OFFICE OF INSPECTOR GENERAL

National Flood Insurance Program's Management Letter for DHS' FY 2014 Financial Statements Audit

(Redacted)

Homeland Security

March 25, 2015

OIG-15-52

HIGHLIGHTS

National Flood Insurance Program's Management Letter for DHS' FY 2014 Financial Statements Audit

March 25, 2015

Why We Did This

The Federal Government has a fundamental responsibility to be an effective steward of taxpayers' dollars. Sound financial practices and related management operations, reliable financial systems, and effective internal control are essential for reliable, timely financial information that supports management decision making needed to achieve the Department of Homeland Security's (DHS) mission.

For Further Information:
Contact our Office of Public Affairs at (202) 254-4100, or email us at DHS-OIG.OfficePublicAffairs@oig.dhs.gov

What We Found

KPMG LLP reviewed National Flood Insurance Program's internal control over financial reporting. The resulting management letter contains four observations related to internal controls and other operational matters for management's consideration. KPMG LLP noted deficiencies and the need for improvements in certain National Flood Insurance Program (NFIP) processes. These deficiencies did not meet the criteria to be reported in the *Independent Auditors' Report on DHS' FY 2014 Financial Statements and Internal Control over Financial Reporting, dated* November 14, 2014, included in DHS' fiscal year (FY) 2014 *Agency Financial Report*. These observations are intended to improve internal control or result in other operating efficiencies.

FEMA Response

FEMA will continue to communicate with the insurance companies and NFIP Direct Servicing Agent regarding the observations reported by KPMG LLP. Specifically, FEMA will (1) ensure that reported errors are corrected; (2) continue to provide guidance and clarification of procedures, ratings and rules; and (3) host training seminars. FEMA will also continue remediation efforts by developing a corrective action plan in FY 2015.

OFFICE OF INSPECTOR GENERAL
Department of Homeland Security

MAR 25 2015

TO: Brad Kieserman
Deputy Associate Administrator for Federal Insurance
Federal Insurance and Mitigation Administration

FROM: Mark Bell
Assistant Inspector General for Audits

SUBJECT: *National Flood Insurance Program's Management Letter for DHS' FY 2014 Financial Statements Audit*

Attached for your information is our final report, *National Flood Insurance Program's Management Letter for DHS' FY 2014 Financial Statements Audit.* The report contains observations related to internal controls for management consideration. The observations did not meet the criteria to be reported in the *Independent Auditors' Report on DHS' FY 2014 Financial Statements and Internal Control over Financial Reporting,* dated November 14, 2014, which was included in the Department of Homeland Security's (DHS) fiscal year (FY) 2014 *Agency Financial Report.*

The independent public accounting firm KPMG LLP conducted the audit of DHS' FY 2014 financial statements and is responsible for the attached management letter and the conclusions expressed in it.

Consistent with our responsibility under the *Inspector General Act,* we will provide copies of our report to appropriate congressional committees with oversight and appropriation responsibility over the Department of Homeland Security. In a February 10, 2014, request, the Federal Emergency Management Agency's Chief Financial Officer requested that we redact certain information from the report. Specifically, the flood insurance policy numbers and date of loss are considered Sensitive Personally Identifiable Information as defined in the Privacy Office's *Handbook for Safeguarding Sensitive Personally Identifiable Information at the Department of Homeland Security.* As a result, we have redacted the policy numbers and date of loss information from the report and will post a redacted version of the report on our website.

Please call me with any questions, or your staff may contact Paul Wood, Acting Deputy Assistant Inspector General for Audits, at (202) 254-4100.

Attachment

KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

December 19, 2014

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

Ladies and Gentlemen:

In planning and performing our audit of the consolidated financial statements of the U.S. Department of Homeland Security (DHS or Department), as of and for the year ended September 30, 2014, in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 14-02, *Audit Requirements for Federal Financial Statements*, we considered the Department's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements. In conjunction with our audit of the consolidated financial statements, we also performed an audit of internal control over financial reporting in accordance with attestation standards established by the American Institute of Certified Public Accountants.

