The internal control weaknesses discussed in this report, and the Federal Emergency Management Agency's (FEMA) progress toward correcting these weaknesses, are discussed in the context of FEMA's existing statutory and organizational structure and its future as a part of the newly-formed Department of Homeland Security (DHS). We recognize that many Information Technology (IT) control enhancements have been externally postponed because of FEMA's integration into DHS. In addition, as of the date of this report, it is unclear how future legislative and budgetary changes will impact FEMA, and what effect such changes may have on FEMA's ability to implement existing or future corrective action plans.

We acknowledge that FEMA has taken certain actions to address these matters. However, we understand that implementing sufficient change to mitigate the internal control weaknesses is a multiyear task due to the complexity of the issues and depends upon available resources.

This appendix describes the material weaknesses and the reportable condition as of and for the year ended September 30, 2002 and our recommendations. Our assessment of management's response is presented in Appendix II.

MATERIAL WEAKNESSES

1. INFORMATION SECURITY CONTROLS FOR FEMA'S FINANCIAL SYSTEMS ENVIRONMENT NEED IMPROVEMENT

Information security is a critical control element for FEMA. This is especially true for the agency's financial systems. The citizens of the United States entrust the stewardship of federal government financial resources and assets to government financial and program managers. Without effective information security controls for financial systems, there is substantial risk that the resources under stewardship may be exposed to unauthorized modification, disclosures, loss, or impairment.

Because of the criticality of information security for federal systems, several laws require that federal systems, including financial systems, have high quality information security controls. For example:

- The *Chief Financial Officer's Act of 1990* (the CFO Act) mandates through general requirements that agencies develop and maintain financial management systems that comply with applicable accounting principles, standards, and requirements; internal control standards; and requirements issued by the Office of Management and Budget (OMB), U.S. Treasury, and others. OMB has issued Circular A-130, *Management of Federal Information Resources*, Appendix III, *Security of Federal Automated Information Resources*. OMB Circular A-130, Appendix III, requires agencies to implement technical information security controls in accordance with National Institute of Standards and Technology guidance. Such guidance relates to the implementation of access controls, maintenance and review of audit trails, segregation of duties, and maintenance of software in a secure manner.

- The *Federal Financial Management Improvement Act of 1996* (FFMIA) mandates that federal financial management be advanced by ensuring that federal financial management systems provide reliable, consistent disclosure of financial data, and that they do so on a basis that is uniform across the federal government from year-to-year, consistently, using professionally-accepted accounting standards. As with the CFO Act, federal agencies need to comply with FFMIA by adhering to policies established by OMB, such as OMB Circular A-130, Appendix III.

- The *Government Information Security Reform Act (*GISRA), passed as part of the *Defense Authorization Act of 2000*, mandates that federal agencies implement sufficient processes for security program management, security controls implementation, and security evaluation. The *Federal Information Security Management Act of 2002* (FISMA), passed as part of the *E-Government Act of 2002*, replaces GISRA for FY2003.

During our FY2001 financial statement audit, we identified several security weaknesses related to FEMA's IT environment that led to a reported material weakness. During FY2002, FEMA took actions to improve information security, including addressing certain issues identified during the FY2001 financial statement audit. For example, in FY2002, FEMA established the Office of Cyber Security, which subsequently began designing an information security program planning and evaluation process. FEMA also strengthened security controls for devices available over the Internet, such as agency websites, and addressed a key security weakness that was identified with the Integrated Financial Management Information System (IFMIS), the agency's core financial management system.

Despite addressing these information security weaknesses, FEMA still needs to address a number of outstanding weaknesses from prior audits, as well as address new issues identified during this audit. Contributing to these weaknesses is FEMA's lack of an adequate information security program that ensures consistent and effective information security controls throughout the life cycle of the agency's various information systems. FEMA's Office of Cyber Security was established to address this underlying problem.

Information security issues that remain outstanding from the FY2001 financial statement audit are:

- Entity-wide security controls need to be improved, most notably in the areas of information security program planning, training and awareness, background investigations, and system certification and accreditation. Although the Office of Cyber Security is in the process of addressing these areas, as of the end of FY2002 they had not been fully addressed.

- Several significant security weaknesses continue to exist with FEMA's system, database, and network environment, including devices supporting the National Emergency Management Information System (NEMIS), which is FEMA's enterprise-wide disaster response system. The existence of these technical weaknesses can be directly attributed to weaknesses in the agency's overall information security program.

- Several information security weaknesses with IFMIS, including issues with audit trails, segregation of duties, and user access controls, continue to exist.

FEMA attributes its inability to fully address these weaknesses to a lack of sufficient resources.

We also identified the following additional information security related weaknesses during the FY2002 audit:

- FEMA's payroll system, QuickTime, lacks certain information security controls required by federal information security guidelines and FEMA requirements.

- FEMA's acquisition system, the Automated Acquisition Management System (AAMS), lacks certain information security controls.

- FEMA does not have consistent policies or practices for ensuring that IT contractors that process, store, or maintain agency data have sufficient information security controls.

