or damages a claimant has incurred as a result of the fire.

The claim reviewer then assigns a claim number and enters the information into OCGFC's claim-processing database, the Automated Claim Information System (ACIS). The claims reviewer then begins the process of verifying the victim's claim. Once completed, the claims reviewer prepares a claim payment recommendation package, which specifies that a claimant's injuries or damages occurred as a result of the Cerro Grande fire and that claimed amounts are eligible for compensation under CGFAA. The claim reviewer also inputs reserve amounts equal to the total claimed amounts it expects to be paid into the claim-processing database and a claims supervisor reviews and approves each recommendation package. This review, among other things, is intended to ensure that a proper investigation of the claim occurred and that the proper documentation exists.

Following the approval of the claim payment recommendation package, an Approval for Payment form is completed and sent to an OCGFC authorizing official for review and approval. The amounts approved for payment are then added to a Schedule of Payments that is forwarded to the Comptroller. The Comptroller reviews a sample of requested and approved payments and then approves the Schedule of Payments and records the approved amounts in OCGFC's payment approval system before sending it on to FEMA's Disaster Finance Center (DFC) for additional manual processing and final approval for the Department of the Treasury to disburse the funds. FEMA records all payments in its accounting system, the Integrated Financial Management Information System, which is not linked to OCGFC's payment approval system.

In addition to this process, which is used for both partial payments¹⁴ and final payments, prior to processing a final payment, the claims reviewer prepares a Proof of Loss form. This form summarizes all amounts recommended for payment, including those amounts previously paid through a partial payment. The Proof of Loss form must be signed by the claimant subject to the provisions of 18 U.S.C. §1001, which establishes criminal penalties for false statements. Once a signed Proof of Loss form is received, an OCGFC authorized official sends a Letter of Final Determination to tell the claimant the total amount of compensation being offered under CGFAA. Accompanying this letter is a Release and Certification form that the claimant signs if he or she accepts the OCGFC compensation determination, thereby releasing the federal government from any additional claims arising from the Cerro Grande fire.¹⁵ Upon receipt of the signed Release and Certification form, FEMA will process and mail a claimant's final payment.

Scope and Methodology

In performing our review, we considered the *Standards for Internal Control in the Federal Government*.¹⁶ To reaffirm our understanding of the claim review and payment process established by OCGFC and to follow up on the changes made to this process since our last report, we interviewed FEMA officials and analyzed data used (1) in FEMA's annual report to the Congress, (2) by KPMG during its audit of FEMA's financial statements, and (3) by FEMA to determine the estimated claim liability. We also reviewed the following:

- the requirements of CGFAA,
- the final regulations published in the *Federal Register*,
- FEMA's policies and procedures manual,

¹⁴In order to get assistance to fire survivors as soon as possible, CGFAA allows for claimants to receive partial payments before the start of the rebuilding process. Partial payments may be based upon actual receipts or estimates. Final payments are made only after the entire claims review process is completed.

¹⁵Section 295.34 of the final rule published in the *Federal Register* provides for the reopening of claims, notwithstanding the submission of a Release and Certification form, under certain circumstances.

¹⁶U.S. General Accounting Office, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999).

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- the independent actuarial report estimating FEMA's total claim liability for fiscal year 2001,
 - a summary of FEMA's unpaid claim liability estimates for fiscal year 2002,
 - FEMA's fiscal years 2001 and 2002 audited financial statements, and
 - the current year Cerro Grande trial balance and other documentation concerning the Cerro Grande program.

We also obtained, reviewed, and considered the results of numerous desk reviews, by FEMA's Office of Inspector General, of claims approved for payment. Finally, we selected two statistical samples from the population of all partial and final claim payments to determine whether FEMA processed, approved, and paid the Cerro Grande fire claims in accordance with its applicable policies and procedures.

