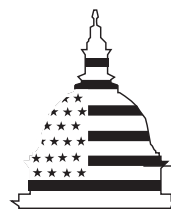


July 2001

FEDERAL
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AGENCY

Weaknesses Exist in
the Cerro Grande Fire
Assistance Claim
Validation Process



G A O

Accountability * Integrity * Reliability



United States General Accounting Office
Washington, DC 20548

July 13, 2001

The Honorable Barbara A. Mikulski
Chairman
The Honorable Christopher Bond
Ranking Minority Member
Subcommittee on VA, HUD and Independent Agencies
Committee on Appropriations
United States Senate

The Honorable James T. Walsh
Chairman
The Honorable Alan B. Mollohan
Ranking Minority Member
Subcommittee on VA, HUD and Independent Agencies
Committee on Appropriations
House of Representatives

On July 13, 2000, the President signed into law the Cerro Grande Fire Assistance Act (CGFAA).¹ The CGFAA established the Office of Cerro Grande Fire Claims (OCGFC) and directed the Federal Emergency Management Agency (FEMA) to expeditiously investigate victims' claims and to determine and compensate the victims of the Cerro Grande fire in northern New Mexico for injuries resulting from the fire. The CGFAA also mandated that we annually audit all claim payments made under the CGFAA, including reviewing all subrogation claims² for which insurance companies have been paid or are seeking reimbursement as subrogees.

As agreed with your offices, our report, the first required under the CGFAA, discusses whether OCGFC established a systematic process to ensure the validity and reasonableness of claim payments in accordance with the CGFAA. Our report also discusses one additional matter we believe may be of importance to the Congress as it oversees FEMA's response to the Cerro Grande fire—whether the funding currently appropriated will be sufficient to pay all approved claims.

¹ Public Law 106-246, Div. C, Title I, 114 Stat. 511, 583 (2000).

² A subrogation claim is the right of one who has paid an obligation that another should have paid to be indemnified by the other. In this case, insurance companies and possibly others paid claims that the federal government is responsible for paying.

As indicated above, the CGFAA also requires that we review all subrogation claims for which insurance companies have been paid or are seeking payment as subrogees. We could not review any subrogated claim payments as part of our initial year audit because according to OCGFC officials as of June 2001, no subrogated claim payments had been made. The CGFAA specifies that nonsubrogee claims, to the maximum extent practicable, are to be paid before subrogee claims. OCGFC in its first 9 months of operations has complied with this aspect of the act. OCGFC officials did tell us, however, that as of June 2001, approximately 2,500 subrogation claims totaling approximately \$70 million had been submitted and are awaiting processing. OCGFC officials, based on estimates provided by the insurance industry, indicated that as much as \$160 million in subrogated claims may be paid. OCGFC is developing the applicable policies and procedures for processing these claims and estimates it may start processing subrogated claims in August 2001 and make the first payments in early 2002. We will audit these payments as part of our subsequent year audits.

Results in Brief

OCGFC has established and generally followed a systematic process for the payment of fire victims' injury claims in accordance with the CGFAA. However, we found certain key procedures used by the claims reviewers hired under contract by OCGFC were not formally documented and actions taken by the claim reviewers to verify claimant-provided information and determine claim reimbursements were typically not documented. As a result, OCGFC officials responsible for approving claim payments did not have a basis for determining the steps or actions the claims reviewers had taken to determine the validity or reasonableness of most claim payments and therefore, did not have the key information upon which to base their payment approval determinations. FEMA's Office of Inspector General has raised similar issues as a result of the claim payment reviews it has conducted.

Our review also disclosed that additional funds might be needed to pay fire claims. As of September 30, 2000, FEMA reported, based on an actuarial review of the damages, an estimated liability of \$437 million for outstanding claims. This estimate was not complete because damages for various categories of claims, some of which could be significant, were not estimable at the time. When this actuarial estimate was prepared, the final rules and certain key policies and procedures for addressing how certain claim types would be compensated had not yet been finalized. Some of these policies and procedures were being developed during the time of our review. In addition, the volume of claims submitted has been much greater

than originally anticipated. As of June 20, 2001, OCGFC officials told us that approximately 14,000 claims had been submitted—approximately 10 times the volume initially expected. Accordingly, it is possible that the \$455 million appropriated to pay claims may be insufficient.

We are making recommendations in this report to strengthen OCGFC claims review and payment processes. In commenting on a draft of the report, FEMA stated that it was pleased that we recognized that a systematic process for paying fire victim's claims in accordance with the CGFAA was established and followed, but said that it did not believe that we had a balanced viewpoint of all of its efforts to develop and implement the program since inception 9 months ago. It listed several areas where it thought we were overly critical, particularly related to the adequacy of policies and procedures and the level of documentation for supporting claims. We made certain revisions to our report in response to FEMA's comments in order to clarify our positions in these areas. At the same time, our overall position remains the same—the documentation deficiencies we identified significantly diminish the effectiveness of the claims review and approval process. OCGFC officials did not have reasonable assurances that its claim review contractors performed adequate procedures during their claims review and that the payment process was consistently applied.

Background

On May 4, 2000, the National Park Service initiated a prescribed burn on federal land at Bandelier National Monument, New Mexico, in an effort to reduce the threat of wildfires in the area. The plan was to burn up to 900 acres. On May 5, 2000, the prescribed burn exceeded the capabilities of the National Park Service, spread to other federal and nonfederal land, and was characterized as a wildfire. By May 7, 2000, the fire had grown in size and caused evacuations in and around Los Alamos, New Mexico. On May 13, 2000, the President issued a major disaster declaration, and subsequent to it, the Secretary of the Interior and the National Park Service assumed responsibility for the fire and the subsequent loss of federal, state, local, tribal, and private property. The fire, known as the Cerro Grande Fire, burned approximately 48,000 acres in four counties and two Indian pueblos, destroyed over 200 residential structures, and forced the evacuation of more than 18,000 residents.

