

**DOCUMENT RESUME**

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**The Financial Control over the National Flood Insurance Program.  
November 9, 1977. 4 pp**

**Testimony before the Senate Committee on Governmental Affairs:  
Efficiency and the District of Columbia Subcommittee; by Henry  
Eschwege, Director, Community and Economic Development Div.**

**Issue Area: Domestic Housing and Community Development (2100).  
Contact: Community and Economic Development Div.**

**Budget Function: Community and Regional Development: Disaster  
Relief and Insurance (453).**

**Organization Concerned: Department of Housing and Urban  
Development; National Flood Insurers Association.**

**Congressional Relevance: Senate Committee on Governmental  
Affairs: Efficiency and the District of Columbia  
Subcommittee.**

**Authority: 42 U.S.C. 4071.**

Previous reports have called attention to numerous weaknesses in the accounting system of the National Flood Insurers Association's ability to generate accurate financial data. These weaknesses, it was advised, could adversely affect the Government's ability to determine amounts payable to the Association, determine flood insurance premium rates, prepare financial statements, and make management decisions. The Inspector General of the Department of Housing and Urban Development (HUD) reviewed the financial control problems with the Association and concluded that neither the Federal Insurance Administration nor the Association possessed the needed technical staff expertise to properly monitor and direct the development and implementation of an automated system for the program. The two organizations were also found to be involved in frequent disagreements over their respective authorities. HUD, in negotiations with the Association, tried to assert additional regulatory control over the national flood insurance program as part of an attempt to renew the existing agreement. However, the Association notified HUD that it did not intend to renew the agreement. A new contract has been granted to Fds Federal Corporation to operate the program as a fiscal agent. An audit of the program will be conducted starting in December 1977. (3C)

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UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, DC 20548

FOR RELEASE ON DELIVERY  
EXPECTED AT 9:30 A.M. EST  
WEDNESDAY, NOVEMBER 9, 1977

STATEMENT OF  
HENRY ESCHWEGE, DIRECTOR  
COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION

BEFORE THE  
SUBCOMMITTEE ON GOVERNMENTAL EFFICIENCY  
AND  
THE DISTRICT OF COLUMBIA  
SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS  
UNITED STATES SENATE

ON

THE FINANCIAL CONTROL OVER  
THE NATIONAL FLOOD INSURANCE PROGRAM

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

WE ARE HERE TODAY AT YOUR INVITATION TO DISCUSS OUR PRIOR EFFORTS AND FUTURE PLANS TO REVIEW THE FINANCIAL CONTROLS OVER THE NATIONAL FLOOD INSURANCE PROGRAM.

IN MARCH 1977, WE ISSUED A REPORT (CED-77-47) TO THE SECRETARY OF HOUSING AND URBAN DEVELOPMENT (HUD) COMMENTING ON THE LOSS OF FINANCIAL CONTROLS OVER THE NATIONAL FLOOD INSURANCE PROGRAM. WE POINTED OUT NUMEROUS WEAKNESSES IN THE ACCOUNTING SYSTEM OF THE NATIONAL FLOOD INSURERS ASSOCIATION THAT WOULD GENERATE ACCURATE FINANCIAL DATA. WE WERE CONCERNED THAT THESE WEAKNESSES WOULD ADVERSELY AFFECT THE GOVERNMENT'S ABILITY TO (1) DETERMINE PREMIUM RATES PAYABLE TO THE ASSOCIATION, (2) DETERMINE FLOOD INSURANCE PREMIUM RATES, (3) PREPARE FINANCIAL STATEMENTS, AND (4) MAKE MANAGEMENT DECISIONS. WE RECOMMENDED THAT THE SECRETARY OF HUD DIRECT THE FEDERAL INSURANCE ADMINISTRATION TO REVIEW THE FINANCIAL CONTROL PROBLEMS WITH THE

OBJECTIVE OF GETTING THE ASSOCIATION TO PROVIDE RELIABLE FINANCIAL AND STATISTICAL DATA. WE RECOMMENDED ALSO THAT THE INSPECTOR GENERAL BE INVOLVED IN THIS EFFORT. AS A LAST RESORT, WE RECOMMENDED THAT, IF ADEQUATE FINANCIAL CONTROL COULD NOT BE ESTABLISHED, THE SECRETARY CONSIDER A PARTIAL OR FULL TAKEOVER BY THE GOVERNMENT OF NECESSARY SERVICES.

