



Department of Homeland Security Office of Inspector General

Federal Emergency Management Agency's Management Letter for FY 2010 DHS Consolidated Financial Statements Audit





Homeland
Security

APR 13 2011

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 prepared as part of our oversight responsibilities to promote economy, efficiency, and effectiveness within the department.

This report presents the Federal Emergency Management Agency's Management Letter for FY 2010 DHS Consolidated Financial Statements Audit. It contains observations related to internal control that were not required to be reported in the financial statements audit report. The independent public accounting firm KPMG LLP (KPMG) performed the integrated audit of DHS' FY 2010 financial statements and internal control over financial reporting and prepared this management letter. KPMG is responsible for the attached management letter dated March 14, 2011, and the conclusions expressed in it. We do not express opinions on DHS' financial statements or internal control or provide conclusions on compliance with laws and regulations.

The observations herein have been discussed in draft with those responsible for implementation. We trust 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 black ink that reads "Anne L. Richards".

Anne L. Richards
Assistant Inspector General for Audits



KPMG LLP
2001 M Street, NW
Washington, DC 20036-3389

March 14, 2011

Office of Inspector General
U.S. Department of Homeland Security, and
Chief Financial Officer
U.S. Department of Homeland Security Federal Emergency Management Agency
Washington, DC

Ladies and Gentlemen:

We were engaged to audit the balance sheet of the U.S. Department of Homeland Security (DHS or Department) as of September 30, 2010 and the related statement of custodial activity for the year then ended (referred to herein as “financial statements”). We were also engaged to examine the Department’s internal control over financial reporting of the balance sheet as of September 30, 2010, and the statement of custodial activity for the year then ended. We were not engaged to audit the accompanying statements of net cost, changes in net position, and budgetary resources for the year ended September 30, 2010 (referred to herein as other fiscal year (FY) 2010 financial statements), or to examine internal control over financial reporting over the other FY 2010 financial statements.

Because of matters discussed in our *Independent Auditors’ Report*, dated November 12, 2010, the scope of our work was not sufficient to enable us to express, and we did not express, an opinion on the FY 2010 financial statements, and we were unable to perform procedures necessary to form an opinion on DHS’ internal control over financial reporting of the balance sheet as of September 30, 2010 and the related statement of custodial activity for the year then ended.

The Federal Emergency Management Agency (FEMA) is a component of DHS. We noted certain matters involving internal control and other operational matters, related to FEMA that are summarized in the Table of Financial Management Comments on the following pages, and presented for your consideration in Section I of this letter. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies. These comments are in addition to the significant deficiencies presented in our *Independent Auditors’ Report*, dated November 12, 2010, included in the FY 2010 DHS *Annual Financial Report*. A description of each internal control finding, not related to information technology, and its disposition as either a significant deficiency or a financial management comment is provided in Appendix A. Our findings related to information technology systems security have been presented in a separate letter to the Office of Inspector General and the FEMA Chief Financial Officer and Chief Information Officer.



As described above, the scope of our work was not sufficient to express an opinion on the balance sheet as of September 30, 2010 or the statement of custodial activity of DHS for the year then ended, and we were not engaged to audit the statements of net cost, changes in net position, and budgetary resources for the year ended September 30, 2010. Accordingly, other internal control matters may have been identified and reported had we been able to perform all procedures necessary to express an opinion on the FY 2010 financial statements and had we been engaged to audit the other FY 2010 financial statements. We aim, however, to use our knowledge of DHS' organization gained during our work to make comments and suggestions that we hope will be useful to you.

FEMA's written response to our comments and recommendations, presented in Appendix C, has not been subjected to auditing procedures and, accordingly, we express no opinion on it.

We would be pleased to discuss these comments and recommendations with you at any time. This report is intended for the information and use of DHS' and FEMA's management, the DHS Office of Inspector General, the U.S. Office of Management and Budget, the U.S. Congress, and the Government Accountability Office, and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

KPMG LLP

Federal Emergency Management Agency
Table of Financial Management Comments
September 30, 2010

TABLE OF FINANCIAL MANAGEMENT COMMENTS (FMC)

Comment Reference	Subject	Page(s)
FMC 10-01	Internal Control Deficiencies over Claims Paid at Selected Insurance Companies that Participate in FEMA's National Flood Insurance Program (NFIP)	2
FMC 10-02	Inaccuracy of Claims' Loss Reserves at Selected Insurance Companies that Participate in FEMA's NFIP	3-4
FMC 10-03	Internal Control Deficiencies over Premiums Written at Selected Insurance Companies that Participate in FEMA's NFIP	4
FMC 10-04	Deficiencies in the Budget Execution Report Preparation Process	5
FMC 10-05	Deficiencies in the Development and Application of Policies Related to the Non-Grant, Non-Mission Assignment, and Non-System Generated Accounts Payable (A/P) Accrual	5-6
FMC 10-06	Control Deficiencies and Underlying Data Deficiencies Related to the Non-Grant, Non-Mission Assignment, and Non-System Generated A/P Accrual	6-8
FMC 10-07	Insufficient Office of the Chief Financial Officer Review of FEMA's Legal Liability and Related Disclosure	8
FMC 10-08	Deficiencies in the Development of Mission Assignment (MA) Policies and Procedures	9
FMC 10-09	Improvements Needed in Review and Recording of Year-end MA Accrual	9
FMC 10-10	Lack of Certain Documentation Related to Compliance with the Improper Payments Information Act of 2002, as amended	10
FMC 10-11	Inability to Link Systems to Significant Grant Programs	10
FMC 10-12	Failure to Identify and Assess Accounting Policies/Practices Not in Accordance with Generally Accepted Accounting Principles (Non-GAAP)	10-11
FMC 10-13	Deficiency Identified Related to the Preparation and Review of the Retrospective Reserve Analysis	11
FMC 10-14	Lack of Supporting Documentation for Prompt Payment Sample Item	11
FMC 10-15	Deficiency in the Methodology Used to Calculate the Non-Current Portion of the Insurance Liability Estimate	12
FMC 10-16	Failure to Close Assistance to Firefighter Grants Timely	12

APPENDIX

Appendix	Subject	Page(s)
A	Crosswalk – Financial Management Comments to Active Notices of Findings and Recommendation (NFRs)	13-14
B	Status of Prior Year NFRs	15-17
C	Management Response	18-20

Federal Emergency Management Agency
Financial Management Comments
September 30, 2010

