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INDEPENDENT AUDITORS' REPORT

Office of Inspector General, Federal Emergency Management Agency and
Director, Federal Emergency Management Agency:

We have audited the accompanying consolidated balance sheet of the Federal Emergency Management Agency (FEMA) as of September 30, 2001, and the related consolidated statements of net cost, changes in net position and financing, and the related combined statement of budgetary resources (hereinafter referred to as consolidated financial statements) for the year then ended. The objective of our audit was to express an opinion on the fair presentation of these consolidated financial statements. In connection with our audit, we also considered FEMA's internal control over financial reporting and tested FEMA's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on its consolidated financial statements.

Summary

As stated in our opinion on the consolidated financial statements, we concluded that except for the effects on the fiscal year 2001 consolidated financial statements of such adjustments, if any, as might have been determined to be necessary had we been able to apply adequate procedures to FEMA's equipment and unliquidated obligation adjustments, FEMA's consolidated financial statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

Our consideration of internal control over financial reporting resulted in the following conditions being identified as reportable conditions, all of which we consider to be material weaknesses:

- Information Security Controls for FEMA's Financial Systems Environment Need Improvement
- FEMA's Financial System Functionality Needs Significant Improvement
- FEMA Must Improve its Financial Statement Reporting Process
- FEMA Must Improve its Real and Personal Property Accounting Systems and Processes
- FEMA Must Improve its Account Reconciliation Processes
- FEMA Must Improve its Accounts Receivable Processes

The results of our tests of compliance with certain provisions of laws and regulations, exclusive of the Federal Financial Management Improvement Act of 1996 (FFMIA), disclosed instances of noncompliance that are required to be reported herein under *Government Auditing Standards,* issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements,* related to complying with the:

- Government Information Security Reform Act
- Clinger Cohen Act of 1996
- Federal Managers' Financial Integrity Act

The results of our tests of FFMIA, described in the Compliance with Laws and Regulations section of this report, disclosed that FEMA's financial management systems did not substantially comply with federal financial management systems requirements or applicable federal accounting standards.

The following sections discuss our opinion on FEMA's consolidated financial statements, our consideration of FEMA's internal control over financial reporting, our tests of FEMA's compliance with certain provisions of applicable laws and regulations, and management's and our responsibilities.

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheet of the Federal Emergency Management Agency as of September 30, 2001, and the related consolidated statements of net cost, changes in net position and financing, and the related combined statement of budgetary resources for the year then ended.

At September 30, 2001, FEMA had not maintained customary records for its equipment and related depreciation. It was not practicable to extend our auditing procedures sufficiently to satisfy ourselves as to the accuracy of such equipment, stated at a net book value of $10,753,000, in the accompanying consolidated financial statements as of September 30, 2001. Such amounts enter into the determination of financial position and net costs, and affect the consolidated statement of financing.

At September 30, 2001, FEMA made an unsupported reduction to unliquidated obligations. It was not practicable to extend our auditing procedures sufficiently to satisfy ourselves as to the accuracy of the $77,000,000 adjustment included in the accompanying consolidated financial statements as of September 30, 2001. This amount enters into the determination of ending unliquidated obligations and unobligated balances available on the combined statement of budgetary resources, and also affects the consolidated statement of financing.

In our opinion, except for the effects on the fiscal year 2001 financial statements of such adjustments, if any, as might have been determined to be necessary had we been able to apply adequate procedures to FEMA's equipment balances and unliquidated obligations adjustment, the consolidated financial statements referred to above, present fairly, in all material respects, the financial position of FEMA as of September 30, 2001, and its net costs, changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations, for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 11 to the financial statements, FEMA has been designated by Congress to administer entitlement claims under the Cerro Grande Fire Assistance Act (CGFAA). Claims for certain devaluation, contamination, and flood damage are probable but not currently estimable. In addition, as discussed in Note

23 to the financial statements, FEMA was given authority to respond to the September 11, 2001, terrorist attacks against the United States of America. Costs that FEMA will incur during this response are not currently estimable.

The consolidated financial statements of FEMA as of September 30, 2000 were audited by other auditors whose report dated February 16, 2001, expressed an unqualified opinion on those statements. As allowed by OMB guidance for fiscal year 2001 financial statements, FEMA is presenting only the consolidated balance sheet and statement of net cost for fiscal year 2000, within the accompanying consolidated financial statements. The fiscal year 2000 consolidated statement of net cost has been labeled unaudited because FEMA changed its presentation of responsibility segments and programs in fiscal year 2001 and restated its fiscal year 2000 consolidating statement of net cost in a comparable format. However, the restatement has not been audited.

The information in the management discussion and analysis, Required Supplementary Information (RSI) and Required Supplementary Stewardship Information (RSSI) sections is not a required part of the consolidated financial statements, but is supplementary information required by the Federal Accounting Standards Advisory Board or OMB Bulletin No. 97-01, *Form and Content of Agency Financial Statements,* as amended. We have applied certain limited procedures which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information, and accordingly, we express no opinion on it. We determined that FEMA did not complete the intragovernmental balance reconciliations with its trading partners, as required by the January 2000 technical amendment to OMB Bulletin No. 97-01.

Internal Control over Financial Reporting

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect FEMA's ability to record, process, summarize, and report financial data consistent with the assertions by management in the consolidated financial statements.

Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements, in amounts that would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal control, misstatements, due to error or fraud may nevertheless occur and not be detected.

We noted certain matters, described in Appendix I, involving internal control over financial reporting and its operations that we consider to be reportable conditions, all of which we consider to be material weaknesses. A summary of the status of prior year material weaknesses is included as Appendix II.

We also noted other matters involving internal control over financial reporting and its operation that we have reported to the management of FEMA in a separate letter.

Compliance with Laws and Regulations

The results of our tests of compliance with certain provisions of laws and regulations described in the Responsibilities section of this report, exclusive of FFMIA, disclosed the following instances of noncompliance that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 01-02.

- The Government Information Security Reform Act (GISRA), passed as part of the Defense Authorization Act of 2000, mandates that federal agencies implement sufficient information security program management processes, including security planning, implementation, and evaluation. As part of our financial audit procedures, we conducted information security testing and reviewed other assessments performed on FEMA's security program. We found that FEMA needs to make improvements to its information security program to fully comply with GISRA.

- The Clinger Cohen Act of 1996 (CCA) requires federal agencies to select, control, and evaluate information resource investments to effectively support the agency's strategic mission and link budget formulation and execution. During a separate review, the FEMA Office of the Inspector General (OIG) has found that FEMA needs to implement additional processes and controls to be in full compliance with CCA. The FEMA OIG found weaknesses in FEMA's selection, control, and evaluation processes for information resource investments.

- The Federal Managers' Financial Integrity Act of 1982 (FMFIA) is implemented in part through policy guidance in OMB Circular A-127, *Financial Management Systems*. OMB Circular A-127 requires that agencies prepare annual financial management systems plans and ensure that appropriate reviews are conducted of its financial management systems. However, we found that FEMA does not meet these requirements of FMFIA and OMB Circular A-127. FEMA does not have a financial management system plan with action plans and timeframes for enhancing the agency's financial systems environment, and, other than FEMA OIG coordinated reviews, FEMA does not perform reviews of financial management systems to ensure sufficient controls are in place and operating. Although FEMA OIG reviews provide a key control, FEMA management should have financial management system review processes in place as well to meet the intent of FMFIA.

The results of our tests of compliance with other laws and regulations, exclusive of FFMIA, disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 01-02.

The results of our tests of FFMIA disclosed instances, described in Appendix I, Material Weaknesses, in which FEMA's financial management systems did not substantially comply with federal financial management systems requirements or applicable federal accounting standards. Appendix I includes our recommendations to the acting Chief Financial Officer and to the Chief Information Officer. The results of our tests disclosed no material instances in which FEMA did not substantially comply with the United States Government Standard General Ledger at the transaction level.

Responsibilities

Management's Responsibilities

The Government Management Reform Act (GMRA) of 1994 requires federal agencies to report annually to Congress on its financial status and any other information needed to fairly present its financial position and results of operations. To meet the GMRA reporting requirements, FEMA prepares annual consolidated financial statements.

Management is responsible for:

- Preparing the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America;

- Establishing and maintaining internal controls over financial reporting, required supplementary information, required supplementary stewardship information, and performance measures; and

- Complying with laws and regulations, including FFMIA.

In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies.

Auditors' Responsibilities

Our responsibility is to express an opinion on the fiscal year 2001 consolidated financial statements of FEMA based on our audit. Except as discussed in the second and third paragraphs in the Opinion on the Consolidated Financial Statements section above, we conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* and OMB Bulletin No. 01-02. Those standards and OMB Bulletin No. 01-02 require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements;

- Assessing the accounting principles used and significant estimates made by management; and

- Evaluating the overall consolidated financial statement presentation.

We believe that our audit, except as discussed in the second and third paragraphs in the opinion on the financial statements section above, provides a reasonable basis for our opinion.

In planning and performing our fiscal year 2001 audit, we considered FEMA's internal control over financial reporting by obtaining an understanding of FEMA's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02 and *Government Auditing Standards.* We did not test all internal controls relevant to operating objectives as broadly defined by the FMFIA. The objective of our audit was not to provide assurance on internal controls over financial reporting. Consequently, we do not provide an opinion on internal control over financial reporting.