During our audit, we noted certain matters involving the Federal Emergency Management Agency's (FEMA) National Flood Insurance Program (NFIP) internal control and other operational matters that are presented for your consideration. These comments and recommendations have been discussed with the appropriate members of management of the named insurance companies (where applicable), FEMA's Office of the Chief Financial Officer (OCFO), FEMA's Federal Insurance and Mitigation Administration (FIMA), and communicated through a Notice of Finding and Recommendation. These observations and recommendations are intended to improve internal control or result in other operating efficiencies; are summarized in Exhibit I of this letter; and are not considered significant deficiencies or material weaknesses in internal control over financial reporting. Significant deficiencies and material weaknesses in internal control over financial reporting have been previously communicated to the DHS Office of Inspector General (OIG) and management in our *Independent Auditors' Report*, dated November 13, 2014, included in the fiscal year 2014 DHS *Agency Financial Report*.

Deficiencies related to FEMA information technology (IT) controls will be presented in a separate letter to the DHS OIG and the FEMA Chief Information Officer (CIO). In addition, certain other deficiencies related to FEMA's internal control exclusive of our IT findings will be presented in a separate letter to the DHS OIG and the FEMA Chief Financial Officer.

KPMG LLP is a Delaware limited liability partnership, the U.S. member firm of KPMG International Cooperative ("KPMG International"), a Swiss entity.

Our audit procedures are designed primarily to enable us to form opinions on the financial statements and on the effectiveness of internal control over financial reporting, and therefore may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the NFIP organization gained during our work to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

The purpose of this letter is solely to describe comments and recommendations intended to improve internal control or result in other operating efficiencies. Accordingly, this letter is not suitable for any other purpose.

FEMA's response to the deficiencies identified in our audit is included in Exhibit II. FEMA's response was not subjected to the auditing procedures applied in the audit of the consolidated financial statements and, accordingly, we express no opinion on it. Our auditors' response is presented in Exhibit III.

Very truly yours,

KPMG LLP

Exhibit I

I. BACKGROUND

The Federal Insurance & Mitigation Administration (FIMA) of U.S. Department of Homeland Security Federal Emergency Management Agency (FEMA) manages the National Flood Insurance Program (NFIP). Private insurance companies and the Direct Servicing Agent (DSA) (NFIP insurers) administer the flood insurance policies issued through the NFIP. The NFIP insurers write NFIP policies, adjust flood claims, process and distribute claim payments to policyholders, and establish and maintain loss reserves. The NFIP has contracted with a third-party service provider to assist the NFIP in managing the program. The NFIP insurers submit NFIP data to the third-party service provider via the Transaction Record Reporting and Processing (TRRP) system. The service provider uses underwriting transactions (i.e., written premiums) data associated with flood policies to calculate the deferred revenue liability for the actual NFIP financial statements and the deferred revenue liability estimate for the year-end estimated NFIP financial statements, which is recorded in the year-end FEMA financial statements. The estimated financial statements are based on two months of actual data and one month of forecasted data, due to the timing of available data versus financial reporting deadlines. Once the actual data is available, FEMA compares the recorded estimated financial statements to the actual statements to identify any large or unusual differences to determine whether an on-top adjustment is necessary. The NFIP paid losses (i.e., claim payments) data for the current year and historical data are used by the service provider actuary to calculate the year-end actuarial liability for the NFIP financial statements, which is also recorded in the year-end FEMA financial statements. The case loss reserve data associated with flood claims may marginally and indirectly be used in this process, but is not separately disclosed in the NFIP financial statements. The consistency of this reserve from period to period is most important. Thus the precision of the estimate to reflect actual events is dependent upon the accuracy and consistency of the underlying data submitted by the NFIP insurers on a monthly basis.

II. INTERNAL CONTROL DEFICIENCIES RELATED TO WRITTEN PREMIUMS

Observation (NFR FEMA 14-01):

We selected five vendors or insurance companies at which to perform audit procedures over the operating effectiveness of controls related to written premiums for the periods October 1, 2013 through March 31, 2014; April 1, 2014 through June 30, 2014; and July 1, 2014 through August 31, 2014. For the five vendors/companies selected, we tested a sample of written premiums totaling 258 items covering the three testing periods identified above. During this testing, we noted the following internal control deficiencies and errors:

1. Based on our March 31, 2014 testwork, for one sample item, we noted a refund was issued to the agent for reimbursement to the insured, which is not allowed under FEMA's reimbursement policy:

Company	Policy #	Premium Receipt Date	Refund Amount
Hartford Fire Ins. Co.	[redacted]	10/29/2013	$ 6.00