On July 13, 2000, the President signed the CGFAA into law. Under the CGFAA, each claimant is entitled to be compensated by the United States government for certain injuries and damages that resulted from the Cerro Grande fire. The Congress appropriated \$455 million to the FEMA for the

payment of such claims and \$45 million for the administration of the Cerro Grande program. The act requires that GAO conduct annual audits on the payment of all claims made and annually report the results of the audits to the Congress by July 13, beginning in fiscal year 2001. The act also requires that our report include a review of all subrogation claims for which insurance companies have been paid or are seeking payment as subrogees under this act. FEMA is also required to annually submit a report to Congress that provides information about claims submitted under the act. This report is to include the amounts claimed, a description of the nature of the claims, and a status or disposition of the claims, including the amounts paid. FEMA's first report is to be issued by August 28, 2001, based on the issuance of the program rules as discussed below.

The CGFAA required FEMA to promulgate and publish implementing regulations for the Cerro Grande program within 45 days of enactment of the law. On August 28, 2000, FEMA published the Disaster Assistance: Cerro Grande Fire Assistance; Interim Final Rule in the *Federal Register* (Interim Final Rules).³ FEMA followed the Interim Rule with a set of implementing policies and procedures on November 13, 2000. FEMA updated these policies and procedures in January and March 2001. After reviewing public comments on the interim rule, FEMA finalized and published The Disaster Assistance: Cerro Grande Fire Assistance; Final Rule (Final Rule) on March 21, 2001.⁴

Scope and Methodology

In performing our review, we considered *the Standards for Internal Control in the Federal Government*.⁵ To gain an understanding of the claim review and payment process established by the OCGFC, we interviewed FEMA and OCGFC officials, General Adjusters Bureau (GAB) Robins officials,⁶ and staff from FEMA's Office of Inspector General. We also reviewed the requirements of the CGFAA, the interim and final regulations published in the *Federal Register*, OCGFC's policies and procedures manual, an actuarial report, FEMA's fiscal year 2000 audited

³ 44 CFR Chapter I and Part 295 (65 FR 52260).

⁴ 44 CFR Part 295 (66 FR 15948).

⁵ [GAO/AIMD-00-21.3.1](#), November 1999.

⁶ OCGFC awarded a contract to GAB (General Adjusters Bureau) Robins, an independent claims adjusting firm to review and process all claims submitted by those who were injured or suffered damages as a result of the Cerro Grande fire.

financial statements and the current year Cerro Grande trial balance and other documentation concerning the Cerro Grande program. We also obtained, reviewed, and considered the results of numerous desk reviews completed by FEMA's Office of Inspector General. Finally, we selected three separate random probability samples from the population of claim payments to determine whether policies and procedures in place were being followed and to ensure that they provided adequate internal controls over appropriated federal funds. We did not assess the reasonableness of individual payments made.

Our first sample of 59 partial claim payments was drawn from a population of 1,195 partial claim payments made through November 24, 2000, that was processed under the August 28, 2000, Interim Rules. The second random probability sample consisted of 59 items drawn from a population of 488 partial payments made between November 25 and December 28, 2000. These payments were processed using the policies and procedures adopted by the OCGFC on November 13, 2000. For these two samples, we reviewed the claim files to determine if all the required forms and key signatures required to process a partial payment had been obtained. Our third sample consisted of 63 final claim payments selected using a stratified sampling approach from a population of 255 final payments made through March 23, 2001. Fifty-eight of these 63 items were randomly selected from the population of claim payments in which the amount paid was less than \$40,000. The remaining five items comprised all claim payments greater than or equal to \$40,000. For these 63 items, we reviewed the claim files not only to see if all the required forms and signatures existed but to also look for evidence that victims' claims had been investigated to determine their validity and that the payment amounts were adequately supported and reasonable.⁷

As mentioned previously, we were not able to audit subrogated claim payments because, as of June 2001, no subrogated claims had been processed or paid. We did, however, inquire and obtain information about the number and dollar amount of subrogated claims submitted to the OCGFC through June 2001. We also inquired about the status of the policies and procedures being drafted by the OCGFC to process these claims.

⁷ In order to get assistance to fire survivors as soon as possible, the CGFAA allows for claimants to receive partial payments before the start of the rebuilding process. Partial payments may be based upon actual receipts or estimates. Final payments are made only after the entire claims review process, as discussed below, is completed.

Our work was conducted in Sante Fe, New Mexico, and Washington, D.C., from December 2000 through June 2001 in accordance with generally accepted government auditing standards. We requested agency comments on a draft of this report from the Director of FEMA. FEMA provided certain technical comments orally, which we have incorporated as appropriate. FEMA's Assistant Director of the Readiness, Response and Recovery Directorate also provided written comments in response to our draft on behalf of FEMA and OCGFC, which are reproduced in appendix I. We evaluated the written comments in the "Agency Comments and Our Evaluation" section of this report.