To determine whether FEMA implemented corrective actions to address our prior year recommendations and OCGFC processed and paid claims in accordance with the revised policies and procedures, we followed up on FEMA's corrective actions and performed certain tests to ensure that policies and procedures were being followed. We reviewed the revised policies and procedures to ensure that they were incorporated into FEMA's policies and procedures or modified in its claim-processing contract, and performed tests of both claims approved for payment by OCGFC and amounts paid by DFC, as reported by FEMA, as follows.

- We selected a dollar unit (statistical) sample of 95 claims totaling \$311,232,388 that were approved for payments from a population of 15,394 reported partial and final claim amounts that had been approved for payment from August 28, 2000 (inception), through September 7, 2002, to test specific control activities, such as adequacy of supporting documentation, evidence of claims manager and approving official review, and actual payment by FEMA. We obtained and reviewed related supporting documentation for the approved claim payments that were selected from OCGFC's payment approval system.
- We selected a dollar unit (statistical) sample of 77 claim payments totaling \$152,493,242 from a population of 47,674 actual payments made by FEMA from August 28, 2000, through September 7, 2002, to verify that only approved claims were paid. We obtained and reviewed related

supporting documentation for the claim payments that were selected from a database of claim payments made by DFC as reported in FEMA's accounting system.

In order to determine whether FEMA properly reported claim payment information to the Congress, we compared its reported payment information to the claimed amounts that were approved by OCGFC for payment from its payment approval system and to the actual claim payments made by DFC and reported in FEMA's accounting system. We also obtained and reviewed supporting documentation and discussed the unreconciled differences we identified with FEMA officials.

As mentioned previously, we did not audit subrogated claim payments since none were paid. We did, however, obtain a report from OCGFC indicating that as of January 15, 2003, 3,847 of 4,561, or 84 percent, of the subrogated claims totaling approximately \$103 million had been submitted and approved for payment, but not yet paid.

Our work was conducted in Santa Fe, New Mexico; Denton, Texas;¹⁷ and Washington, D.C., from September 2002 through January 2003 in accordance with generally accepted government auditing standards. We requested agency comments on a draft of this report from the Under Secretary of the Department of Homeland Security's Emergency Preparedness and Response Directorate. The Department of Homeland Security's Office of Inspector General provided certain technical comments orally, which we have incorporated as appropriate. The Acting Director of the Recovery Division of the Department of Homeland Security's Emergency Preparedness and Response Directorate also provided written comments in response to our draft on behalf of FEMA and OCGFC, which are reprinted in appendix I. We discussed the written comments in the "Agency Comments and Our Evaluation" section of this report.

¹⁷In December 2002, OCGFC closed its headquarters operations in Santa Fe, New Mexico, and moved the remaining claims operations to FEMA's National Processing Center in Denton, Texas.

Policies and Procedures for Claims Processing Improved and Followed

Since our last audit report, FEMA implemented corrective actions and revised its policies and procedures to address issues related to its controls over the claims review process. Based on the results of our statistical testing, claims were processed, approved, and paid in accordance with FEMA guidelines that were established and in place at the time the claims were reviewed and processed.¹⁸

In response to our July 2001 report, FEMA implemented corrective actions to address our recommendations related to its policies and procedures. In that report, we recommended that FEMA (1) require claims reviewers to document all steps and procedures they perform to determine the validity of a claim and the amount recommended for payment, (2) review and consolidate all existing informal guidance and incorporate this guidance into a set of formal policies and procedures, and (3) establish standardized policies and procedures to address claims for which no policy currently exists. During this review, we confirmed that FEMA had done this. Specifically, FEMA's improvements consisted of revising its policies and procedures and issuing a new task order.

- FEMA revised its contract with its claims reviewers and issued a new task order. This task order required that certain documentation obtained related to claims verification or attempts the claims reviewer made to obtain this sort of documentation¹⁹ be placed in each claim file. The required documentation consists of items such as proof of identity, proof of ownership or occupancy at the time of the fire, systems used to verify or estimate values, proof of vehicle ownership (title or registration) at the time of the fire, and verification of insurance as part of efforts to preclude duplicate reimbursements for losses. The task order also required evidence of supervisory review, with the signatures of the claims manager and approving official on the Approval for Payment form. Based on the results of our statistical testing, we found that all claim files submitted after the implementation of the new task

¹⁸We did not identify any control weaknesses in our review of the 95 statistically selected approved claims.