FMC 10-01 – Internal Control Deficiencies over Claims Paid at Selected Insurance Companies that Participate in Federal Emergency Management Agency’s (FEMA) National Flood Insurance Program (NFIP) (NFR Nos. 10-01 and 10-01a)

We selected 10 insurance companies and tested a sample of 300 claim payments across those companies covering October 1, 2009 to March 31, 2010. During this testing, we noted the following errors at the respective insurance companies:

- For one sample item, we noted that evidence of the claim examiner’s review of the increased cost of compliance (ICC) report and claim file prior to claim payment was not available and included in the claim file.
- For one sample item, we noted that the claim file was not appropriately reviewed prior to the claim payment to the policyholder based on the claim examiner’s payment authority limit.
- For 19 sample items, we noted that based on the claim file, the loss reserve was not updated in the appropriate accounting month for subsequent preliminary/final reports received from the adjuster and/or payments made to the policyholder.
- For one sample item, we noted that a loss reserve was not established upon the insurance company receiving the notice of loss.
- For one sample item, we noted that the loss reserve was not closed in the month that the final payment was made.
- For one sample item, we noted that the loss reserve was closed before the month of final payment.
- For six sample items, we noted that the Loss Adjustment Expense (LAE) payment was incorrect based on supporting documentation in the claim file and the NFIP LAE Schedule.
- For one sample item, we noted an underpayment of claim payments to the insured based on the adjuster’s final report and other supporting documentation in the claim file.

We selected 10 insurance companies and tested a sample of 250 claim payments across those companies covering April 1, 2010 to June 30, 2010. During this testing, we noted the following errors at the respective insurance companies:

- For one sample item, we noted an LAE overpayment based on supporting documentation in the claim file and the NFIP LAE Schedule.
- For two sample items, we noted an overpayment/underpayment of claim payments to the insured based on the adjuster’s final report and other supporting documentation in the claim file.

Recommendations:

We recommend that FEMA:

- Follow-up with each of the insurance companies to determine that appropriate corrective action has been implemented to address the exceptions noted.
- Provide increased oversight to insurance companies participating in the NFIP to ensure claims files are being processed and reviewed in accordance with NFIP guidelines before approval and issuance of claim payments and to ensure the specific and consistent establishment and reporting of loss reserves and subsequent adjustments to the loss reserves.

Federal Emergency Management Agency
Financial Management Comments
September 30, 2010

FMC 10-02 – Inaccuracy of Claims’ Loss Reserves at Selected Insurance Companies that Participate in FEMA’s NFIP (NFR Nos. 10-02 and 10-02a)

We selected 10 insurance companies and tested a sample of 587 loss reserves reported by these companies as of January 31, 2010. During this testing, we noted the following errors at the respective insurance companies:

- For two sample items, the recorded date of loss was not accurate based on the supporting documentation in the claims files.
- For three sample items, the loss reserve amount was incorrectly adjusted by the claims examiner based on the claims file supporting documentation.
- For 17 sample items, the loss reserve was not adjusted for partial and/or advance payments made to the policyholder.
- For three sample items, the insurance company attempted to correct an attribute related to the claims file in the claims system; however, this reset the loss reserve to the default system amount. Therefore, claim payments made prior to January 31, 2010 did not reduce the loss reserve balance as of that date.
- For eight sample items, the loss reserve was not adjusted for subsequent adjuster reports and/or the final denial letter.
- For one sample item, the preliminary report indicated a loss reserve for both building and contents; however, a loss reserve was not established for the contents portion by the claims examiner.
- For three sample items, the loss reserve was not closed in a timely manner after full payment of the claim was made to the policyholder.
- For four sample items, the loss reserve was not appropriately established/adjusted due to a claims examiner clerical error.
- For one sample item, the loss reserve was converted from a previous insurance company vendor and did not reflect the activity identified in the claim file supporting documentation.
- For 17 sample items, the claims file supporting documentation did not support the loss reserve recorded in the insurance company NFIP claims system.

We selected 10 insurance companies and tested a sample of 612 loss reserves reported by these companies as of June 30, 2010. During this testing, we noted the following errors at the respective insurance companies:

- For 58 sample items, we noted that the loss reserves were not accurately recorded in the general ledger based on documentation in the claim file (e.g., Final Report, Preliminary Report, and payments to date).
- For one sample item, we noted that a claim was opened with an incorrect date of loss and remained open when a new claim was opened with the correct date of loss, resulting in a duplicate claim.
- For one sample item, the Company did not provide the file for the claim.

Recommendations:

We recommend that FEMA

- Follow-up with each of the insurance companies to determine that appropriate corrective action has been implemented to address the exceptions noted.

Federal Emergency Management Agency
Financial Management Comments
September 30, 2010

- Provide increased oversight to ensure specific and consistent documentation of the established loss reserve and subsequent adjustment to the loss reserve per claim at the insurance companies participating in the NFIP is maintained.

FMC 10-03 – Internal Control Deficiencies over Premiums Written at Selected Insurance Companies that Participate in FEMA’s NFIP (NFR Nos. FEMA 10-05 and 10-05a)

We selected 10 insurance companies and tested a sample of 284 written premium transactions across those companies covering October 1, 2009 to March 31, 2010. During this testing, we noted the following errors at the respective insurance companies:

- For one sample item, we noted that the designated flood zone per the policy declaration page did not agree to the FEMA flood maps for the insured property address. Based on the incorrect flood zone used, we noted that the policy premium was calculated incorrectly. For another sample item, an incorrect property address was used.
- For two sample items, we noted that the policy declaration page indicated that the premium should be calculated using pre-firm construction rates, but the policy premium was calculated using post-firm rates. Per the NFIP Manual, elevated pre-firm premiums may be calculated using post-firm rates if an elevation certificate is completed. However, we were unable to obtain the elevation certificates to support the use of post-firm rates for those policies.
- For one sample item, we noted that the premium was calculated using a basement and above contents rate. However, the application indicated that contents should be calculated using lower floor only – above ground level rates.
- For one sample item, we noted that the premium was calculated based on a preferred risk policy without basement or enclosure rates. However, the application indicated that the property had a finished basement below the building.

We selected 10 insurance companies and tested a sample of 50 written premium transactions across those companies covering the period July 1, 2010 to August 31, 2010. During this testing, we identified the following error at one insurance company:

- For one sample item, we noted that the designated flood zone per the policy declaration page did not agree to the FEMA flood maps for the insured property address. Based on the incorrect flood zone used, we noted that the policy premium was calculated incorrectly.

