

FEMA Should Recover \$2.4 Million in Investment Gains Pennsylvania Improperly Earned on Federal Disaster Funds





OFFICE OF INSPECTOR GENERAL

Department of Homeland Security

**November 8,
2016**

Why We Did This Audit

During the course of a related audit, we learned that the Commonwealth invested disaster funds drawn down months and, in some cases, years in advance of the actual need, but did not remit the investment gains to the Federal Government.

What We Recommend

FEMA should collect \$2.4 million from the Commonwealth for investment returns earned on Federal disaster assistance funds. FEMA should also determine whether any additional Federal funds were invested and take steps to collect earnings that may exist.

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

Contrary to Federal regulations and the Pennsylvania Emergency Management Agency's (PEMA) own policies and procedures, PEMA drew down all available Federal disaster assistance funds for all (both large and small) public assistance projects on two disasters in 2004 and 2005. The Commonwealth of Pennsylvania (Commonwealth) invested these funds, earning \$2.4 million. PEMA did not report to the Federal Emergency Management Agency (FEMA) that it drew down funds prematurely. The investment gains were not remitted to FEMA, as required by Federal regulations.

PEMA made the drawdowns available to the Commonwealth's subgrantees for their projects, regardless of project completion. PEMA did not monitor the subgrantees' use of these funds.

As a result, FEMA should collect \$2.4 million of investment gains the Commonwealth earned on Federal disaster funds. Additionally, we recommend that FEMA work with PEMA to determine whether any of the funds disbursed to the other subgrantees were invested and, if so, collect any investment returns.

FEMA's Response

FEMA Region III officials agreed with our two recommendations and identified corrective actions sufficient to record our recommendations as resolved and open. FEMA's written response is included as appendix B.



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Department of Homeland Security

Washington, DC 20528 / www.oig.dhs.gov

November 8, 2016

MEMORANDUM FOR: MaryAnn Tierney
Regional Administrator, Region III
Federal Emergency Management Agency
Thomas M. Salmon

FROM: Thomas M. Salmon
Assistant Inspector General
Office of Emergency Management Oversight

SUBJECT: *FEMA Should Recover \$2.4 Million in Investment Gains
Pennsylvania Improperly Earned on Federal Disaster
Funds*

For your action, attached is our final report, *FEMA Should Recover \$2.4 Million in Investment Gains Pennsylvania Improperly Earned on Federal Disaster Funds*. We incorporated the comments provided by your office.

The report contains two recommendations aimed at correcting conditions that existed as a result of the Pennsylvania Emergency Management Agency's cash management of disaster funds. Your office concurred with both of our recommendations. Based on information provided, we consider recommendations 1 and 2 resolved and open.

Consistent with our responsibility under the *Inspector General Act*, we will provide copies of our report to congressional committees with oversight and appropriation responsibility over the Department of Homeland Security. We will post the report on our website for public dissemination.

Please call me with any questions, or your staff may contact Paul Wood, Director of the Emergency Management Oversight, National Capital Region Office, at (202) 254-4100.



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Background

The Commonwealth of Pennsylvania (Commonwealth) experienced five consecutive disasters from August 2004 to June 2006. These five disasters caused considerable damage from heavy rains, flooding, and mudslides. The Pennsylvania Emergency Management Agency (PEMA) explained that Tropical Storm Ivan (disaster 1557) was the third storm to hit the Commonwealth during a six-week period. After the first two disasters, the situation across the Commonwealth was rapidly deteriorating when Ivan (disaster 1557) severely damaged infrastructure statewide.

PEMA further explained that, during the performance of the recovery efforts for Ivan (disaster 1557), the Commonwealth Coordinating Officer made a decision to pay the full Federal share to applicants of large public assistance projects as soon as funds were available. This decision carried over to the next presidentially declared disaster (disaster 1587), a storm that brought severe weather and flooding to the Commonwealth in April 2005.