¹⁹Claims reviewers are now required to include documentation of all telephone conversations and attempts to contact or obtain support from claimants in the notes maintained in ACIS. In cases where documentation submitted is insufficient, the claims reviewers will perform the independent investigations necessary to make recommendations to FEMA.

order contained the required documentation and evidence of supervisory review.

- In April 2002, FEMA issued revised guidelines to ensure that all existing informal guidance was incorporated into a set of formally documented policies and procedures and distributed them to all staff members responsible for the claims review and award determination process. FEMA stated that the revised guidelines were distributed to all staff members and that it now has a process to review its policy manual monthly and incorporate new policies or policy changes into it as needed. We reviewed the new guidelines and verified that the previously informal and unofficial policies that the claim reviewers used had been incorporated.
- FEMA also developed various policies and procedures to cover situations for which none previously existed. For example, to address claimants' concerns about the declining value of residential property as a result of the fire, FEMA determined the decline to be temporary and developed policies and procedures to compensate claimants only for losses suffered if their residential property was sold at less than fair market value.²⁰ Policies and procedures were also developed to address the unique aspects of compensation under CGFAA, such as legal issues regarding who is a proper claimant if the injured party is now deceased and compensation for lost rental income. We reviewed the new guidelines and verified that such policies and procedures were incorporated.

The improvements FEMA made to its claims processing function help ensure that paid claims are valid and reasonable. However, as discussed in the next section, we found four errors related to FEMA's tracking and reporting of amounts approved and paid.

²⁰Fair market values were established in PricewaterhouseCooper's *Economic Study of the Los Alamos Post-Fire Residential Real Estate Market (Final Report)*.

Reported Claim Payment Information Was Somewhat Overstated

FEMA's report to the Congress overstated the amount of claim payments made under CGFAA through September 7, 2002, by about \$12 million, or 3 percent of reported payments. CGFAA requires FEMA to issue a report detailing the amounts claimed, a brief description of the nature of the claims, and their status or disposition, including the amount of any payments. For its most recent annual report to the Congress, FEMA used the information contained in OCGFC's payment approval system, which contains amounts approved for payment by OCGFC. However, there were errors in this system that overstated the amounts actually paid by DFC to claimants by approximately \$12 million. The overstated approved claim data were also used to determine FEMA's December 2002 requests for additional appropriations. However, since FEMA received less than it requested, this error likely did not result in an appropriation in excess of amounts needed to pay claims.

The overstatement of the claims paid amount was not identified by FEMA because it did not reconcile the amounts OCGFC approved for payment to the actual DFC payment data²¹ and was not aware of the differences between the two databases. As a result, FEMA incorrectly reported in its annual report to the Congress that \$418 million was paid on claims through September 7, 2002, instead of the almost \$406 million actually paid, as summarized in FEMA's accounting system for activity through the same date, a difference of \$12 million, or about 3 percent of amounts reported paid.

Most of the difference was due to FEMA's treatment of claimed amounts that were approved for payment and/or appealed claims. When approved amounts are not fully paid because of appeals or other reasons, the payment approval system continues to show the entire claimed amount that was approved for payment even though the approved amount or a portion of it has, in fact, been withheld from payment, canceled and not paid, or replaced by a new claim request. FEMA did not remove these amounts from its system or adjust the total approved amounts not yet paid. As a result, OCGFC's payment approval system overstates approved claims designated as paid.

²¹As part of FEMA's fiscal year 2002 financial statement audit, its auditors determined that amounts were correctly reported as paid by DFC in FEMA's accounting system. In addition, our review of the 77 statistically selected claim payments verified the accuracy of the amounts paid by DFC and no control weaknesses were identified.