- FEMA does not have consistent policies or practices to ensure that employee system access is promptly removed upon employee termination.

- FEMA's process for managing the security of its wireless devices needs improvement. Maintaining controls over devices with wireless communication capabilities is a key step in protecting an organization from unauthorized access via wireless network penetrations.

- FEMA's policies and practices for identifying sensitive but unclassified (SBU) IT information needs to be improved to ensure proper handling.

These issues significantly reduce the overall information security controls for FEMA's financial systems processing environment.

We have provided details of the issues summarized above to FEMA management. Management has agreed to the issues, and in some cases has started corrective actions.

Recommendations:

We recommend the Chief Information Officer (CIO):

1.a. Continue efforts to implement enhanced entity-wide information security controls to address the identified weaknesses.

1.b. Ensure that technical vulnerabilities with FEMA IT platforms are corrected, and that processes are established and maintained to ensure the conditions are not repeated.

1.c. Ensure that policies and practices are implemented to better manage the agency's devices that have wireless connectivity capabilities.

1.d. Ensure that policies and practices are implemented regarding the appropriate classification and management of SBU data.

1.e. Ensure that an inventory is completed of all agency functions where contractors process, transmit, or maintain data on behalf of FEMA. After the completion of the inventory, and as part of the agency's certification and accreditation methodology, the potential risks to the agency should be assessed based on the nature of the support the contractors provide and the level of access the contractors have into the agency's physical and logical IT environment.

We recommend the Assistant Director for the Administration and Resource Planning Directorate, in coordination with the CIO:

1.f. Ensure that QuickTime information security controls are improved.

1.g. Implement additional policies and practices to ensure that terminated employees' system access is promptly removed.

We recommend the Acting Chief Financial Officer (CFO), in coordination with the CIO:

1.h. Ensure that noted information security weaknesses with IFMIS are corrected.

We recommend the Acting CFO and Senior Procurement Officer, in coordination with the CIO:

1.i. Ensure that AAMS information security controls are improved.

1.j. Develop acquisition policies and practices to require that for all procurements where a contractor's site is used to process, transmit, or maintain FEMA data, the site's information security controls are reviewed, or evidence of an independent review is obtained, prior to the contract being awarded. Security reviews should be performed or obtained on a yearly basis, as required by FISMA. This requirement should be included in all applicable agency Statements of Work.

2. FEMA'S FINANCIAL SYSTEM FUNCTIONALITY NEEDS SIGNIFICANT IMPROVEMENT

Maintaining quality federal financial management system functionality is critical to increasing the accountability of financial and program managers, providing better information for decision-making, and increasing the efficiency and effectiveness of services provided by the federal government. FFMIA mandates that federal financial management be advanced by ensuring that federal financial management systems provide reliable, consistent disclosure of financial data. OMB Circular A-127, *Financial Management Systems,* sets forth policies for establishing and maintaining federal financial management systems in accordance with FFMIA. Specifically, OMB Circular A-127 requires that federal financial systems comply with requirements issued by the Joint Financial Management Improvement Program (JFMIP). JFMIP, in its *Core Financial Systems Requirements*, requires that proper and reliable financial management systems provide for:

- *Accountability*. Inform taxpayers, Congress, and agency personnel in terms they can readily understand, on how the Nation's tax dollars are spent, and how federal assets are protected.

- *Efficiency and Effectivenes*s. Provide efficient and effective service to the federal agency's internal and external customers (e.g., individuals, contractors, partnerships, state and local governments, other federal agencies/organizations, the military, and foreign governments).

- *Better Decision-Makin*g. Provide to Congress, agency heads and program managers, timely reports linking financial results and program data so that financial and program results of policy and program decisions can be identified, tracked, and forecasted more accurately.

During our FY2001 financial statement audit, we identified several weaknesses related to financial systems that led to a reported material weakness for the agency. During FY2002, FEMA took actions to improve financial systems capabilities, including addressing several issues identified during last year's financial statement audit. For example, FEMA contracted for services to begin addressing IFMIS vendor processing issues. In addition FEMA prepared a remediation plan that included steps to acquire and implement an ERP system, which was initially intended to better track agency property. Although the preparation of the remediation plan was a positive step, we noted issues with planned action steps. For example, FEMA capital planning requirements had not been fully met for the ERP project, and the purpose of the ERP had not been sufficiently communicated across the agency. However, the ERP acquisition was subsequently halted as a result of OMB's directive to stop IT improvement efforts for agencies moving to the Department of Homeland Security.

Financial system issues that remain outstanding from the FY2001 financial statement audit are:

- FEMA's personal property management system, the Logistics Information Management System (LIMS), is not interfaced with IFMIS, and requires numerous manual workarounds to ensure accounting information is accurately recorded.

- The posting of payroll transactions to IFMIS takes approximately two weeks from the end of the pay cycle because of processing inefficiencies.

- FEMA does not have a managerial cost accounting system. FEMA's implementation of IFMIS does not currently capture data at a detailed enough level to serve in this capacity.

