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October 3, 2003

The Honorable Lane Evans
Ranking Minority Member
Committee on Veterans Affairs
House of Representatives

The Honorable Bob Filner
Ranking Minority Member
Subcommittee on Coast Guard
and Maritime Transportation
Committee on Transportation and
Infrastructure
House of Representatives

The Honorable Corrine Brown
House of Representatives

Subject: *U.S. Coast Guard National Pollution Funds Center: Claims Payment
Process Was Functioning Effectively, but Additional Controls Are Needed
to Reduce the Risk of Improper Payments*

The Oil Spill Liability Trust Fund (Fund) is a \$1 billion fund authorized by the Oil Pollution Act of 1990 (OPA) to pay for (1) federal removal actions, (2) certain claims for uncompensated removal costs and damages, and (3) natural resource damage and restoration activities resulting from oil spills or the substantial threat of oil spills to the waters or shorelines of the United States. The Fund is administered by the National Pollution Funds Center (NPFC) of the U.S. Coast Guard. In May 2002, at your request, our Office of General Counsel reported on legal issues and limitations of the Fund and concluded that certain administrative costs were inappropriately being paid out of the Fund. In light of this conclusion, you asked that we review the internal controls over disbursements from the Fund.

This report summarizes the information provided during our briefing on our review of claim payments made from the Fund, which was provided to your staff on September 17, 2003. A second briefing will be provided to your staff on the results of our review of controls over operating expenses and other disbursements from the Emergency Fund.¹ The enclosed briefing slides highlight the results of our work and the information provided. Specifically, we reviewed the Fund to determine whether

¹The Emergency Fund is used to pay for emergency removal activities and the initiation of natural resource damage assessments.

(1) the design of internal controls over the claims process provides reasonable assurance that improper payments will not occur or will be detected in the normal course of business and (2) internal controls over the claims process are operating as designed to help ensure proper payment of claims.

Results in Brief

The U.S. Coast Guard NPFC follows a systematic and effective process for payment of claims. However, there are some weaknesses in the design of internal controls over the claims process that expose the Fund to improper payments. The weaknesses in the design of controls include (1) ineffective access restrictions to the Authorization-to-Pay² (ATP) form, (2) lack of segregation of duties between individuals preparing and approving ATPs for payment, (3) lack of procedures to verify the validity of ATPs prior to payment by the U.S. Coast Guard Finance Center, (4) lack of compliance with certain established policies and procedures in the claims process and the claims processing system, and (5) inadequate documentation of the originator of actions in the claims processing system.

We found that existing internal controls related to the documentation and approval of claims were generally operating in accordance with established policies and procedures. Of the 88 statistically sampled paid claims for fiscal year 2002, all but 3 had adequate documentation.³ We found no exceptions with approvals for the 88 statistically sampled claims. We also found that all 88 claims met NPFC's 10 requirements for validity, as listed in appendix I of the attached slides. Through data mining,⁴ we selected a nonstatistical sample of 50 claim payments and 8 denied claims for fiscal years 1998 through 2002 and performed limited tests to determine if the claims payments were valid and if the denied claims were properly processed. While we found some documentation and approval issues, we found that the 50 claim payments were valid and that the 8 denied claims were properly processed.

Recommendations for Executive Action

To improve the design of internal controls over the claims process, we recommend that the Commandant of the U.S. Coast Guard direct the Director of the National Pollution Funds Center to

- require automatic control numbers for each ATP form;
- limit access to the ATP form control numbers to one individual and an alternate in each claims division;
- require two signatures on each ATP form, one for the preparer and one for the approver;

²An ATP is a form used to approve claim payments and generate the payments to claimants.

³Based on these results, we estimate that 3.4 percent of the fiscal year 2002 paid claims lacked adequate documentation. We are 95 percent confident that the error rate was between 1 to 9 percent for claims paid in fiscal year 2002.

⁴Data mining applies a search process to a data set, analyzing for trends, relationships, and interesting associations. For instance, it can be used to efficiently query transaction data for characteristics that may indicate potentially improper activity.

- establish procedures requiring the National Pollution Funds Center to authenticate ATP forms prior to submitting them to the U.S. Coast Guard Finance Center for payment;
- establish and implement controls so that any required legal reviews of claims are completed before they are approved for payment;
- establish and implement controls to ensure that a release form is received from a claimant before a claim can be approved for payment; and
- modify the claims processing system to consistently identify the originator of all actions on user screens.