Recommendations:

We recommend that FEMA:

- Follow-up with each of the insurance companies to determine that they have implemented the appropriate corrective action to address the exceptions identified.
- Provide increased oversight to insurance companies participating in the NFIP to ensure they process and review underwriting files in accordance with NFIP guidelines.

Federal Emergency Management Agency
Financial Management Comments
September 30, 2010

FMC 10-04 – Deficiencies in the Budget Execution Report Preparation Process (NFR No. FEMA 10-06)

Based on our testwork performed over the Budget Execution Report as of March 31, 2010, we noted the process to prepare the Budget Execution Report is not properly designed. Specifically:

- The Budget Execution Report “Spend Plan Amount” is not consistently reported by the Budget Planning and Analysis Division (BPAD) budget analysts. The reporting process is not standardized throughout the BPAD and, as such, the reconciliation is not programmed to accurately capture the original budget and subsequent allocations to each FEMA office/directorate. Further, BPAD management does not formally review the Budget Execution Report spend plan data for accuracy.
- The “Spending to Date” balances do not agree to external financial reports, such as FEMA’s financial statements or Office Management and Budget (OMB) budget reports (e.g., the SF-132, *Apportionment and Reapportionment Schedule*, and the SF-133, *Report on Budget Execution and Budgetary Resources*). The Budget Execution Report “Spending to Date” activity is obtained from the Integrated Financial Management Information System (IFMIS) cost-posting module funds disposition report, which differs from data recorded in the general ledger because the report excludes journal vouchers (JVs). Therefore, the reconciliation data does not provide a true representation of FEMA’s budget and fiscal year spending for monitoring purposes.

Recommendations:

We recommend that FEMA:

- Develop and implement standard operating procedures (SOP), including appropriate internal controls, over the preparation and review of the Budget Execution Report to ensure that a consistent process is established throughout the BPAD and proper review of the report is performed by management prior to report distribution.
- Develop and implement enhancements to the data gathering process, including appropriate internal controls, to ensure that the Budget Execution Report “Spending to Date” data reflects FEMA’s fiscal year spending, including JVs, and agrees to external financial reports.

FMC 10-05 – Deficiencies in the Development and Application of Policies Related to the Non-Grant, Non-Mission Assignment, and Non-System Generated Accounts Payable (A/P) Accrual (NFR No. FEMA 10-07)

Our review of the A/P accrual model methodology as of December 31, 2009 revealed the following conditions:

- An A/P accrual was not generated for the following fund codes (FCs) and budget object codes (BOCs):
 - FCs 79, 87-89, 8C, 9B, 9C (all related to limited and no-year funds for the Chemical Stockpile Emergency Preparedness Program - CSEPP).
 - FCs H7 (related to State and Local Programs Fund - Public Safety Interoperable Communications – PSIC).
 - BOCs 2503 (Delegation of Authority – Disaster Unemployment Assistance) and 2504 (Delegation of Authority – Crisis Counseling Assistance).

Federal Emergency Management Agency
Financial Management Comments
 September 30, 2010

Due to the nature of the funds and BOCs, we noted a separate accrual approach from the A/P accrual model is required. Subsequent to our testwork as of December 31, 2009, FEMA drafted an Intergovernmental Accrual Process. However, the policy does not specifically identify the FCs and BOCs noted above.

- The A/P accrual model used an improper United States Standard General Ledger (USSGL) account to limit the A/P accrual balance to the available undelivered order (UDO). UDO balances within the model are comprised of USSGL accounts 4801, 4802, 4871, and 4881. However, USSGL account 4802, *Undelivered Orders – Obligations, Prepaid/Advance*, represents UDOS that were previously paid; accordingly, USSGL account 4802 has no applicable A/P and should not be considered in the A/P accrual limit determination.
- The A/P accrual methodology does not consider the impact of balances within USSGL account 1410, *Advances and Prepayments*, including whether any advances should be liquidated prior to recording an A/P balance.
- The A/P model methodology tolerates an exceptionally high validation error rate: +/- 30% of the total model-calculated accrual.

Recommendations:

We recommend that FEMA:

- Update the Intergovernmental Accrual Process SOP to provide clearer documentation of the accrual processes in place over the BOCs and FCs noted above.
- Limit the UDO balance to the unpaid amount for A/P accrual limitation purposes by excluding USSGL account 4802, *Undelivered Orders – Obligations, Prepaid/Advanced* from the Automated Accounts Payable Model.
- Perform a documented review of USSGL account 1410, *Advances and Prepayments*, to determine whether material non-governmental advances exist and require liquidation prior to booking the quarterly A/P accrual.
- Re-evaluate the target error rate for the A/P accrual model validation to provide management with more reasonable assurance that the A/P accrual estimates recorded are not materially misstated.

FMC 10-06 – Control Deficiencies and Underlying Data Deficiencies Related to the Non-Grant, Non-Mission Assignment, and Non-System Generated A/P Accrual (NFR No. FEMA 10-08)

Based on our review of the December 31, 2009 A/P accrual model, we noted the following control deficiencies:

- The A/P accrual model process lacks sufficiently documented review controls. The A/P accrual methodology provides for additional documentation in the event the model reconciliation or validation exceeds tolerable thresholds; however, the methodology does not require documented review controls throughout the model, as follows:
 - Reconciliation of the underlying invoice and UDO data to the general ledger - we noted no documentary evidence exists to support the model reconciliation review.
 - BOCs and A-11 codes (object classification codes defined in OMB Circular No. A-11, Section 83) included in the model - we noted no documentary evidence exists to support FEMA's review of the BOCs and A-11 codes used in the model or a study of additional/new BOCs and FCs that may impact the model in FY 2010. As a result, our review of the December 31, 2009 A/P accrual model identified three BOCs improperly included in the model: BOC 2115, Rental/Lease of Vehicles from Government Motor

Federal Emergency Management Agency
Financial Management Comments
September 30, 2010

Pools; BOC 2310, Rental Payments to the General Services Administration (GSA); and BOC 2589, Interagency Agreements. BOC 2589 (A-11 code 25.3) was excluded from core IFMIS data but was not excluded from grants and training (G&T) data as of December 31, 2009. As a result, the model underlying data included one G&T invoice within BOC 2589. BOCs 2115, 2310, and 2589 relate to intragovernmental transactions; however, all A/P resulting from the A/P accrual model is allocated and accrued to non-governmental A/P.

