Issue Date March 15, 2012	
Audit Report Number 2012-FO-0005	

TO: David Sidari, Acting Chief Financial Officer, F

FROM: Thomas R. McEnanly, Director of Financial Audits Division, GAF

SUBJECT: Annual Evaluation of HUD's Compliance With the Reporting Requirements of the Improper Payments Information Act of 2002, Executive Order 13520, and Office of Management and Budget Circular A-123 Implementing Guidance

HIGHLIGHTS

What We Audited and Why

We conducted an annual limited scope audit of the U.S. Department of Housing and Urban Development's (HUD) compliance with the reporting requirements of the Improper Payments Information Act of 2002 (IPIA) as amended. Each agency's inspector general is required to review and report on the agency's annual financial report and accompanying materials. We performed our audit in conjunction with our audit of HUD's consolidated financial statements. The objectives of our audit were to (1) determine whether HUD's agency financial report met the reporting requirements and whether HUD had implemented its plan to address improper payments as described in the accountable official report, (2) assess HUD's risk assessment process for identifying programs susceptible to improper payments, and (3) evaluate the sufficiency of HUD's improper payment reduction strategies for its high-priority programs and improper payment rate for its rental housing assistance programs (RHAP).

What We Found

In general, HUD's fiscal year 2011 agency financial report and accountable official report plans to address improper payments complied with IPIA, Executive Order 13520, and the Office of Management and Budget (OMB) Circular A-123 implementing guidance. However, HUD's outdated risk assessment process did not fully support its basis for identifying which programs should be included in its erroneous payment study since it did not include a methodology for determining dollar amounts of potential improper payments. In addition, although HUD's improper payment reduction strategies were progressing in a positive direction, we noted specific areas for improvement that would strengthen HUD's improper payment reduction strategies and enhance the accuracy of HUD's estimated improper payment rate for RHAP.

What We Recommend

We recommend that the Chief Financial Officer update HUD's process for assessing other programs' risk by developing a methodology for estimating the dollar amount of potential improper payments. We also recommend that HUD obtain clarification from OMB as to what constitutes the expenditures that should be included for improper payment testing and for calculating the overall RHAP gross error rate.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

The draft report was issued on March 8, 2012, and written comments were requested by March 14, 2012. We received written comments on March 15, 2012. HUD acknowledged and appreciated our recognition of their general compliance with IPIA, Executive Order 13520, and the Office of Management and Budget (OMB) Circular A-123 implementing guidance, and their progress in reducing improper payments. However, they did not entirely agree with our findings related to deficiencies in the risk assessment process or what cost elements should be included in calculating the rental housing assistance programs' estimated error rate.

The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix A of this report.

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BACKGROUND AND OBJECTIVES

In November 2002, the U.S. Congress passed the Improper Payments Information Act of 2002 (IPIA). The major objective of this legislation was to improve the accuracy and integrity of Federal payments. IPIA, in conjunction with implementing guidance from the Office of Management and Budget (OMB), requires executive branch agency heads to review their programs and activities annually, identify those that may be susceptible to significant improper payments, estimate amounts improperly paid, and report on the amounts of improper payments and actions to reduce them. IPIA was amended in July 2010 by the Improper Payments Elimination and Recovery Act. The Act increased the reporting requirements for agencies regarding improper payments in their annual financial reports and added the requirement that each agency inspector general determine whether the agency complies with IPIA based on specified criteria.

Due to the nearly $100 billion in governmentwide improper payments reported for fiscal year 2009 according to OMB, the President issued Executive Order (E.O.) 13520, Reducing Improper Payments, on November 20, 2009. Pursuant to E.O. 13520, each agency identified by OMB as operating a high-priority program must provide its inspector general with a report that contains (1) the agency's methodology for identifying and measuring improper payments by the agency's high-priority programs; (2) the agency's plans, together with supporting analysis, for meeting the reduction targets for improper payments in the agency's high-priority programs; and (3) the agency's plan, together with supporting analysis, for ensuring that initiatives undertaken pursuant to E.O. 13520 do not unduly burden program access and participation by eligible beneficiaries. Following the receipt and review of the report, the agency inspector general must assess the level of risk associated with the applicable program; determine the extent of oversight warranted; and provide the agency head with recommendations, if any, for modifying the agency's methodology, improper payment reduction plans, or program access and participation plans.