We also recommend that the Commandant of the U.S. Coast Guard direct the Chief Financial Officer of the U.S. Coast Guard to require that the Finance Center verify the validity of ATP forms prior to processing claim payments.

Agency Comments

We obtained oral comments on a draft of our briefing slides from the U.S. Coast Guard. U.S. Coast Guard officials agreed with our findings and recommendations and stated that they have already begun to take corrective actions to implement many of them and will continue to take additional actions as soon as possible to address the remaining recommendations. They provided us with a detailed list of actions taken or to be taken, which if properly implemented, should address our recommendations. U.S. Coast Guard officials also provided technical and clarifying comments that we incorporated as appropriate.

Scope and Methodology

To determine whether the design of internal controls over the claims process provided reasonable assurance that improper payments would not occur or would be detected in the normal course of business, we (1) reviewed OPA and related sections of the Code of Federal Regulations, (2) reviewed the Comptroller General's *Standards for Internal Control in the Federal Government*,⁵ (3) reviewed NPFC's *Standard Operating Procedures* related to the claims process, and (4) performed walkthroughs of the claims process, including the claims processing system, and compared the results to NPFC's *Standard Operating Procedures* and the Comptroller General's *Standards for Internal Control in the Federal Government*.

To determine if internal controls over the claims process were operating as designed to ensure proper payments of claims, we selected a statistical sample of 88 paid claims for fiscal year 2002, and reviewed the related claim files and the claims processing system records to test for adequate documentation, proper approvals, and validity. To test for validity, we also performed limited data mining of claims paid in fiscal years 1998 through 2002 to identify unusual transactions and patterns. Based on the data mining, we selected a nonstatistical sample of 50 claim payments and 8 denied claims, reviewed the related documentation, and performed limited tests.

⁵U.S. General Accounting Office, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3 (Washington, D.C.: November 1999).

We requested comments on a draft of the enclosed briefing slides from the Commandant of the U.S. Coast Guard or his designee and have included any comments as appropriate in the letter and enclosed slides. We conducted our work from December 2002 through July 2003, in accordance with generally accepted government standards.

This report is available at no charge on our home page at <http://www.gao.gov>. If you have any questions about this report, please contact me at (202) 512-9508 or Rosa R. Harris, Assistant Director, Financial Management and Assurance, at (202) 512-9492. You may also reach us by e-mail at calboml@gao.gov or harrisrr@gao.gov. Additional contributors to this assignment were H. Donald Campbell, Lisa J. Crye, and Edward F. Tanaka.



Linda M. Calbom
Director, Financial Management and Assurance

Enclosure



**U.S. Coast Guard
National Pollution Funds Center**

**Claims Payment Process Was Functioning Effectively, but
Additional Controls Are Needed to Reduce the Risk
of Improper Payments**

Briefing to the Staff of the Committees on Veterans Affairs and
Transportation and Infrastructure, House of Representatives

September 17, 2003



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- The Oil Spill Liability Trust Fund (Fund) is a \$1 billion fund authorized to pay for (1) federal removal actions, (2) certain claims for uncompensated removal costs and damages, and (3) natural resource damage assessments and restoration activities by designated federal, state, or Indian tribe officials, resulting from oil spills or the substantial threat of oil spills to the waters or shorelines of the United States.
- In May 2002, at your request, the GAO Office of General Counsel (OGC) reported on legal issues related to the uses and limitations of the Fund.
- The U.S. Coast Guard reported that the Fund was being used to pay not only uncompensated claims, but also costs associated with processing those claims, including salaries and other administrative expenses. OGC concluded that the Fund is not available to pay employee salaries and other administrative expenses.



- In light of this conclusion, you asked that we review the controls over disbursements from the Fund. This is the first of two briefings on our review of disbursements from the Fund. This briefing covers the results of our work related to the review of claim payments made from the Fund. A second briefing on the results of our review of controls over operating expenses and other disbursements from the Emergency Fund¹ will be presented at a later date.
- Specifically, we reviewed the Fund to determine whether
 - the design of internal controls over the claims process provides reasonable assurance that improper payments will not occur or will be detected in the normal course of business and
 - internal controls over the claims process are operating as designed to help ensure proper payment of claims.

¹The Emergency Fund is used to pay for emergency removal activities and the initiation of natural resource damage assessments.