- Model parameters and thresholds, including the JV materiality threshold and the moving average length - per discussion with FEMA personnel, FEMA reviewed the model parameters and thresholds used in the December 31, 2009 A/P accrual model. However, we were unable to obtain documentation supporting FEMA's review and assessment of the parameters in FY 2010.
- Model calculations and outputs - we noted the JV reviewer reviewed the model JV list (model output) as supporting documentation for the A/P accrual JVs. However, we noted no documentary evidence exists to support an additional review of the A/P accrual model, including the model calculations and the model output.
- Accrual estimate validation - the accrual estimate validation is not formally documented. Per the A/P accrual methodology and FEMA personnel, FEMA may draft a memorandum if the validation error rate exceeds the target error rate. However, the validation review is not documented if the validation error rate falls below the target error rate.
- The model does not operate effectively to limit the A/P accrual allocation to the UDO balance for the applicable fund, budget fiscal year (BFY), and BOC combination within the model. Specifically, we noted the following exceptions:
 - In three instances, the model UDO data contained insufficient UDO balances within the fund, BFY, and BOC combinations, and the corresponding accrual allocations were not properly limited. The model populated estimated accruals for the corresponding fund, BFY, and BOC combinations that exceeded the model UDO balances.
 - In three instances, the model utilized UDO data within the incorrect A-11 codes for the accrual allocation limit. G&T funds use A-11 codes 21 and 31; core funds use A-11 codes 21.0 and 31.0. The A/P accrual model was designed to capture UDO data within A-11 codes 21.0 and 31.0; as a result, G&T fund UDO balances within A-11 codes 21 and 31 were not properly captured by the model allocation limit functionality. As such, per the A/P accrual model, no available UDO balance exists for the G&T entries. However, the model did not limit the JVs to the UDO balance per the JV Limit tab.
- Based on our review of 50 A/P accrual model underlying data invoices as of December 31, 2009, we noted the following underlying data discrepancies:
 - Two travel vouchers were paid incorrectly based on supporting documentation.
 - One invoice was included in the incorrect period of performance quarter-end based on supporting documentation. Per the invoice, we noted the period of performance was June 23, 2009 to September 25, 2009. However, the invoice was included within the period of performance for the quarter-ended December 31, 2009.

Federal Emergency Management Agency
Financial Management Comments
September 30, 2010

Recommendations:

We recommend that FEMA:

- Revise the current A/P accrual methodology to require formal, documented review controls throughout the Automated Accounts Payable Model execution process, including annual review and reconciliation of BOCs/A-11 codes; annual review of model parameters and JV materiality thresholds; quarterly reconciliation of underlying data utilized within the model; and quarterly review of the model calculations, outputs, and estimate validation.
- Perform a thorough review of the A/P accrual model, including A-11 codes, subsequent to any changes to ensure consistency in the model data and functionality.
- Ensure accounting technicians undergo sufficient training to understand how to properly populate the vendor invoice data fields within IFMIS. In addition, reinforce existing procedures to ensure underlying data transactions undergo sufficient review to validate the accuracy of the transactions.

FMC 10-07 – Insufficient Office of the Chief Financial Officer (OCFO) Review of FEMA’s Legal Liability and Related Disclosure (*NFR No. FEMA 10-12*)

We noted that the FEMA OCFO did not perform an adequate review of its legal liability and related financial statement disclosures as of June 30, 2010. Specifically, the FEMA OCFO did not:

- Evaluate the reasonableness of responses from the FEMA Office of Chief Counsel (OCC) attorneys related to the likelihood of an unfavorable outcome.
- Review the reasonableness of the amounts of potential loss related to reasonably possible cases that are disclosed and probable cases that are accrued as contingent liabilities.
- Perform look-back analyses on the estimate of the amount or range of potential losses. The OCFO did not compare what was actually awarded to the plaintiff to the estimated amount of potential losses to assess the accuracy of the estimation process.

Subsequent to our notification to the FEMA OCFO of the condition above, the FEMA OCFO documented the FEMA OCC methodology for identifying reasonably possible and probable ranges.

Recommendations:

We recommend that FEMA OCFO implement a documented review process over the legal liability and related financial statement disclosures which encompass the following:

- Assessment of the reasonableness of FEMA OCC attorneys’ responses as to likelihood of an unfavorable outcome.
- Assessment of the reasonableness of the amount of potential loss related to reasonably possible cases that are disclosed and probable cases that are accrued as contingent liabilities.
- Look-back analyses to determine the accuracy of the estimate of the amount or range of potential losses.

Federal Emergency Management Agency
Financial Management Comments
September 30, 2010

FMC 10-08 – Deficiencies in the Development of Mission Assignment (MA) Policies and Procedures (NFR No. FEMA 10-15)

Under SOP Number 2600-007, *Financial Reporting of Mission Assignments*, FEMA requires MA-related UDO balances to be validated annually as of June 30th of each year. In the event an Other Federal Agency (OFA) is non-responsive to the validation request, FEMA will set a specific response deadline prior to closing the MA. However, the closeout process initiated by the validation contains deadlines that may not be completed by the fiscal year end, September 30th. The policy calls for UDOs to be reviewed but not validated at other times throughout the year.

Recommendations:

We recommend that FEMA:

- Continue to refine its process for the annual MA UDO validation and work closely with OFAs to receive timely responses.
- Continue to work closely with the regional offices to coordinate any necessary de-obligation/close out actions prior to fiscal year end.
- Evaluate instituting a process in which a JV would be entered to effectively record the de-obligation of MA UDOs that have been identified as invalid/closed by an OFA, but not yet de-obligated by the regional offices prior to September 30.

FMC 10-09 – Improvements Needed in Review and Recording of Year-end MA Accrual (NFR No. FEMA 10-17)

FEMA attempted to perform a validation of the estimated September 30, 2009 MA A/P accrual to determine the accuracy and reliability of the estimate. However, during our review of the validation, we noted that the validation was not effective as FEMA compared all reimbursement requests received in the 1st quarter of FY 2010 to the accrual balance as of September 30, 2009. For comparison purposes, the reimbursement requests received in FY 2010 used to validate the accrual should only include the requests received for services and/or expenses incurred prior to October 1, 2009.

In addition, FEMA did not review and analyze the accrual by agency prior to recording the accrual to ensure that validity and reasonableness of each accrual.