Since the passage of IPIA, the U.S. Department of Housing and Urban Development (HUD) has identified and reported in its annual agency financial reports several HUD programs that are susceptible to significant erroneous payments, such as the Community Development Block Grant entitlement and State or small cities programs (CDBG program) and public housing, tenant-based voucher, and project-based assistance programs (collectively referred to as HUD's rental housing assistance programs (RHAP)). Except for the CDBG program (excluded from annual improper payment reporting since March 2007), HUD has continued to report improper payments for RHAP. For RHAP, beneficiaries pay 30 percent of their adjusted income as rent, and HUD payments cover the remainder of the rental cost (or the operating cost in the case of public housing). HUD has identified the following three sources of errors and improper payments in RHAP:

- Program administrator error – The program administrator's failure to properly apply income exclusions and deductions and correctly determine income, rent, and subsidy levels;

- Tenant income reporting error – The tenant beneficiary's failure to properly disclose all income sources and amounts upon which subsidies are determined; and
- Billing error – Errors in the billing and payment of subsidies due between HUD and third-party program administrators or housing providers.

HUD implemented additional supplemental measures to comply with IPIA requirements as amended by the Improper Payments Elimination and Recovery Act and E.O. 13520. In consultation with OMB, HUD developed six supplemental measures for the Office of Public and Indian Housing (PIH) and four supplemental measures for the Office of Multifamily Housing (MF Housing) to track and report on intermediaries' efforts in addressing improper payments. HUD provided the details of these supplemental measures in its accountable official reports to the Office of Inspector General (OIG) as required. PIH and MF Housing have developed Enterprise Income Verification systems to reduce tenant income reporting error, and PIH's and MF Housing's supplemental measures use data produced by the systems. All of HUD's supplemental measures are reported quarterly on OMB's payment accuracy Web site.

HUD has made substantial progress in reducing erroneous payments from an estimated $3 billion in fiscal year 2000 to under $1 billion in each of the last couple of fiscal years. HUD calculates its estimated annual improper payment amount using a quality control study, an income match study, and a billing study, which are conducted by outside contractors. These studies use data from the prior fiscal year. The latest quality control study found that in fiscal year 2010, the gross program administrator error was $650 million. The income match fiscal year 2010 study found that the tenants' income reporting error was $203 million. HUD did not perform the billing study but estimated $106 million in billing errors for fiscal year 2010. HUD reported a total of $959 million in its fiscal year 2011 agency financial report, representing 2.9 percent of its RHAP.

The objectives of our limited scope audit were to (1) determine whether HUD's agency financial audit report met the reporting requirements and whether HUD had implemented its plan to address improper payments as described in its accountable official report, (2) assess the sufficiency of HUD's risk assessment process for identifying programs susceptible to improper payments, and (3) evaluate the sufficiency of HUD's improper payment reduction strategies for its high-priority programs and improper payment rate for its RHAP.

RESULTS OF AUDIT

Finding 1: HUD Generally Complied With IPIA Requirements; However, Its Risk Assessment Process and RHAP Error Rate Calculations Had Weaknesses

HUD complied with IPIA regarding its reporting in its annual financial report. The report contained all of the required elements. We also reviewed HUD's accountable official annual report for 2011 and determined that it complied with the requirements of E.O. 13520 and OMB Circular A-123. Although HUD complied with the IPIA reporting requirements, there were some areas that needed improvement. HUD's outdated risk assessment process for identifying programs susceptible to improper payments did not estimate a potential dollar amount of improper payments as required. This noncompliance occurred because HUD believed that its process fully complied with requirements and, therefore, had not updated the process. As a result, it could not fully support that it had identified and included all programs susceptible to significant improper payments in its erroneous payments study. Also, although HUD's improper payment reduction strategies were progressing in a positive direction, HUD may not have accurately calculated its total gross estimated improper payment rate for RHAP because it did not include administrative fees and program expenses in its testing but added them to its universe when calculating the error rate. As a result, HUD may have understated its gross estimated improper payment rate, which would affect the accuracy and transparency of its reporting. Further, there were two other program areas in which HUD could further reduce its risk of improper payments.