- FEMA currently operates two accounts receivable systems. IFMIS has an embedded accounts receivable sub-system, but because this sub-system does not provide detail sufficient to meet agency disaster management needs, a separate commercial-off-the-shelf product, ACCPAC, is also maintained to manage disaster related debtor accounts.

- The interface between IFMIS and the Department of Health and Human Services (HHS) Smart Link system requires significant manual processing to correct interface errors which are caused, in part, by FEMA's inconsistent management of processing codes. In addition, an automated interface no longer exists to transmit payment data from Smart Link to IFMIS. Smart Link is used to process several types of FEMA obligations, including grant obligations.

- Although FEMA has engaged a contractor to clean up the IFMIS vendor table, these efforts have not been completed.

- FEMA continues to lack a contingency plan for IFMIS.

During the FY2002 financial statement audit, we identified two additional issues impacting FEMA's financial processing efficiency and effectiveness:

- Since 1989, when FEMA originally began using the NFC for payroll processing, FEMA's Management Account Structure Codes System (MASC) database information at NFC has not been updated. As a result, FEMA has had to pay NFC to correct unnecessary payroll processing errors. FEMA's payroll processing costs for FY2000, FY2001, and FY2002 have been $691,079, $728,744; and $750,606, respectively, and costs for correcting payroll-processing errors is estimated at 20% annually. In addition, FEMA has one of the highest number of payroll processing errors of all agencies using NFC.

- During FY2002, FEMA upgraded IFMIS to version 5.1.6. While we found that the upgrade was generally managed in an effective manner, we also found that a FEMA required document, the Requirements Traceability Matrix (RTM), was not completed. The RTM helps ensure that a system is designed and maintained in such a manner to meet applicable functional and user requirements. Information Technology Services Directorate (ITSD) personnel attributed the lack of a completed RTM to insufficient agency personnel with the required knowledge to accurately complete the matrix. In January 2003 FEMA engaged a contractor to produce the RTM.

Recommendations:

We recommend that the Acting CFO:

2.a. Coordinate the performance of business process reviews for key financial processes, such as personal property management, payroll, cost accounting, and accounts receivable. These reviews should include assessments of how the existing financial systems processing cycles need to be improved to better meet mission needs, FFMIA requirements, and OMB Circular A-127 policy guidance. Based on the results of the business process reviews, the Acting CFO, in coordination with other agency executives, should review all issues identified with the current financial systems environment and relevant interfaces, and update remediation plans as appropriate, with the goal of improving financial system functionality and efficiency.

2.b. Continue to improve the management of Smart Link-related processing codes and to consider the development of a full interface between IFMIS and Smart Link.

2.c. Continue efforts to clean up the IFMIS vendor table and related processes, including planned efforts to institute a quarterly review of the vendor file audit trail, work with the IFMIS development contractor to develop analytical tools to help maintain effective and efficient vendor table data, and close-out of old vendor data.

2.d. Ensure that the MASC table at the NFC is updated with current FEMA payroll processing data, and implement a policy whereby the MASC table is regularly updated.

In addition, we recommend that the Acting CFO, in coordination with the CIO:

2.e. Ensure that IFMIS contingency planning efforts be improved. This should include:

- Performing a business impact assessment to fully assess the impact an IFMIS outage would have on FEMA operations, and how long FEMA could operate given different outage scenarios.
- Developing a contingency plan focused on recovering critical operations within the necessary timeframes, or implementing workarounds as necessary. The contingency plan should consider the activities performed at general support facilities, such as data processing centers and telecommunications facilities, as well as the activities performed by users of specific applications.
- Periodically testing the IFMIS contingency plan to ensure the recovery planning steps will work as intended.

2.f. Ensure that the IFMIS 5.1.6 RTM is completed.

3. FEMA MUST IMPROVE ITS FINANCIAL REPORTING PROCESS

To meet the requirements of the CFO Act and the Government Management Reform Act, FEMA prepares annual consolidated financial statements. The preparation of financial statements should be a routine process that is a by-product of already existing mission-driven policies and procedures and financial internal controls.

As directed by the *Federal Managers Financial Integrity Act* (FMFIA), the United States General Accounting Office (GAO), in November 1999, issued the *Standards for Internal Control in the Federal Government* (Standards). The Standards "define the minimum level of quality acceptable for internal control in government and provide the basis against which internal control is to be evaluated." The Standards segregate internal control into five areas, i.e., control environment, risk assessment, control activities, information and communications, and monitoring.

The Standards define control activities as "the policies, procedures, techniques, and mechanisms that enforce management's directives." As stated in the Standards, control activities "include a wide range of diverse activities such as approvals, authorizations, verifications, reconciliations, performance reviews, maintenance of security, and the creation and maintenance of related records which provide evidence of execution of these activities as well as appropriate documentation."