2. Based on our March 31, 2014 testwork, for one sample item, we were unable to verify the historical flood zone and calculated the following premium variance based on the current, verifiable flood zone:

Company	Policy #	Policy Effective Date	Sample Premium Amount	KPMG Calculated Premium	Premium Difference (Under)/Over
NFIP DSA	[redacted]	1/15/2014	$ 2,034.00	$ 3,408.00	($ 1,374.00)

3. Based on our March 31, 2014 testwork, for one sample item, we noted the policy was incorrectly rated using post-Flood Insurance Rate Map (FIRM) rating, creating the following premium variance:

Company	Policy #	Policy Effective Date	Sample Premium Amount	KPMG Calculated Premium	Premium Difference (Under)/Over
Selective Ins.	[redacted]	11/12/2013	$ 566.00	$ 353.00	$ 213.00

4. Based on our March 31, 2014 testwork, for one sample item, we noted the policy effective date was incorrectly calculated and did not adhere to the standard 30-day wait period:

Company	Policy #	Transaction Type	Policy Effective Date	Correct Effective Date
Selective Ins.	[redacted]	New Business	3/11/2014	3/12/2014

Federal Insurance and Mitigation Administration did not provide adequate oversight to ensure premium refunds and premiums written were properly reviewed prior to issuance to confirm compliance with the *NFIP Flood Insurance Manu*al. Additionally, FEMA's *NFIP Flood Insurance Manual* does not require all flood zones included in insurance policy applications to be verified by the underwriter.

Recommendations:

We recommend that the Federal Insurance and Mitigation Administration:

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

III. INTERNAL CONTROL DEFICIENCIES RELATED TO PAID CLAIMS

A. Internal Control Deficiencies and Errors Identified over Claims' Payments

Observation (NFR FEMA 14-03):

We selected five vendors or insurance companies at which to perform audit procedures over the operating effectiveness of controls related to claims' payments for the periods October 1, 2013 through March 31, 2014; April 1, 2014 through June 30, 2014; and July 1, 2014 through August 31, 2014. For the five vendors/companies selected, we tested a sample of paid claims totaling 234 items covering the three testing periods identified above. During this testing, we noted the following internal control deficiencies and errors:

1. Based on our March 31, 2014 testwork, for one sample item, we noted the insurance company did not obtain a Proof of Loss (POL) or Final Report prior to issuing the claim payment.

Company	Policy No.	Date of Loss	Payment Amount	Payment Date
Farmers Ins. Group	[redacted]	[redacted]	$ 6,567.34	2/27/2014

2. Based on our March 31, 2014 testwork, for two sample items, we noted the claims were paid without a signed POL.

Company	Policy No.	Date of Loss	Payment Amount	Payment Date
Wright National Flood	[redacted]	[redacted]	$ 9,387.00	3/6/2014
Wright National Flood	[redacted]	[redacted]	$ 32,324.65	11/7/2013

3. Based on our March 31, 2014 testwork, for one sample item, we noted the claim was paid without a 60-day POL waiver from FEMA.

Company	Policy No.	Date of Loss	Payment Amount	Payment Date
NFIP DSA	[redacted]	[redacted]	$13,542.37	1/6/2014

4. Based on our March 31, 2014 testwork, for one sample item, we noted the claim payment was issued 91 days after receipt of the POL.

Company	Policy No.	Date of Loss	Approval Date	Payment Date
Farmers Ins. Group	[redacted]	[redacted]	9/11/2013	11/27/2013

5. Based on our March 31, 2014 testwork, for one sample item, we noted the claim payment was reported to the NFIP with the incorrect payment date.

Company	Policy #	Date of Loss	Payment Amount	Sample Payment Date	Correct Payment Date
Selective Ins.	[redacted]	[redacted]	$ 13,278.27	10/29/2013	10/31/2013

Federal Insurance and Mitigation Administration did not provide adequate oversight to ensure claim files were processed and reviewed in accordance with the NFIP guidelines prior to the approval and issuance of claim payments.

Recommendations:

We recommend that the Federal Insurance and Mitigation Administration:

1. Follow up with each NFIP insurer identified above to determine that appropriate corrective action has been implemented to ensure compliance with *the Standard Flood Insurance Policy's* Proof of Loss requirements.
2. Enhance monitoring and oversight of the NFIP insurers to ensure claims files are processed and reviewed in accordance with NFIP guidelines before approval and issuance of claims.