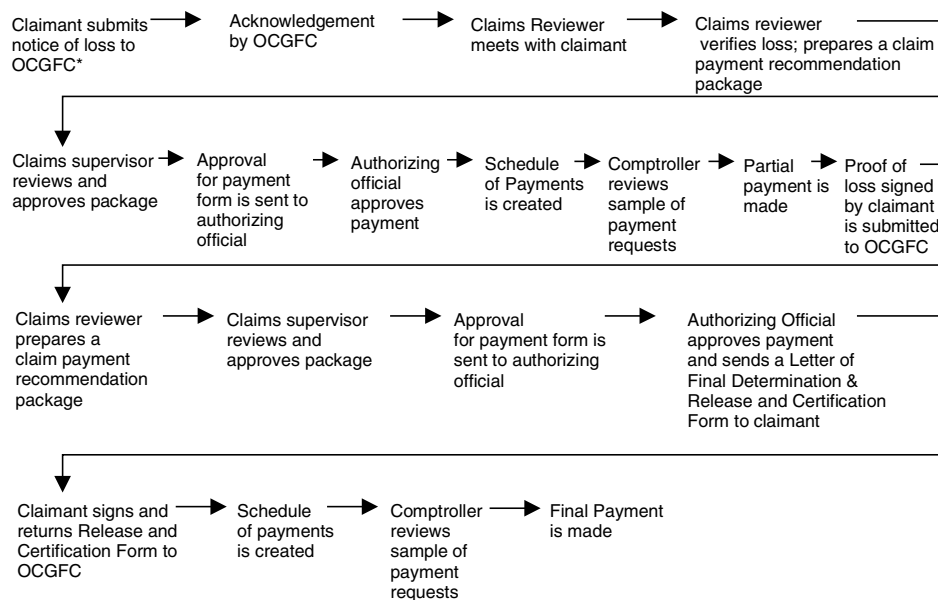
OCGFC Has Established a Systematic Claims Payment Process but Implementation Weaknesses Exist

The OCGFC has established and generally followed a systematic process for the payment of claims resulting from the Cerro Grande fire. However, this process, as illustrated in figure 1 and described below, needs to be strengthened. We found that certain key procedures used by the claims reviewers were not formally documented and actions taken by the claim reviewers to verify claimant-provided information and determine claim reimbursements were typically not documented. We also noted that OCGFC is in the process of developing policies and procedures for how certain claims to be paid in the coming months will be processed and paid.

The *Standards for Internal Control in the Federal Government* specifies that internal control and all transactions and other significant events need to be clearly documented and be readily available for examination. Control activities should be documented in management directives, administrative policies, or operating manuals which are properly maintained.

OCGFC Claim Payment Process

Figure 1: Claims Payment Process



*OCGFC=Office of Cerro Grande Fire Claims

Source: OCGFC Claims Processing Information Handbook.

The claims payment process is initiated when an injured party submits a Notice of Loss (NOL) form to the OCGFC. The NOL describes in general terms the types of injury and/or damages a claimant has incurred as a result of the fire. After the NOL is received, claim reviewers contact the claimant to discuss their claim, explain the claims process, and determine the best means to substantiate the loss or damages. The claims reviewer then begins the process of verifying the victim's claim. This includes tasks such as

- confirming the cause and origin of the loss,
- reviewing supporting documentation provided by the claimant,
- confirming and assessing damages,
- determining the accuracy of the claimed amount,
- estimating or researching the values of damaged property,
- securing affidavits,
- contacting third parties to confirm or verify claimant information, and

-
- documenting the claims review process.

Once these activities are complete, the claims reviewer prepares a claim payment recommendation package which specifies that a claimant's injuries or damages occurred as a result of the Cerro Grande fire and that claimed amounts are eligible for compensation under the CGFAA. A claims supervisor reviews and approves this package. This review, among other things, is intended to ensure that a proper investigation of the claim occurred and that the proper documentation exists.

Following the approval of the claim payment recommendation package, an Approval for Payment form is completed and sent to an OCGFC Authorizing Official for review and approval. Requested payment amounts are then added to a Schedule of Payments that is forwarded to the Comptroller. The Comptroller reviews a sample of requested payments and then approves the Schedule of Payments before sending it on to FEMA's Disaster Finance Center in Virginia for additional processing and final approval for Treasury to disburse the funds.

In addition to this process, which is used for both partial payments (when warranted) and final payments, prior to processing a final payment, the claims reviewer prepares a Proof of Loss form. This form summarizes all amounts recommended for payment, including those amounts previously paid through a partial payment. The Proof of Loss must be signed by the claimant subject to the provisions of 18 U.S.C. §1001, which establishes criminal penalties for false statements. Once a signed Proof of Loss is received, an OCGFC Authorized Official sends a Letter of Final Determination to tell the claimant the total amount of compensation being offered under the CGFAA. Accompanying this letter is a Release and Certification form which, if the claimant accepts the OCGFC compensation determination, is signed thereby releasing the federal government from any additional claims arising from the Cerro Grande fire.⁸ Upon receipt of the signed Release and Certification form, OCGFC will process and mail a claimant's final payment.

We found that OCGFC has generally followed its process for accepting, processing and paying damage claims in terms of obtaining all the key

⁸ Section 295.34 of the final rule published in the *Federal Register* provides for the reopening of claims, notwithstanding the submission of a Release and Certification Form, under certain circumstances.

forms and signatures described above and maintaining this documentation in the claim files. For instance, the claim files included properly signed Notice of Loss forms, Claim Payment Recommendation Pages, and Authorizations for Payment; and in the case of final payments, also included Proof of Loss and Release and Certification forms. In addition, the claim files included various documents that supported the amount paid. However, as discussed below, certain key aspects of the claims process were not sufficiently documented and other key control activities were not being performed thereby leaving the Cerro Grande claims program vulnerable to potential improper payments.