As required by OMB Bulletin No. 01-02, we considered FEMA's internal control over RSSI by obtaining an understanding of FEMA's internal control, determining whether these internal controls had been placed in operation, assessing control risk, and performing tests of controls. Our procedures were not designed to provide assurance on internal control over required supplementary stewardship information and, accordingly, we do not provide an opinion on such controls.

As further required by OMB Bulletin No. 01-02, with respect to internal control related to performance measures determined by management to be key and reported in the management discussion and analysis, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions. Our procedures were not designed to provide assurance on internal control over performance measures and, accordingly, we do not provide an opinion on such controls.

As part of obtaining reasonable assurance about whether FEMA's fiscal year 2001 financial statements are free of material misstatement, we performed tests of FEMA's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 01-02, including certain provisions referred to in FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws and regulations applicable to FEMA. Providing an opinion on compliance with laws and regulations was not an objective of our audit, and, accordingly, we do not express such an opinion.

Under OMB Bulletin No. 01-02 and FFMIA, we are required to report whether FEMA's financial management systems substantially comply with (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA section 803(a) requirements.

Distribution

This report is intended for the information and use of FEMA's management, FEMA's OIG, OMB, and the U.S. Congress, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

February 6, 2002

1. Information Security Controls for FEMA's Financial Systems Environment Need Improvement

Information security is a critical control element for the Federal Emergency Management Agency (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, 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.

Despite the above laws and policy guidance relating to the maintenance of sound information security controls, we identified significant information security issues with FEMA's financial systems environment, including feeder systems and the supporting network infrastructure, as follows:

- FEMA's core financial system, the Integrated Financial Management Information System (IFMIS), suffers from significant information security control weaknesses. For example, we noted that access to the IFMIS vendor database was not controlled adequately. Specifically, users established with the capability to view vendor information also had the capability to modify that information, including the creation of new vendor records. Unauthorized changes to the IFMIS vendor database might affect payment transactions and elevate the potential that any irregularities that may occur might remain undetected. Of further concern was the fact that this access control weakness was not attributed to a human error but to a system design flaw. As a result, there may be other existing system design flaws of similar significance that have not yet been identified. We also noted that:

- IFMIS audit trails, particularly those involving sensitive system privileges, are not reviewed on a periodic basis. This significantly elevates the risk that unauthorized transactions may not be identified;

- There is only one IFMIS administrator. This system administrator is the only FEMA employee with full control of IFMIS, and there are no formal procedures to ensure that transactions performed by the system administrator are periodically reviewed for appropriateness. In addition, if the system administrator were to leave FEMA, IFMIS processing continuity could be impacted because no one else has a full understanding of the system.

- We identified six IFMIS users with excessive privileges. These personnel have the system privileges to obligate/commit funds and approve payments.

- IFMIS password controls need to be improved. For example, IFMIS passwords can be easily compromised. If a user's password is locked or expires, the user only has to contact the IFMIS Security Administrator by phone and provide his/her name to have the password re-activated. No other form of authentication is required. In addition, we found that users can log on to IFMIS simultaneously from multiple computers. This increases the risk that unauthorized IFMIS access attempts will not be timely identified by FEMA.

- A review of IFMIS user access rights has not been performed to ensure existing rights are appropriate. Financial Acquisition and Management Division (FAMD) procedures call for a review to be performed at least on an annual basis, but it has not occurred. This elevates the risk that users may be provided with system privileges that are in excess of what their job responsibilities require. Given the vendor table access issue described earlier, this issue takes on even more significance.

▪ The National Emergency Management Information System (NEMIS) is FEMA's enterprise-wide system used to manage all aspects of the agency's disaster responses. We noted that NEMIS has several password control weaknesses. For example, NEMIS does not lock out users even after several invalid log-in attempts.

▪ We noted several significant security weaknesses with FEMA's network environment. For example, we were able to gain access to a key NEMIS communication device in our testing, and we found that users can log on to the network simultaneously from multiple computers.

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

Recommendations:

We recommend the acting Chief Financial Officer (CFO):

1.a. Ensure that a comprehensive review of IFMIS user access profiles is performed to ensure that all users are only capable of accessing the system resources to which they are authorized. A key purpose for this review should be to identify potential other cases where a system design flaw may be causing security weaknesses.

1.b. Ensure that procedures are developed for performing periodic reviews of IFMIS audit trail data, including the review of sensitive system privileges, and that audit trail reviews are performed in accordance with the established procedures.

1.c. Ensure that at least one alternate IFMIS system administrator is appointed. This alternate administrator should be trained on IFMIS system administration functions, and procedures should be implemented directing the primary and alternate system administrators to periodically perform a peer review of each other's system activities. To ensure independence, neither of the system administrators should have supervisory responsibilities over the other.

1.d. Ensure that the user access rights for the six identified IFMIS users with apparent excessive rights are investigated. If the rights are not needed, they should be reduced. If they are needed to conduct business, compensating controls should be implemented (e.g., having a management official periodically review all transactions associated with those personnel). Also, ensure that as future access rights are provided, privileges are segregated or compensating controls are established.

1.e. Ensure that IFMIS password controls are improved. This should include a more formalized process for communicating passwords to IFMIS users, especially for users who already have passwords and are being provided with new passwords because their passwords have been de-activated (i.e., as a result of multiple unsuccessful log on attempts). A second level of authentication, such as providing a social security number or secret word, should also be used to provide additional control over the issuance of IFMIS passwords. In addition, IFMIS should be designed to prevent users from simultaneously logging on to the system from multiple machines.

We also recommend the Chief Information Officer (CIO):

1.f. Ensure that password controls for NEMIS are enhanced.

1.g. Ensure that technical vulnerabilities identified with FEMA network devices are corrected, and that processes are established and maintained to ensure the conditions are not repeated.

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.

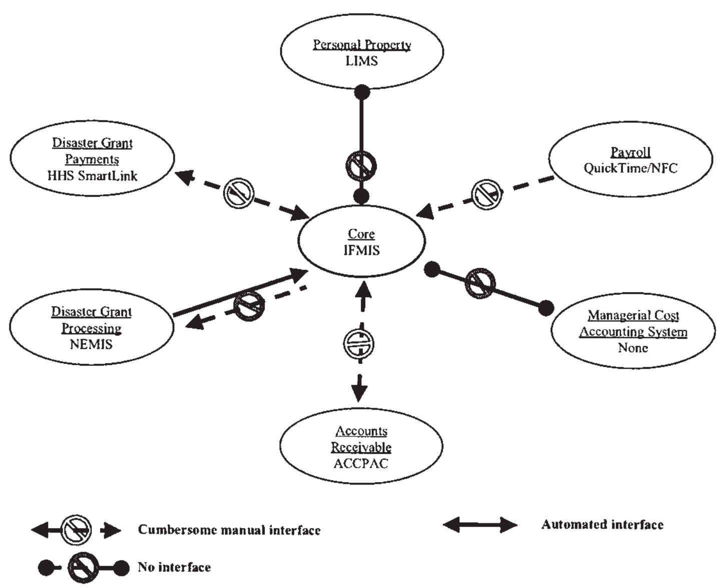
OMB Circular A-127, *Financial Management Systems,* sets forth policies for establishing and maintaining federal financial management systems in accordance with FFMIA. Specifically, OMB Circular A-127 requires that federal financial systems comply with requirements issued by the Joint Financial Management 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 Effectiveness*. 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-Making*. 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.

We noted numerous examples where FEMA's financial systems processing environment needs to be improved to more efficiently support agency processes and comply with FFMIA requirements, OMB Circular A-127 policy guidance, and JFMIP requirements. The key areas which require improvement include interfaces between systems and core functionality.

Regarding interfaces, certain FEMA systems that are integral to the processing of financial data exchange information with FEMA's core financial system, IFMIS, by inefficient manual processes, as displayed in Exhibit 1, and as described further below. Such manual interfaces can cause duplicate data entry, increase the risk of errors, and require significant human resources.

Exhibit 1 – Key IFMIS Feeder Systems and Related Interfaces



Specific interface issues that we noted include:

- Personal Property – Logistics Information Management System (LIMS). FEMA's personal property management system, LIMS, is not interfaced with IFMIS, and requires numerous manual workarounds to ensure accounting information is entered into IFMIS. Given the significant issues with LIMS, FEMA initiated a property management task force prior to the end of fiscal year 2001 to assess the current limitations of LIMS, and to help determine the needs of FEMA's property management system. This is significant as FEMA recognized the issue and is taking appropriate action. In addition, there is a significant lack of efficient financial processes for key areas such as real and personal property, construction-in-progress, and leasehold improvements. For these areas, assets are recorded in PC-based spreadsheets that are not integrated with IFMIS for financial reporting or financial statement preparation.

  Because of the lack of system functionality, FAMD has two different manual accounting processes for personal property. However, neither method is adequate for financial reporting purposes.

  - At FEMA headquarters, the manual process involves creating an annual acquisition cost for property by searching through historical transactions recorded in IFMIS for the fiscal year. The accounting information, including depreciation, is maintained in a PC-based spreadsheet. Annually, calculated property related balances are journal vouchered into IFMIS. However, FAMD is unable to reconcile the agency's actual physical inventory of equipment to the equipment recorded in its spreadsheets.