Recommendations:

We recommend that FEMA:

- Develop and implement procedures to compare the MA A/P accrual estimates to the actual expenses incurred, communicate with OFAs on discrepancies noted to make estimation improvements in the future, and reassess the process to develop the estimate as necessary. The verification and validation should be documented and properly reviewed.
- Thoroughly review MA A/P accrual supporting documentation for reasonableness prior to recording amounts reported by OFAs, and communicate timely with OFAs on any discrepancies noted to prevent an intragovernmental reconciliation problem.

Federal Emergency Management Agency
Financial Management Comments
September 30, 2010

FMC 10-10 – Lack of Certain Documentation Related to Compliance with the Improper Payments Information Act of 2002, as amended (IPIA) (NFR No. FEMA 10-20)

We reviewed FEMA's risk assessment approach and test plan for each of the eight programs that were determined to be of significant risk for improper payments. Based on our review, we determined that FEMA used multi-year sampling for the Homeland Security Grant Program and the Transit Security Grant Program given the large size of the programs. Because this approach was used, FEMA was unable to extrapolate the sample results over the entire population and could not provide results within the required 2.5 percent precision level. For this approach to be considered compliant with IPIA and OMB Circular No. A-123, FEMA must obtain approval from the OMB. FEMA did not obtain official written approval until after our audit request in late October.

Recommendations:

We recommend that FEMA obtain OMB written approval prior to utilizing a multi-year sampling approach for its IPIA testing.

FMC 10-11 – Inability to Link Systems to Significant Grant Programs (NFR No. FEMA 10-22)

We requested that FEMA provide an analysis to demonstrate the amount of UDOs flowing through each grant system during fiscal year (FY) 2010. We asked that the analysis include a listing of which system FEMA was using to obligate and pay each specific grant program. FEMA provided a listing of systems; however, FEMA was not able to provide specific information to show what grants were being managed within each system and the volume of those grants.

Recommendations:

We recommend that FEMA:

- Develop a crosswalk of agency grant programs to the appropriate systems used to process obligations and payments.
- Develop and implement a method of determining the accounting string used to identify each individual grant program.
- Develop and implement a monitoring control to ensure that the crosswalk and accounting string information are updated and kept current.

FMC 10-12 – Failure to Identify and Assess Accounting Policies/Practices Not in Accordance with Generally Accepted Accounting Principles (Non-GAAP) (NFR No. FEMA 10-23)

We inquired of FEMA OCFO personnel regarding the existence of any non-GAAP policies or procedures in FY 2010 and obtained a response stating that FEMA did not follow any non-GAAP policies or practices in FY 2010. However, based on testwork performed in FY 2010, we noted the following non-GAAP policies/practices:

- FEMA's A/P model accrued expenses based on the use of thresholds.
- FEMA evaluated current and future litigation claims using a threshold of \$3 million for individual cases and \$6 million for aggregate cases. This policy was adopted by management and acts as an internal materiality threshold when evaluating litigation.

Federal Emergency Management Agency
Financial Management Comments
 September 30, 2010

Recommendation:

We recommend that FEMA develop and implement procedures to evaluate new and existing policies for compliance with GAAP. FEMA should track those policies determined to not be in compliance with GAAP and periodically assess the impact of the non-GAAP policies on its financial information.

FMC 10-13 – Deficiency Identified Related to the Preparation and Review of the Retrospective Reserve Analysis (NFR No. FEMA 10-25)

We identified that the monthly Retrospective Reserve Analysis over the insurance liability estimate for July 31, 2010 prepared by the third-party service provider’s actuary contained discrepancies in the calculation of “total reserves retrospectively” and the reserve “redundancy/deficiency” amount for the month of July 2010. We noted the subsequent losses paid, current outstanding case reserve (O/S), and current incurred but not reported (IBNR) reserve for the Direct Servicing Agent were improperly excluded from the “total reserves retrospectively,” which resulted in the calculation of the “redundancy” being misstated by \$45,919,624.

	Subsequent Loss Paid	Current O/S Case Reserve	Current IBNR Reserve	Total Reserves Retrospectively	Financial Statement Reserves	Redundancy / (Deficiency)
FEMA	\$82,779,557	\$90,716,321	\$129,274,906	\$ 256,851,160	\$334,758,959	\$77,907,799 *
KPMG	\$82,779,557	\$90,716,321	\$129,274,906	\$ 302,770,784	\$334,758,959	\$31,988,175
Difference						\$45,919,624

* The documented “redundancy/deficiency” in the Retrospective Reserve Analysis was \$23,477,443 because of a formula error. Based on the documented “total reserves retrospectively” and “financial statement reserves,” the amount that should have been shown as the “redundancy/deficiency” was \$77,907,799.

Recommendation:

We recommend that FEMA enhance the Chief Actuary’s Retrospective Reserve Analysis review procedures to include a review of the accuracy of the amounts and calculations in the analysis.

FMC 10-14 – Lack of Supporting Documentation for Prompt Payment Sample Item (NFR No. FEMA 10-28)

During test work over compliance with the Prompt Payment Act as of September 30, 2010, FEMA was unable to provide documentation for 1 of 58 payments selected.

Recommendation:

We recommend that FEMA develop a monitoring control to ensure proper adherence to existing document retention policies and procedures for all payment activities.

Federal Emergency Management Agency
Financial Management Comments
September 30, 2010

FMC 10-15 – Deficiency in the Methodology Used to Calculate the Non-Current Portion of the Insurance Liability Estimate (NFR No. FEMA 10-29)

We noted the following conditions relate to the calculation of the current and non-current portions of the insurance liability estimate:

- In FY 2009, the OCFO calculated the current and non-current portions of the insurance liability estimate using a 33 percent and 67 percent split, respectively. In FY 2010, the third-party service provider's actuary was asked to determine the percentage and calculated the current and non-current portions of the insurance liability as 85 percent and 15 percent, respectively. FEMA did not provide rationale for the large change in percentages used for the current and non-current portions of the insurance liability from FY 2009 to FY 2010, explain the methodology used last year, or provide rationale for the change in methodology from the prior year to the current year.
- In FY 2010, the methodology used by FEMA to calculate the current and non-current portions of the insurance liability estimate, developed by the third-party service provider's actuary, utilized the assumption that non-current liabilities represented estimated losses for accident months September 2009 and earlier. FEMA explained that, absent any major disasters, it would expect that a similar percentage of claims would have accident months older than one year at 9/30 each year. FEMA's reasoning provided for the current and non-current portions of the insurance liability calculation is not consistent with Statement of Federal Financial Accounting Standards (SFFAS) No. 1 and is not supported by actual FY 2010 claim payment data. The non-current portion of the liability should represent the insurance claims that will not be paid within the next year, not insurance claims with an accident month older than one year.