During our FY2001 financial statement audit, we identified several weaknesses related to FEMA's financial reporting process that led to a reported material weakness for the agency. During FY2002, FEMA included these weaknesses in its remediation plan and took corrective actions to partially address several identified issues, including the drafting of a standard operating procedure (SOP) for financial statement preparation, issuing an SOP entitled *Processing Mission Assignments*, beginning efforts to identify obligations that should be de-obligated, and improving the timeliness of recording certain corrections to grant-related balances.

Despite these corrective actions, the following FY2001 weaknesses have not been fully addressed:

- The financial statements were prepared late, as compared to FEMA's 2002 Year-End Closing Instructions, and required significant revisions. On December 24, 2002, we received the first draft of FEMA's FY2002 consolidated financial statements. This draft did not include notes to the consolidated financial statements or any of the required supplementary information. Furthermore, the first draft excluded several material adjustments, and the statements were not in the required format. On January 9, 2003, we received the second draft of FEMA's consolidated financial statements. Although the second draft included all required components, numerous adjustments and follow-up questions were necessary. Final statements and notes were not received until late January. As a result of these delays, final audit procedures were significantly compressed so that FEMA could meet the accelerated OMB reporting deadline of January 31, 2003. Beginning with FY2003, interim unaudited financial statements are required on a quarterly basis, and due to OMB within 45 days after the end of the quarter.

- The Required Supplementary Stewardship Information does not include outcome measures for each stewardship investment disclosed, as required.

- Although FEMA drafted an SOP for financial statement preparation, the SOP has not been finalized. The adjustments and revisions made to the first and second drafts of the consolidated financial statements appear to demonstrate that the SOP was not implemented during the FY2002 preparation process, and is reflective of a lack of control to ensure that the financial statements are accurate.

- FEMA does not have an integrated financial reporting process that can generate financial statements as a by-product of already existing processes. For example, FEMA manually enters financial data from IFMIS into personal computer spreadsheets in order to prepare the consolidated financial statements.

- FEMA took several measures to address the timely close-out of mission assignments. However, of a sample of 15 mission assignments that were closed during FY2002, we identified 12 mission assignments that were not financially closed within one year of the project completion date. The closure of a mission assignment requires the cooperation of the other federal agency.

- As noted above, FEMA began efforts to identify obligations that should be de-obligated. However, obligations at May 31, 2002, and September 30, 2002, totaling $2.3 billion and $127 million, respectively, were tested by us during the audit. Of these amounts, we identified, and FEMA agreed, that $28 million should have been de-obligated prior to September 30, 2002. FEMA adjusted the consolidated financial statements, accordingly. The obligations related primarily to grants, mission assignments, and interagency agreements.

- Although FEMA's process for accruing accounts payable includes the review of subsequent disbursements and bills received for a period of time after the end of the reporting period, it does not include techniques to accrue an estimate of bills not received prior to the cut-off dates. We identified several disbursements before and after these cut-off dates that related to FY2002, but were not accrued for. FEMA agreed that $8 million should have been included in the FY2002 accounts payable accrual, and adjusted the consolidated financial statements accordingly.

During the FY2002 financial statement audit, we identified the following additional issues impacting the financial reporting process:

- FEMA FY2001 consolidated financial statements were issued with an error that resulted from a lack of version control. FEMA identified the error and re-issued the financial statements; however, this demonstrates a significant lack of control in the financial statement issuance process.

- At our request, FEMA reviewed its mission assignment disbursements to the United States Department of Labor and the National Institute of Mental Health. Upon FEMA's review, an adjustment of $43 million was made to the FY2002 consolidated financial statements to properly record these disbursements as advances to others. Similarly, FEMA recorded a $16 million adjustment to properly record disbursements under interagency agreements as advances to others.

- Public Law 107-206, Title I, Chapter 13 granted FEMA three emergency, contingent appropriations, totaling $306 million. These amounts were contingent on the President informing the Congress that the amounts were designated as an emergency requirement. However, the President did not make such a designation within the required time period. FEMA accounted for the transactions in different ways in its draft FY2002 consolidated financial statements. Therefore, we recommended and FEMA posted adjustments for all of these appropriations.

- FEMA does not perform close out procedures for its interagency agreements timely upon expiration of the performance period or receipt of the final invoice, resulting in the untimely de-obligation of remaining funds. In addition, interagency agreement close out policies and procedures are not documented.

The above conditions significantly increase the risk that the consolidated financial statements and required disclosures could be inaccurately presented. In addition, significant resources are required to review and validate the financial statement presentation due to the intensive, and not fully documented, manual processes that are used to prepare FEMA's consolidated financial statements.

Recommendations:

We recommend that the Acting CFO:

3.a. Continue to evaluate existing resources, automated systems, and processes to identify improvements to ensure the accuracy of the financial statements and that the financial statements are in conformity with generally accepted accounting principles, as outlined in applicable OMB Bulletins.

3.b. Require the completion of the GAO *Checklist for Reports Prepared Under the CFO Act* and the documentation of senior management review and approval of the financial statements prior to issuance.

3.c. Finalize and implement the policies and procedures surrounding the financial reporting process in light of the requirements of OMB Bulletin 01-09.