HUD Complied With Requirements Related to Improper Payments

HUD complied with IPIA regarding its reporting in its agency financial report. OMB Circular A-123, appendix C, provides guidance on the implementation and reporting of IPIA requirements as amended. The guidance requires agencies to (1) publish in their agency financial reports and on OMB's Web site the improper payment estimates for all programs and activities identified as susceptible to significant improper payments, (2) publish programmatic corrective action plans in the report, (3) publish annual reduction target results for each program measured for improper payments, (4) report a gross improper payment rate of less than 10 percent for each program and activity for which an improper payment estimate was obtained and published in the report, (5) report information on its efforts to recapture improper payments, and (6) conduct a program-specific risk assessment for each program or activity that conforms to Section 3321 of Title 31 U.S.C. (United States Code) as amended. HUD's agency financial report contained all of the required elements.

We reviewed HUD's accountable official annual report for 2011 and determined that it complied with the requirements of E.O. 13520 and OMB Circular A-123. The accountable official report provided the plans for 10 supplemental measures developed for reducing and eliminating improper payments in RHAP. The most significant supplemental measures included the detection of tenants' underreported income, verification of tenants' eligibility, and detection of deceased tenants. We evaluated each supplemental measure (including supporting documents and reports) and concluded that HUD had internal controls in place to detect and reduce improper payments in RHAP.

HUD's Outdated Risk Assessment Process Did Not Estimate the Dollar Amount of Potential Improper Payments

Our review of HUD's risk assessment process for identifying HUD programs susceptible to significant improper payments raised some concerns. OMB Circular A-123, appendix C, part I, requires that agencies institute a systematic method of reviewing all programs and identifying programs susceptible to significant improper payments. The systematic method can be a quantitative evaluation based on a statistical sample, or it could take into account risk factors likely to contribute to significant improper payments. HUD used the risk factors methodology and established risk factors to determine susceptibility to improper payments of a particular program. HUD measured the risk of susceptibility on a scale from 1 to 5 for each factor, using 3.5 as the threshold for taking further actions to determine estimated improper payments. We noted that HUD did not estimate a potential dollar amount of improper payments based on the scores determined to each program after assessing the risk factors. For the past 3 years, HUD determined that none of the 33 programs evaluated was susceptible to significant improper payments. These were grant programs of the Office of Community Planning and Development, MF Housing, and PIH. The Chief Financial Officer ranked these programs at under 3.5 points overall; therefore, they were determined not to be susceptible to significant improper payments.

The Chief Financial Officer ranked grantees for their quality of external payment processing controls between 3 and 4 based on an evaluation of the existence of known issues with controls at the recipient and subrecipient level from the evaluation of audit results and HUD monitoring process results. HUD's risk assessment did not estimate the dollar amount of potential improper payments from OIG audits' ineligible and unsupported costs and from OMB statistics of grantees' audits with material weaknesses and reportable conditions. OMB's 2010 statistics on grantees' single audit reports showed that for most programs, as much as 49 percent had reportable conditions and 27 percent had material weakeneses. Further, the risk assessment evaluated OIG audits on grantees containing findings with unsupported costs and other costs that were not expended in compliance with program requirements. OMB Circular A-123 apendix C, part I states that when an agency's review is unable to discern whether a payment was proper as a result of insufficient or lack of documentation, this payment must also be considered an improper payment. Additionally, the circular defines "significant improper payments" as gross annual improper payments in a program exceeding (1) both 2.5 percent of program outlays and $10 million of total program outlays made during the fiscal year or (2) $100 million regardless of the improper payment percentage. Footnote 5 in OMB Circular A-123, appendix C, part I, states that improper payment rates should be measures of dollars rather than occurrences. HUD's risk assessment process did not include the estimated potential improper payments dollar amounts needed to assess the programs' susceptiblity to improper payments against the $10 million or the 2.5 percent requirement.

Personnel from HUD's Office of the Chief Financial Officer responsible for administering the program improper payment risk assessment stated that HUD's risk assessment methodology was designed by a contractor several years ago. Accordingly, HUD had not updated the process because it believed that its process complied with applicable guidance. As a result, HUD could not fully support its determination that the 33 programs assessed were not susceptible to improper payments to the level recommended by OMB guidance.

HUD's Chief Financial Officer for Financial Management needs to develop an updated methodology for estimating the amount of potential improper payments when performing the risk assessment. For those grant programs with identified improper payments, HUD should try to determine whether the improper payments exceed the $10 million or 2.5 percent error rate for fiscal year 2012 or 1.5 percent for 2013 reporting as required by OMB guidance.