Table 1 - Pennsylvania Disasters DR 1557 and 1587

Disaster Number	Date Declared	Disaster Beginning	Period Ending	Federal Share	Total Public Assistance Dollars Obligated
1557	9/19/2004	9/17/2004	10/1/2004	75%	\$ 85,266,595
1587	4/14/2005	4/2/2005	4/23/2005	75%	\$ 18,759,804
Total Public Assistance Funding					\$104,026,399

Source: Prepared by DHS Office of Inspector General (OIG) using data from FEMA.gov

Results of Audit

Contrary to Federal regulations and PEMA's own policies and procedures, PEMA drew down all available Federal disaster assistance funds for all (both large and small¹) public assistance projects on two disasters in 2004 and 2005. PEMA took these funds as soon as FEMA approved the projects and obligated the funds without regard of actual costs incurred. Project funds awarded to departments and agencies of the Commonwealth (state agencies), not immediately needed to pay current obligations, were held in the general fund. The Commonwealth's Treasurer invested the excess general fund account balances through the Commonwealth Investment Program. Under this program, the Commonwealth's Treasury created two separate investment

¹ Federal regulations in effect at the time of these disasters set the large project thresholds at \$54,100 for disaster 1557 and \$55,500 for disaster 1587. For small projects, payment is made at the time of project approval. For large projects, funds generally are made available to the applicant as costs are incurred and work is completed.



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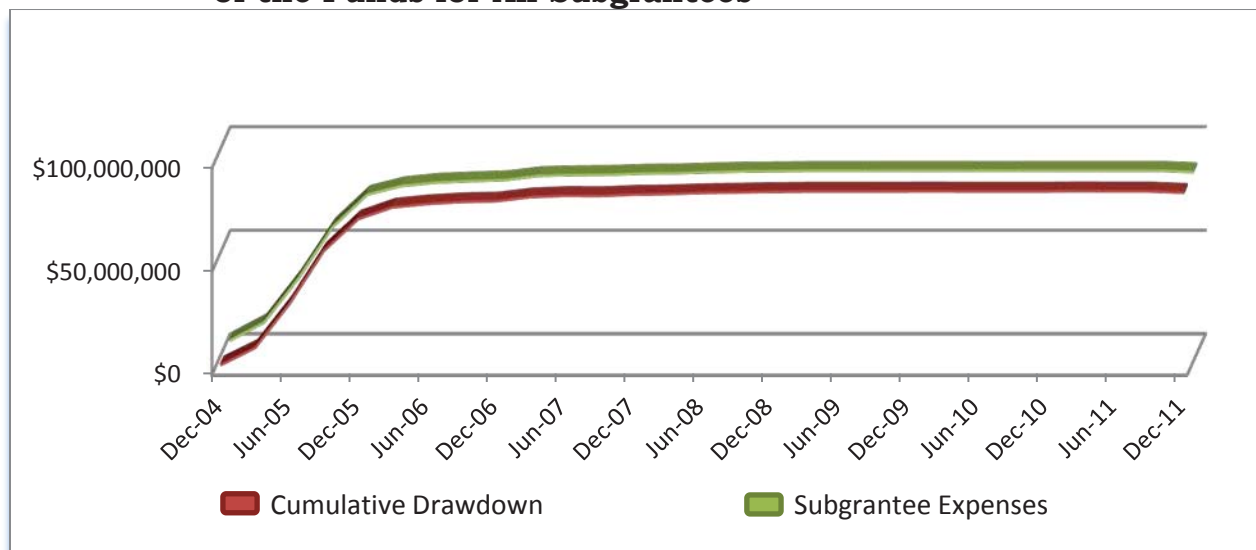
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options, called pools, each with its own distinct investment strategies, goals, and holdings.

Subgrantees, other than Commonwealth agencies, such as counties, cities, towns, and boroughs, (other subgrantees) promptly received the full Federal share of their disaster assistance awards. The Single Audit for Fiscal Year 2005 reported that PEMA had no procedures in place to monitor other subgrantees for excess cash on hand during project performance.

Charts 1 and 2 demonstrate the timing relationship between the drawdowns, reported expenditures of all subgrantees, and the expenditures of the Commonwealth agencies.

Chart 1 - Cumulative Drawdowns Compared to Cumulative Transfers of the Funds for All Subgrantees



Source: Prepared by DHS OIG using data from PEMA

Chart 1 shows that the drawdowns equaled the reported expenses for all subgrantees (both Commonwealth agencies and other subgrantees). This occurred because PEMA withdrew the full-approved Federal share of the project and reported this amount as the current expense when it initiated the drawdowns. As a result, PEMA took all of the available, approved funds for the two disasters by the summer of 2006.