  - At FEMA's Disaster Finance Branch (DFB), the manual process involves extracting information from LIMS for recording in PC-based spreadsheets. However, FEMA is unable to link this property information with the related purchase invoices, which support the proper valuation and acquisition date of the property, because LIMS is not integrated with IFMIS.

- Payroll - QuickTime/U.S. Department of Agriculture's National Finance Center (NFC). The posting of payroll transactions to IFMIS takes approximately two weeks from the end of the pay cycle. Within this two week timeframe, there are numerous manual processes that occur, including the manual download of files from NFC, and then the completion of various processing and file format conversions to ready the data for posting to IFMIS. In addition, posting of disaster payroll data (Fund 6) is facilitated through a manual oriented process using PC-based databases.

- Managerial Cost Accounting System. 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 function. Such a system would allow FEMA to more effectively present performance measures and assess program budget execution. An example of where a managerial cost accounting system would be relevant for FEMA is accounting for the full cost of property, plant, and equipment (PP&E) under construction. Costs for the current period and in total should be maintained for each construction project and item of property. When a project is completed, construction-in-progress is transferred to the appropriate asset account. This information should be passed to the core financial system and property management system(s) for asset valuation purposes, which does not occur at FEMA.

- Accounts Receivable - ACCPAC. 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. PC-based database tools need to be used to query both IFMIS and ACCPAC to generate required accounts receivable reports, such as the *Report on Receivables Due from the Public*.

- Disaster Grant Processing – NEMIS. FEMA has developed an automated interface to send disaster grant data from NEMIS to IFMIS. However, there is no interface to return financial data from IFMIS to NEMIS so that disaster grant personnel can fully compare obligations against disaster allotments. To compensate for this, FEMA has developed the Financial Information Tool (FIT), which includes daily reports showing obligations and the related disaster allocations. Although FIT reports provide valuable information, they are very labor intensive to prepare, as they require queries from both NEMIS and IFMIS, and then presentation to users in PC-based spreadsheets.

- Grant Reporting. We noted that a key financial management report generated by NEMIS is not accurate. The Hazard Mitigation Grant Program *Fiscal Year Management* report shows amounts allocated and obligated for disasters. For Disaster Number 1268, the *Fiscal Year Management* report showed the total obligated amount for the disaster as more than the allocated amount. Because of the potential financial audit impact, we researched this issue, and found that the report was incorrectly reflecting system information.

- Disaster Grant Payment – Department of Health and Human Services (HHS) Smart Link. Interfaces between IFMIS and the HHS SmartLink system, which is used to process several types of FEMA obligations, including grant obligations, require significant manual processing to correct interface errors. These interface issues are caused in part because of inconsistency in how FEMA manages processing codes. In addition, an automated interface no longer exists to transmit payment data from SmartLink to IFMIS.

In addition, IFMIS functionality needs improvement as follows:

- The IFMIS vendor table has numerous duplicate vendors and inaccurate codes reflecting the status of vendors. This issue has resulted because multiple addresses cannot be associated with one vendor record, system edit checks do not sufficiently prevent duplicate vendors, there is a lack of regular management review of additions and modifications to the vendor table, and there is excessive access to the vendor table. In addition to reduced effectiveness for vendor table maintenance, this issue causes a very cumbersome IRS Form 1099 *Miscellaneous Income* processing cycle. Many manual processes are required to prepare 1099s for vendors who received payments from FEMA.

- IFMIS cannot readily produce the information needed to permit FAMD to perform the required reconciliation of transactions and balances with FEMA's intragovernmental trading partners. Although trading partner codes are in the vendor tables, the general ledger module does not have the fields available to capture the trading partner codes. Thus, the trading partner codes are not transferred to the general ledger module when the transactions are posted. As a result, FAMD is not capable of generating reports from IFMIS that reflect all transactions by trading partner.

- We identified an instance where during an IFMIS accounts receivable processing cycle, identical transaction numbers were provided to different transactions. FEMA personnel have been unable to identify the cause of this issue, but it raises significant concerns as to the capabilities of IFMIS to ensure a unique transaction number for each transaction.

- FEMA lacks a contingency plan for IFMIS. As a result, if IFMIS were to be disabled, FEMA may lose the capability to process, retrieve, and protect financial information. This could significantly affect FEMA's ability to accomplish its mission.

- Several IFMIS functions need to be well controlled to prevent users from causing significant system degradation. For example, use of an IFMIS system mail function available to all users, known as HP-UX, can delay and potentially stop IFMIS processing. In addition, access to a database query tool, *CLEAR:Access,* which is used to extract financial information from IFMIS, needs to be accessed by only a very few knowledgeable users because use of common database queries can cause serious system degradation.

- In order to obtain historical financial information (e.g., accounts receivable and undelivered orders), as of a specific date any and all new activity after the requested date must be 'backed out' through *CLEAR:Access* queries or spreadsheets. For example, in order to arrive at a total as of September 30, 2001, FEMA needs to "back out" transactions that had occurred after September 30.

These issues significantly impact FEMA's ability to process, maintain, and report financial information. In addition, the operation of effective financial systems and processes has taken on increased importance for FEMA in recent months, as the agency has a large role in supporting the nation's Homeland Security efforts. For example, as part of the President's FY 2003 budget, $2 billion is proposed for new emergency response equipment, $1.1 billion is proposed to train emergency response personnel, and $105 million is proposed to help local governments develop comprehensive plans to prepare for and respond to terrorist attacks. If the current proposed budget is approved, FEMA will be tasked with administering the funds for these projects.

During fiscal year 2001, FEMA attempted to improve its financial system functionality. However, these attempts were not successful. For example:

- Plans were in place to implement an IFMIS upgrade, which management stated would improve financial reporting. However, we identified significant concerns with the life cycle approach for the implementation. For example, although an estimated several hundred thousand financial data elements were being modified, a data conversion plan was not documented. FEMA personnel stated that because the vendor performing the upgrade had performed similar data conversions for other IFMIS clients, a documented data conversion plan was not necessary. In addition, documented testing plans for the data conversion process and testing of IFMIS interfaces were not completed before the scheduled implementation. Also, FEMA contract files showed that the agency reduced contract costs to fit into available funds by eliminating key life cycle management activities, such as system documentation and training. System documentation is important to allow FEMA personnel to understand and maintain the system. Training is important to ensure that users and systems staff can operate the system correctly, especially if new functionality is added.

- FEMA engaged a contractor to perform detailed business process reviews of key financial operations. Such reviews are important for assessing the current state of agency financial processing and management capabilities. However, the contractor was not able to complete all planned review efforts because of insufficient funding.

Recommendations:

Given the significant issues FEMA is facing, we recommend that the acting CFO:

2.a. Continue the business process reviews for key financial processes. 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 current financial systems environment and relevant interfaces, and develop a detailed action plan with estimated timeframes to improve the financial systems environment. The following recommendations should be reflected in this action plan.

2.b. Ensure that a comprehensive effort is implemented to clean up the IFMIS vendor table. This should include:

- Designing edit checks and assessing functionality in the system to help prevent duplicate vendors. Edit checks should be designed to prevent new records from being added if the vendor name is already in the table, unless another payment address is being added.

- Performing periodic management review of additions and modifications to the vendor table, or new payee relationships, on a regular basis.

- Establishing procedures and conducting training to ensure users are fully aware of how to enter and manage vendor data.

- Reducing access to the vendor maintenance table to only those users who require such access.

- Updating the *Posting IFMIS Transactions* manual to be consistent with current processing procedures.

- Performing a vendor table "clean up," to reflect the above recommended procedures and standards. At a minimum, this effort should also include setting all old and inactive vendors to inactive status, consolidating duplicate vendors, and addressing incorrect or blank category codes, federal IDs, alpha keys, and other relevant vendor table codes.

2.c. Coordinate with the FEMA CIO to ensure that IFMIS contingency planning efforts be improved. This should include:

- Performing a business impact assessment to fully assess the impact an IFMIS outage may 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.d. Ensuring IFMIS processing capabilities are improved to reduce the risk that system utilities, such as HP-UX mail and *CLEAR: Access*, cause system degradation.

3. FEMA MUST IMPROVE ITS FINANCIAL STATEMENT 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 audit, we noted that:

- The financial statements were prepared late as compared to the 2001 Year-End Closing Instructions and required significant revisions. On December 18, 2001, we received the first set of six drafts of FEMA's consolidated financial statements that included all funds. On December 20, 2001, we received the first set of notes to the consolidated financial statements. Early drafts of the fiscal year 2001 financial statements and notes were not complete and required extensive editing and follow-up questions. Numerous revisions were necessary throughout January and mid-February 2002 until we received final statements and notes. The schedule for fiscal year 2002 reporting under OMB Bulletin 01-09, *Form and Content of Agency Financial Statements,* requires reports by February 1, 2003.

- FAMD does not have written policies and procedures in place outlining the steps to be performed to prepare the consolidated financial statements. There is also a lack of control to ensure that the financial statements are accurate, as demonstrated by a significant number of adjustments that were made to the financial statements.