3.d. Continue to implement procedures to ensure the timely financial close out of mission assignments.

3.e. Continue efforts to periodically review obligations based on aged amounts to ensure de-obligations are performed timely.

3.f. Develop and implement improved accounts payable accrual policies and procedures that include estimation of payables for bills not received prior to the cut-off dates. Such procedures become increasingly important as OMB continues to require financial statement submission deadlines closer to the end of the reporting period.

3.g. Develop and implement a version control process to ensure that the issued consolidated financial statements are the correct and final version.

3.h. Develop and implement procedures to ensure that advance payments for services are appropriately classified.

3.i. Develop and implement procedures to ensure consistent and appropriate accounting treatment of unusual transactions and events.

3.j. Develop, document, and implement procedures to ensure the timely close out of interagency agreements.

4. FEMA MUST IMPROVE ITS REAL AND PERSONAL PROPERTY SYSTEM PROCESSES

Statement of Federal Financial Accounting Standards (SFFAS) No. 6, *Accounting for Property, Plant, and Equipment*, defines PP&E as tangible assets that have estimated useful lives of two years or more, are not intended to be sold in the ordinary course of operations, and have been acquired with the intention of being used by the entity.

SFFAS No. 6 requires that the cost of property be recorded as an asset. The cost may be recorded at acquisition cost, estimated fair value, or other specified methods, depending upon how the asset was acquired. This cost is to be depreciated over the life of the PP&E, with the exception of land, which is non-depreciable. SFFAS No. 10, *Accounting for Internal Use Software*, requires federal agencies to capitalize certain internal use software costs.

The proper accounting for PP&E requires that systems and processes be in place and operating effectively to ensure all property above the entity's established capitalization threshold is properly recorded, accurately depreciated, and tracked for safeguarding purposes.

During our FY2001 audit, we identified several weaknesses related to FEMA's property systems and processes. In particular, FEMA did not have a property management system that adequately met FEMA's accounting needs or JFMIP requirements. In FY2002, FEMA placed on hold plans to acquire a JFMIP compliant system because of an OMB moratorium on system purchases, as mentioned earlier. In addition, FEMA did not have policies and procedures in place to ensure the accuracy of data recorded in LIMS, its personal property management system. During the past year, FEMA has taken steps to improve its property accounting. In particular, FEMA conducted an agency-wide inventory of personal property valued at $25,000 or greater (i.e., property meeting the capitalization threshold) to ensure the correct reporting of equipment and related depreciation. As a result of its agency-wide inventory, FEMA recorded a prior period adjustment to increase equipment acquisition cost and accumulated depreciation as of September 30, 2001 by $74.5 million and $71.7 million respectively. Also, FEMA developed processes for tracking construction-in-process (CIP) and deferred maintenance amounts, improved processes for the calculation of depreciation, and developed procedures for valuing internal use software.

However, we noted that certain weaknesses identified during FY2001 have not yet been addressed. FEMA attributes the inability to address these issues to the lack of sufficient resources and the moratorium on system purchases. These issues include:

- FEMA does not have a property management system that meets its accounting needs and JFMIP requirements. LIMS is used primarily to track the location and availability of equipment. LIMS does not track other types of property and cannot perform the accounting functions required by JFMIP. As stated above, FEMA has not been able to acquire a new system due to the systems purchase moratorium.

- LIMS continues to change acquisition dates for equipment when items are transferred within FEMA, and it does not contain data fields, such as purchase order or invoice numbers, that link equipment to the accounting records. Acquisition dates are important for depreciation calculations. Equipment needs to be linked to the accounting records so that equipment can be substantiated as to acquisition date and valuation. In general, property items should track to its supporting procurement information, and accounting records should correlate to any FEMA property located at either FEMA sites or in the custody of others.

- Although FEMA conducted an agency-wide inventory of equipment, it has not entered all of the results into LIMS. As a result, baseline inventory information is scattered between LIMS, contractor reports, spreadsheets, and other non-LIMS ("cuff") records. Unless LIMS is fully and completely updated and maintained, FEMA is at high risk of losing the ability to substantiate the baseline numbers it has worked so hard to obtain. To ensure accurate accounting records going forward, FEMA also will need to perform reconciliations and use workarounds to compensate for LIMS' inability to interface with the accounting records and maintain acquisition dates, and to adjust for property acquisitions, disposals, and impairments.

- FEMA has not fully implemented a centralized facilities management system because of the systems purchase moratorium.

- Although FEMA has developed processes for identifying, valuing, and tracking CIP and deferred maintenance, these processes have not been fully implemented. Reports related to CIP and deferred maintenance are to be submitted by accountable property officers (APOs) and facilities managers on a quarterly basis. FEMA, however, has not implemented procedures to ensure timely submission and proper follow-up on delinquent or inadequate reports. For its FY2002 financial statements, FEMA developed the deferred maintenance information through a one-time engineering assessment provided by a contractor on a selected number of FEMA locations.