Chart 2 shows that all available Federal funds awarded to Commonwealth agencies were drawn down as soon as the projects were approved and obligated by FEMA. The blue line on the graph demonstrates that the Commonwealth took all available funds before June 2006. All funds that remained after the Commonwealth paid the current expenses were held in the general fund account. These funds are the source of the excess balances invested by the Commonwealth. The red line represents the expenditures of the

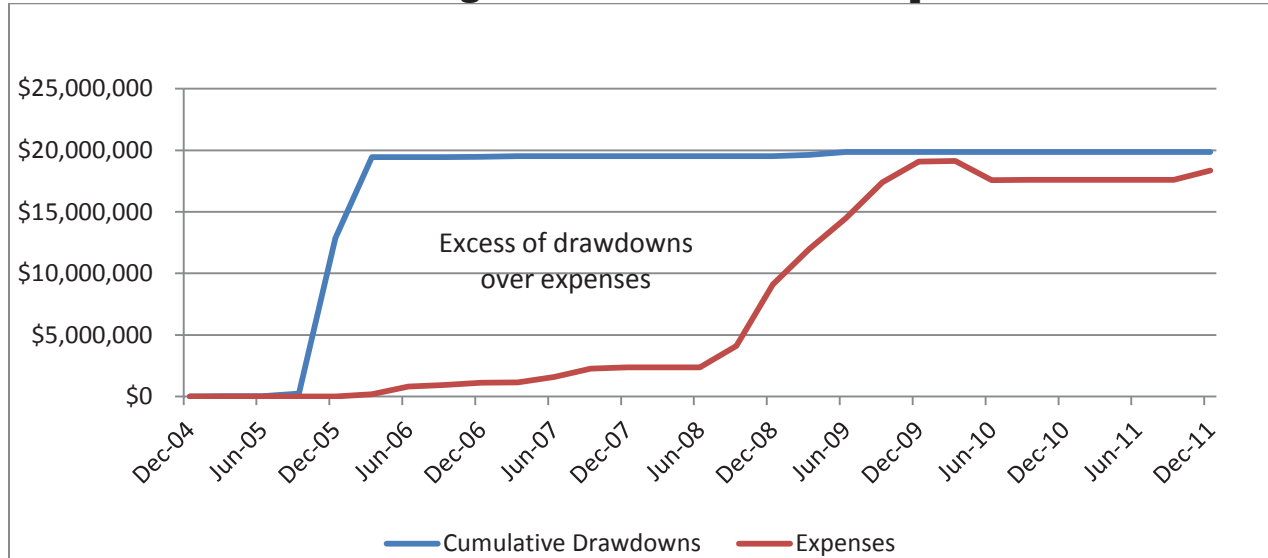


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Commonwealth agencies as they used the funds to pay for current expenses. Consistent progress on the projects began after June 2008, and most of the funds were used by the end of 2009.

Chart 2 - Commonwealth Agencies Drawdowns and Expenses



Source: Prepared by DHS OIG using data from PEMA

PEMA's Actions Violated the Cash Management Improvement Act of 1990

These actions did not follow PEMA's normal procedure of initiating drawdowns and violated the *Cash Management Improvement Act of 1990* (CMIA), that require:

- (a) a State and a Federal Program Agency ... minimize the time elapsing between the transfer of funds from the United States Treasury and the State's payout of funds for Federal assistance program purposes, whether the transfer occurs before or after the payout of funds²; and
- (b) a State and a Federal Program Agency ... limit the amount of funds transferred to the minimum required to meet a State's actual and immediate cash needs.³

² 31 Code of Federal Regulations (CFR) § 205.11(a)

³ 31 CFR § 205.11(b)