- Processes need improvement to ensure that (1) management reviews of the trial balance and financial statements are performed (by fund and consolidated); (2) comparison is performed of the current standard general ledger (SGL) accounts with FEMA's chart of accounts; (3) verification that the PC-based trial balance and financial statement spreadsheets are revised to incorporate changes, if any, to the SGL accounts and the U.S. Treasury crosswalks; and (4) verification that all active funds have been assigned to an accountant and are included in the financial statements.

- As displayed in Exhibits 1 and 2, FEMA does not have an integrated financial reporting process that can generate financial statements as a by-product of an already existing process.

In addition to the lack of system integration, other processes need refinement, including:

- Of a completed sample of 21 mission assignments with activity during fiscal year 2001, we identified eight mission assignments with obligations outstanding at September 30, 2001 totaling $1 million that were financially closed out or have not been financially closed out more than one year after the project completion date. The closure of a mission assignment requires the cooperation of the other federal agency.

- Certain grant obligations are not recorded timely in HHS's SmartLink system, corrections to SmartLink are not made timely by FEMA Headquarters, and SmartLink and IFMIS subaccounts are not adequately interfaced.

- Grant obligations amounting to $24 million had last obligation transaction dates prior to fiscal year 1997. At our request, FEMA reviewed a sample of these obligations, totalling $14 million, de-obligated $3.3 million, and identified $10 million that required further investigation.

During our review of FEMA's draft financial statements, we noted a number of required disclosures that were omitted. These omissions were corrected in the final consolidated financial statements. We also noted that the required supplementary stewardship information does not include outcome measures for each stewardship investment disclosed.

The conditions above 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 process that exists to prepare the consolidated financial statements.

Recommendations:

We recommend that the acting CFO:

3.a. Evaluate existing resources 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. 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.b. Consider and document the policies and procedures surrounding the financial reporting process in light of the requirements of OMB Bulletin 01-09, including the detailed steps for preparing the consolidated financial statements and for meeting expedited fiscal year 2002 reporting deadlines.

3.c. Develop and implement procedures to ensure the timely financial close out of mission assignments.

3.d. Ensure grant obligations are recorded timely, and corrections to subaccounts are processed timely, and consider the cost/benefit of developing a full interface between IFMIS and SmartLink.

3.e. Periodically review grant obligations based on aged amounts to ensure de-obligations are performed timely.

4. FEMA Must Improve its Real and Personal Property Accounting Systems and 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 its 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 audit, we noted that:

- As discussed in Material Weakness No. 2, *FEMA's Financial System Functionality Needs Significant Improvement*, FEMA does not have a property management system to account for property that meets the requirements stipulated by the JFMIP.

- LIMS only has the capabilities to track the acquisition, location, and disposition of personal property; it cannot perform the required accounting functions as required by JFMIP. In addition, we identified issues related to the proper valuation and proper acquisition date for items recorded in LIMS.

- LIMS does not contain information such as purchase order or invoice number. Therefore, DFB personnel cannot track an item from their personal property spreadsheet (which is based on LIMS information) to its supporting invoice, and Headquarters personnel cannot track an item from their personal property spreadsheet (which is based on IFMIS historical transactions and supporting invoices) to LIMS, to determine the asset's location. In addition, when an asset is transferred to a new FEMA location, the asset's history (e.g., original acquisition date) is removed from LIMS.

- Based on our review of records and discussions with FAMD personnel, no formal process has been established to (a) identify when a construction project for buildings or improvements has begun, (b) capture the expenditures related to the construction, or (c) identify when the project is completed other than certain manual procedures performed by FAMD personnel, which do not ensure that construction-in-progress is properly identified, valued, accounted for, and reported in the consolidated financial statements.

- Depreciation in the Disaster Relief Fund's property spreadsheets was not calculated in accordance with FEMA's policy. For equipment with useful lives of five years, FEMA calculated one and one-half year's depreciation expense for the fifth year of the assets' useful lives. FEMA subsequently corrected this error for financial reporting purposes.

- Although, at our request, FAMD recorded an estimate of internal use software at September 30, 2001, a process does not exist to adequately identify, capitalize, and depreciate the full cost of such software and significant enhancements to such software as required by SFFAS No. 10. Full cost includes direct and indirect costs incurred internally and paid to contractors/vendors. In addition, procedures have not been implemented to associate internal use software costs with the software's life-cycle phases, such as planning, development, and operations. As a result, FAMD cannot distinguish amounts to be capitalized as development or acquisition costs from the software's operational and maintenance costs.

- FAMD's manual accounting process at Headquarters does not address disposals, donations, and transfers of property.

- FAMD does not have a system in place to obtain deferred maintenance information related to FEMA's PP&E. It is our understanding that the Facilities Management and Services Division (FMSD), Administration and Resource Planning Directorate (ARPD) is in the process of implementing a centralized facility management program for FEMA's real property, which could facilitate FAMD's efforts to obtain deferred maintenance information for this type of property. According to personnel in FMSD, Region 6, the Working Capital Fund, and the National Emergency Training Center are the only offices/funds that have prepared facility management assessments.

The effect of the conditions detailed above is to significantly increase the risk that PP&E and its related accounts will not be accurately reported.

Recommendations:

We recommend that the acting CFO, the assistant director for ARPD, and the CIO should:

4.a. Consider implementing a JFMIP-compliant property management system that is integrated with IFMIS; addresses the tracking of the addition, disposal, donation, and transfer of property; provides the required accounting functionality; and documents policies and procedures surrounding the system.

4.b. Evaluate the means by which FEMA records its personal property for the Disaster Relief Fund. If DFB continues to use LIMS as the basis for this recordation, considerable clean-up of LIMS should be performed to account for Disaster Relief Fund personal property at the correct historical cost and actual acquisition date.

4.c. Perform a comprehensive personal property inventory to ensure the completeness and existence of items maintained in FAMD's personal property spreadsheets.

4.d. Develop a process to identify, value, and track construction-in-progress projects, and document the policies and procedures for the system implemented.

4.e. Review and correct the depreciation calculations in the DFB property spreadsheets to ensure depreciation is calculated in accordance with FEMA's depreciation policy.

4.f. Continue the implementation of a centralized facilities management program.

4.g. Develop and implement a process for identifying, capitalizing, and depreciating the costs of internal use software and significant enhancements to such software in accordance with SFFAS No. 10.

4.h. Establish a system to obtain deferred maintenance information for all categories of property, plant, and equipment and document related policies and procedures.

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.

We noted that many of FEMA's accounts had not been fully reconciled during the year. When, at our request, these accounts were reconciled, FEMA discovered significant adjustments to the financial accounts and records were required. For example:

- Subsidiary records for unliquidated obligations (e.g., system queries of transaction detail which support the general ledger balance) did not equal the general ledger. FEMA subsequently adjusted the general ledger downward by $77 million, as of September 30, 2001.

- Although supporting detail for reimbursable activity is maintained in the general ledger, this information had not been reconciled to reimbursable agreement files and other supporting documentation. After certain reconciliations were performed, FEMA increased advances by $3.4 million and decreased accounts receivable by $22.6 million, as of September 30, 2001. However, not all requested reconciliations were provided by FAMD primarily because of the complexity of the reconciliations, and not all issues identified by us in the reconciliations provided were resolved because the reimbursable agreement files did not contain all relevant information.

- Subsidiary records supporting accounts payable were reconciled by FEMA, at our request, resulting in a downward adjustment of $177 million at September 30, 2001.

- The Fund Balance with Treasury account 58-F-3875, per FEMA's financial records, differed from U.S. Treasury's records by $22 million at September 30, 2001. This account was still unreconciled at February 6, 2002.

In addition, we noted that differences identified on the TFS–6652, *Statement of Differences*, and in the TFS-6653, *Undisbursed Appropriations Account Ledgers*, reconciliation process are not reconciled and resolved timely. Further, the manner in which the TFS-6653 reconciliation is documented does not easily permit the identification of the unreconciled amounts between U.S. Treasury's and FEMA's records. Each fund is reconciled on separate spreadsheets, and then the spreadsheets are combined into a summary cash reconciliation. At September 30, 2001, the reconciliation summary on each of the individual fund reconciliation spreadsheets reflected the ending "reconciled balance" for IFMIS and for Treasury as the same amount. However, differences appear to exist that have not been fully identified or that have been identified but appropriate corrective action (e.g., journal voucher entry and/or supplemental SF-224 submission) has not been taken. Whether the cause of a difference has been fully identified or not, the amount is reflected in the reconciling items detail section of the individual fund spreadsheet, and then the total of the detail section is brought forward to the reconciliation summary of that spreadsheet, resulting in "reconciled balances" that equal.

When comparing the balance for each Treasury symbol per the TFS-6653 and the balance reflected in IFMIS, as adjusted, we computed an unidentified difference with an absolute value of $5.8 million at September 30, 2001, excluding the difference noted above related to account 58-F-3875. However, the unidentified amount on the September 30, 2001 summary cash reconciliation spreadsheet was $200,267.

We believe that many of these reconciliations had not been performed, or reconciling items had not been resolved timely, because FEMA lacks sufficient human resources and sufficiently trained financial management personnel to adequately perform its financial reconciliations. The effect of not performing timely reconciliations is that material errors in the financial records could exist and remain undetected by FEMA management. This is indicated by the incorrect queries that were performed, long delays in providing subsidiary records, significant adjustments, and the difficulty in performing the reconciliations we requested.