Lack of Documentation Weakens Claims Process and Precludes Validation of Claims

Based on our test work and discussions with OCGFC officials, we determined that certain payment determinations were based on policies and procedures that were not formally documented. OCGFC officials told us that certain policies have only been documented in e-mails or in notes from staff meetings. This can result in inconsistent determinations of claim amounts and raised questions regarding the basis for certain claim determinations. For example, we identified inconsistencies in the calculation of lost wages for certain individuals. In one case, the reimbursed amount was determined based on the claimant's gross wages whereas in another case, the claimant was reimbursed based upon net wages. OCGFC officials stated that as part of renegotiating its contract with its claims adjusting firm, it will require that all policies and procedures be identified, formally documented, and updated monthly.

In addition to the lack of formally documented procedures, there generally was insufficient documentation in the claim files to enable us to determine what steps, if any, the claims reviewers hired under contract by OCGFC had taken to verify certain key data provided by the claimants or to determine the reasonableness of amounts claimed. This was the case for 43 of the 63 final claim payments we tested. When projected to the universe of final payments made as of March 23, 2001, we can conclude with 95 percent confidence that between 57 and 78 percent of the final payments had similar documentation deficiencies. For the other 20 cases where we determined the documentation was sufficient, the payments usually involved victims' claims for reimbursement of insurance

deductibles and/or flood insurance premiums.⁹ In these cases, the claim payments were evidenced by documentation provided by the insurer.

The following examples illustrate the types of documentation deficiencies we observed during our review of the case files. In numerous cases we examined, the fire forced victims to evacuate their homes. OCGFC compensated these victims for the “loss of use” of their homes based upon a square footage methodology. In these cases, we found in the claim files the calculations to determine the amount of compensation. What we did not typically find was evidence to substantiate the square footage of the home used in the calculations. We did not see evidence that the claims adjusters had visited the property to obtain measurements or that they had obtained or considered other documentation, such as property records or insurance policies, that would substantiate the square footage.

For cases where personal property losses occurred, we commonly found lists or spreadsheets prepared by the claimants listing the property destroyed by the fire as well as the claimants’ estimates of the costs of replacing these items. What was commonly lacking, however, was documentation of the steps the claims reviewers took to verify that the victims owned the items claimed to have been lost in the fire or to assess the reasonableness of the replacement costs. Most often, the amount paid for personal property was simply the total listed on the spreadsheet with no evidence that any of the items or amounts were reviewed or substantiated.

Officials we spoke with from FEMA’s Flood Insurance Administration told us that its claims reviewers would routinely take steps to verify and document that the information provided by the claimant was valid and that the costs were reasonable before recommending a payment. Such steps may include confirmation of purchases with a vendor or store, viewing photographs taken prior to the fire, or performing reasonableness tests, such as determining if items claimed are typical household items. While OCGFC’s policy manual and its contract with GAB Robins do require an investigation of the claim, there was frequently no evidence that such an investigation was performed. Only in a limited number of circumstances were we able to tell based on documentation in the claims file that a claims reviewer had investigated particular items to establish that a

⁹ The CGFAA and the final program rules provide for the payment of flood insurance premiums where there is an increased risk of flooding as a result of the fire.

claimant did in fact own an item or that the amount requested to replace the item was reasonable. For example, in one case, the claims reviewer's notes showed that he questioned and ultimately reduced the amount claimed for an autographed poster from \$1000 to \$5.50 after researching the poster's value on the internet.

In another example of documentation deficiencies, a claims reviewer recommended that certain medical expenses, although evidenced by third party receipts and a physician's letter, not be paid because the reviewer determined that the claimant had a pre-existing condition. Based on our discussions with OCGFC officials, we were told that this recommendation was forwarded to an OCGFC authorizing official who reversed the claims reviewer's decision because the OCGFC policies provide for such a payment under certain circumstances. However, the claim file contained no explanation as to why the initial recommendation of the claim reviewer was reversed. Key decisions such as this should be clearly documented in the claim files to facilitate the supervisory review process and establish an adequate audit trail as required by the *Standards for Internal Control in the Federal Government*.

OCGFC officials advised us that the GAB Robins claims reviewers use an automated claims information system (ACIS) to document their interactions with the claimants and to document certain aspects of their claim investigation work. Such an automated system could help mitigate some of the documentation deficiencies we have discussed in this report. We requested that OCGFC provide us with the available ACIS information for specific cases in our sample. We reviewed the ACIS reports and found that the reports documented GAB Robins' contacts with the fire victims but provided little or no information about what steps had been taken to verify the validity or reasonableness of the claim payments for these particular cases. In addition, the OIG reviews of OCGFC claim payments, like our work, raised a number of questions regarding the adequacy of documentation contained in the case files and also questioned whether in certain circumstances OCGFC had established written policies on how to handle certain claims. An OIG official told us that he has not found ACIS to be helpful in resolving the documentation issues he has identified.

Without sufficient documentation, claims supervisors and authorizing officials can not properly review the work of the claims reviewers, and the risk of improper payments is increased. In addition, as stated above, the lack of documentation in the claim files precluded us from determining what steps the claims reviewers had taken to determine the validity and reasonableness of most of the claim payments we tested.

Certain Key Policies and Procedures Are Under Development

As of June 2001, OCGFC was in the process of developing certain key policies and procedures for the payment of various claim types. Established policies and procedures that are both documented and communicated throughout an organization are a key component of an effective system of internal control. As previously discussed, OCGFC is still developing policies and procedures for paying subrogated claims. In addition, OCGFC has deferred formulation of policies on how to compensate property owners for unrealized declines in their property values until the Los Alamos real estate market is further analyzed. Under the CGFAA, fire victims have until August 28, 2002, to file Notices of Loss for injuries resulting from the fire. OCGFC officials acknowledged that finalizing all necessary policies and procedures is important and stated that they have and will continue to approach policy development in a prioritized manner. For instance, since the CGFAA specified subrogated claim payments were not to occur until after the payment of other claims, OCGFC placed a lower priority on the development of these policies and procedures. OCGFC officials stressed that no claims have been paid without first having put policies and procedures in place and that so far all claims have been paid within 180 days after the receipt of a Notice of Loss as specified in the CGFAA.