- The U.S. Coast Guard National Pollution Funds Center (NPFC) generally follows a systematic process for payment of claims. However, we found some weaknesses in the design of internal controls over the claims process that increase the risk of improper payments.
- Weaknesses in the design of the controls included
 - ineffective access restrictions to the Authorization-to-Pay (ATP) form,
 - lack of segregation of duties between individuals preparing ATPs and approving ATPs for payment,
 - lack of procedures to verify the validity of ATPs prior to payment by the U.S. Coast Guard Finance Center,



- lack of compliance with certain established policies and procedures in the claims process and the claims processing system, and
- inadequate documentation of the originator of actions in the claims processing system.



- We also found that, generally, existing internal controls related to documentation and approval of claims were operating in accordance with established policies and procedures.
 - We statistically sampled 88 paid claims for fiscal year 2002. Of these, 3 did not have adequate documentation. We found no instances of invalid claim payments.
 - We selected a nonstatistical sample of 50 claim payments and 8 denied claims through data mining² for fiscal years 1998 through 2002. While we found some documentation and approval issues, we found no instances of invalid claim payments. The 8 denied claims were properly processed.

²Data mining applies a search process to a data set, analyzing for trends, relationships, and interesting associations. For instance, it can be used to efficiently query transaction data for characteristics that may indicate potentially improper activity.



- We are making several recommendations intended to improve the design of internal controls over the claims process.
- U.S. Coast Guard officials agreed with our recommendations and indicated that they have already prepared an action plan to address them.



- The Oil Pollution Act of 1990 (OPA)³ authorized the Fund to pay claims for certain costs resulting from oil spills or the substantial threat of oil spills. The act also
 - authorized the President to make available from the Fund without further congressional appropriation up to \$50 million each year to pay for emergency removal costs and initiation of natural resource damage assessments resulting from oil spills,
 - authorized an appropriation from the Fund of not more than \$25 million each year for operating expenses incurred by the U.S. Coast Guard to implement the act, and
 - provided authorization for the appropriation of funds for other uses, such as research, development, testing, and evaluation, and acquisition, construction, and improvements.

³Pub. L. No. 101-380, 104 Stat. 484 (1990).



- Administration of the Fund was delegated to the U.S. Coast Guard by Executive Order, and in February 1991, NPFC was commissioned to perform this function as an independent headquarters unit reporting directly to the Coast Guard Chief of Staff.
- NPFC administers and manages uses of the Fund by
 - making funds available for immediate federal oil removal activities and the initiation of natural resource damage assessments,
 - paying claims for losses or damages associated with an oil spill, and
 - recovering costs from responsible parties.



- NPFC has two claims processing divisions:
 - Claims – adjudicates claims for uncompensated removal costs and damages from oil spills
 - Natural Resource Damage Claims – adjudicates natural resource damage (NRD) claims from federal, state, Indian tribe, or foreign trustees as designated pursuant to OPA



Claims paid in fiscal years 1998 through 2002

Fiscal year	Number of paid claims	Total dollars (millions)
1998	598	\$ 3.7
1999	507	10.4
2000	601	2.4
2001	311	16.8
2002	300	7.0
Totals	2,317	\$ 40.3

Source: NPFC's data file for fiscal years 1998 through 2002.



- NPFC's *Standard Operating Procedures* (SOP)
 - provides guidance and requirements for the Claims and Natural Resource Damage Claims Divisions for the adjudication and payment of uncompensated removal costs and damages and NRD claims and
 - describes the responsibilities and conduct for each division.
- The claims processing system (CPS) is NPFC's current automated system for tracking and controlling claims.



As discussed in GAO's *Standards for Internal Control in the Federal Government*,⁴

- internal control—a major part of managing an organization—is a continuous, built-in component of operations that provides reasonable, not absolute, assurance of meeting agency objectives;
- internal control consists of the plans, methods, and procedures used to meet the agency's missions, goals, and objectives; and
- internal control should be designed to provide reasonable assurance regarding prevention or prompt detection of unauthorized acquisition, use, or disposition of an agency's assets.

⁴*Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1, which was prepared to fulfill our statutory requirement under the Federal Managers' Financial Integrity Act, provides an overall framework for establishing and maintaining internal control and for identifying and addressing major performance and management challenges and areas at greatest risk of fraud, waste, abuse, and mismanagement.



The design of internal controls over the claims process did not provide reasonable assurance that improper payments would not occur or would be detected in the normal course of business.