Recommendation:

We recommend that FEMA document, approve, and develop procedures to periodically reassess a methodology for calculating the current and non-current portions of the insurance liability estimate that is in compliance with the applicable accounting standards.

FMC 10-16 – Failure to Close Assistance to Firefighter Grants (AFG) Timely (NFR No. FEMA 10-30)

During our testwork performed over AFG grants, we noted that no grant closeouts had been processed in the AFG System for the period October 1, 2009 to September 30, 2010. Per discussion with the Grant Programs Directorate (GPD), the implementation of the SF 425, *Federal Financial Report*, to comply with the Office of Management and Budget use of standard forms created a problem within the AFG System which prevented GPD from closing grants within the system. Because no manual closeout process exists, GPD has not been able to closeout any AFG grants since October 1, 2009.

Recommendation:

We recommend that FEMA develop and implement an alternate manual process to timely closeout AFG grants until the system is updated and to use if the system were to fail again in the future.

Federal Emergency Management Agency
 Crosswalk - Financial Management Comments to NFRs
 September 30, 2010

NFR No.	Description	Disposition ¹			
		IAR			FMC
		MW	SD	NC	No.
10-01	Internal Control Deficiencies over Claims Paid at Selected Insurance Companies that Participate in FEMA's National Flood Insurance Program (NFIP)				10-01
10-01a	Internal Control Deficiencies over Claims Paid at Selected Insurance Companies that Participate in FEMA's NFIP				10-01
10-02	Inaccuracy of Claims' Loss Reserves at Selected Insurance Companies that Participate in FEMA's NFIP				10-02
10-02a	Inaccuracy of Claims' Loss Reserves at Selected Write Your Own (WYO) Insurance Companies that Participate in FEMA's NFIP				10-02
10-03	Lack of Formal Policies and Procedures in Various Areas		G		
10-04	Non-Compliance with 5 CFR Part 2638 and 5 CFR Part 2638 Related to Ethical Requirements		G		
10-05	Internal Control Deficiencies Identified Over Premiums Written at Selected Insurance Companies that Participate in FEMA's NFIP				10-03
10-05a	Internal Control Deficiencies Identified Over Premiums Written at Selected Insurance Companies that Participate in FEMA's NFIP				10-03
10-06	Deficiencies in the Budget Execution Report Preparation Process				10-04
10-07	Deficiencies in Development and Application of Policies Related to the Non-Grant, Non-Mission Assignment, Non-System-Generated Accounts Payable (A/P) Accrual				10-05
10-08	Control Deficiencies and Underlying Data Deficiencies Related to the Non-Grant, Non-Mission Assignment, Non-System-Generated A/P Accrual				10-06
10-09	Deficiencies in the Preparation and Review of the Government Accountability Office (GAO) Financial Audit Manual (FAM) 2010 – Checklist for Federal Accounting	A			
10-10	Inherited Problems in Legacy Grants & Training's (G&T's) Integrated Financial Management Information System (IFMIS) and Other Issues Noted in the Treasury Information Executive Repository (TIER) to IFMIS Reconciliation as of June 30, 2010	A			
10-11	Control Deficiencies Noted in the Financial Reporting Environment as of 3/31/10	A			
10-12	Insufficient Office of the Chief Financial Officer (OCFO) Review of FEMA's Legal Liability and Related Disclosure				10-07
10-13	Deficiencies Identified in the IFMIS Chart of Accounts and Transaction Codes			J	
10-14	Ineffective Controls Over Processing Obligations	F			
10-15	Deficiencies in Development of Mission Assignment (MA) Policies and Procedures				10-08
10-16	Ineffective Controls Over Processing and Monitoring MA	F			
10-17	Improvements Needed in Review and Recording of Year-End MA Accrual				10-09
10-18	Financial Monitoring of Grants by the Former Office of G&T	E			
10-19	Ineffective Controls Over Grants Management	E			
10-20	Lack of Certain Documentation Related to Compliance with the Improper Payments Information Act of 2002, as amended				10-10
10-21	Budgetary Accounting Issues Identified Journal Voucher (JV) Testwork through June 30, 2010	F			

Federal Emergency Management Agency
 Crosswalk - Financial Management Comments to NFRs
 September 30, 2010

NFR No.	Description	Disposition ¹			
		IAR			FMC
		MW	SD	NC	No.
10-21a	Budgetary Accounting Issues Identified JV Testwork from July 1, 2010 through September 30, 2010	F			
10-22	Inability to Link Systems to Significant Grant Programs				10-11
10-23	Failure to Identify and Assess Accounting Policies / Practices Not In Accordance with Generally Accepted Accounting Principles (Non-GAAP)				10-12
10-24	Improvements Needed in Management's Review of Grant Data and Automated Reconciliations in Grant Accrual Models	A			
10-25	Deficiency Identified Related to the Preparation and Review of the Retrospective Reserve Analysis				10-13
10-26	Issues Deficiencies Identified in JV Testwork through June 30, 2010	A			
10-26a	Issues Deficiencies Identified in JV Testwork from July 1, 2010 through September 30, 2010	A			
10-27	Monitoring of Audit Findings in Accordance with Office of Management and Budget (OMB) Circular No. A-133 and No. A-50, and Related Compliance Matters	E		K	
10-28	Lack of Supporting Documentation for Prompt Payment Sample Item				10-14
10-29	Deficiency in the Methodology Used to Calculate the Non-Current Portion of the Insurance Liability Estimate				10-15
10-30	Failure to Close Assistance to Firefighter Grants Timely				10-16
10-31	Deficiencies over NFIP TIER JV Adjustments	A			
10-32	Untimely De-Obligation of UDOs and Accounting for Public Assistance Grant Arbitration Cases in FY 2010	F			

¹Disposition Legend:

IAR	Independent Auditors' Report dated November 12, 2010
FMC	Financial Management Comment
MW	Contributed to a Material Weakness at the Department level when combined with the results of all other components
SD	Contributed to a Significant Deficiency at the Department level when combined with the results of all other components
NC	Contributed to Noncompliance with laws, regulations, contracts, and grant agreements at the Department level when combined with the results of all other components
NFR	Notice of Finding and Recommendation

Cross-reference to the applicable sections of the IAR:

A	Financial Management and Reporting
B	Information Technology Controls and System Functionality
C	Fund Balance with Treasury
D	Property, Plant, and Equipment
E	Actuarial and Other Liabilities
F	Budgetary Accounting
G	Other Entity-Level Controls
H	Custodial Revenue and Drawback
I	<i>Federal Managers' Financial Integrity Act of 1982 (FMFIA)</i> , and Laws and Regulations Supporting OMB Circular No. A-50, <i>Audit Followup</i> , as revised
J	<i>Federal Financial Management Improvement Act of 1996 (FFMIA)</i>
K	<i>Single Audit Act Amendments of 1996</i>
L	<i>Chief Financial Officers Act of 1990 (CFO Act)</i>
M	<i>Antideficiency Act</i> , as amended (ADA)
N	<i>Government Performance and Results Act of 1993 (GPRA)</i>

Federal Emergency Management Agency
 Status of Prior Year NFRs
 September 30, 2010

NFR No.	Description	Disposition ¹	
		Closed ²	Repeat (2010 NFR No.)
09-01	<i>Number not used</i>		Not applicable
09-02	Financial Monitoring of Grants by the Former Office of G&T		FEMA 10-18
09-03	<i>Number not used</i>		Not applicable
09-04	Non-Grant Related Unliquidated Obligations within the Former G&T Not Adequately Supported and De-obligated Timely		FEMA 10-32
09-05	<i>Number not used</i>		Not applicable
09-06	<i>Number not used</i>		Not applicable
09-07	Lack of Current Antideficiency Act Policies and Procedures	X	
09-08	Ineffective Controls over Processing MA Payments		FEMA 10-16
09-09	Untimely De-obligation of MAs and Delegations of Authority, and Control Deficiencies Related to Quarterly Review of MAs		Combined into FEMA 10-32
09-10	<i>Number not used</i>		Not applicable
09-11	<i>Number not used</i>		Not applicable
09-12	Lack of Supporting Documentation for the Reporting of Internal Use Software and Internal Use Software In Development	X	
09-13	Non-compliance with Ethics Requirements		FEMA 10-04
09-14	<i>Number not used</i>		Not applicable
09-15	<i>Number not used</i>		Not applicable
09-16	<i>Number not used</i>		Not applicable
09-17	Unavailability of Supporting Documentation for Certain Entity Level Controls	X	
09-18	<i>Number not used</i>		Not applicable
09-19	Lack of Formal Policies and Procedures in Various Areas		FEMA 10-03
09-20	Monitoring of Audit Findings in Accordance with OMB Circular Nos. A-133 and A-50, and Related Compliance Matters		FEMA 10-27
09-21	<i>Number not used</i>		Not applicable
09-22	<i>Number not used</i>		Not applicable
09-23	<i>Number not used</i>		Not applicable
09-24	<i>Number not used</i>		Not applicable
09-25	<i>Number not used</i>		Not applicable
09-26	<i>Number not used</i>		Not applicable
09-27	<i>Number not used</i>		Not applicable
09-28	Temporary Adjustments of Fund Balance with Treasury Reconciling Differences	X	
09-29	<i>Number not used</i>		Not applicable
09-30	<i>Number not used</i>		Not applicable
09-31	<i>Number not used</i>		Not applicable
09-32	Inherited Problems in Legacy Grants & Training IFMIS and Other Issues Noted In the IFMIS to TIER Reconciliations		FEMA 10-10
09-33	<i>Number not used</i>		Not applicable
09-34	<i>Number not used</i>		Not applicable
09-35	<i>Number not used</i>		Not applicable

Federal Emergency Management Agency
 Status of Prior Year NFRs
 September 30, 2010

NFR No.	Description	Disposition ¹	
		Closed ²	Repeat (2010 NFR No.)
09-36	Internal Control Deficiencies over Claims Paid at Selected Insurance Companies that Participate in FEMA's NFIP		FEMA 10-01, 10-01a
09-37	Inaccuracy of Claims' Loss Reserves at Selected WYO Insurance Companies that Participate in FEMA's NFIP		FEMA 10-02, 10-02a
09-38	<i>Number not used</i>	Not applicable	
09-39	Insufficient FEMA Oversight of the NFIP Service Provider's Methodology Used to Calculate Estimates Reported in the FEMA Financial Statements	X	
09-40	<i>Number not used</i>	Not applicable	
09-41	Deficiencies in the Submit for Rate Program and Claims Reinspection Program	X	
09-42	Lack of Consistent Policies and Procedures Over and Timely Documentation of the Initial Response Resources Inventory (IRR) Reconciliation Process	X	
09-43	Lack of Consistent Policies and Procedures Involving the Monthly IRR Inventory Rollforward Process	X	
09-44	Insufficient Resources in the Risk Management & Compliance Branch	X	
09-45	Monitoring and Communication of Significant Financial-Related Matters in the NFIP	X	
09-46	<i>Number not used</i>	Not applicable	
09-47	<i>Number not used</i>	Not applicable	
09-48	<i>Number not used</i>	Not applicable	
09-49	<i>Number not used</i>	Not applicable	
09-50	Improvements Needed in Review and Recording of Year-end MA Accrual		FEMA 10-17
09-51	Internal Control Deficiencies over the NFIP Restricted Bank Account Reconciliations at Selected Insurance Companies that Participate in FEMA's NFIP	X	
09-52	Issues identified in JV Testwork Relating to DHS TIER File Adjustments and IFMIS Abnormal Balances		FEMA 10-26, 10-26a
09-53	Internal Control Deficiencies over NFIP TIER JV Adjustments		FEMA 10-31
09-54	Deficiencies in Development and Application of Policy and Lack of Controls Related to the Non-Grant, Non-System-Generated A/P Accrual		FEMA 10-07
09-55	Deficiencies in Development and Application of MA Policies		FEMA 10-15
09-56	Ineffective Review Controls over the Accounts Receivable Process	X	
09-57	Lack of Supporting Documentation for Disaster Fund (Fund 6) UDOs		Combined into FEMA 10-32
09-58	Lack of Supporting Documentation for Non-Fund 6 UDOs		Combined into FEMA 10-32
09-59	Improvements Needed in Management's Review of Grant Data and Automated Reconciliations in Grant Accrual Models		FEMA 10-24
09-60	Improper Accounting for Budgetary Entries in Treasury Appropriation Fund Symbol (TAFS) 709/00561	X	

¹ KPMG was engaged to perform an audit over the DHS balance sheet and statement of custodial activity as of and for the year ended September 30, 2010, and was not engaged to perform an audit over the statement of net cost, statement of changes in net position, and statement of budgetary resources for the year ended September 30, 2010. In addition, we were engaged to follow up on the status of all active NFRs that supported significant deficiencies

Federal Emergency Management Agency
Status of Prior Year NFRs
September 30, 2010

reported in KPMG's *Independent Auditors' Report* dated November 13, 2009.