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

<u>*Recommendations:*</u>

We recommend that the acting CFO:

5.a. Assess the full-time equivalent level and skills requirement of its financial operations, determine the adequacy of current human resources in this area, and seek the resources to remedy any gap. This assessment could be done in conjunction with the business process reviews discussed earlier.

5.b. Prepare monthly reconciliations of all financial accounts, from the subsidiary ledger to the general ledger, for all accounts which record detail transactions, such as Fund Balance with Treasury, reimbursable agreements, and obligations. Accounts used to accrue estimates solely for financial statement purposes, such as the estimate of grant liability, should be performed at least quarterly for reporting purposes.

5.c. Perform a complete reconciliation of the reimbursable activity in the general ledger as of September 30, 2001, to the reimbursable agreement files and other supporting documentation, and make adjustments to the general ledger as needed. In addition, FEMA should evaluate the information necessary to be maintained in the reimbursable agreement files in order to support the accounting transactions and balances related to reimbursable agreements, and reorganize the files based on this evaluation. FEMA should then develop and implement periodic reconciliation procedures, to be performed quarterly at a minimum, of the reimbursable activity in the general ledger to the reimbursable agreement files. These reconciliations should be reviewed and approved by a supervisor.

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 during audit resolution.

FEMA Manual 2610.1 states "When a FEMA employee determines that an individual, business entity, or a state or local government owes money to the Federal Government under any program administered by FEMA, the employee must take corrective action to issue a Bill for Collection." FEMA Instruction 1270.1, dated September 7, 1995, states that the audit follow-up official is responsible for ensuring that action plans resulting from resolutions of audit reports are implemented as rapidly as possible.

During our fiscal year 2001 audit, we noted that:

- Numerous receivable accounts totaling over $42 million are recorded in the general ledger for which no formal bills for collection have been issued. The majority of these receivable accounts are over one year old.

- Certain audit report action plans agreed to by auditors and FEMA management were not implemented timely or properly, including the final determination of accounts receivable from the auditee. For example, in May 1998, management responded to the FEMA OIG report, *Audit of FEMA's Grantee Compliance with Selected Grants Management Requirements*, by indicating that they would recoup approximately $30 million in overpayments identified in this report. Although the $30 million was recorded as accounts receivable in 1998 (part of the $42 million discussed above), we noted there was no attempt to recoup these overpayments as of September 30, 2001, and there was no review to verify that all action plans were properly executed or satisfied. In addition, we noted that FEMA management responded to a February 2001 FEMA OIG audit report by indicating that FEMA would prepare a related bill for collection of $8.5 million. As of the date of this report, a final determination of the amount owed by the auditee had not been made and a corresponding receivable had not been recorded.

As a result of these issues, accounts receivable balances require detailed analysis prior to further collection efforts.

Recommendations:

We recommend that the acting CFO:

6.a. Issue formal bills for collection for all unbilled amounts currently owed to the agency.

6.b. Strengthen procedures to ensure that audit resolution and all audit-related action plans requiring the recoupment of funds from grantees are properly and timely implemented. These procedures should ensure that final amounts owed to FEMA as a result of audit resolution are (1) determined timely, (2) properly and timely communicated for billing and recording as accounts receivable, and (3) billed and collected timely.

6.c. Evaluate the collectibility of all accounts receivable and ensure that the allowance for uncollectible accounts is adequate, and that uncollectible accounts are turned over to the U.S. Treasury for collection.

Fiscal Year 2000 - Material Weaknesses	Fiscal Year 2001 - Status
Lack of a fully Integrated Financial Management System as defined in Office of Management and Budget (OMB) Circular A-127, "Financial Management Systems."	Continues as a material weakness in fiscal year 2001.
Lack of fully implemented controls related to financial management systems.	Continues as a material weakness in fiscal year 2001.

We have analyzed managements' response to our report. Regarding financial system functionality, we have specified that our concern was that key elements of the systems development life cycle, including fully documented data conversion and testing plans, had not been completed. With respect to the financial statement reporting process, we recognize that FEMA staff provided a substantial amount of information to us during the course of our audit. We believe that many of the reconciliations and reports that we requested should have been routinely prepared as part of the financial control process and, therefore, should have been readily available. In addition, we noted that certain data was incomplete or inaccurate, thus leading us to request clarification.

As we have recommended, we believe that significant corrective action must be taken to improve FEMA's financial systems and reporting processes. We noted that FEMA has not met their schedule to prepare financial statements in previous years; therefore, we believe corrective action must occur promptly to meet the fiscal year 2002 submission requirements. We acknowledge the courtesy and assistance extended to us by FEMA personnel during the course of our audit.

Federal Emergency Management Agency

Office of Inspector General
Washington, D.C. 20472

FEB 25 2002

MEMORANDUM FOR: Nancy L. Hendricks
Assistant Inspector General for Audit

FROM: Gary Crowell
Assistant Director
Administration and Resource Planning Directorate

Ronald Miller
Assistant Director
Information Technologies Services Directorate

SUBJECT: Auditors' Report on FEMA's Fiscal Year 2001 Financial Statements

The following narrative responds to the draft auditors report on FEMA's FY 2001 financial statements. We generally agree with the findings, conclusions, and recommendations set forth in the report. We are pleased that this year's report contains more substantive information on long-standing accounting deficiencies and compliance issues. This information will enable us to more effectively plan and implement corrective actions and assist us in securing the resources and tools we need to meet ever-increasing financial management and information systems demands. Considering the focus and value of the issues discussed in the report, we recognize that there are serious material weaknesses and control problems that need to be addressed. What we have previously lacked were resources, both financial and human, and tools to correct the problems. Hopefully, this report will bring to light the challenges we have faced over the past several years as well as garner the support and commitment to improving FEMA's financial management operations.

The following narrative provides brief comments on the two qualifications and six material weaknesses as well as instances of non-compliance with laws and regulations.

Report Qualifications

Property

We agree that overall property management in FEMA, including accounting for property, needs improvement. A recently established task force consisting of managers responsible for property, information systems, and finance has been established and is aggressively developing both a process and system that meet Federal property reporting and accountability requirements. We expect the process to be in place during FY 2002.

Undelivered Orders

The report was qualified due to an adjustment in unliquidated obligations. Based on our reconciliation of the subsidiary ledger to the general ledger for un-liquidated obligations, a reduction of $77 million was posted to the general ledger. The reduction was required to correct an overstatement resulting from errors recorded during a financial management system conversion in the mid-1990s when FEMA's general ledger was first established. The basis for this adjustment was a complete analysis of unliquidated obligations by vendor as of September 30, 2001. Supporting documentation dating back to the conversion was not available or would have required intensive and time-consuming research. The financial statements are now more accurate because of this one-time adjustment.

Material Weaknesses

1. **Information Security Controls**

We agree with the findings and recommendations and find the references to IT related matters and information system security controls to be an accurate portrayal of the situation, as it existed during FY2001. Some of the IT related deficiencies identified in the report or in associated "Notification of Findings and Recommendations (NFRs)" have already been corrected by ITSD.

We look forward to publication of the final report when we will provide responses to the recommendations directed to the CIO. Our responses will be in line with previous responses to specific NFRs.

2. **Financial System Functionality**

We generally agree with the findings and recommendations. The report correctly indicates that the financial management system needs improvements and cites numerous examples of deficiencies. However, the report does not reflect the efforts undertaken by FEMA during FY 2001 to improve the system. To meet new reporting requirements, a current version of IFMIS was obtained which has been JFMIP certified to meet the new OMB reporting requirements for financial statement preparation and contains attributes for intragovernmental trading partners. Although the purchase and implementation of the new version was not budgeted some funds became available during the year. Unfortunately, those limited funds only provided a fraction of what was needed to conduct all the exhaustive procedures, requirements, and analysis for implementing information systems. Our restricted choices, therefore, were to implement the new version, without fully testing performance, or not implement the system. Since the new version provided the enhancements to meet the new requirements, we exercised our option to proceed with implementation. Our goal was to prepare the FY 2001 statements with the new system. In September 2001, we were advised by the auditors to delay implementation because the schedule was too aggressive. Based on this recommendation, the implementation was delayed and we reverted to the manual process to prepare the agency financial statements.

We engaged a contractor to assist in the implementation. The contractor performed a similar implementation on the same system for another agency. The report incorrectly infers that the contractor did not complete the planned efforts because of funding problems. The contractor is still engaged by FEMA and will complete all assigned implementation tasks.

The recommendation states that FEMA is not able to improve the financial system environment. As discussed above, attempts to improve financial system were severely constrained by the lack of funding and resources, not by the inability of the agency. We believe that given the proper resources, financial management and information systems personnel in FEMA have the expertise and desire to make major and required financial systems improvements.

Please see the response to material weakness number four for additional comments on property management.

3. **Financial Statement Reporting Process**

We agree that the financial statement reporting process needs improvement. As indicated above, we attempted to automate the preparation process, but that initiative was curtailed. While we agree with the findings and recommendations, there were other factors that resulted in delays in producing the statements.

Although a small agency, FEMA administers nearly 50 funds, including the National Flood Insurance Fund, the Disaster Relief Fund, and scores of smaller, but equally important, funds. In addition, FEMA has recently received several additional requirements including a fire grant program and is administering and paying all claims from the recent Los Alamos fire. There are currently six accountants that handle all the activity for these accounts and their workload is staggering and growing.