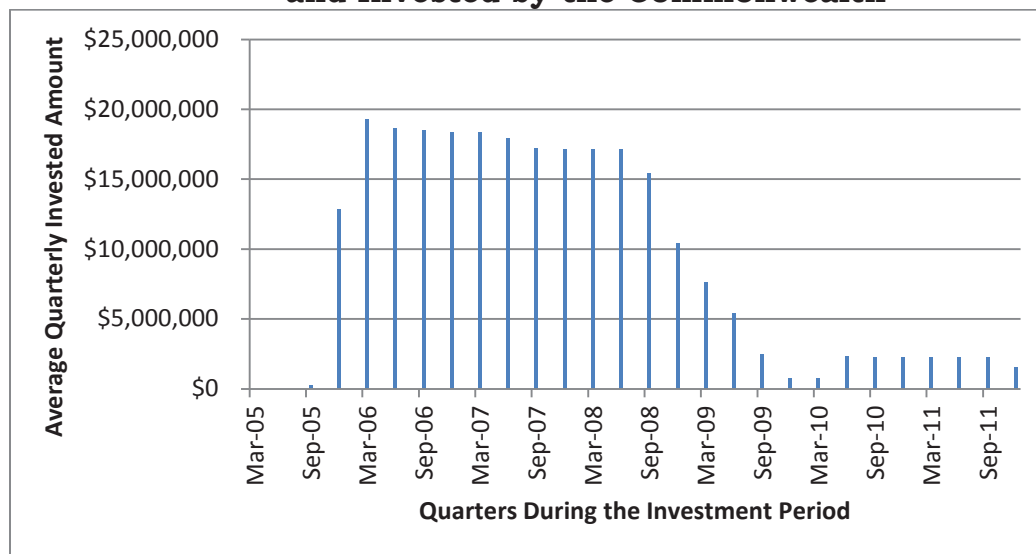
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PEMA Accumulated Cash Balances, Invested the Excess Cash, Earning \$2.4 million

PEMA's withdrawal of the full Federal share resulted in substantial invested cash balances. These cash balances averaged approximately \$12 million per year, and PEMA held these balances over a period of 6 years. The highest cash balance was more than \$19.4 million in early 2006.

Table 2 – Excess Federal Funds Held as Cash Balances and Invested by the Commonwealth



Source: Prepared by DHS OIG using the Commonwealth's Comptroller data

The Pennsylvania Department of Conservation and Natural Resources (DCNR) received disaster assistance for the repair and restoration of the Delaware Canal, a National Historic Landmark. DCNR was slow to begin the restoration project because the back-to-back storms created the need for repeat survey work and slowed the completion of historic and environmental reviews. As a result, PEMA and DCNR did not see a measurable reduction in the excess balances until mid-2008, after which the work progress increased and the balances began to decline until all projects were completed in 2011.

We first learned that the Commonwealth invested the excess balances during our audit DA-13-25, *Pennsylvania Department of Conservation and Natural Resources Appropriately Expended \$33.6 Million of FEMA Public Assistance Funds*, dated September 2013. During that audit, a DCNR official asked us for guidance on the appropriate handling of investment returns earned on FEMA funds held by the Commonwealth. We received an electronic spreadsheet, which detailed investment gains totaling approximately \$2.4 million.



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FEMA Was Aware of PEMA's Actions to Take Funds Early But Did Not Know the Commonwealth Invested the Funds

FEMA Region III officials were aware of PEMA's practice of drawing down the available Federal disaster assistance funds as soon as the funds were obligated. DHS OIG issued a limited review report, OIG-S-23-08, in September 2008 following an analysis of the Commonwealth's Single Audit for Fiscal Year Ending June 30, 2005. The Single Audit noted that PEMA was drawing the full Federal share of total eligible costs on the approved projects rather than actual costs. FEMA Regional staff worked with PEMA to address the issues identified in that report. In addition, FEMA Region III implemented procedures in 2015 that would identify any excess drawdowns.

Due to staff turnover, current FEMA Region III staff was not familiar with the Commonwealth disasters covered by our audit. FEMA Regional officials told us they were not aware that PEMA invested the Federal funds.

PEMA Does Not Agree with the Amount of Investment Returns We Claimed Was Due

We shared our preliminary findings with PEMA officials on March 4, 2016, and March 31, 2016, and encouraged them to contact FEMA to resolve the outstanding investment issue. PEMA sent a letter to FEMA Region III, addressing our preliminary finding. In its letter, PEMA acknowledged that the Commonwealth drew down the entire amount of obligated Federal disaster funds in advance of actual expenditures. PEMA also acknowledged that the Commonwealth invested the money in two separate investment funds⁴ created by the Treasury for its Commonwealth Investment Program. The funds had separate investment strategies, goals, and holdings that accommodated differing needs for income, cash flows, and investment risk tolerance. PEMA did not agree with the amount of investment gains we calculated and provided summary totals for a lower investment gain totaling \$1,834,550. Since PEMA did not provide details to support its investment gains calculation, we could not verify PEMA's computations. PEMA's letter to FEMA Region III is included as appendix C to this report. See appendix D for further comments.