During the FY2002 financial statement audit, we identified the following additional issues impacting FEMA's property:

- FEMA does not have procedures to ensure that equipment is consistently recorded on either a system or a component basis. For example, we found that some regions recorded servers as a single unit in LIMS, while other regions entered the components of the server as individual items in LIMS. Therefore, servers might be recognized as a capitalizable item in one region but not in another because the individual components were under the capitalization threshold. Also, we found that equipment sometimes was recorded twice – once as part of a system, and once as a component. Specifically, we found equipment in FEMA's mobile response vehicles that was sometimes double-counted in LIMS – once as part of the vehicle, and once as a component. This situation made it more difficult to obtain an accurate inventory valuation.

- FEMA does not have procedures to ensure that property inventories are performed properly. To establish a baseline inventory, as mentioned earlier, FEMA required its 6 APOs to perform equipment inventories. A FEMA contractor then validated these inventories. During our review, we found that some regional inventories were not performed properly, a finding consistent with the validation contractor's findings. For example, some APOs did not check property onsite against LIMS records; i.e., they did not do a "floor to book" test. We also identified several locations that did not provide a current or complete certified inventory as part of the baseline inventory effort. These omissions indicate that the required annual inventories that APOs are to perform might also be incomplete.

- FEMA does not have procedures to ensure that all equipment is entered into LIMS. Based on our inquiries of the APOs and FEMA management, we verified that two significant equipment items had never been entered into LIMS, although this equipment was monitored by various FEMA programmatic offices. As a result, their related acquisition cost, accumulated depreciation, and net book value, had never been reflected in FEMA's financial statements. Specifically, radio communication equipment located throughout the United States, as part of FEMA's National Radio System (FNARS) and government-furnished equipment (GFE) located at a contractor site, had never been entered into LIMS. The acquisition cost of the FNARS and GFE property items were valued at $27,876,000 and $882,000, respectively.

Recommendations:

We recommend that the Acting CFO, the Assistant Director for the Administration and Resource Planning Directorate, in coordination with the CIO:

4.a. Continue seeking to implement a JFMIP-compliant property management system that supports accounting for all types of property; is integrated with the accounting system; addresses the tracking of the addition, disposal and internal transfer of property; and provides the required accounting functionality.

4.b. Ensure that all baseline inventory information is entered into LIMS and is maintained. We suggest that a single FEMA unit, such as the Automated Inventory Control Group, be given the responsibility for ensuring the entry of the baseline data into LIMS in order to maintain control over this process.

4.c. Continue to implement FEMA's centralized facilities management program.

4.d. Until the JFMIP-compliant property management system is implemented, policies and procedures should be implemented to ensure that:

- CIP and deferred maintenance amounts continue to be identified, valued and tracked.
- Property additions, either by purchase, transfer-in, or construction, are all recorded and reconciled on a timely basis with the relevant property additions recorded in IFMIS.
- Property deletions, either by sale, transfer-out or excess disposal, are all recorded and reconciled on a timely basis with the relevant property disposals recorded in IFMIS.
- Personal property additions are correctly and consistently entered as either a system (i.e., modified, network, or end unit items) or as individual components in LIMS.
- Personal property inventories are conducted on a periodic basis and the results of those inventories are certified by the appropriate APO or other property manager and that the Administration and Resource Planning Directorate provide oversight over those inventories to verify their accuracy and completeness.

5. FEMA MUST IMPROVE ITS ACCOUNT RECONCILIATION PROCESSES

As required by the FMFIA, federal agencies must establish controls that reasonably ensure that (a) obligations and costs comply with applicable laws; (b) assets are safeguarded against waste, loss, unauthorized use, and misappropriation; and (c) revenues and expenditures are properly recorded and accounted for. A typical control used for these purposes is the reconciliation of the agency's financial accounts on a periodic basis.

During our FY2001 financial statement audit, we noted that many of FEMA's accounts had not been fully reconciled during the year. During FY2002, FEMA included this weakness in its remediation plan and took corrective actions to partially address several identified examples, including contracting for the performance of accounts payable and unliquidated obligations reconciliations at year-end, implementing procedures to reconcile each of FEMA's reimbursable agreements, and improving the timeliness of TFS 6652, *Statement of Differences*, reconciliations.

Despite these corrective actions, we concluded from our FY2002 audit procedures that the following FY2001 weaknesses have not been fully addressed:

- In FY2001, we noted that reconciliations between subsidiary records and the general ledger had not been performed for accounts payable and unliquidated obligations. As noted above, FEMA contracted for the performance of these reconciliations at the end of FY2002. However, when these reconciliations were requested for the six months ended June 30, 2002, only the reconciliations for one fund were provided. Reconciliations should be performed periodically throughout the course of the fiscal year and not only at year end.

- We noted that differences identified during the TFS-6653, *Undisbursed Appropriations Account Ledgers,* reconciliation process were not reconciled and resolved timely. Further, the manner in which the TFS-6653 reconciliation is documented does not easily permit the identification of unreconciled amounts between the U.S. Treasury's and FEMA's records.