For example, as part of our review of the 95 statistically selected approved claims, we found 4 claims in which the approved amounts reported in OCGFC's payment approval system were larger than the actual payments made by DFC.²² In one case, a claim file included more than \$1.8 million in approved payments, while the actual amount paid was \$919,802.²³ OCGFC records on this case showed that it originally approved \$934,802 for a final payment. However, when the claimant appealed the amount, OCGFC approved the claimant's request to pay \$919,802 as a partial payment pending the appeal. OCGFC prepared and approved a second claim without canceling the original claim or removing the original amount from its payment approval system. This one oversight alone overstated the approved claim amounts by \$934,802. As of February 2003, FEMA officials began manually reconciling the payment data between the two systems and identifying the errors in the payment approval system.

The overstated payment amounts were also used to determine FEMA's request for additional funding from the Congress. In December 2002, FEMA requested additional funding of \$155 million for fiscal year 2002, including \$5 million for administrative costs.²⁴ However, only \$90 million was appropriated to FEMA.²⁵ Thus, it does not appear that the overstated payments resulted in an appropriation in excess of the amounts needed to pay estimated claims.

²²We did not statistically estimate the total amount in error since the reconciliation between the two systems revealed that \$12 million was the actual dollar amount of the total errors in the payment approval system.

²³The claimant originally submitted a claim with total damages and losses in the amount of \$1.6 million.

²⁴The request was based on FEMA's original calculation of its October 2, 2002, unfunded liability, which was for \$149.2 million.

²⁵In February 2003, the VA, HUD and Independent Agencies Appropriations Act appropriated FEMA an additional \$90 million, of which \$5 million may be made available for administrative purposes (Pub. L. 108-07, Div. K, 2003).

We also noted that FEMA's estimate of unfunded claims liability had increased significantly compared to the prior year. In January 2003, FEMA revised its estimated unpaid Cerro Grande claims liability as of October 2, 2002, and calculated an estimated unpaid claim liability of \$177.5 million, of which \$127.5 million was unfunded.²⁶ This compares to an actuarially determined estimate calculated by an independent accounting firm of \$260.1 million as of September 30, 2001, of which \$36.5 million was unfunded. As part of the audit of FEMA's fiscal year 2002 financial statements, its auditors assessed FEMA's methodology for calculating its estimated unfunded liability for fiscal year 2002 and attempted to determine the reason for the \$91 million increase in the liability since the prior year.

The auditors determined that FEMA's fiscal year 2002 methodology was reasonable, but were unable to explain the reason for the difference in the two estimates since FEMA used a different methodology to calculate the estimate than had been previously used, but did not provide a "crosswalk" between the two approaches. The auditors reported this as a weakness in FEMA's process for estimating the remaining liability for the Cerro Grande program in its internal control report for fiscal year 2002. The weakness specifically related to a lack of (1) an impact analysis for the change in estimating methodology and (2) supporting documentation for certain factors and assumptions, for which FEMA eventually re-created the documentation to support the calculation.²⁷ In April 2003, FEMA officials stated FEMA is in the process of awarding a contract to perform an analysis to determine the dollar effect on the increased claim liability estimate due to changes in methodology, assumptions, systems, data, or other factors, from fiscal year 2001 to fiscal year 2002.

²⁶The unfunded liability was adjusted for the overstated payments plus another adjustment as part of the fiscal year 2002 audit of FEMA's financial statements. Therefore, FEMA's initial estimate of the unfunded liability of \$149.2 million was decreased to \$127.5 million.

²⁷The auditors recommended that FEMA (1) perform an analysis to determine the dollar impact on the liability estimate due to changes in methodology, assumptions, systems, data, or other factors, from fiscal years 2002 through 2001, and (2) ensure that supporting documentation for program estimates that are used for financial reporting purposes be maintained as part of the estimate documentation file. FEMA agreed with the recommendation.