Other Corrective Actions Are Needed To Address Controls Over Reducing Improper Payments

In Audit Report 2012-FO-0003, we recommended that PIH modify its corrective action plans and internal controls for RHAP to use remote and onsite monitoring, as necessary, to ensure that public housing authorities have a review process in place to prevent consistency and transcription errors and to ensure that income and allowance amounts used in the rent calculation are correct. According to the quality control study for fiscal year 2010, the two most common administrative errors were discrepancies in the information reported in different sections of the form HUD-50058 and errors in transferring information from documentation in the tenant file to the form HUD-50058. PIH agreed to track and compile all remote and onsite monitoring reviews, analyze the results, and determine the risks of noncompliance to effectively address them.

In the same report, we also recommended that MF Housing modify its corrective actions and internal controls for RHAP to (1) report on income discrepancies at the 100 percent threshold level as a supplemental measure; (2) assign staff to review and resolve deceased single-member household and income discrepancy reports; (3) and include in contracts a requirement to resolve income discrepancies, failed identity verification, and cases of deceased single-member households. MF Housing concurred with these recommendations and expected to implement them by April 2014.

HUD's Reported 2011 Estimated Error Rate Could Be Slightly Understated

HUD reported in its fiscal year 2011 agency financial report $959 million in total gross RHAP improper payments, representing a 2.9 percent error rate. The percentage rate reported could be higher. In our assessment of HUD's methodology for calculating the RHAP total gross estimated improper payment rate, we noted that certain housing subsidies, administrative fees, and other program expenses were excluded from the quality control testing of improper payments but expenses were considered as part of HUD's error rate calculations. HUD excluded housing subsidies paid to Moving to Work agencies because it assumed a zero error rate. For administrative fees and other program expenses, HUD assumed that these were an integral part of the operations, although they did not represent housing assistance.

OMB Circular A-123, appendix C, part 1, section 11, step 2, provides scenarios on how the calculation of the program error rate should be performed for the particular program component tested. This program component should be statistically sampled annually to obtain an improper payment rate consistent with the statistical rigor requirements of this guidance in part l A, section 7. The goal for the component study is not to extrapolate an improper payment rate for the program as a whole. Rather, the goal is only to estimate an improper payment amount for the relevant program component being studied. Therefore, HUD's rationale was not consistent with the guide, and HUD inappropriately extrapolated the statistical results from the program tested to the entire group of programs.

To provide better and accurate transparency, HUD should obtain clarification from OMB as to what constitutes the expenditures that should be included for testing and those that should be used for calculating the total gross error rate.

Conclusion

HUD generally complied with the annual reporting requirements of E.O. 13520 and IPIA, as amended, in its reporting in its annual financial report. The report contained all of the required elements. HUD's accountable official annual report for fiscal year 2011 also complied with the requirements.

Our review of HUD's risk assessment process for identifying HUD programs susceptible to significant improper payments raised some concerns. Although HUD used a systematic method in compliance with OMB Circular A-123, appendix C, part I, HUD did not determine the dollar amounts of improper payments for each program to assess whether a program was susceptible to improper payments. HUD's Chief Financial Officer for Financial Management needs to develop an updated methodology so that HUD can more accurately identify programs susceptible to improper payments.

To enhance the accuracy and integrity of HUD's estimated improper payment rate, HUD should consult with OMB to determine whether to include all subsidies, administrative fees, and program costs when it calculates the gross estimated improper payment rate.

Recommendations

We recommend that the Office of the Chief Financial Officer

1A. Develop a methodology for estimating the dollar amount of potential improper payments when performing the risk assessment by considering unsupported and ineligible costs in OIG's and independent public accountants' audit reports.

1B. Obtain clarification from OMB as to what constitutes the expenditures that should be included when testing for improper payments and for calculating the total gross error rate.