ON APRIL 11, 1977, WE FURTHER AIKED OUR CONCERNS IN HEARINGS BEFORE THIS SUBCOMMITTEE. SUBSEQUENTLY, THE SECRETARY, IN A WRITTEN RESPONSE TO OUR REPORT, CONCURRED WITH OUR REPORT FINDINGS AND RECOMMENDATIONS. SHE EXPRESSED THE PREFERENCE FOR CONTINUING TO INVOLVE THE PRIVATE SECTOR IN THE FUNCTIONAL ASPECTS OF THE INSURANCE COMPONENT OF THE PROGRAM, AS ENVISIONED IN PART OF THE ACT. SHE NOTED THAT SHE DID NOT WISH TO DEPART FROM THE DESIGN ORIGINALLY FASHIONED BY THE CONGRESS, UNLESS THERE WAS NO REASONABLE ALTERNATIVE TO THE PARTIAL OR FULL GOVERNMENT TAKEOVER PERMITTED UNDER PART B OF THE ACT (42 U.S.C. 4071).

HUD'S INSPECTOR GENERAL REPORTED THE TENTATIVE RESULTS OF ITS REVIEW TO THE SECRETARY IN JULY 1977. THE FINAL RESULTS WERE CONTAINED IN A SUMMARY DATED SEPTEMBER 7, 1977. IN ESSENCE, THE INSPECTOR GENERAL CONCLUDED THAT NEITHER THE FEDERAL INSURANCE ADMINISTRATION NOR THE ASSOCIATION POSSESSED THE NEEDED TECHNICAL STAFF EXPERTISE TO PROPERLY MONITOR AND DIRECT THE DEVELOPMENT AND IMPLEMENTATION OF AN AUTOMATED SYSTEM FOR THE PROGRAM. ALSO, THE ROLES OF THE TWO PARTIES WERE SAID TO BE NOT CLEARLY DEFINED AND BOTH ORGANIZATIONS WERE FREQUENTLY INVOLVED IN DISAGREEMENTS OVER THEIR RESPECTIVE AUTHORITIES. FINALLY, THE COSTLY AUTOMATED DATA PROCESSING SYSTEM, ALTHOUGH IMPROVED, WAS STILL DEFICIENT IN SUCH AREAS AS PROCESSING CLAIMS, PROVIDING ADEQUATE DOCUMENTATION AND STATISTICAL DATA; FINANCIAL AND OPERATIONAL CONTROLS WERE CONSIDERED INEFFICIENT AND COSTLY.

THE DEPARTMENT, IN NEGOTIATIONS WITH THE ASSOCIATION, TRIED TO ASSERT ADDITIONAL REGULATORY CONTROL OVER THE PROGRAM AS PART OF AN ATTEMPT TO RENEW THE 1969 AGREEMENT. EARLY IN JULY 1977 THE ASSOCIATION FORMALLY NOTIFIED HUD OF ITS INTENT NOT TO RENEW THE AGREEMENT. THE ASSOCIATION DID EXPRESS A CONTINUED WILLINGNESS TO NEGOTIATE AND ATTEMPT TO REACH A NEW AGREEMENT.