Additional Claim Funding May Be Required

As previously discussed, the CGFAA appropriated \$455 million to compensate victims for losses resulting from the Cerro Grande fire. In its fiscal year 2000 audited financial statements, FEMA recognized an estimated claim liability of \$437 million. This amount represents the known probable and estimable losses that were unpaid as of September 30, 2000, and is based on the August 28, 2000, Interim Final Rules published in the *Federal Register*. In addition, FEMA reported that there is a reasonable possibility that additional liabilities may have been incurred. However, these amounts could not yet be estimated because the potential claims were unknown or had not been defined under the CGFAA "Interim Final Rules." FEMA's estimated claim liability is based largely on a December 5, 2000, independent actuary's report. This report has not been updated to reflect the policy changes contained in the final program rules published in March 2001 or to reflect new policies implemented since December. FEMA officials told us that because this report is costly to prepare, they only intend to update the study annually for financial statement purposes.

Based on our analysis of this actuarial report, we believe there is a possibility that additional funding may be required to satisfy the claims

likely to arise as a result of the fire. The actuary's study did not provide estimates for certain categories of losses that could be significant. For example, no estimates of loss were included for business losses outside of the immediate fire area¹⁰ or for damaged or lost sacred Pueblo (tribal) lands. At least one Pueblo has filed a Notice of Loss where there is a potential claim for damages to unique cultural and religious sites as well as environmental damages to the Pueblo grounds. The Notice of Loss also mentions potential claims for loss of range productivity and agricultural lands, cultural plants, big game, and archeological and cultural sites.

In addition, to date, no estimates for devaluation of residential and commercial real estate and Pueblo lands as a result of the fire have been made. OCGFC contracted with an independent public accounting firm to analyze the residential real estate in the County of Los Alamos. The purpose of this analysis was to assess whether the value of residential property that was not physically damaged by the fire declined as a result of the fire, and if so, which communities and types of housing were most effected. The results of this study were released on March 28, 2001, and concluded that single-family residences in Los Alamos County sold between May 10, 2000, and January 31, 2001, experienced an average diminution in value in the range of 3 to 11 percent.¹¹ In addition, the study concluded that other types of housing, including quads, duplexes, condos, and townhouses in the eastern area of the City of Los Alamos, also appear to have lost value. As of March 28, 2001, there have been approximately 25 claims for realized and unrealized property value diminution¹² filed by Los Alamos residents. On April 2, 2001, OCGFC issued policy guidance on how it intends to compensate claimants who have realized losses. The policy states that unrealized loss claims will not be addressed until an additional follow-up analysis of the residential real estate market in Los Alamos is completed during the second quarter of 2002. Until this study is completed and policies are developed that address compensation for unrealized losses, uncertainties about the potential cost will continue to exist.

¹⁰ The fire region is defined as Los Alamos, Rio Arriba and Santa Fe Counties, as well as, the Santa Clara, San Ildefonso, Pojoaque, Picuris, Nambe, and San Juan Pueblos.

¹¹ PricewaterhouseCooper's Economic Study of the Los Alamos Post-Fire Residential Real Estate Market (Final Report).

¹² Realized losses are recognized only after a home is sold. Unrealized losses reflect possible declines that will not be realized until home is sold.

Also, in the CGFAA Final Rules published in the *Federal Register* on March 21, 2001, FEMA increased the amount of allowable compensation for miscellaneous and incidental expenses incurred in the claims process. These payments are made after FEMA has obtained a properly executed Release and Certification form from the claimant. Under the interim rule that was in effect when the original actuarial report was issued, claimants (most individuals and businesses) were reimbursed for 1 percent of their insured and uninsured losses (excluding flood insurance premiums) with a minimum payment of \$100 and a maximum payment of \$3,000. Under the final rule, claimants now receive a payment equal to 5 percent of their insured and uninsured losses subject to a \$100 minimum and a \$15,000 maximum payment. This policy change will increase the total amount paid under the CGFAA and increases the likelihood that additional funding may be needed.

Finally, OCGFC officials stated that the volume of claims received has been greater than originally anticipated. As of June 20, 2001, OCGFC officials told us that approximately 14,000 claims had been submitted. Initial estimates we were able to obtain only anticipated 1,200 to 1,500 claims being submitted. Therefore, the volume of claims submitted through mid-June of this year is approximately 10 times more than the initial estimates. This further calls into question the adequacy of the \$455 million appropriated to pay victims' claims.

Conclusion

While the federal government has accepted responsibility for the Cerro Grande fire and enacted legislation to expeditiously compensate those injured by the fire, it is incumbent on FEMA as the administering agency to establish an effective system of internal control to safeguard the funds appropriated for the Cerro Grande program. The CGFAA lays a framework to establish such accountability by requiring FEMA to determine that victims' injuries and losses occurred as a result of the fire and to determine the amount of allowed compensation. In addition, the act requires that we conduct annual audits of all claim payments. FEMA has established a process to review all claims submitted. However, this process as currently implemented does not provide adequate assurance that only valid claims were paid or that the amounts paid were reasonable because there is insufficient documentation of the steps taken to determine the validity and reasonableness of the claim amounts. This lack of documentation precluded us from determining what steps or actions the claim reviewers took to determine the validity and reasonableness of the claims we attempted to review but more importantly, may limit or prevent FEMA officials responsible for approving the payments from

obtaining assurance that the payments are proper. In addition, certain OCGFC policies and procedures for paying claims have either not yet been developed or have not been formally and centrally documented.