FEMA Region III officials told us they would support PEMA's own calculations for repayment if it could support the numbers. While we commend PEMA's initiative to resolve this issue, we are concerned with the potentially adverse message that a decision to accept PEMA's position may have. This could have future implications for other recipients of disaster assistance. That message could include some, if not all, of the following elements:

⁴ During our audit, we were unable to ascertain how much of the money was directed to each fund. Disaster assistance funds comingled in the general fund become untraceable.



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- There are no consequences to disregarding policies and procedures, regulations, and laws that relate to the receipt of disaster assistance;
- It is an acceptable practice to draw down Federal funds for which there is not an immediate need and to hold these funds as excess balances;
- It is an acceptable practice to invest Federal funds in an investment tool that does not provide the most conservative and highest possible security to the resources of the taxpayers; and
- The Federal Government will share in the investment losses of recipients of Federal aid.⁵

Regulations found in 44 Code of Federal Regulations (CFR) §13.21(i)⁶ address interest earned on advances. Advances are payments received in advance of the intended use and are allowed under 44 CFR §13.21 (c). However, we believe by taking the funds months and years in advance of the intended use, PEMA made unnecessary and inappropriate advances. Paragraph (i) of §13.21 states that “grantees and subgrantees shall promptly...remit interest earned on advances to the Federal agency.” PEMA did not comply with this provision and furthermore did not notify FEMA that it had invested the funds in Commonwealth Treasury investment products.

As a result, FEMA should recover the total amount of investment gains, calculated as \$2,430,541, using the returns for the most conservative investment offered by the Commonwealth Treasurer.

Recommendations

We recommend that the Regional Administrator, FEMA Region III:

Recommendation 1: Collect \$2,430,541 from the Commonwealth of Pennsylvania for investment gains earned on disaster assistance funds.

Recommendation 2: Work with PEMA to determine whether any of the funds disbursed to the other subgrantees were invested and, if so, collect any investment returns.

⁵ We noted that one of the investment pools used to invest Federal funds earned a negative return, or lost money, in 27 of the 76 months during the period February 2005 to November 2011.

⁶ In December 2014, FEMA adopted 2 CFR Part 200, or the “Super Circular,” for disasters declared on or after December 26, 2014. For disaster declarations before December 26, 2014, 44 CFR Part 13 continues to apply to state and local governments.



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Management Comments and OIG Analysis

We discussed the results of our audit with PEMA, and with FEMA Region III officials during our audit. We also provided a summary of our findings and recommendations in advance and discussed it with PEMA and the Commonwealth officials on March 4, 2016, and March 31, 2016, and with FEMA officials on March 17, 2016, and August 4, 2016. We included their comments in this report, as appropriate.

Your office provided a written response dated October 17, 2016 and agreed with our findings and recommendations. The response indicated that FEMA will work with PEMA to set up a schedule for re-payment of the investment returns earned and to determine if any additional investment returns were earned by the other subgrantees. FEMA provided an estimated completion date of June 30, 2017 for recommendation 1, and September 30, 2017 for recommendation 2. Therefore, we consider the report recommendations to be resolved and open. Please provide our office documentation necessary to inform us about the status of the open recommendations by June 30, 2017, the estimated completion date of recommendation 1.



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Appendix A

Objective, Scope, and Methodology

The Department of Homeland Security (DHS) Office of Inspector General (OIG) was established by the *Homeland Security Act of 2002* (Public Law 107-296) by amendment to the *Inspector General Act of 1978*.

We audited PEMA's cash management practices relating to FEMA disaster assistance funds on two disasters, numbers DR-1557 and DR-1587. Our objective was to determine whether Pennsylvania complied with the administrative and reporting requirements related to cash management of Federal grant funds.