B. Internal Control Deficiencies and Errors Identified over Claims' Case Loss Reserves

Observation (NFRs FEMA 14-02 and FEMA 14-02a):

We selected five vendors or insurance companies at which to perform audit procedures over the operating effectiveness of controls related to the establishment and closure of case loss reserves for the periods October 1, 2013 through March 31, 2014; April 1, 2014 through June 30, 2014; and July 1, 2014 through August 31, 2014. For the five vendors/companies selected, we tested a sample of paid claims totaling 234 items covering the three testing periods identified above. We also performed substantive audit procedures over the accuracy and completeness of case loss reserves reported as of February 28, 2014 and August 31, 2014 over all insurance companies participating in the NFIP through a sample of 130 case loss reserve balances. During this testing, we noted the following internal control deficiencies and errors:

1. Based on our February 28, 2014 and August 31, 2014 testwork, for six sample items, the case reserve balance was not reduced to zero when the claim was closed (either paid or closed without payment).

As of February 28, 2014:

Company	Policy No.	Month of Loss	Month Claim Closed	Reserve Balance Per System	Correct Reserve Calculation	Over Statement
USAA	[redacted]	[redacted]	06/2009	$ 4,000.00	$ 0.00	$ 4,000.00
National Lloyds	[redacted]	[redacted]	12/2013	$ 0.55	$ 0.00	$ 0.55
Wright Flood	[redacted]	[redacted]	01/2013	$ 4,487.33	$ 0.00	$ 4,487.33

As of August 31, 2014:

Company	Policy No.	Month of Loss	Month Claim Closed	Reserve Balance Per System	Correct Reserve Calculation	Over Statement
USAA	[redacted]	[redacted]	9/2013	$ 1,500.00	$ 0.00	$ 1,500.00
NFIP DSA	[redacted]	[redacted]	1/2014	$ 22,000.00	$ 0.00	$ 22,000.00
USAA	[redacted]	[redacted]	6/2009	$ 21,400.00	$ 0.00	$ 21,400.00

2. Based on our February 28, 2014 testwork, for one sample item, FEMA was unable to determine what company was responsible for the open claim, and had not closed the claim or case reserve from 1988 for inactivity.

Company	Policy No.	Month of Loss	Reserve Balance Per System	Correct Reserve Calculation	Over Statement
Continental Ins. Group	[redacted]	[redacted]	$ 7,600.00	$ 0.00	$ 7,600.00

3. Based on our February 28, 2014 testwork, for one sample item, a previous overpayment on a claim was incorrectly applied to the open Increased Cost of Compliance (ICC) reserves.

Company	Policy No.	Month of Loss	Reserve Balance Per System	Correct Reserve Calculation	Over Statement
Travelers	[redacted]	[redacted]	$ 9,787.21	$ 0.00	$ 9,787.21

4. Based on our August 31, 2014 testwork, for two sample items, the case reserve balance was not properly reduced when an advance payment was issued.

Company	Policy No.	Month of Loss	Reserve Balance Per System	Correct Reserve Calculation	Over Statement
Selective	[redacted]	[redacted]	$ 30,000.00	$ 15,000.00	$ 15,000.00
Selective	[redacted]	[redacted]	$ 30,000.00	$ 15,000.00	$ 15,000.00

5. Based on our August 31, 2014 testwork, for one sample item, the case reserve balance was not updated to reflect the updated amount of the Final Report or Proof of Loss (POL).

Company	Policy No.	Month of Loss	Reserve Balance Per System	Correct Reserve Calculation	Over Statement
USAA	[redacted]	[redacted]	$ 17,035.92	$ 2,419.55	$ 14,616.37

6. Based on our February 28, 2014 testwork, for one sample item, the insurance company's IT system prevented the claim file from closing after the final payment was issued.

Company	Policy No.	Month of Loss	Reserve Balance Per System	Correct Reserve Calculation	Over Statement
USAA	[redacted]	[redacted]	$ 10,011.63	$ 0.00	$ 10,011.63

7. Based on our February 28, 2014 testwork, for two sample items, reserves were re-populated by the Company's IT system after the Building claim was closed.