Beyond identifying deficiencies in FEMA's claims process, our work raised questions about whether the \$455 million appropriation to pay victims' claims will be sufficient. The current estimate of the government's liability (\$437 million) does not include estimates for all claim types and was determined prior to the implementation of the final rules for compensating fire victims. FEMA has not re-estimated the government's liability in light of significant changes that have occurred since December 2000.

Recommendations for Executive Action

In order to strengthen the claim review and approval process, we recommend that the Director of FEMA direct the OCGFC to take the following actions:

- Require claims reviewers to document all steps and procedures they perform to determine the validity of a claim and the amount recommended for payment.
- Review and consolidate all existing informal guidance and incorporate this guidance into a set of formally documented policies and procedures that are regularly updated and distributed to all staff responsible for the claims review and award determination process.
- Establish standardized policies and procedures to address claims for which no policy currently exists as expediently as possible.
- Based on the information currently available, re-estimate the remaining claims to determine if there is sufficient funding available to fulfill the objectives of the CGFAA. In the future, update the estimate as necessary to reflect new claims information or changes in key policies and procedures.

Agency Comments and Our Evaluation

FEMA, in a letter from its Assistant Director of the Readiness, Response and Recovery Directorate, stated that FEMA and the Office of Cerro Grande Fire Claims (OCGFC) were pleased that this report recognized that a systematic process for paying fire victim's injury claims in accordance with the Cerro Grande Fire Assistance Act (CGFAA) was established and generally followed. However, FEMA expressed its concern that our report did not provide a sufficiently balanced view of its efforts to develop and implement the program since its inception 9 months ago and provided comments on areas of the report where FEMA and OCGFC took issue with our findings and comments on its progress. FEMA did not specifically

comment on our recommendations. FEMA's comments are reproduced in appendix I and discussed in more detail below.

FEMA expressed the need for further clarification on several of our comments and findings on the (1) level of documentation contained in claim files and (2) policies and procedures/methodologies used for calculating losses. FEMA stated that it believes guidance and procedures necessary to support claims determination are present and are in use. Our evaluation of FEMA's comments follows. We amplified the discussion on several topics in our report in response to these comments.

With regard to our finding that OCGFC's current policies do not cover all needed procedures and do not require sufficient evidentiary documents, FEMA stated that consistent with the resources provided, OCGFC has responded timely and energetically to emerging policy and procedure needs for a first-time program. FEMA also stated that claim reviewers have responded to their direction to improve the claim file documentation. While we recognize the unique nature of this program, the necessity for documentation that proper policies and procedures have been carried out still exists. The documentation contained in the claim files during the period of our audit, did not provide us with a basis for determining what steps, if any, the claims reviewers had taken to determine the validity and reasonableness of most claim payments we attempted to audit. Further and more importantly, because of the condition of the files, FEMA officials cannot effectively carry out their responsibilities for assessing the contractor's work to determine the validity and reasonableness of the amounts claimed. As a result, inconsistent claims determinations can occur and there is no assurance that the amounts paid are proper.

FEMA further stated that the key separation of duties and multiple layers of review in its process (reviewer, supervisor, and authorizing official) constitute substantial documentary evidence of the validation of an individual claim. The main point of our report is that sufficient documentary support is either not obtained or not written down to evidence the specific procedures performed by the contracted claims reviewers. Therefore, the effectiveness of the supervisory review process, even though it consists of multiple layers of review, is diminished and does not provide reasonable assurances that the claim payment determinations were proper. Better documentation is needed so that OCGFC officials are able to properly oversee the work of the contractors and to make a fully informed decision concerning approval of a claimed amount for payment.

FEMA stated that the legislative history of the CGFAA provides that “the regulation should not be overly burdensome for the claimants and should provide an understandable and straightforward path to settlement.” In this regard, our recommendations in no way put any additional burden on the victims of the fire, but rather are directed toward obtaining reasonable assurance that the procedures performed by OCGFC and its contractors during the claim review and payment process are properly documented and provide a reasonable basis for payment decisions under the circumstances.

Regarding our example of insufficient documentation of square footage, FEMA stated that GAB Robins claims reviewers followed industry standards and that OCGFC required complete documentation of steps taken by claim reviewers during verification of square footage and personal property losses. While we were told that the claim reviewers performed various procedures to determine the validity of the claimed amounts, we typically found that there was no evidence of these steps in the case files. Therefore, there is no basis for any after-the-fact determinations on whether enough work was done to access the reasonableness of the claims for square footage or other types of losses.

In commenting on our observation regarding the development of key policies and procedures, FEMA stated that OCGFC policies that were in effect during our review were detailed and extensive, and were intended to help first those whose homes had been lost or damaged by fire, those who suffered interruption of their businesses, and those who were evacuated in response to the fire. They further stated that other policies were developed when the need arose and only after consulting with several other U.S. government agencies to ensure consistency with other policies and positions taken in lawsuits. We revised our report to make it clear that we do not take issue with FEMA’s development of policies in a prioritized manner. However, we continue to believe that FEMA should work expediently to develop and finalize all remaining policies so that victims know what losses are eligible for compensation and how their compensation will be determined well in advance of the August 28, 2002, deadline for filing Notices of Loss.

We are sending copies of this report to the congressional committees and subcommittees responsible for FEMA related issues; the Director of the Federal Emergency Management Agency; Director of the Office of Cerro Grande Fire Claims; and the Inspector General of the Federal Emergency Management Agency. Copies will also be made available to others upon request.