To accomplish our objective we interviewed PEMA, Commonwealth, and FEMA personnel; reviewed PEMA files to confirm excess drawdowns, the timing of the drawdowns, the amounts, and investment returns earned. We independently calculated interest liability on excess funds based on the U.S. Treasury rates for the period and compared this interest to PEMA's actual investment earnings; reviewed related FEMA and PEMA guidance, procedures, and documentation; reviewed pertinent rules and regulations relating to cash management practices.

We conducted this audit between February 2015 to August 2016 pursuant to the *Inspector General Act of 1978*, as amended, and according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based upon our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based upon our audit objectives.

The Office of Emergency Management Oversight's major contributors to this report are Paul Wood, Director; John McPhail, Supervisory Program Analyst; Ken Valrance, Auditor-in-Charge; and Stuart Josephs, Independent Referencer.



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Appendix B
FEMA Region III Audit Response

U.S. Department of Homeland Security
Region III
One Independence Mall, 6th Floor
615 Chestnut Street
Philadelphia, PA 19106-4404

OCT 17 2016



FEMA

MEMORANDUM FOR: Thomas M. Salmon
Assistant Inspector General
Office of Emergency Management Oversight

FROM: MaryAnn Tierney
Regional Administrator
Federal Emergency Management Agency

SUBJECT: Management's Response to OIG Draft Report:
"FEMA Should Recover \$2.4 million in Investment
Gains Pennsylvania Improperly Earned on Federal Disaster Funds"
Project No. G-14-047-EMO-FEMA

Thank you for the opportunity to review and comment on this draft report. The U.S. Department of Homeland Security (DHS), Federal Emergency Management Agency (FEMA), appreciates the work of the Office of Inspector General (OIG) in planning and conducting its review and issuing this report. FEMA is pleased that the OIG recognized FEMA's commitment to work with Pennsylvania Emergency Management Agency (PEMA) to address issues with draw down since the last audit report in 2005, including the implementation of procedures in 2015 that would identify any excess draw downs.

The draft report contained two recommendations with which the FEMA concurs. Please see the attached for our response to each recommendation.

Again, thank you for the opportunity to review and comment on this draft report. Technical comments were previously provided under separate cover. Please feel free to contact Janice Barlow, Director, Grants Division at 215-931-5569 or Janice.barlow@fema.dhs.gov, if you have any questions. We look forward to working with you in the future.

Enclosures:

www.fema.gov



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Appendix B (continued)

Attachment: Management Response to Recommendations Contained in G-14-047-EMO-FEMA

Recommendation 1: Collect \$2,430,451 from the Commonwealth of Pennsylvania for investment gains earned on disaster assistance funds.

Response: Concur. FEMA, Region III, will work with PEMA to set up a schedule of re-payment for the interest earned. Estimated Completion Date (ECD): June 30, 2016.

Recommendation 2: Work with PEMA to determine whether any of the funds disbursed to the other sub-grantees were invested and, if so, collect any investment returns.

Response: Concur. FEMA, Region III, has already begun to compile a list of sub-grantees. Region III will work on verifying whether interest was earned by the sub-grantees of these disasters. Our corrective action plan with PEMA will include a milestones and deliverables schedule over the next year to work with PEMA on this task, and Region III will work to ensure re-payment should it be found that interest had been earned on federal funds at the sub-grantee level. ECD: September 30, 2017.



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Appendix C
Correspondence from PEMA to FEMA Region III



May 25, 2016

Ms. MaryAnn Tierney
Regional Administrator, Region III
Federal Emergency Management Agency
One Independence Mall
615 Chestnut Street, Sixth Floor
Philadelphia, Pennsylvania 19106-4404

Dear Ms. Tierney:

The Pennsylvania Emergency Management Agency (PEMA) has received informal notice of an Office of Inspector General (OIG) draft audit finding regarding interest earned on federal disaster funds awarded to Pennsylvania for disasters as a result of Tropical Depression Ivan, followed by severe storms and flooding in April 2005. The draft finding indicates that Pennsylvania owes \$2,387,262 in interest earned on the federal disaster funds. Our draft response to the audit finding is enclosed for your information.