The demands from the FY 2001 financial statement audit overwhelmed an already overburdened staff. There were over 250 requests for information, including special reports and reconciliations. Some requests were for thousands of documents to support substantive and control testing. The staff spent hundreds of hours gathering information and meeting with auditors to discuss the financial statements. In addition, the same staff was responsible for researching and responding to nearly 50 NFRs. Every hour spent on audit issues was an hour lost on performing essential financial management functions, including critical reconciliations and financial statement preparation. In addition to the financial statement audit, there were concurrent full-scope audits of Federal Financial Management Improvement Act (FFMIA), financial information systems using the General Accounting Office's Financial Information System Control Audit Manual (FISCAM), and IT capital planning. As a result of these successive audits and requests, the preparation and review of the financial statements slipped and slipped badly. The original plan was to have the statements ready in early December 2001. If not for this overwhelming audit burden, we believe that we could have met this schedule.

Property

We agree that overall property management in FEMA, including accounting for property, needs improvements. In fact, the program office has identified the issues outlined in this item and plans have been in place for corrective action. The events of September 11, however, have delayed implementation.

This issue identification is further evidenced by the FY 2001 agency realignment where a unified real property management program was established for the first time; however, no new resources were provided for program development or implementation. The activity was staffed and funded through reprioritization from other activities.

While we agree with the finding, we believe the fact that the agency had already identified the issues and is working on a solution should be acknowledged in the report. Furthermore, it should be noted that the oversight of personal property management operations and LIMS is in the Readiness, Response and Recovery Directorate. The policy aspects remain in the Administration and Resource Planning Directorate. That notwithstanding, our actions are all closely coordinated among the programs.

We continue to reprioritize resources to help address these and other program concerns, and are evaluating other staff realignments to better leverage human resources in support of property management.

A task force consisting of managers for property, information management, finance, acquisition and response has been established and is aggressively pursuing a rapid prototype of a fully integrated enterprise resources planning (ERP) system that meets Federal property and accountability requirements. The process should be in place during FY 2002.

5. **Account Reconciliation Process**

We agree with the findings and recommendations. We are aware of the shortcomings in the reconciliation process and engaged an independent accounting firm to evaluate our procedures and make recommendations to re-engineer that process and other internal accounting functions. Unfortunately, that work was curtailed because of funding constraints. Hopefully, we will be able to commit additional funding to complete the work during FY 2002. In addition, we are evaluating our staffing requirements and structure with the desired outcome of and will attempt assigning additional staff to this important function.

6. **Accounts Receivable**

We agree with the findings and recommendations. We are actively pursuing these debts; but, it has been an arduous process because of poor or no documentation, lack of final inspections on disaster related projects, and difficulty negotiating final debt amounts with the States. Furthermore, we have followed-up on the OIG audit that identified the debts, but have had limited success obtaining supporting documentation from FEMA regional offices, the State, or the OIG to provide the basis for the debt and whether it was appropriately resolved. Finally, FAMD staff needed approval by agency management prior the sending bills of collection to the States. This issue was recently resolved and the bills will be sent. Despite these obstacles, we will aggressively identify, report, and collect all debts in a timely manner.

Compliance with Laws and Regulations

The report indicates certain instances of noncompliance with laws and regulations, including the Government Information Security Reform Act (GISRA), the Clinger Cohen Act, and the Federal Financial Management Improvement Act (FFMIA). We generally agree with the audit conclusions and have already begun implementing corrective action. We plan to revise our remediation plan now that we have additional details on FFMIA noncompliance. In addition, the Administration and Resource Planning staff will collaborate with the Chief Information Officer to improve system security, evaluations, and planning.

There are certain additional matters in the report that need clarification or corrections; and we will arrange a meeting with OIG personnel to discuss these issues in more detail.

We appreciate the opportunity to comment on this draft report. Please understand that we are committed to improving the financial management operations in FEMA and will work with the Office of Inspector General to correct the conditions disclosed in this report.

Federal Emergency Management Agency

Office of Inspector General
Washington, D.C. 20472

January 25, 2002

MEMORANDUM FOR: Joe M. Allbaugh
Director

FROM: George J. Opfer George J. Opfer
Inspector General

SUBJECT: Management Challenges

This memorandum summarizes what the Office of Inspector General considers to be the most serious management and performance challenges facing FEMA and briefly assesses FEMA's progress in addressing those challenges. We are required to provide this statement to you under the Reports Consolidation Act of 2000. This statement is to be included in the consolidated report that is described by the Act.

Based on our work, as well as our general knowledge of FEMA operations and programs, the Office of Inspector General believes FEMA must continue to focus attention on the following management and program initiatives in its efforts to ensure public accountability and improve program effectiveness. Although FEMA managers acknowledge most of these issues and are addressing them to varying degrees, much work is left to be done to ensure that business is carried out in an economical and efficient manner and appropriate program results are achieved.

Program Challenges

Homeland Security Support. On October 8, 2001, the President established the Office of Homeland Security and the Homeland Security Council. The mission of the Office is to develop, coordinate, and implement a comprehensive national strategy to secure the United States from terrorist threats or attacks. The Office, in consultation with the Homeland Security Council, is responsible for coordinating efforts to detect, prepare for, prevent, protect against, respond to, and recover from terrorist attacks within the United States. The FEMA Director is a member of the Homeland Security Council, which also includes the Secretaries of Treasury, Defense, Transportation, and Health and Human Services; the Attorney General; and the Directors of the Federal Bureau of Investigation and Central Intelligence Agency. FEMA's mission is to lead and support the nation in preparing for, mitigating against, responding to, and recovering from any destructive event, whether natural or man-made. FEMA expects to have a major role in supporting the Office of Homeland Security and the Homeland Security Council. FEMA supports the recently-developed Homeland Security Roadmap and expects to continue its efforts in supporting first responders with planning, equipment, training and exercises. The OIG plans to monitor FEMA's efforts to support the Office of Homeland Security and the Homeland Security Council as roles and missions are further defined.

Disaster Response and Recovery. FEMA's disaster response and recovery program has been and continues to be the cornerstone of FEMA's emergency management program, and managing it continues to be one of FEMA's largest challenges. Improvements in FEMA's public image can be directly attributed to the success of FEMA's disaster response and recovery system. Notwithstanding the record-breaking number of disasters that are declared each year, FEMA has managed to make improvements to its disaster response and recovery system. As the number of Federally declared disasters continues to increase, it is critical that FEMA reduce disaster response and recovery costs, better manage its disaster workforce, ensure the integrity of its many financial assistance programs, and improve program service delivery. FEMA is also faced with implementing major changes in the Stafford Act. FEMA has begun initiatives to address all of these problems. One of FEMA's initiatives is to reduce disaster field office (DFO) costs by limiting the number of DFO staff to the minimum necessary based on a pre-determined template. Another is to turn over management of small disasters to States. We plan to monitor all these efforts and conduct audits to assess their effectiveness and make recommendations for improvements.

In an effort to improve the efficiency and effectiveness of disaster recovery operations, FEMA has redesigned its largest recovery program, Public Assistance Grants (PA). The redesign included new policy guidance to clarify program requirements, improved customer service through training and enhanced State involvement, simplified processes, and performance targets. We are auditing the redesigned PA program to determine if the objectives are being met. We have identified some problems with the redesign and will report on the results of our audit later this year. In addition, we will monitor FEMA's implementation of the PA program associated with the World Trade Center attack.

Another area where FEMA has made improvements, but problems remain, is debris removal. FEMA needs to continue improving its controls over the debris removal program to prevent serious fraud, waste, and abuse. If left unchecked, the abuse within that program will overshadow the improvements FEMA has made in its disaster response and recovery programs. We issued a report in 2001 on FEMA's debris removal program and identified additional actions FEMA should take to improve debris management. We will continue to focus on debris removal in our audits of PA grants to State and local governments. Also, we are closely monitoring debris removal operations at the World Trade Center.

State and Local Preparedness. FEMA awards approximately $140 million each year to State emergency management offices to encourage the development of comprehensive emergency management, including terrorism consequence management, at the State and local level and to improve emergency planning, preparedness, mitigation, response, and recovery capabilities. This figure will, in all probability, increase drastically in future years as a result of the terrorist events of September 11th. By combining several funding streams into a consolidated Emergency Management Performance Grant, FEMA's role is to ensure that recipients have the flexibility necessary to achieve measurable results in key functional areas of emergency management. This flexibility will be achieved within the standard grant administration process. FEMA has made considerable progress in streamlining and making the preparedness grant process more meaningful. Despite the progress, two major management challenges remain: (1) developing a reliable method of assessing State and local capability, and (2) developing a reliable basis to implement risk-based funding allocations to States.

In February 1998, FEMA submitted its first report to Congress on "Capability Assessment for Readiness (CAR)." This effort is a step in the right direction, but more needs to be done. Local governments and other applicable State agencies need to be brought into the process. Currently, there are plans to query local governments. State Emergency Management Agencies, local governments, and various Emergency Management Associations have reviewed an initial local CAR draft. The process also needs to identify State disaster assistance programs, determine how large a disaster a State/local government can handle with its own resources, and measure a State's financial capability to respond to disasters. We further believe that since the development of CAR will continue to be a dynamic process, FEMA needs to explore how financial capability can be assessed. FEMA officials told us that efforts will continue to improve the existing CAR process so that future assessments reflect more accurate and reliable representation of State emergency management capability.