If you have questions about this report, please contact me at (202) 512-9508 or Steven Houghton, Assistant Director, at (202) 512-5999. Other key contributors to this assignment were Julia Duquette, Phillip McIntyre, and Christine Fant.

A handwritten signature in black ink that reads "Linda Calbom". The signature is written in a cursive, flowing style.

Linda M. Calbom
Director, Financial Management and Assurance

Appendix I: Comments From the Federal Emergency Management Agency



Federal Emergency Management Agency
Washington, DC

JUN 29 2001

Ms. Linda M. Calbom
Director
Financial Management and Assurance
General Accounting Office
Washington, D.C. 20548

Dear Ms. Calbom:

Thank you for providing the Federal Emergency Management Agency (FEMA) and the Office of Cerro Grande Fire Claims (OCGFC) with the opportunity to respond to the draft of the GAO's report entitled, "Weaknesses Exist in the Cerro Grande Fire Assistance Claim Payment Process" dated June 18, 2001. We are pleased that the report recognizes the fact that FEMA and the OCGFC have established and followed a systematic process for the payment of fire victims' injury claims in accordance with the Cerro Grande Fire Assistance Act (CGFAA) but we firmly believe the report does not provide a balanced viewpoint of all the efforts that have taken place to develop and implement this program since the inception of the OCGFC nine months ago.

FEMA and OCGFC have developed a strategic plan (furnished to your office) that is comprehensive, realistic, and provides the necessary focus for getting claims closed in a timely and efficient manner without sacrificing necessary checks and balances. The establishment of streamlined procedures for paying small individual and business claims, the involvement of Small Business Administration claims experts, the formation of a Government and Tribal Claims task force, major revision of the initial GAB Robins contract, and the addition of additional supervisors for claims reviewers have all been geared toward improving both the quality and the speed at which survivors can be compensated. None of these initiatives are mentioned in the report.

In the following sections we address the main areas of concern from the report that we believe are in need of further clarification and comment. The dominant issues are the level of documentation contained in claim files and the policies and procedures/methodologies used for calculating losses. We believe that guidance and procedures necessary to support claims determinations are present and are in use. This fact is documented in the your draft report. The following comments respond to comments and findings with which FEMA and OCGFC do not concur:

Finding (page 6): OCGFC's current policies do not cover all of the procedures needed for the claim review process and do not require sufficient documentation to evidence the work performed by the claim reviewers.

Response: This program was created from the ground up beginning in August 2000. No precedents existed within the Federal Government for such a program. No regulations existed, no policies existed, and no FEMA staff was trained for such a program. Consistent with the resources provided, OCGFC has responded timely and energetically to emerging policy and procedure needs. Likewise, claims reviewers have responded to direction to improve claims documentation and have consistently improved review documentation.

Finding (page 9): OCGFC documentation is not sufficient.

Response: The legislative history of the Cerro Grande Fire Assistance Act provides that "the regulation should not be overly burdensome for the claimants and should provide an understandable and straightforward path to settlement" Statement of Senator Bingaman, 164 Cong. Rec. S. 5258 (daily ed. June 15, 2000). Consistent with that intent, OCGFC has established a policy on documentation of claims based on the following:

"At a minimum, Claimants will be required to attest to the nature and extent of each Injury for which compensation is sought in the Proof of Loss. The Proof of Loss must be signed under penalty of perjury and subject to the provisions of 18 U.S.C. 1001, which establishes penalties for false statements. Claimants may be required to provide other documentation, which is reasonably available...." 44 CFR §295.30

Documentation

The OCGFC will be as flexible as possible with the type and amount of documentation required for the reimbursement process. A claimant will be required to submit information detailing the nature and the extent of the damages for which compensation is being requested. A claimant may be required to provide other documentation that is reasonably available to verify the nature, extent and value of the losses. In some circumstances the OCGFC may rely on sworn statements, as well. The Claims Reviewer will work with the claimant to determine what documentation is needed and how best to obtain it. Claimants may submit any documents that they believe are relevant to their claim. (Source: OCGFC Policy Manual, Sec. 295.31)

Claims reviewers and authorizing officials operate in a dynamic process, frequently conversing among each other and asking questions -- and always in the context of the "norm" for all claims and the resources available to perform their functions. The key separation of duties and multiple layers of review inherent in the reviewer, supervision and authorizing official process constitute substantial documentary evidence of the validation of the individual claim.

Finding (page 10): Insufficient documentation of square footage.

Response: It is common procedure in the industry for claims reviewers to use county assessor records and blueprints to verify square footage, in addition to their general knowledge of the neighborhoods, and visits to specific homes. The GAB Robins claims

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reviewers followed these industry standards in evaluating claims. This is particularly true for those loss-of-use payments that are associated with homes that were totally destroyed and the amount and duration of such payments are significant. We require complete documentation by the claims reviewer on what steps were taken during verification, while continuing our efforts to not require impossible burdens of proof to verify claims.

Finding (page 11): Reviewers do not document how they verify personal property losses.

Response: As stated in our response above, we have sought to implement the clear Congressional intent to not be overly burdensome on claimants. In most cases, it is impossible to verify the specific items and ownership of personal property in a home that is totally destroyed, except to say that there is a range of personal items that is reasonable and expected among households -- such as blankets, kitchenware, furniture, clothing, appliances, electronics, tools, etc. Aggressive attempts are indeed made to verify the ownership of "unusual" items such as specialty items, rare collections, antiques, etc. Those efforts are openly documented.