The destruction resulting from Tropical Depression Ivan and the April 2005 storms and flooding was extensive. Significant flood and wind damage led to road and bridge closures, impacting residents and businesses. Funds were needed to cover the estimated costs of rebuilding and repairs. At that time there was also an impending shutdown of the federal government due to stalled budget negotiations. Given these conditions, the Commonwealth drew down the entire amount of federal disaster funds obligated in advance of actual expenditures. Although the projects commenced as soon as possible after the federal funds were available, the recovery process was delayed as subsequent storms resulted in the need for new damage assessments before contracts could be awarded.

The federal disaster funds were placed in two separate types of investment pools, each with its own distinct investment strategies, goals and holdings that reflect the differing needs of Commonwealth funds for income, liquidity, and investment risk tolerance. Pool 99 consists of short-term fixed income and cash equivalent investments and provides a high degree of liquidity and security. Pool 198, a somewhat less liquid vehicle, allows for investment in assets that offer potentially higher returns with commensurate risk.

The Commonwealth of Pennsylvania (COPA) calculated the actual earnings gained within Pool 99 and Pool 198 from September 2005 to December 2011. In contrast, the OIG calculations reflect use of a national earnings average during that time, not actual earnings. The COPA calculations derived from actual earnings show that the total interest accrued was \$1,834,550. An enclosed schedule of interest earnings is attached for review.

Office of the Director
2605 Interstate Drive | Harrisburg, PA 17110 | 800-Hbg-PEMA | www.pema.pa.gov



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Appendix C (continued)

Ms. MaryAnn Tierney
May 25, 2016
Page 2

The Commonwealth of Pennsylvania is prepared to move forward with a repayment plan upon confirmation and agreement of the parties of the final value of interest earned. Should you have any questions or wish to discuss the matter further, please contact Rita Rellick, Deputy Director for Administration, at 717-651-2186 or via email at rrellick@pa.gov.

Sincerely,

Richard D. Flinn, Jr.
Director, PA Emergency Management Agency

Enclosures



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Department of Homeland Security

Appendix C (continued)

RESPONSE TO OIG AUDIT

Pennsylvania's Cash Management of Disaster Funds Audit
Job Code - G-14-047-EMO-FEMA
PTS 516348
Findings as of 2-16-16

1. Finding – agreed by all parties this finding is irrelevant.
2. Finding – Remitting Interest Earned on Federal Funds

Condition

The Commonwealth claims to have earned interest on these federal funds of about \$2.4 million dollars.

PEMA initiated a funds transfer upon approval of the large projects by FEMA. PEMA then placed the awarded funds for Commonwealth recipients in a savings account. For all other recipients the funds were transferred to them, without regard for expenditures incurred to date.

As for small PWs, regulations allow recipients to receive the entire Federal share of eligible project costs once FEMA as approved and obligated the disaster funds.

Criteria

The Code of Federal Regulations (44 CFR) 13.21(f) & (i), requires that interest earned on advances must be remitted back to the Federal Government.

Cause

Finding -- PEMA drew down the entire federal share of obligated disaster funds on large projects under Ivan and April 2005 Storms disasters, without regard for recipient expenditures. PEMA then placed the awarded funds for Commonwealth recipients in a savings account. For all other recipients the funds were transferred to them.

The interest was calculated based on balances in the Commonwealth's savings accounts. The principal is simply that amount held until actual costs were incurred. The Commonwealth had no procedures to monitor the funds transferred to Non- Commonwealth recipients.

Effect

Commonwealth reports to have earned about \$2.4 million, which should be remitted to FEMA.

Recommendation

FEMA should collect the Commonwealth interest earned on disaster funds.

PEMA Response

The Commonwealth categorically denies that anyone "claims" or "reports" that the Commonwealth earned interest or owes \$2.4 million in interest to FEMA. Moreover, the Commonwealth disagrees with the funding methodology and calculation used by FEMA to determine the \$2.4 million number.



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Appendix C (continued)

RESPONSE TO OIG AUDIT

Pennsylvania's Cash Management of Disaster Funds Audit
Job Code - G-14-047-EMO-FEMA
PTS 516348
Findings as of 2-16-16

In addition, DHS FEMA OIG auditor assumed that the federal disaster funds were placed into a highly liquid, interest bearing vehicle, Pool 99. This assumption is wrong. The funds were placed into two separate types of Pools, each with its own distinct investment strategies, goals, and holdings that reflect the differing needs of Commonwealth Funds for income, liquidity, and investment risk tolerance.