To date, FEMA has not developed a basis to implement risk-based funding to States. We recommended such a basis for funding in our first report issued on the Comprehensive Cooperative Agreement process in March 1994. FEMA, however, is working on a risk assessment initiative. This initiative is called HAZUS (Hazards-US). HAZUS is designed to produce loss estimates for use by State, regional, and local governments in planning for natural hazard loss mitigation, emergency preparedness, and response and recovery. Currently, HAZUS has been developed for earthquakes, and FEMA is working on expanding it into a multi-hazard methodology with models estimating potential losses from wind, floods, and tornadoes. HAZUS could provide the basis for developing a risk-based funding methodology. We believe FEMA needs to explore the potential of HAZUS in future funding allocations to States. FEMA officials told us that risk-based funding could potentially face significant political opposition because such a system could result in eliminating allocations to some States because they have no significant risks. Also, the officials cautioned that the HAZUS model may not be adequate to produce accurate and complete risk assessments.

Furthermore, FEMA's focus on State/local preparedness has taken on a new urgency due to the events of September 11th. FEMA must continue to place a high priority on developing State/local capabilities to respond to terrorist events and natural disasters. It is critical that capability can be exercised and assessed as often as possible. Another challenge for FEMA is devolving more responsibility to States for responding to and administering disasters rather than routinely issuing disaster declarations — especially for small and medium size disasters. Over the past decade the frequency of federally declared disasters has almost doubled. Instead of just responding to major disasters such as Northridge and terrorist attacks, FEMA is regularly called upon to respond to events that are fairly predictable – such as repeated flooding in flood-prone areas as well as snowstorms. Both Congress and OMB have urged FEMA to develop improved criteria for disaster declarations. While FEMA has agreed that disaster criteria could be clarified, resistance from stakeholders – particularly States – has impeded FEMA's efforts to reform the criteria. The criteria should recognize the financial capacity of States as well as include capability thresholds that States are expected to meet prior to a declaration. Also, the criteria should include incentives to States to enhance capability. Pursuant to a proposal contained in the President's fiscal year 2002 budget blueprint, FEMA plans to improve its disaster assistance criteria guidelines for determining when and under what conditions a Presidential disaster declaration should be made.

Finally, September 11th has highlighted the need to fully equip and train fire departments so they will be better prepared to respond to terrorist events. This puts sharper focus on the $150 million Federal grant program for local fire departments in fiscal year 2002. The purpose of the program is to help fire departments meet needs in such areas as personal protective equipment, health and safety initiatives, fire prevention programs, and critical vehicle expenditures. As of June 2001, there were 19,000 applications for funding from departments throughout the United States. Since it is likely that this program will continue and probably increase in light of recent events, it is critical that FEMA effectively and efficiently administer the program to ensure that funds are directed to those most in need as well as to those that have a high probability of responding to terrorist attacks and predictable natural disasters.

Mitigation Programs. Mitigation at the State/local level continues to present FEMA with significant opportunities as well as challenges. It can complement as well as bring an enhanced focus to preparedness at all levels of government. However, the challenges are great. The overarching challenge is how to effectively coordinate the various property acquisition programs, including those of the Corps of Engineers to address national mitigation strategies. Also, it is important that FEMA have regulations and guidance as to how its buyout program is implemented. In February 2001, the OIG issued a report that addressed (1) the need for reliable cost effectiveness determinations, (2) the need for additional guidance for buyouts, (3) improved mitigation planning by States, and (4) improved coordination with the National Flood Insurance Program (NFIP). Given the primary role buyouts have played and will continue to play, it is critical that FEMA ensure that they are effectively executed and address mitigation priorities. FEMA is continuing to evaluate the Hazard Mitigation Grant Program and implement program and grants management improvements. For example, the Property Acquisition Handbook for Local Communities is being updated and Property Acquisition training is being piloted for States.

In this regard, it is important that FEMA have a strategy that allows buyouts to occur in the immediate aftermath of flooding before homeowners use insurance payouts to repair their homes. This could result in greater leveraging of insurance proceeds to accomplish mitigation. Also, buyouts should be evaluated in light of structural and land management alternatives that may be more appropriate in addressing the problems. At the State level, FEMA needs to address how the mitigation planning process in States can be more effectively coupled with buyout projects and repetitive loss properties. At the local level, FEMA needs to continue to explore how enforcement of the substantial damage rule can be improved. This rule requires mitigation if a structure is declared substantially damaged – 50 percent or more of market value.

Finally, there are several challenging issues that need to be addressed with respect to modernization of Flood Insurance Rate Maps. First, secure sufficient funds necessary to modernize maps; second, utilize the best available technology that could provide data on elevation of structures; third, prioritize areas to be mapped that will yield the maximum benefits to the National Flood Insurance Program, including areas of coastal erosion. Studies have shown that roughly half of homeowners in high erosion areas on the Atlantic and Gulf coasts currently purchase flood insurance, which to a large extent covers erosion losses as well. Assuming NFIP enrollment remains at present rates, it is estimated that the payout is likely to be roughly $80 million per year. In contrast, it is estimated that mapping erosion areas would cost approximately $44 million and be valid for 10 years. From a business standpoint, FEMA needs to address this critical mapping issue.

FEMA's map modernization program continues to evolve as more information is obtained about communities' mapping needs, new technologies are developed, and cost data is further refined. In addition, FEMA is vigorously pursuing its Cooperating Technical Partner initiative. In fiscal year 2001, FEMA entered into 42 additional partnership agreements with local, State, and regional agencies across the nation to fully integrate them into the flood hazard mapping process and make more resources available for flood hazard data collection and mapping efforts.

National Flood Insurance Program. The NFIP, the largest single line property insurer in the nation with coverage totaling approximately $589 billion, presents a formidable management challenge for FEMA. When Congress originally enacted the NFIP in the early 1970s, the flood program was expected to reduce the financial burden of flood disasters on the American taxpayer and reduce the number of homes and businesses residing in the flood plain. These at-risk structures, which receive a subsidy for their risk from the NFIP, were expected to be gradually replaced over the years. By 1990, it was projected that only 10 percent of homes would be subsidized.

Clearly, the projection was overstated. Today about 40 percent of those structures remain in the NFIP policy base. These at-risk structures are flooded repetitively. FEMA officials said it was understood that heavier losses were an acceptable price to pay if the communities committed to safer new construction. The NFIP pays claims from these floods again and again, yet the policyholders are not required to pay risk-based premiums. It is not a small problem, and it undermines the financial stability of the insurance program. Of the estimated $200 million in repetitive losses in the NFIP during an average year, about 96 percent are from these subsidized structures. FEMA acknowledges the problem, but believes the problem is not easily overcome since it has been an integral part of the NFIP since its inception and closely related to promotion of floodplain management and the widespread purchase of flood insurance. Currently, FEMA has a concentrated effort to address the "hard core" repetitive loss properties. Also, the OIG is conducting a review to determine how mitigation funds are being used to alleviate repetitive losses.

It is estimated that there are about 7 million structures located in special flood hazard areas throughout the country. Yet, as of December 2001, only approximately 2.4 million of those structures have flood insurance coverage. FEMA not only needs to maintain a sustained campaign to provide insurance coverage for the millions of uninsured properties that are still at-risk, it also must promulgate rules that would eliminate subsidies to policy holders who have filed repetitive loss claims, such as those proposed in the President's 2002 budget blueprint. While the two objectives of increasing coverage and at the same time reducing repetitive loss claims may appear to be in conflict with one another, FEMA has tools available to prevent this. For example, the *Increased Cost of Compliance* terms in flood insurance policies can and should be used more frequently to reduce repetitive loss claims and further mitigation objectives. The *Increased Cost of Compliance* terms in flood insurance policies provides funds to homeowners who have sustained substantial damage to make repairs that would mitigate future flood damages. Additionally, stricter enforcement of the *Substantial Damage Rule* would further both repetitive loss and mitigation objectives. Under the *Substantial Damage Rule*, a substantially damaged structure must be elevated or flood-proofed to the same standards as new construction. In September 1999, the OIG issued a report that demonstrated weaknesses in communities' enforcement of the rule.

In last year's management challenges, we noted several areas where the Federal Insurance Administration and the Mitigation Directorate could work together to achieve common objectives and further the mission of the NFIP. This year, these two organizations have been combined into an entity called the Federal Insurance and Mitigation Administration. In our opinion, this merger is the nucleus for making the NFIP more effective. However, the merger does not ensure that common goals and objectives of insurance and mitigation will be achieved. The management challenge will be to integrate the organizations to achieve the synergy needed to make the NFIP an effective program. For example, questions that need to be addressed include:

- ❖ How effectively is compliance with floodplain management criteria being enforced as a condition of maintaining eligibility in the NFIP?

- ❖ Are insurance premium discounts provided for under the Community Rating System warranted based on conditions and mitigation actions taken by a community?

- ❖ How effectively are mandatory flood insurance purchase requirements for homeowners being monitored?

FEMA believes that most communities participating in the NFIP have effective floodplain management programs where new construction is performed in accord with the minimum requirements of the NFIP. FEMA officials also told us that communities participating in the Community Rating System are closely monitored and subject to periodic inspections. With respect to mandatory flood insurance purchase requirements, the General Accounting Office is conducting a study of lender compliance and FEMA is supporting this effort.