Company	Policy No.	Month of Loss	Reserve Balance Per System	Correct Reserve Calculation	Over Statement
Selective	[redacted]	[redacted]	$ 166.99	$ 0.00	$ 166.99
Selective	[redacted]	[redacted]	$ 16,121.77	$ 15,000.00	$ 1,121.77

8. Based on our February 28, 2014 testwork, for one sample item, the transaction was incorrectly submitted with zeroes instead of asterisks in the reserve fields.

Company	Policy No.	Loss Month	Reserve Balance Per System	Correct Reserve Calculation	Over Statement
NFIP DSA	[redacted]	[redacted]	$ 22,000.00	$ 0.00	$ 22,000.00

Adequate policies and procedures have not been fully developed and implemented to monitor open case loss reserves and ensure claim payments properly reduce the related reserve.

NFIP insurer IT systems were not properly monitored for errors created by IT system limitations which prevented individual case loss reserves related to closed claims from being accurately reported to the third-party service provider.

TRRP transactions were not adequately reviewed prior to submission by the NFIP insurers to the third-party service provider.

Recommendations:

We recommend that the Federal Insurance and Mitigation Administration:

1. Follow up with each NFIP insurer identified above to determine that appropriate corrective actions have been implemented to address the exceptions identified.
2. Implement policies and procedures over the review of the TRRP report of closed claims with outstanding case loss reserves to ensure all open reserves on closed claims are reduced to zero in a timely manner which may include an automated logic edit in TRRP to reject the closure of a claim with an outstanding case loss reserve balance (i.e., verify the reserves are properly at zero before a claim can be closed).
3. Require NFIP insurers develop and implement procedures to review transactions prior to submission to the third-party service provider.

Exhibit II

MANAGEMENT'S RESPONSE

U.S. Department of Homeland Security
500 C Street, SW
Washington, DC 20472

FEMA

January 23, 2015

MEMORANDUM FOR: Mark Bell
Assistant Inspector General for Audits

FROM: Brad Kieserman
Deputy Associate Administrator for Federal Insurance
Federal Insurance and Mitigation Administration

SUBJECT: FIMA's Response to OIG Draft Report: NFIP's Management Letter for the FY 2014 DHS Financial Statements Audit

Thank you for the opportunity to comment on the FY 2014 draft NFIP Management Letter for the FY 2014 Financial Statements Audit.

FEMA 14-01: Internal Control Deficiencies Related to Written Premiums.

FEMA conducts an average of six to eight operation reviews of selected Write Your Own (WYO) companies annually. When conducting these operation reviews, FEMA reviews the types of transactions noted in KPMG's audit findings. Following the reviews, FEMA immediately follows up with the WYO companies to review the errors and ensure that the errors of the type noted in KPMG's findings are corrected.

Immediately after receiving the Notice of Findings and Recommendations (NFR) from KPMG, FEMA contacted the WYO companies with errors listed in the audit findings. The companies timely corrected the errors and provided documentation that the policies were corrected.

FEMA remains in constant communication with the WYO companies: FEMA provides guidance and clarification of procedures, rating, and rules; hosts training seminars; regularly consults on Program changes necessitated by changes in the National Flood Insurance Act; and publishes guidance bulletins. The companies are required to follow the rules and procedures of the NFIP as published in the *WYO Accounting Procedures Manual*, the *NFIP Flood Insurance Manual*, and the *NFIP Edit Specifications for the WYO Program*. In response to KPMG's FY 2014 audit findings, FEMA issued FEMA WYO Bulletin No. W-14037 to clarify the refund process and specified that refunds should not be sent to the agent or any other third party for subsequent third-party remittance.

www.fema.gov

FEMA will continue remediation efforts by developing a corrective action plan in FY 2015. In addition, as part of the FY 2015 Operation Reviews, FEMA will ensure that all reviews include an examination of optional Post-FIRM rating, refunds, and effective dates as noted in the FY 2014 DHS Financial Statements Audit.

FEMA 14-03: Internal Control Deficiencies and Errors Identified over Claim's Payments – Proof of Loss

During calendar year 2014, FEMA received 4,006 Proof of Loss Waiver Requests. FEMA continues to monitor WYO claims and Proof of Loss through Operation Reviews and through the Proof of Loss Waiver Requests.