Pool 99 consists of short-term fixed income and cash equivalent investments and provides a high degree of liquidity and security. A somewhat less liquid vehicle, Pool 198, allows for investment in assets that offer potentially higher returns with commensurate risk.

When taking into consideration these distinctions, the amount of interest generated on the funds is significantly lower than the DHS, FEMA, OIG auditors calculated and assigned.



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Appendix C (continued)

Purpose: To accumulate the estimate interest owed the Federal Gov't based on PA data as initially provided.

Source: The following data was provided by the State of PA.
The specific person is not known at this time. The was acquired by Jim Miller a prior DHS OIG EMO auditor.

Scope: Add the estimated interest due from disasters 1557 and 1587.

Conclusion:
Accumulate the estimate interest owed the Federal Gov't based on PA data as initially provided is: \$2,387,262
or
\$2.4 million

Results:

Disaster	Interest	Tab Cell
1557	\$1,042,012 from tab: 1557 Revenue and Expenses	H175
1587	\$1,345,250 from tab: 1587 Revenue and Expenses	I133
Total	<u>\$2,387,262</u>	



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Appendix C (continued)

Purpose: To accumulate the estimate interest owed the Federal Gov't based on PA data as initially provided.

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Scope: Add the estimated interest due from disasters 1557 and 1587.

Conclusion:
Accumulate the estimate interest owed the Federal Gov't based on PA data as initially provided is: \$1,834,550

Results:

Disaster	Interest	Tab Cell
1557	\$1,081,628 from tab: 1557 Revenue and Expenses	H175
1587	\$752,921 from tab: 1587 Revenue and Expenses	I133 + M133
Total	\$1,834,550	



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Appendix D
Our Interpretation of PEMA's Interest Computation

Table 3 – Investment Gains and Interest Liability

	Amount
PEMA Computed Investment Gains	\$ 1,834,550
OIG's Computed Accrued Interest Liability	\$ 2,013,350
OIG's Computed Investment Gains	\$ 2,430,541

PEMA's Calculation of Investment Returns Includes Investment Losses

PEMA did not provide details to support its calculation of the investment gains; as a result, we are unable to compare PEMA's calculations of investment gains with our calculations.

PEMA acknowledged the funds were invested in two separate investment pools created by the Treasury for its Commonwealth Investment Program. PEMA further explained the pools had "distinct investment strategies, goals, and holdings that reflect the differing needs ... for income, liquidity, and investment risk tolerance". We noted that one of the investment pools earned a negative return, or lost money, in 27 of the 76 months during the period February 2005 to November 2011.

OIG's Calculation of the Interest Liability Accrual and Investment Returns

Our computation of the CMIA interest liability accrual resulted in a liability of \$2,013,350. This computation is based on the CMIA rules and regulations and uses interest rates obtained from U.S. Treasury sources, as agreed to by PEMA via their signed U.S. Treasury agreement. The CMIA interest liability accrual is the minimum amount PEMA owes the Federal Government.

We computed investment earnings of \$2,430,541 using PEMA's returns on investment Pool 99 and PEMA's balance of excess FEMA disaster funds. The earnings period is from November 2005 to November 2011. Commonwealth's investment Pool 99 is described in the Treasurer's investment policy as designed to provide a high degree of liquidity and safety and benchmarked against 3-month Treasuries.

Initially, we reported to PEMA investment earnings of \$2,387,262 based on the principal and interest rate data PEMA provided. Upon verification of PEMA's data, we revised the investment earnings to \$2,430,541. As per paragraph (i) of §13.21 which states that "grantees and subgrantees shall promptly...remit interest earned on advances to the Federal agency." This is the amount PEMA must remit as the interest earned or the investment return.



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Appendix D (continued)

Finally, since regulations in 44 CFR §13.21(b) and (c) require that “methods and procedures for payment shall minimize the time elapsing between the transfer of funds and the disbursement by the grantee or subgrantee”, we believe Federal funds should not be held for investment. However, if they are, regulations in 31 CFR §205.19(b) set a standard of the “annualized rate equal to the average equivalent yields of 13-week Treasury Bills” for interest liabilities, which are considered to be among the most conservative and secure investments available.



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Appendix E **Report Distribution**

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