

DEPARTMENT OF HOMELAND SECURITY

Office of Inspector General

National Flood Insurance Program Management Letter for DHS' Fiscal Year 2004 Financial Statement Audit (Redacted)



Notice: The DHS OIG has modified this report for public release. The modifications were made pursuant to subsection (b)(4) of the Freedom of Information Act, 5 U.S.C. §552(b)(4). A review under the Freedom of Information Act will be conducted upon request.

Office of Audits

OIG-05-48

September 2005



Homeland
Security

Preface

The Department of Homeland Security (DHS) Office of Inspector General (OIG) was established by the Homeland Security Act of 2002 (*Public Law 107-296*) by amendment to the Inspector General Act of 1978. This is one of a series of audit, inspection, and special reports published by our office as part of our DHS oversight responsibility to promote economy, effectiveness, and efficiency within the department.

This report is an abbreviated version of our official use only management letter report specific to the National Flood Insurance Program (NFIP). It contains observations and recommendations related to internal control at the NFIP that were not required to be reported in the *Independent Auditor's Report* on DHS' FY 2004 financial statements. The independent accounting firm KPMG LLP (KPMG) performed the audit of DHS' FY 2004 financial statements and prepared this management letter. Material weaknesses and other reportable conditions were reported, as required, in KPMG's *Independent Auditor's Report*, dated November 8, 2004, that was included in the FY 2004 DHS *Performance and Accountability Report*. KPMG is responsible for the attached management letter dated December 30, 2004, and the conclusions expressed in it. We do not express opinions on DHS' financial statements or internal control or conclusions on compliance with laws and regulations.

The information herein has been discussed in draft with appropriate management officials. It is our hope that this report will result in more effective, efficient, and economical operations. We express our appreciation to all of those who contributed to the preparation of this report.

A handwritten signature in cursive script that reads "Richard L. Skinner".

Richard L. Skinner
Inspector General



KPMG LLP
2001 M Street, NW
Washington, DC 20036

December 30, 2004

Office of Inspector General and
Administrator, Mitigation Division, Emergency Preparedness and Response
Department of Homeland Security
Washington, DC

Ladies and Gentlemen:

We were engaged to audit the consolidated balance sheet of the U.S. Department of Homeland Security (DHS) as of September 30, 2004, and the related consolidated statements of net cost, changes in net position, financing, and custodial activity, and combined statement of budgetary resources (hereinafter referred to as "financial statements"), for the year then ended. Because of matters discussed in our Independent Auditors' Report dated November 8, 2004, the scope of our work was not sufficient to enable us to express, and we did not express, an opinion on the financial statements.

In connection with our fiscal year 2004 engagement, we were also engaged to consider DHS's internal control over financial reporting and to test DHS's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on these financial statements. Our procedures may not include examining the effectiveness of internal controls and do not provide assurance on internal control. We have not considered internal control since the date of our report.

In addition, pursuant to a request made by the DHS Office of Inspector General (OIG), we have conducted additional tests of controls relating to flood insurance activities of the National Flood Insurance Program (NFIP), which is administered by the Mitigation Division, a component within DHS Emergency Preparedness and Response. The objective was to conduct tests of compliance with controls related to financial, underwriting, and claims activities for five Write Your Own (WYO) companies participating in the NFIP and of the NFIP contractor for the Direct Program.

In connection with the additional tests of controls relating to flood insurance activities of the NFIP and our engagement to audit the financial statements of the DHS as of and for the year ended September 30, 2004, we noted certain matters involving controls over NFIP flood insurance activities and compliance with NFIP rules and regulations that are presented for your consideration. These comments and recommendations, which have been discussed with the appropriate members of management of the WYO insurance companies and of the Direct Program servicer, are intended to improve internal control, compliance with applicable rules and regulations, or result in other operating efficiencies, and are summarized in section I of this letter. In accordance with the OIG's requirements, this letter contains the following section:

I. Summary of Recommendations



This letter is intended solely for the information and use of DHS management, the WYO insurance companies, the Direct Program servicer, and the OIG, and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

KPMG LLP

Summary of Recommendations

		A	B	C	D	E	F
Principal Recommendations							
A.	Conform Financial Reporting to NFIP Regulations						
1.	Ensure amounts included on the financial reports agree to supporting detail				X		
B. Investigate Claim File Matters and Correct As Necessary							
1.	Ensure timely receipt of Preliminary Reports	X	X	X	X	X	
2.	Ensure timely receipt of Final Reports	X			X	X	
3.	Ensure timely receipt of Proofs of Loss	X				X	
4.	Ensure that either a Public Notary or the agent witnesses Proofs of Loss		X				
5.	Ensure Preliminary Reports are dated				X		
6.	Ensure timely claim payment once the claim examination is completed				X		
7.	Ensure Proofs of Loss are signed						X
8.	Ensure that payments made to insureds are correct and in compliance with NFIP regulations						X
C. Enhance Underwriting Processes							
1.	Process new business policy applications within NFIP required timeframes	X					
2.	Process policy endorsements within NFIP required timeframes			X			X
3.	Ensure correct application of annual premium rates to policies				X		

Each letter in the first row of the table represents one company at which tests of compliance with controls related to financial, underwriting, and claims were performed.



FEMA

June 27, 2005

MEMORANDUM FOR: J. Richard Berman
Assistant Inspector General for Audit
David I. Maurstad
FROM: David I. Maurstad
Acting Director
Mitigation Division
Emergency Preparedness
and Response Directorate

SUBJECT: National Flood Insurance Program Management Letter for DHS's
FY 2004 Financial Statement Audit

RE: Your memorandum dated May 18, 2005, Subject: National Flood Insurance Program
Management Letter for DHS's FY 2004 Financial Statement Audit

I am responding to the draft report entitled *National Flood Insurance Program Management Letter for DHS's FY 2004 Financial Statement Audit*.

In regard to the recommendations in this report, I concur with the claims and underwriting findings, recommendations, and management responses in the attachment to your memorandum dated May 18, 2005.

I have taken steps to ensure that these recommendations are carried out through the respective Write Your Own (WYO) Companies. I have a number of processes in place to authenticate compliance. First, depending on the number and the nature of the recommendations and in accordance with the terms of the Arrangement, the Administrator, on his or her own initiative or upon recommendation of the Standards Committee or FEMA's Office of the Inspector General, may conduct for-cause audits of participating WYO Companies. Second, I have incorporated procedures within the Operation Review process to verify that recommendations have been carried out. These reviews are conducted every three years for selected WYO Companies. These reviews are conducted with a high level of interaction between the WYO Company staff and FEMA's program experts. These procedures will allow FEMA to evaluate problems, and test the effectiveness of the companies' actions to correct the problem. Third, the Biennial Financial Audits are conducted every two years, and make it possible to monitor the effectiveness of the recommendations. I intend to use these various audit mechanisms alternatively in order to confirm that all necessary recommendations have been addressed.

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The Mitigation Division is also developing the NFIP NextGen Project. It is a multiyear project dedicated to analyzing current NFIP practices and developing technological options to modernize NFIP processes and systems that will among other things, improve and create efficient, financially sound operations necessary for underwriting and claims activities in order to reduce cost to FEMA.

Mitigation intends to use these various audit mechanisms and new technologies alternatively in order to confirm that all necessary recommendations have been addressed.

If you need additional information, please contact me at (202) 646-2780.

Department of Homeland Security

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