- FEMA's suspense fund, which is used to hold transactions until FEMA program officers approve them, was not reconciled with the amount reflected in the U.S. Treasury's records (i.e., Treasury account 58-F-3875). In addition, the amount recorded in the general ledger was not reconciled with the subsidiary ledger. Because the accuracy of the amount in the suspense fund recorded in the general ledger was uncertain, FEMA relied solely on the U.S. Treasury's records in determining the suspense balance, which is allocated at year end to FEMA's various programs based on an analysis of costs. Further, transactions posted to the suspense fund are not being cleared in a timely manner. As of September 30, 2002, the U.S. Treasury's records indicated a balance in the suspense fund of $68 million, which is an increase of $46 million from September 30, 2001. FEMA management was able to clear and properly record $24 million of the $68 million. Therefore, $22 million of the $46 million increase was allocated in the FY2002 consolidated financial statements.

- In FY2001, we noted that account balances (i.e., advances from others and accounts receivable) related to FEMA's reimbursable activity were not reconciled between the general ledger and the reimbursable agreement files and other supporting documentation. As noted above, FEMA began efforts to perform reconciliations of each of FEMA's reimbursable agreements during FY2002. Based on our understanding of the reconciliation procedures performed near year-end, the procedures did not include verifying the accuracy of the amounts recorded in the general ledger against the documentation underlying the transactions. In addition, the related SOP does not designate a supervisor to review the prepared reconciliations. At our request, FEMA performed detailed reconciliations for a sample of 11 of its reimbursable agreements as of September 30, 2002. Although we requested performance of the reconciliations on December 2, 2002, we did not receive acceptable reconciliations for all requested agreements until January 22, 2003. Our review of these reconciliations resulted in a downward adjustment of $12 million to advances from others that FEMA posted to the consolidated financial statements.

- FEMA did not complete the intragovernmental balance reconciliations with its trading partners semi-annually, as required by OMB Bulletin No. 01-09. FEMA attempted to perform these reconciliations by providing FEMA's revenue-related data to its trading partners in December 2002. As of the date of this report, no responses have been received by FEMA nor has FEMA made any follow-up inquiries. Furthermore, the methodology for this entire reconciliation process has not been developed and documented.

During the FY2002 financial statement audit, we identified the following additional issues impacting the reconciliation process:

- FEMA was unable to provide sufficient documentation to support certain adjustments made as part of the TFS-6653 reconciliation process in a timely manner. Although we received most documentation requested before the end of fieldwork, net reconciliation adjustments of $10 million related to the primary reimbursable agreement fund remained unsupported. As this amount represents less than 1% of fund balance with Treasury at September 30, 2002, we did not propose a related audit adjustment.

- FEMA provided three different sets of year-end balances for advances from others and accounts receivable related to its reimbursable agreements. On October 31, 2002, FEMA provided a detailed listing of these advances from others and accounts receivable with total balances of $163 million and $12 million, respectively. On January 21, 2003, FEMA provided a revised detailed listing of these advances from others and accounts receivable with total balances of $130 million and $11 million, respectively. However, FEMA did not provide an explanation of the changes that occurred between the two versions. In addition, the draft FY2002 consolidated financial statements reported theses advances from others and accounts receivable balances as $122 million and $14 million, respectively, and FEMA did not initially provide an explanation of the difference between the revised detailed listing and these reported amounts. FEMA resolved these issues on January 24, 2003 and adjusted the consolidated financial statements, accordingly.

The effect of not performing timely reconciliations is that material errors in the financial records could exist and remain undetected by FEMA management.

Recommendations:

We recommend that the Acting CFO:

5.a. Prepare monthly reconciliations of all transaction accounts from the subsidiary ledger and/or external information to the general ledger, such as Fund Balance with Treasury (including the suspense fund), accounts payable, and unliquidated obligations.

5.b. Ensure that differences identified as a result of the monthly reconciliations are resolved timely.

5.c. Simplify the documentation for each fund's monthly TFS-6653 reconciliation, including the removal of reconciled and cleared discrepancies from earlier months and the display of the true unreconciled difference between the U.S. Treasury's and FEMA's records.

5.d. Resolve and properly record all remaining transactions included in the suspense fund at September 30, 2002. Develop and implement procedures to ensure transactions posted to the suspense fund are investigated and resolved in a timely manner.

5.e. Improve the reconciliation procedures implemented in FY2002 related to reimbursable agreements, to ensure (1) the procedures are comprehensive, (2) that appropriate supervisory personnel review the prepared reconciliations in a timely manner, and (3) that related balances are appropriately and timely recorded in the general ledger and the financial statements.

5.f. Develop and implement policy and procedures for the periodic reconciliation of intragovernmental balances with its trading partners.

5.g. Improve record retention policy and procedures related to adjustments made as part of the TFS-6653 reconciliation process.

6. FEMA MUST IMPROVE ITS ACCOUNTS RECEIVABLE PROCESSES

OMB Circular A-50, *Audit Follow-up*, requires federal agencies to set up receivable accounts for any audit-related debt agreed to by auditors and management audit resolution. FEMA Instruction 1270.1, dated September 7, 1995, states that the audit follow-up official is responsible for ensuring that action plans resulting from resolution of audit reports are implemented as rapidly as possible.