Finding (page 11): A claims reviewer's recommended denial of a claim for medical payments because it was not provided for in OCGFC policy was reversed by an authorized official but the rationale for reversal was not explained.

Response: As stated in the GAO draft report, the authorized official reversed the claims reviewer's denial of a claim because the authorized official determined OCGFC policies did provide for the type of payment initially denied. This is how the process is supposed to work, and enhancements in our payment systems require our Authorizing Officials to provide comment on any amount approved that is different than the recommended amount (higher or lower).

Finding (page 12): Policies and procedures don't exist for all circumstances.

Response: OCGFC policies that were in effect during the GAO review period are detailed and extensive, and were intended to help first those whose homes had been lost or damaged by fire, those who suffered interruption of their businesses, and those who were evacuated in response to the fire. Our policy for "sacred sites," referred to by the GAO as "certain tribal claims," was developed after we received a Notice of Loss in November 2000 that included this category of loss. The actual need for a compensation policy did not arise until later as we worked with the tribe on quantifying its losses through the Proof of Loss form. We then undertook an extensive effort to find out whether compensation for such sites had been paid before by the Federal Government. We formulated a proposed methodology that is reasonable in fixing compensation. We then consulted with several other U.S. Government agencies to ensure that development of our compensation policy would not be inconsistent with any policies or positions taken in lawsuits involving other interested agencies, such as Bureau of Indian Affairs (BIA), Department of Interior (DOI) and Department of Justice (DOJ). The policy that was developed has been separately provided to the GAO. OCGFC requests clarification in the report on the use of specific terminology, such as "procedure" and "policy." Each term has specific meanings in our implementation of the Act.

Finding (page 14): OCGFC has not begun paying subrogee claims.

Response: This is consistent with our statutory mandate. OCGFC may pay subrogation claims only after all other injured parties have been paid to the maximum extent practicable. The anticipated schedule for paying subrogee claims is included in the OCGFC strategic plan, provided separately to the GAO.

Finding (page 14): Additional funds may be needed to pay fire claims and fund the operations of the OCGFC.

Response: While the current estimate of \$437 million is less than the \$455 million available, it is always possible that claims will exceed the estimate, and potentially exceeds the appropriation. It is also possible the claims amount will be less than the current estimate. OCGFC is employing every available estimating methodology to estimate total claims.

The following comment pertains to a finding in GAO's revised draft report received after the June 18th version:

Finding (page 15): OCGFC has deferred formulation of policies on how to compensate property owners for unrealized declines in their property values until further analysis of the Los Alamos real estate market is performed. Under the CGFAA, fire victims have until August 28, 2002, to file Notices of Loss for injuries resulting from the fire. It is important to develop policies and procedures in a timely manner so that victims know what losses are eligible for compensation and how their compensation will be determined.

Response: OCGFC recognizes the importance of timely policy guidance in this and other areas and has provided such guidance. The interim final regulation provided that compensation could be paid for reduction in the value of land where the claimant could establish that the value of the land was diminished as a result of the Cerro Grande Fire. The final regulation, published March 21, 2001, clarified that compensation could only be paid where a claimant can establish that the value of real property was permanently diminished as a result of the Cerro Grande fire. On April 2, 2001, OCGFC promulgated the following policy to explain how it intended to compensate property owners for unrealized declines in their property values:

2. Unrealized Losses

In order to determine if a claimant's residential real property suffered a permanent decline in property values, even though the claimant does not plan to sell his or her property in the near future (unrealized loss), the OCGFC plans to conduct another follow-up analysis of the residential real estate market in Los Alamos County, which will be released in the second quarter of 2002. The OCGFC will entertain such claims at that time.

If the findings of this follow-up analysis indicate that properties continue to reflect a decline in the market value due to the Fire, the OCGFC will compensate those claimants for whom an ongoing, permanent but unrealized loss in residential real estates values can be substantiated at that time. Those claimants will be allowed to either file a first time Notice of Loss, or reopen a Notice of Loss as set forth in Section 295.34(d) of the Final Rule to claim such damages.

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However, nothing in the policy should be construed as prejudging whether any specific claim for unrealized loss in real property value (diminution) will be paid. Claims are decided on a case-by-case basis by authorized officials who determine and fix compensation, if any.

This policy was placed on our website, <http://www.fema.gov/cerrogrande/>, shortly after it was approved and was publicized in the fire-affected communities.

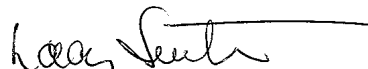
Claimants always have the burden of proving any claimed loss (44 C.F.R. Sec. 295.30(a)). Thus claimants have sufficiently clear guidance at present to receive compensation for unrealized losses in the value of real property if they can establish that any particular piece of real property has suffered permanent diminution in value as a result of the Cerro Grande Fire.

OCGFC, in keeping with the spirit of the Act, undertook the task of surveying the Los Alamos real estate market in an effort to determine (1) whether the market evidenced any signs of diminution, and, if so (2) to what extent. PriceWaterhouseCoopers prepared that report, as noted in the GAO report. As stated in the OCGFC published policy, OCGFC intends to conduct a further study of the market before the final date for filing claims.

We again appreciate the opportunity to comment on the report and appreciate the reviews that help enable FEMA and OCGFC comply with its responsibility to execute the CGFAA in a responsible manner. We acknowledge that a sound claims payment process is a critical requirement and feel that the FEMA and OCGFC have done a most credible job under unique conditions to comply with both the letter and intent of the CGFAA.

We look forward to a continued constructive relationship with the GAO and its staff as we bring this claims program to a successful and rapid conclusion.

Sincerely,



Lacy E. Suiter
Assistant Director
Readiness, Response and Recovery Directorate

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