Control weakness: ATPs are word-processing documents that do not have control numbers and can be readily created by any individual who has access to the ATP in the claims processing system.

- *Standards for Internal Control in the Federal Government* states that access to resources and records should be limited to authorized individuals, and accountability for their custody and use should be assigned and maintained.
- The lack of control over the payment phase of the claims process increases the risk of invalid ATPs and improper or erroneous payments.



Control weakness: NPFC does not have controls to prevent the same individual from preparing and approving an ATP. Because NPFC policies require that an ATP be signed only by the approver, there is no assurance that the preparer and approver functions are separate.

- *Standards for Internal Control in the Federal Government* states that key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud.
- As a result of this weakness, the risk that fictitious ATPs may be prepared and processed is increased.



Control weakness: NPFC does not ensure that ATPs sent to the U.S. Coast Guard Finance Center (FINCEN) for payment are authenticated, nor does FINCEN verify the validity of ATPs prior to processing payments.

- When NPFC faxes ATPs to FINCEN for payment, FINCEN processes payments for claimants without independently verifying whether ATPs have been properly authorized.
- *Standards for Internal Control in the Federal Government* states that controls should be established to ensure that all transactions are authorized.
- As a result of this weakness, anyone with a basic knowledge of the claims payment process could divert funds. The risk of duplicate or erroneous payments is also increased.



Control weakness: The design of NPFC's claims process and its CPS are not in accordance with all of NPFC's policies and procedures. For example, NPFC does not have controls in place to prevent a payment from occurring (1) prior to required legal review and (2) without NPFC's receipt of the claimant's acceptance.

- *Standards for Internal Control in the Federal Government* states that only valid transactions and other events should be initiated or entered into, in accordance with management's decisions and directives. The terms of authorization should be in accordance with directives and within limitations established by law, regulation, and management.
- The lack of controls to help ensure that the SOP is followed further increases the risk of invalid claim payments.



Control weakness: Information regarding who originated claim actions is not always readily available for management review in the claims processing system. While CPS is designed to track this information, due to a coding issue, user screens do not always display who originated claim actions.

- *Standards for Internal Control in the Federal Government* states that significant events need to be clearly documented, and the documentation should be readily available for examination.
- Lack of information regarding who originated claim actions could impede management and others' ability to readily assess the validity of the claims or the integrity of the claims process.



Internal controls over the claims process were generally operating in accordance with established NPFC policies that are currently in place to help ensure proper payment of claims.

- We tested a statistical sample of 88 paid claims for fiscal year 2002 and reviewed the related claim files and CPS records to test for
 - adequate documentation,
 - proper approvals, and
 - validity.



Documentation

- The SOP requires that claim files include supporting documentation for claim payments, including documentation of determinations, offers to claimants, release forms, and authorizations to pay.
- We found that 3 of the 88 claims did not have adequate documentation in the claim files. For example, the claim payment amounts were not fully supported.
- Based on these results, we estimate that 3.4 percent of the fiscal year 2002 paid claims lacked adequate documentation.⁵
- While we found some exceptions, NPFC is generally documenting the claims process in accordance with its policies and procedures.

⁵We are 95 percent confident that the error rate was between 1 and 9 percent for claims paid in fiscal year 2002.



Approvals

- The SOP requires proper approvals of offers to claimants; legal reviews, in certain cases; and approvals of payments to claimants.
- We found no exceptions with approvals of claims for the 88 statistically sampled claims.

Validity

- The SOP requires that a claim meet the 10 initial review requirements to be valid (see app. I).
- We found no exceptions with the validity of the 88 statistically sampled claims.



Through data mining, we selected a nonstatistical sample of 50 claim payments and 8 denied claims and performed limited tests to determine if the claims were valid and if the denied claims were properly processed.

- We found that the claim payments were valid and that the denied claims were properly processed.
- While we were able to satisfy ourselves with the validity of the claims, we found some documentation and approval issues.



Conclusions

- The U.S. Coast Guard NPFC has a systematic and effective process for payment of claims. However, certain weaknesses in the design of internal controls over the claims process expose the Fund to improper payments. While we found no instances of invalid claim payments in our testing, the weaknesses we identified, if left uncorrected, make the Fund vulnerable to future improper payments.