FEMA Manual 2200.8 states that "regardless of their source, the objectives in accounting for receivables are to ensure that all receivables are identified, classified uniformly, accounted for, recorded timely in the accounting system, aggressively collected, and supported by sufficient documentation."

During our FY2001 financial statement audit, we noted several weaknesses in FEMA's accounts receivable processes. During FY2002, FEMA included these weaknesses in its remediation plan and took corrective actions to address identified issues, including the review and write-off of $28 million of unbilled receivables considered invalid.

Despite these corrective actions, we concluded from our FY2002 audit procedures that the following FY2001 weaknesses have not been fully addressed:

- Although FEMA reviewed and wrote off $28 million of invalid receivables, a receivable account for one grantee totaling $14 million remains recorded in the general ledger for which no formal bill for collection has been issued. FEMA recorded a $14 million allowance for doubtful accounts to offset the unbilled receivable until the final amount of the receivable is fully documented.
- Certain audit report action plans agreed to by auditors and FEMA management were not implemented timely or properly, including making the final management determination of disallowed costs. We reviewed seven OIG audit reports issued between 1997 and 2001. In these reports, $41 million of the claimed costs was questioned. Of the seven audit reports, a final determination of the questioned costs had been made by FEMA management and appropriate accounting treatment (i.e., establishment and billing of a receivable or partial deobligation of a current obligation) had occurred for four reports.

During the FY2002 financial statement audit, we identified the following additional issue impacting the accounts receivable process:

- FEMA does not process the billings related to the state share of certain mission assignments in a timely manner. For example, we noted several instances where FEMA had been billed by the other federal agency for mission assignment expenses in the first or second quarter of FY2002, but FEMA did not bill the state for its share until September 26, 2002. FEMA does not record a receivable until the state share has been billed.

As a result of these issues, FEMA may not be pursuing the collection of all valid accounts receivable balances.

Recommendations:

We recommend that the Acting CFO:

6.a. Complete final close-out procedures related to the grantee noted above and issue a formal bill for collection in the appropriate receivable amount.

6.b. Strengthen procedures to ensure that audit resolution and all audit-related action plans requiring the recoupment of grant funds are properly and timely implemented. These procedures should ensure that final amounts owed to FEMA as a result of audit resolution are (a) determined timely, (b) properly and timely communicated for billing and recording as accounts receivable or as a partial reduction of a current obligation, and (c) billed and collected timely.

6.c. Develop and implement procedures to ensure the timely billing of the state share of mission assignment expenses and to ensure the proper recording of such receivables.

REPORTABLE CONDITION

7. FEMA MUST IMPROVE ITS CERRO GRANDE ESTIMATION PROCESSES

OMB Circular A-123, *Management Accountability and Control*, requires that Federal agencies implement management controls that reasonably ensure that (i) programs achieve their intended results; (ii) resources are used consistent with agency mission; (iii) programs and resources are protected from waste, fraud, and mismanagement; (iv) laws and regulations are followed; and (v) reliable and timely information is obtained, maintained, reported and used for decision making.

During our FY2002 financial statement audit, we noted certain weaknesses in FEMA's process for estimating the remaining liability for the Cerro Grande program including:

- FEMA adopted a new methodology to calculate the claims liability estimate in FY2002. While the FY2002 and FY2001 approaches differ significantly, FEMA did not prepare an analysis of the impact of the change in estimation methodology and did not document how the change in methodology impacted the liability estimate. An analysis to determine the source of differences in the claims liability estimate, in particular, an analysis to determine the dollar impact to the liability estimate of changing the methodology between FY2002 and FY2001, would provide a more detailed understanding of the redefinition of categories of claims liabilities in the FY2002 estimate as compared to the FY2001 estimate.

- FEMA did not maintain certain elements of the source documentation to support the factors and assumptions used in the FY2002 estimate process. We requested this information and FEMA was able to recreate the information for our review purposes.

As a result of the first issue, FEMA is currently unable to determine the sources of error in estimating the claims liability. As a result, FEMA cannot evaluate how well the estimation methodology is able to predict the liability estimate from one year to the next for the Cerro Grande program. While the second issue was resolved by FEMA's re-creation of the data, supporting documentation for accounting estimates must be maintained on file.

Recommendations:

We recommend that the Cerro Grande program officials:

7.a. Perform a decomposition of changes analysis to determine the dollar impact on the liability estimate due to changes in methodology, assumptions, systems, data, or other factors, between FY2002 and FY2001. This Analysis would enable the identification of the components of the FY2002 calculation that are driving the overall change in the liability estimates between FY2002 and FY2001. The Analysis should include a discussion of management assumptions and note any differences from year to year in such assumptions and the influence of each assumption change in the liability estimate.

7.b. Ensure that supporting documentation for program estimates that are used for financial reporting purposes be maintained as part of the estimate documentation on file.