




Homeland
Security

July 11, 2006

MEMORANDUM FOR: Margaret Young
Chief Financial Officer
Federal Emergency Management Agency

FROM: Matt Jadacki 
Special Inspector General
Gulf Coast Hurricane Recovery

SUBJECT: *Improvements Needed in the Classification and Distribution of
Hurricane Katrina Disaster Relief Costs
Report Number GC-HQ-06-45*

We reviewed FEMA's procedures for classifying Hurricane Katrina disaster relief costs as part of our ongoing oversight of Hurricane Katrina operations. Our objective was to determine whether the classification of direct and administrative costs for Alabama, Louisiana, and Mississippi was reasonable and accurate.

FEMA needs to improve its cost identification and classification. Because it did not classify costs properly, FEMA provided inaccurate information to managers, Congress, and the public on how taxpayer funds were spent. First, in Alabama, Louisiana, and Mississippi, FEMA charged direct costs to an administrative cost category, resulting in overstated administrative costs and understated direct costs. Second, FEMA charged costs to the Mississippi disaster that should have been distribution among the three states.

Overstated Administrative Costs

FEMA's accounting system has a cost account called administration. Generally, this account includes administrative, support, supervisory and other such costs. However, it also includes costs that would more appropriately be classified as direct costs. As of December 21, 2005, the administration account for Alabama, Louisiana, and Mississippi contained 9.5 percent, 23.9 percent, and 35.7 percent, respectively, of the total Katrina costs charged to the states. The administration account for all three states was 26.2 percent of the total Katrina costs. This indicates that 26.2 percent of all funds were spent for administrative rather than operational purposes. However, that was not the case.

Costs charged to the administration accounts included such items as food, ice, water, power, transporting disaster victims, long-term infrastructure projects, urban search and rescue, and disease prevention and control. These costs accounted for the majority of the administration accounts and

should have been charged to direct cost accounts. This resulted in the overstatement of the administration accounts and understatement of the direct accounts.

Charging these direct costs to the correct account would substantially reduce the administration accounts and provide accurate disaster cost reports. We estimate that the percentage of administrative costs for Louisiana and Mississippi would drop from 23.9 percent and 35.7 percent to about 8 percent and 12 percent, respectively. Because Alabama received less disaster assistance than Louisiana and Mississippi, it was not significantly affected by the misclassification of direct program costs. The overall administration costs for Hurricane Katrina would be reduced from 26.2 percent to about 10 percent.

Costs Not Distributed Among States

An August 31, 2005, a FEMA Headquarters memorandum directed that, in the initial phase of the disaster, expenditures that could not be accurately charged to a specific state should be charged to Mississippi. Presumably this was done because of the inability to identify costs by state and to simplify record keeping. However, it resulted in a significant overstatement for Mississippi and an understatement for the other states. For example, the cost of two large mission assignments to Department of Defense for transportation activities and cruise ships was charged to Mississippi, even though most of those costs should have been distributed to other states. As of December 21, 2005, over \$1.25 billion had been charged to Mississippi. FEMA is determining how much of that should be charged to other states.

We recognize that it is difficult to distribute costs among states in the initial phase of a disaster. However, ultimately, these costs must be distributed so that accurate information is available to managers, Congress and the public on how taxpayer funds were spent.

Recommendations.

We recommend that FEMA revise the process of classifying costs to:

1. Accurately identify direct program costs and administration costs and establish any additional accounts necessary to ensure accurate reporting between administrative costs and direct program costs.
2. Develop a methodology to estimate and distribute costs among states where the goods and services are not state specific.

We discussed the results of our review with the Disaster Finance Center staff members and they concurred with the findings and recommendations. FEMA Finance staff told us that corrective action has been initiated.

The nature and brevity of this assessment precluded the use of our normal audit protocols; therefore, this review was not conducted in accordance with generally accepted government auditing standards. Had we followed such standards, other matters might have come to our attention.

We conducted this review in conjunction with the President's Council on Integrity and Efficiency (PCIE) as part of its examination of relief efforts provided by the federal government in the aftermath of Hurricanes Katrina and Rita. As such, a copy of the report has been forwarded to the PCIE Homeland Security Working Group that is coordinating Inspectors General review of this important subject.

Please advise us within 30 days of the actions taken or planned to implement our recommendations. Should you have any questions concerning this report, please call me at (202) 254-4100 or Dennis White, Deputy Special Inspector General, at (202) 254-4157.

cc: Under Secretary for Management
Under Secretary for Federal Emergency Management
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