ON JULY 21, HUD ISSUED A REQUEST FOR PROPOSALS. OFFERORS COULD SUBMIT PROPOSALS TO OPERATE UNDER PART A OR PART B OF THE ACT. NEGOTIATIONS WITH THE ASSOCIATION, ALTHOUGH BROKEN OFF AT ONE TIME, DID MAKE SOME PROGRESS BY THE LATTER PART OF SEPTEMBER. DURING THIS PERIOD HUD RECEIVED TWO PROPOSALS TO OPERATE THE PROGRAM UNDER A PART B ARRANGEMENT. FINAL OFFERS WERE RECEIVED FROM BRADFORD NATIONAL CORPORATION AND EDS FEDERAL CORPORATION (EDS) ON OCTOBER 11, 1977. A HUD SOURCE EVALUATION BOARD RECOMMENDED THAT HUD ENTER INTO FURTHER NEGOTIATIONS WITH EDS ONLY. THE COST OF THE ASSOCIATION'S PROPOSAL UNDER PART A DURING 1978 WAS ABOUT \$26 MILLION WHILE THE EDS PROVIDED A COST PROPOSAL OF \$11 MILLION TO OPERATE THE PROGRAM UNDER PART B AS A FISCAL AGENT. THE \$15-MILLION DIFFERENCE IN COST WAS AN IMPORTANT FACTOR IN THE SECRETARY'S DECISION OF NOVEMBER 2 TO HAVE THE GOVERNMENT OPERATE THE PROGRAM UNDER PART B.

#### GAO'S CONTINUED ROLE IN REVIEW OF FLOOD INSURANCE PROGRAM

GAO HAS CONTINUED TO STAY ABREAST OF THE SITUATION. AS POINTED OUT IN OUR REPORT AND OUR PRIOR TESTIMONY, WE ARE REQUIRED UNDER THE GOVERNMENT CORPORATION CONTROL ACT TO AUDIT AND EXPRESS AN OPINION ON THE FINANCIAL STATEMENTS OF THE NATIONAL FLOOD INSURANCE PROGRAM AS OF SEPTEMBER 1977. THE CPA FIRM OF TOUCHE, ROSS & CO., RECENTLY CERTIFIED TO THE ASSOCIATION'S FINANCIAL STATEMENTS AS OF JUNE 30, 1976, AND EXPECTS TO REPORT ON ITS

AUDIT FOR FISCAL YEAR 1977 SHORTLY. THE FIRM'S REPORTS AND UNDERLYING WORK WILL BE NEEDED IN OUR AUDIT OF THE PROGRAM'S FINANCIAL STATEMENTS OF SEPTEMBER 30, 1977. OUR AUDIT IS SCHEDULED TO START IN DECEMBER 1977 AND SHOULD BE COMPLETED IN ABOUT 6 MONTHS. AS PART OF THIS EFFORT WE INTEND TO INQUIRE INTO THE CURRENT ADEQUACY OF FINANCIAL CONTROLS AND THE PROGRESS THAT HAS BEEN MADE AS A RESULT OF HUD ACTIONS TAKEN FOLLOWING OUR REPORT AND REPORTS BY THE INSPECTOR GENERAL.

IN RELATED ACTIVITIES, WE DID INITIATE LAST SUMMER A SURVEY OF FEDERAL, STATE, AND LOCAL ACTIVITIES TO REDUCE FLOOD LOSSES THROUGH FLOOD PLAIN MANAGEMENT. WE DEFERRED FURTHER WORK ON THIS SURVEY, HOWEVER, AFTER WE RECEIVED YOUR REQUEST, MR. CHAIRMAN, IN AUGUST 1977, TO REVIEW THE IMPACT OF THE FLOOD INSURANCE PROGRAM AND DISASTER ASSISTANCE IN THE JOHNSTOWN, PENNSYLVANIA, FLOOD AREA. WE HAVE GIVEN THIS REQUEST THE HIGHEST PRIORITY, BUT WE EXPECT TO RESUME OUR SELF-INITIATED SURVEY EARLY NEXT YEAR.

MR. CHAIRMAN, THIS COMPLETES MY PREPARED STATEMENT. WE WILL BE GLAD TO RESPOND TO YOUR QUESTIONS.