Recommendations

To improve the design of internal controls over the claims process, we recommend that the Commandant of the U.S. Coast Guard direct the Director of NPFC to

- require automatic control numbers for each ATP;
- limit access to ATP control numbers to one individual and an alternate in each claims division;
- require two signatures on each ATP, one for the preparer and one for the approver;
- establish procedures requiring NPFC to authenticate ATPs prior to submitting them to the U.S. Coast Guard Finance Center for payment;



Recommendations (cont.)

- establish and implement controls so that any required legal reviews of claims are completed before they are approved for payment;
- establish and implement controls so that a release form is received from a claimant before a claim can be approved for payment; and
- modify the claims processing system to consistently identify the originator of all actions on user screens.



Recommendations (cont.)

We also recommend that the Commandant of the U.S. Coast Guard direct the Chief Financial Officer of the Coast Guard to require that the Finance Center verify the validity of ATPs prior to processing payments.



- U.S. Coast Guard officials agreed with our recommendations and stated that they have already begun to take corrective actions to implement many of them and will continue to take additional actions as soon as possible to address the remaining recommendations. They provided us with a detailed list of actions taken or to be taken, which if properly implemented, should address our recommendations. U.S. Coast Guard officials also provided technical and clarifying comments, which we incorporated as appropriate.



To determine whether the design of internal controls over the claims process provides reasonable assurance that improper payments would not occur or would be detected in the normal course of business, we

- reviewed OPA and related sections of the Code of Federal Regulations;
- reviewed *Standards for Internal Control in the Federal Government*;
- reviewed NPFC's *Standard Operating Procedures* related to the claims process; and
- performed walkthroughs of the claims process, including the claims processing system, and compared the results to NPFC's *Standard Operating Procedures* and GAO's *Standards for Internal Control in the Federal Government*.



To determine if internal controls over the claims process were operating as designed to help ensure proper payments of claims, we

- selected a statistical sample⁶ of 88 claims paid in fiscal year 2002⁷ and
- reviewed the related claims files and CPS records to test for adequate documentation, proper approvals, and validity.

⁶Our sample was based on a 95 percent confidence level and an expected error rate of 3 percent.

⁷We selected claims from fiscal year 2002 because we were assessing the condition of current controls and because this was the most recent information available at the time of review.



- To test for adequate documentation, we reviewed the claims files and CPS records to determine if
 - the claim payments were adequately supported and
 - the files and records were complete and included the offer letters to the claimants, summary/recommendation forms, claimant release forms, and the ATP forms.



- To test for proper review and approval, we reviewed the claim files and CPS records to determine if the
 - Claims Division Branch Chief approved the determination letter prior to the payment of a claim,
 - legal reviews were obtained for policy and determinations when required,
 - determination letters for reconsiderations were properly approved,
 - claims manager signed the determination letter prior to payment of a claim,
 - claimant signed the release form, and
 - Division or Branch Chief approved the ATP prior to payment of a claim.



To test for validity, we

- reviewed documentation for the 88 statistically sampled claims and performed tests to determine if they met the 10 SOP initial review requirements;
- performed limited data mining of claims paid in fiscal years 1998 through 2002 to identify unusual transactions and patterns, specifically looking for claims with even dollar amounts, large dollar amounts, multiple payments of the same dollar amounts, multiple payments to the same claimant for the same incident, incorrect coding, questionable status, and claims that had been denied; and
- selected, based on our data mining, a nonstatistical sample of 50 claim payments and 8 denied claims, reviewed the related documentation, and performed limited tests.



- We requested comments on a draft of these briefing slides from the U.S. Coast Guard. We received oral comments from U.S. Coast Guard officials that were incorporated into these briefing slides as appropriate.
- We conducted our work from December 2002 through July 2003 in accordance with generally accepted government auditing standards.



Ten Initial Review Requirements

The incident is after the implementation of OPA (Aug. 18, 1990).

The incident involved the discharge, or substantial threat of discharge, of oil from a covered source.

The discharge was into or upon the navigable waters of the United States, their adjoining shorelines, or the Exclusive Economic Zone of the United States.

The claimant has demonstrated an injury that was caused by the incident described above, or by the response to that incident.

The claim has been presented to NPFC within the applicable statute of limitations.

The claim is not currently the subject of litigation in any court.

The claimant has not waived right of recourse against any party relative to the incident giving rise to the claim.

The claimant has signed the claim in ink.

The claimant has not already been compensated for the costs or damages in the current claim.

The claim has been properly presented to the responsible party prior to submission to the Fund.

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