FEMA 14-02 and 14-02a: Internal Control Deficiencies and Errors Identified over Claim's Case Loss Reserves

FEMA continues to communicate with the WYO companies and the NFIP Direct Servicing Agent (DSA) to reiterate the need to adjust case loss reserves as new information is received and payments are made, and ultimately reduced to zero when the claim is closed.

During FY 2014, FEMA invited the WYO companies and the DSA to an NFIP Claims and Appeals Processing Refresher, during which FEMA discussed, among other topics, the importance of case loss reserves and their adjustment. In March 2014, FEMA also instituted a new monthly report to monitor the WYO and DSA reserves. Most of the identified cases are now closed. The remaining open cases are due to Increased Cost of Compliance (ICC) claims. Effective October 1, 2014, FEMA implemented a new edit requirement for the WYO companies and the DSA to zero out their reserves when closing a claim. This is known as a "logic edit" in the Transaction Records Reporting and Processing (TRRP) Plan. FEMA issued Bulletin W-14035, dated June 26, 2014, notifying the insurers about the edit requirement. Reference was also made in the *NFIP Flood Insurance Manual,* recently issued with the October 2014 Program changes.

As part of the enforcement, when FEMA conducts Claims Operation Reviews and finds the reserves were not adjusted to zero when the claim was closed, it is reported as a "Critical Error." During FY 2014, FEMA reviewed 1,100 claim files during its Operation Review oversight. The reserves were addressed during each review and in the entrance and exit briefings. FEMA found no closed claims with open reserves.

FEMA will continue these efforts by developing a corrective action plan in FY 2015, subject to resource availability. This plan will elaborate on the positive steps that have been made and identify anticipated future measures.

FEMA continues to believe the auditors' concerns over case loss reserve procedures are misplaced since the case loss reserves they have analyzed are not reported directly on the financial statement. And while the year-end loss reserve estimate that is carried on the financial statement is, in part, influenced by the case loss reserves, the NFIP actuaries have demonstrated, in analysis that has been shared with the auditors, that even a large change in the adequacy of the case loss reserve from the historical pattern has only a very small influence on the year-end estimated loss reserve. The actuaries who develop the sensitivity tests and year-end loss reserve estimate that is carried on the financial statement assure us that the case loss reserves do not have to be accurate in order for them to make a reasonable year-end loss reserve estimate. The actuaries need a reasonably stable pattern of total case loss reserves, regardless of any discrepancies in individual cases. FEMA continues to be concerned that the cost versus benefit of the auditors' review and work may weigh extremely heavily on the cost side, for the true benefit, as described above, is negligible.

FEMA notes that the conditions stated in the report present limited risk to the financial statements.

Thank you again for the opportunity to comment on the draft report.

Exhibit III

AUDITORS' RESPONSE

FEMA's response to the draft of this letter discussed several specific observations noted in the letter. As such, we provide the following additional information.

Regarding Observation II (NFR FEMA-14-01), we acknowledge FEMA's continued efforts to effectively monitor the Write Your Own (WYO) companies, including follow-up regarding our findings communicated in this letter. Additionally, we acknowledge FEMA's remediation efforts, including updates to rules and procedures published by the NFIP, including WYO Bulletins.

Regarding Observation III.A (NFR FEMA-14-03), we acknowledge FEMA's efforts to monitor claims through their implemented policies and procedures.

Regarding Observation III.B (NFRs FEMA-14-02 and FEMA-14-02a), we received during our audit procedures, a letter from the FEMA contracted actuary describing the data elements utilized in computing the actuarial insurance liability estimate as of September 30, 2014. This letter, which guided our testing approach related to the insurance liability estimate, included case reserves as one of the data elements used in the calculation. Our testing of data elements occurred throughout fiscal year 2014. FEMA's year-end analysis demonstrated that case reserves were not a significant factor in the calculation of the insurance liability estimate as of September 30, 2014; we took this information into consideration in determining the severity of the conditions identified, which were concluded to be no more severe than control deficiencies at the Department level.

Additionally, our recommendations related to Observation III.B were intended to focus on the accurate reporting of case reserves to the third party provider and the process of properly opening and closing case reserves based on the life of the claim. We understand that case reserving is a normal business practice for all property and casualty insurers and that FEMA must consider the costs versus benefits of implementing changes to such a disaggregated process. However, each participating insurance company should consistently adhere to its own policies and procedures related to case reserving, which should be documented as part of the company's internal control structure.

Appendix A
Report Distribution

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