² NFRs were closed either through remediation of the findings or that we were not engaged to follow up on active NFRs that did not support significant deficiencies reported in KPMG's *Independent Auditors' Report* dated November 13, 2009.


Federal Emergency Management Agency
*Management Response to the
 Management Letter*

U.S. Department of Homeland Security
 Washington, DC 20528



MAR 11 2011

MEMORANDUM FOR: Anne L. Richards
 Assistant Inspector General for Audits

FROM: Norman Dong 
 Chief Financial Officer
 Federal Emergency Management Agency

SUBJECT: Response to Draft Report "*Federal Emergency Management Agency
 Management Letter for FY 2010 DHS Consolidated Financial
 Statement Audit*"

This memorandum provides a response to the Federal Emergency Management Agency's recommendations cited in *FY 2010 DHS Consolidated Financial Statement Audit*. I am responding to the draft report cited above.

FMC 10-01 – Internal Control Deficiencies over Claims Paid at Selected Insurance Companies that Participate in Federal Emergency Management Agency's (FEMA) National Flood Insurance Program (NFIP) (NFR Nos. 10-01 and 10-01a)

Management concurs with the audit report recommendation. NFIP Management initiated follow-up with the WYO companies on the exceptions noted. The NFIP will continue to review WYO company claims handling as part of the ongoing claims operation reviews to ensure compliance with NFIP guidelines and consistent establishment and reporting of loss reserves and subsequent adjustments. Management does not believe that claims loss reserves are material to the loss reserving process.

FMC 10-02 – Inaccuracy of Claims' Loss Reserves at Selected Insurance Companies that Participate in FEMA's NFIP (NFR Nos. 10-02 and 10-02a)

Management concurs with the audit report recommendation. NFIP Management has initiated follow-up with the WYO companies on the exceptions noted and will continue to review WYO company claims loss reserving as part of the ongoing claims operation reviews to ensure consistent establishment and reporting of loss reserves and subsequent adjustments. Management does not believe that claims loss reserves are material to the loss reserving process.

FMC 10-03 – Internal Control Deficiencies over Premiums Written at Selected Insurance Companies that Participate in FEMA's NFIP (NFR Nos. FEMA 10-05 and 10-05a)

Management concurs with the audit report recommendation. NFIP Management has initiated follow-up with the WYO companies on the exceptions noted and will continue to review WYO company underwriting processes as part of the ongoing underwriting operation reviews.

Federal Emergency Management Agency
*Management Response to the
Management Letter*

FMC 10-04 – Deficiencies in the Budget Execution Report Preparation Process (NFR No. FEMA 10-06)

Management concurs with the audit report recommendation. OCFO has a dedicated remediation effort underway to remediate this issue.

FMC 10-05 – Deficiencies in the Development and Application of Policies Related to the Non-Grant, Non-Mission Assignment, and Non-System Generated Accounts Payable (A/P) Accrual (NFR No. FEMA 10-07)

Management concurs with the audit report recommendation. OCFO has a dedicated remediation effort underway to remediate this issue.

FMC 10-06 – Control Deficiencies and Underlying Data Deficiencies Related to the Non-Grant, Non-Mission Assignment, and Non-System Generated Accounts Payable Accrual (NFR No. FEMA 10-08)

Management concurs with the audit report recommendation. OCFO has a dedicated remediation effort underway to remediate this issue.

FMC 10-07 – Insufficient Office of the Chief Financial Officer (OCFO) Review of FEMA's Legal Liability and Related Disclosure (NFR No. FEMA 10-12)

Management concurs with the audit report recommendation. OCFO is working towards remediation of this issue.

FMC 10-08 – Deficiencies in the Development of Mission Assignment (MA) Policies and Procedures (NFR No. FEMA 10-15)

Management concurs with the audit report recommendation. OCFO is working towards remediation of this issue.

FMC 10-09 – Improvements Needed in Review and Recording of Year-end Mission Assignment Accrual (NFR No. FEMA 10-17)

Management concurs with the audit report recommendation. OCFO is working towards remediation of this issue.

FMC 10-10 – Lack of Certain Documentation Related to Compliance with the Improper Payments Information Act of 2002, as amended (IPIA) (NFR No. FEMA 10-20)

Management concurs with the audit report recommendation. OCFO is working towards remediation of this issue.

FMC 10-11 – Inability to Link Systems to Significant Grant Programs (NFR No. FEMA 10-22)
Management concurs with the audit report recommendation. OCFO is working towards remediation of this issue.

Federal Emergency Management Agency
*Management Response to the
Management Letter*

FMC 10-12 – Failure to Identify and Assess Accounting Policies/Practices Not in Accordance with Generally Accepted Accounting Principles (Non-GAAP) (NFR No. FEMA 10-23)

Management concurs with the audit report recommendation. OCFO is working towards remediation of this issue.

FMC 10-13 – Deficiency Identified Related to the Preparation and Review of the Retrospective Reserve Analysis (NFR No. FEMA 10-25)

Management concurs with the audit report recommendation. The Chief Actuary has enhanced the retrospective reserved analysis review process to include a review of the accuracy of the amounts and the calculations in the analysis.

FMC 10-14 – Lack of Supporting Documentation for Prompt Payment Sample Item (NFR No. FEMA 10-28)

Management concurs with the audit report recommendation. OCFO is working towards remediation of this issue.

FMC 10-15 – Deficiency in the Methodology Used to Calculate the Non-Current Portion of the Insurance Liability Estimate (NFR No. FEMA 10-29)

Management concurs with the audit report recommendation. FEMA's OCFO and the Mitigation Directorate are developing procedures to reassess periodically a methodology for calculating the current and non-current portions of the insurance liability estimate that complies with the applicable accounting standards.

FMC 10-16 – Failure to Close Assistance to Firefighter Grants (AFG) Timely (NFR No. FEMA 10-30)

Management concurs with the audit report recommendation. OCFO is working towards remediation of this issue.

Should you have any questions or concerns, please contact Kathy Hill, Director, Risk Management and Compliance at (202) 646-7057 or by e-mail at Kathy.Hill@fema.gov

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