Conclusion

FEMA's actions to strengthen its policies and procedures over its claim approval process helped ensure that paid claims were valid and reasonable. However, weaknesses in how the Emergency Preparedness and Response Directorate records and tracks approved claims in its payment approval system resulted in an overstatement of approved claims, which had a cascading effect on payment amounts reported to the Congress and used to calculate requests for additional funding. While the amount of the overstatement was relatively insignificant, left unchecked, the weaknesses in the payment approval system could result in larger errors in future reports to the Congress and requests for additional funding.

Recommendations for Executive Action

We recommend that the Secretary of the Department of Homeland Security direct the Emergency Preparedness and Response Directorate to

- complete the reconciliation of the amounts approved for payment in its payment approval system to amounts actually paid in FEMA's accounting system and correct all identified errors in its payment approval system and
- perform monthly reconciliations of the approved claim amounts in its payment approval system with the actual amounts reported in its accounting system as paid by DFC for as long as both systems are used to track and report paid amounts or request additional funding.

Agency Comments and Our Evaluation

FEMA, in a letter from the Acting Director of the Recovery Division of the Department of Homeland Security's Emergency Preparedness and Response Directorate, agreed with our recommendations and described specific corrective actions currently under way to address each one. For example, the Acting Director indicated that OCGFC has substantially completed the reconciliation of the amounts approved for payment in its payment approval system to amounts actually paid in FEMA's accounting system and intends to implement monthly reconciliations beginning this month. We will perform a follow-up review of these activities as part of our review of the Cerro Grande annual report that is due to the Congress on August 28, 2003. The Department of Homeland Security's comments are reprinted in appendix I.

We are sending copies of this report to the congressional committees and subcommittees responsible for issues related to FEMA and the Department

of Homeland Security; the Secretary of the Department of Homeland Security, the Under Secretary of the Department of Homeland Security's Emergency Preparedness and Response Directorate; and the Inspector General of the Department of Homeland Security. Copies will also be made available to others upon request.

If you have any questions about this report, please contact me at (202) 512-9508 or Steven Haughton, Assistant Director, at (202) 512-5999. The other key contributor to this assignment was Christine Fant.

A handwritten signature in black ink, reading "Linda Calbom". The signature is fluid and cursive, with the first name "Linda" and last name "Calbom" clearly distinguishable.

Linda M. Calbom
Director, Financial Management and Assurance

Comments from the Department of Homeland Security



Office of Cerro Grande Fire Claims

Post Office Box 90215
Denton, Texas 76202

May 1, 2003

Linda M. Calbom
Director, Financial Management and Assurance Office
United State General Accounting Office
441 G Street, N.W.
5th Floor
Washington, D.C. 20548

Dear Ms. Calbom:

I am writing in response to the draft General Accounting Office (GAO) report entitled "FEMA Cerro Grande Claim Payments Are Properly Processed, But Reported Payments Somewhat Overstated (GAO-03-623)". I appreciate your having forwarded the draft report on April 17, 2003, so we are able to provide comments on the report before it is finalized. We agree with the recommendations contained in the draft report and, as indicated in the balance of this letter, we are already well underway in taking steps to implement the recommendations.

The Office of Cerro Grande Fire Claims (OCGFC) is pleased with GAO's acknowledgment of our implementation of the recommendations included in GAO's initial audit report of July 2001. The primary recommendations from the earlier report suggested more detailed documentation, increased formalized guidance to OCGFC staff, as well as the establishment of additional standardized policies and procedures and assurance of supervisory reviews. As you have acknowledged in the draft report, these recommendations were initiated upon receipt of GAO's initial report, and they have served to strengthen the Cerro Grande program. Based upon our ongoing discussions with GAO staff, action on recommendations that we expected in this year's report has already commenced and is nearing completion.