Management Challenges

Information Technology Management. Information technology (IT) is vital to FEMA's ability to accomplish its mission, but it presents several management challenges. Increasing connectivity between systems, especially through the Internet, and constantly changing and evolving technology and communications, while creating new opportunities for enhancing existing processes, also dramatically increase technology and security risks. As a result, FEMA must remain ever vigilant in guarding its systems and data. In several audit reports, we have recommended ways to improve FEMA's information security processes and controls. However, it has been difficult for FEMA to obtain sufficient resources to take corrective action.

Also, technology maintenance, enhancements, and implementations demand resources and require a sound capital planning and investment process. We identified weaknesses in FEMA's IT capital planning and investment control process. FEMA revised the process to help ensure that it is making technology investment decisions that are cost effective and contribute to accomplishing the agency's mission. FEMA also faces several upcoming technology decisions regarding its financial, property management, and emergency management systems, making implementation of a good IT capital planning process critical.

Other challenges FEMA faces include executing its Homeland Security responsibilities while also managing its existing systems and programs; pursuing an e-government agenda; implementing significant system and program changes to address the requirements of the Disaster Mitigation Act of 2000; ensuring privacy of sensitive data; managing systems effectively in a rapidly changing IT environment with limited resources; and planning for potential IT human capital issues.

To help address these challenges, FEMA initiated a major functional and organization realignment of its IT operations. The realignment is designed to improve service delivery, give FEMA better control over its IT investments, and ensure that FEMA's program and administrative requirements are consistently fulfilled. In addition, FEMA is in the process of reengineering its processes to ensure better control of its IT environment, and ensure more efficient use of time, funding, and people assigned to IT activities. The OIG endorses FEMA's IT realignment and reengineering initiatives and plans to work closely with IT managers to improve stewardship of information technology assets.

Financial Management. FEMA faces a significant challenge in addressing long-standing financial management problems and garnering resources to correct them. FEMA does not have a functioning integrated financial management system and its system of internal controls has material weaknesses. For years, these deficiencies have adversely affected the agency's ability to record, process, summarize, and report accurate, reliable, and timely financial data, and have increased the risk that material errors or irregularities could occur without detection.

Between fiscal years 1992 and 2001, FEMA successfully invested in its disaster preparedness, response, recovery, and mitigation programs. However, this was done at the expense of FEMA's infrastructure, i.e., human resource management, information technology management, and financial management. Due to resource constraints, policies and strategies for resolving financial management problems and enhancing financial operations were either ignored or limited to the most fundamental tasks. As a result, FEMA's financial operations continue to deteriorate each year, creating an unstable financial management environment, and jeopardizing FEMA's ability to fulfill its financial management responsibilities in future years. This is particularly troublesome in light of the increased responsibilities and associated funding that has been given to the agency as a result of the events of September 11th. In order to fulfill these new and important responsibilities in an effective and efficient manner, it is imperative that FEMA develop and maintain an enhanced financial management and internal control structure that includes an integrated accounting system and ensures reliable and timely financial reporting.

To meet this challenge, and to better support President Bush's restructuring and streamlining goals, the Director has transferred engineering, development, and operations responsibility for FEMA's Integrated Financial Management Information System to the Information Technology Services Directorate. Also, for the first time in ten years, FEMA is in the process of recruiting for a Chief Financial Officer with extensive financial management experience. We believe both of these actions will go a long way in improving the financial management system and operations of the agency.

Human Capital Management. Maximizing the value of FEMA employees and increasing organizational performance are significant challenges for FEMA. FEMA's most valuable asset is its human capital. How FEMA acquires, develops, and deploys its human capital will determine how effectively its mission will be accomplished. Developing a human capital strategy will require hard analysis and forward thinking. Through its strategic planning process, FEMA is working to develop an enterprise-wide human capital strategy that can be integrated with mission, goals, operational requirements, and financial resources. This effort will include workforce planning and developing initiatives to address imbalances in staff talent and skill requirements. It will address the anticipated surge of voluntary retirements over the next three to five years and the attrition factors that normally impact the stability of the workforce. FEMA also performed a workforce analysis for OMB that will serve to drive future management reform, budgetary planning, and performance goals. We plan to monitor FEMA's commitment and approach to this new challenge.

Grants Management. FEMA awards billions of dollars in grants each year to State and local governments to administer a myriad of preparedness, mitigation, and response and recovery projects. Grants are the primary tool used by FEMA to administer its emergency management responsibilities. Although grant funds are spent at the State or local level, it is ultimately FEMA's responsibility to ensure that these funds are spent according to prescribed Federal laws and regulations. Therefore, it is imperative that FEMA has an effective grants management system in place to fulfill both its program and fiduciary responsibilities. This is particularly important to satisfy GPRA requirements. Not only must FEMA adhere to the procedural and compliance aspects of grants management, it must also focus on what grantees actually accomplish using FEMA grant funds. In order for FEMA to demonstrate its own program efficiency and effectiveness, it must require grantees to do so as well. Without requiring more internal accountability from grantees, FEMA will not have the data to demonstrate that it has met its programmatic and fiduciary responsibilities.

Prior to fiscal year 1998, FEMA did not have a grants management structure that was sufficient to ensure the stewardship of funds that it awards. FEMA has acknowledged that major improvements are needed in grants management and has begun an effort to correct long-standing issues. For example, improved policy guidance has been written and distributed to regional offices to clarify and standardize procedures; training and credentialing are being implemented for grant managers; and grant closeout teams have been formed to facilitate the timely closeout of grants and to provide technical assistance to regional office personnel in their closeout efforts.

There still are, however, significant problems that need to be addressed. FEMA, through its 10 regional offices, is responsible for monitoring grant recipients in their use of Federal funds and enforcing their compliance with Federal regulations. Historically, FEMA's principal problem has been ineffective performance and financial oversight, which in turn has allowed grant recipients and subgrantees to misuse millions of dollars in Federal funds.

We have documented waste and mismanagement at grantee and subgrantee agencies throughout the country over the past seven years. For example, between 1993 and 2000, our audits of disaster assistance grants have questioned the use of funds totaling nearly $900 million. In addition, during the past three years, we completed audits in 17 States covering their management of FEMA disaster grants. There are a number of grant management problems that are recurring among the States. For example, States often do not monitor and accurately report on subgrantee performance and financial activities, make payments or closeout projects in a timely manner, and financial status reports filed with FEMA are often incorrect or untimely. In addition, States do not always maintain adequate documentation supporting their share of disaster costs and other financial requirements. Although FEMA has been very aggressive to correct the problems that we have reported, much can be done proactively to prevent these types of problems from recurring.

FEMA faces several hurdles in implementing its recent initiatives to improve its grants management system; in particular, it must resolve issues of staffing. FEMA needs to continue to take the initiative to provide technical assistance and guidance to States to ensure they have reliable disaster grant management systems to safeguard FEMA funds. This will require resources dedicated to the grants management function. FEMA will also have to be persistent in its efforts to ensure that implementation of its recent initiatives does not lose momentum when the next catastrophic disaster strikes. Successful implementation will ultimately depend on the continuing support that top management is now giving to an effective grants management system.

In an effort to further assist FEMA focus its resources and maintain its momentum, we plan to conduct a comprehensive programmatic audit of FEMA's management of its largest grant program, Public Assistance. This effort combined with our other recent audit efforts to identify weaknesses in FEMA, State and subgrantee grant management systems will prove useful in identifying critical issues and recommending corrective actions that should be taken in order for FEMA to move forward in its efforts to better safeguard Federal grant funds.

Government Performance and Results Act Implementation. Measuring and reporting on performance, as required by the Government Performance and Results Act (Results Act), continues to be a critical challenge for FEMA. FEMA complied with Results Act requirements that call for Annual Performance Plans and Report. However, according to FEMA and GAO, only some performance goals related to its three strategic goals outlined in its fiscal year 2000 Annual Performance Report, issued in March 2001. Our recently issued audit report on FEMA's Results Act implementation also identified additional shortcomings. While FEMA used accurate and complete data to measure its performance, FEMA's top management did not make implementation of the Results Act a priority and did not always use performance goals and measures as management tools. FEMA did not always devise measurable annual performance goals that, if accomplished, would demonstrate progress toward accomplishing strategic goals. In addition, FEMA did not integrate its budget and performance plan by accurately reporting resources budgeted and used to accomplish program goals and objectives outlined in its Annual Performance Plan. At present, some Results Act performance measures have little impact on the decisions made by FEMA managers in their allocation of resources or setting of program and management priorities.

FEMA has made some progress during fiscal year 2002. For example, a senior-level Planning and Budget Council will work to integrate the performance goals and measures with the agency's budget. The OIG is a participant on this Council. However, more needs to be done. For example, the office managing GPRA has been placed at a fairly low level in the Financial and Acquisition Management Division, while strategic planning is in the Office of the Director. This raises concerns about whether GPRA will get the high-level management attention it deserves – a problem we pointed out in our audit report. We plan to continue our efforts to monitor FEMA's commitment to implementing GPRA and its use of performance goals as a management tool. All future audits of FEMA's programs will incorporate a review of Results Act compliance.