The draft GAO report recommends that OCGFC "...complete the reconciliation of the amounts approved for payment in its payment approval system to amounts actually paid in FEMA's accounting system and correct all identified errors in its payment approval system..." As you know, initially OCGFC processed fire claim payments only in paper-based format. Early in 2001 we developed an automated Payment Approval

System (PAS). After implementation, it was necessary to import historical paper-based data. These imports included approval data, but initially did not include payment schedule data. As a result, the initial reporting algorithm did not ensure consistency between payment schedule data and payment approval data. Upon identification of this discrepancy, the reporting algorithm was redesigned. Although Information Management Systems staff “backfilled” schedules data, partial incomplete consideration of such data over time caused our PAS to “over-report” funding commitments by approximately 3% of total reported payments as of early September 2002.

GAO identified this anomaly in reporting during the OCGFC second annual audit and has recommended that the Office perform an approval vs. payment reconciliation. We initiated this process by coordinating between the OCGFC staff and IT staff to conduct research, create programs, and formulate spreadsheets allowing the completion of the task through automation insofar as possible. Automated research of almost 16,000 files involving approximately 64,000 partial and final payments resulted in successful reconciliation of approximately 90% of all payments from the program inception to the project target date of February 19, 2003.

For those files which could not be reconciled through an automated approach, we generated spreadsheets to resolve any differences through access to “hard copy” paper records. It became apparent that the manual reconciliation process would necessitate identification and correction of two data sets – financial (“dollar”) reconciliation, matching approvals to actual payments, and administrative (“data only” - transposed digits in Tax ID Numbers, etc.) reconciliation in order to comply with the GAO recommendation that OCGFC “... correct all identified errors in its payment approval system....” Therefore, OCGFC staff manually researched approximately 315 claimant records and approximately 1450 investigation items. The reconciliation process is now complete. As of the previously established target date, February 19, 2003, our approach resulted in successful reconciliation of all but approximately \$5,000.00 out of \$426.3 million dollars approved in PAS and paid in IFMIS.

GAO’s draft report also recommends that we “...perform monthly reconciliations of the approved claim amounts in (the OCGFC) payment approval system with the actual amounts reported in its accounting system as paid...” OCGFC intends to perform the first periodic reconciliation encompassing data from the end of the initial reconciliation (February 19, 2003) through April 30, 2003. This reconciliation will be performed at the end of May. Following that, monthly reconciliations will be performed at the end of each month, and we will maintain appropriate records.

Finally, the draft GAO report points out that OCGFC unfunded claims liability increased from an estimated \$36.5 million as of the end of Fiscal year 2001 to \$127.5 million as of the end of Fiscal Year 2002. During Fiscal Year 2002, OCGFC recognized that the methodology used for Fiscal Year 2001 needed to be refined to improve the accuracy in projecting liabilities. Accordingly, a new methodology was developed to estimate future liabilities as of the end of Fiscal Year 2002. Successive checks of this methodology and the endorsement of FEMA's external auditor have proven the current methodology to be sound. However, a variety of factors have prevented OCGFC from constructing a "crosswalk" between the two methodologies. OCGFC plans to address this problem by contracting with a forensic accountant to perform a "decomposition of change analysis" that will enable us to successfully document the shortcomings of the previous methodology ("lessons learned"), construct the "crosswalk" between the previous and present systems, and solidify our confidence factor in the methodology currently being used to move the program toward closeout. We are in discussions with accountants who have the expertise to perform such an analysis, and we hope to soon identify the firm that will develop the analysis.

We appreciate the cooperation you and your staff have demonstrated in our work with each other on the Cerro Grande claims processing activities. We are pleased that your draft report acknowledges the strides we have made over the course of our implementation of this unique program. We are also satisfied that we are already well underway in our implementation of the recommendations you have made in the draft report. We would therefore appreciate your revising the draft report to reflect the significant progress we have already made with respect to your recommendations relating to the reconciliation process and the decomposition of change analysis.

Please call me at (940) 891-8799 if you have any questions about this letter. Thank you again for all of the helpful input and assistance which you and your staff have provided to this Office.

Sincerely,



Laurence W. Zensinger
Acting Director, Recovery Division
Emergency Preparedness & Response Directorate
Department of Homeland Security

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