SCOPE AND METHODOLOGY

We conducted an annual limited scope audit of HUD's fiscal year 2011 compliance with the reporting requirements of IPIA, as amended by the Improper Payments Elimination and Recovery Act of 2010, and E.O. 13520, Reducing Improper Payments. This review included analyzing the fiscal year 2011 quality control study and income match study of certain fiscal 2010 payments and fiscal year 2011 improper payment risk assessments. OMB Circular A-123, appendix C, parts I and II, provide guidance on the implementation of IPIA. Part II requires each agency's inspector general to review the agency's improper payment reporting in its annual performance and accountability report or annual financial report and accompanying materials in conjunction with its fiscal year 2011 financial statement audit. OMB Circular A-123, appendix C, part III, requires each agency inspector general to review the accountable official annual report required under section 3(b) of E.O. 13520.

To complete this work, we interviewed appropriate personnel of the HUD Office of the Chief Financial Officer, program representatives, and HUD quality control study and income match study contractors to gather sufficient information to evaluate HUD's plans and the accuracy of the underlying improper payment data. We reviewed the nature, timing, and extent of HUD's improper payment reduction strategies, internal controls, policies, procedures, and practices to determine the reasonableness of its plans. In addition, we reviewed the applicable Federal laws, E.O. 13520, and the implementing guidance found in OMB Circular A-123, appendix C, that govern actions needed by the agency to address the issue of improper payments. We conducted our review from August 2011 to March 2012 at HUD's headquarters in Washington, DC.

We conducted the audit in accordance with 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 on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objectives:

- HUD's design and implementation of improper payment internal controls, policies, procedures, and practices and
- Compliance with E.O. 13520 and IPIA.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiencies

We evaluated internal controls related to the audit objectives in accordance with generally accepted government auditing standards. Our evaluation of internal controls was not designed to provide assurance regarding the effectiveness of the internal control structure as a whole. Accordingly, we do not express an opinion on the effectiveness of HUD's internal controls.

FOLLOW-UP ON PRIOR AUDITS

Audit Report No. 2011-FO-0004

In Audit Report 2011-FO-0004, “Annual Evaluation of HUD’s Compliance With Presidential Executive Order 13520, Reducing Improper Payments for Fiscal Year 2010,” we recommended that HUD test the operating effectiveness of monitoring controls related to PIH and Office of Housing supplemental measures as part of HUD’s annual OMB Circular A-123 assessment reviews. HUD concurred with our recommendation but had not implemented it.

APPENDIXES

Appendix A

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-3000

CHIEF FINANCIAL OFFICER

MAR 15 2012

MEMORANDUM FOR: Thomas R. McEnanly, Director, Financial Audits Division, GAF

FROM: For David P. Sidari, Chief Financial Officer, F

SUBJECT: Management Comments on Draft Report related to OIG's Annual Evaluation of HUD's Compliance With the Reporting Requirements of the Improper Payments Information Act of 2002, Executive Order 13520, and Office of Management and Budget Circular A-123 Implementing Guidance

Thank you for the opportunity to comment on the subject draft report. We offer the following summary comments for your consideration when formulating the final audit. Management strongly disagrees with the Office of Inspector General's (OIG) assertion that HUD's risk assessment process is outdated. OIG's finding cites OMB's Improper Payments Elimination and Recovery Act (IPERA) Implementing Guidance, dated April 14, 2011, in Circular A-123, Appendix C, Part 1 as requiring that agencies, "institute a systematic method of reviewing all programs and identifying programs susceptible to significant improper payments. The systematic method can be a quantitative evaluation based on a statistical sample, or it could take into account risk factors likely to contribute to significant improper payments." OIG correctly states that HUD used the account risk factors methodology and established risk factors to determine program susceptibility to improper payments. Furthermore, our systematic method for assessing programs to identify those susceptible to significant improper payments takes into account the risk factors likely to contribute to significant improper payments listed in the IPERA Implementing Guidance such as:

- Whether the program or activity reviewed is new to the agency;
- The complexity of the program or activity reviewed, particularly with respect to determining correct payment amounts;
- The volume of payments made annually;
- Whether payments or payment eligibility decisions are made outside of the agency, for example, by a State or local government, or a regional Federal office;
- Recent major changes in program funding, authorities, practices, or procedures;
- The level, experience, and quality of training for personnel responsible for making program eligibility determinations or certifying that payments are accurate;
- Significant deficiencies in the audit reports of the agency including, but not limited to the agency Inspector General or the Government Accountability Office report audit findings, or other relevant management findings that might hinder accurate payment certification; and,
- Results from prior improper payment work.

As OIG states in the draft report, HUD's methodology was developed several years ago. It was

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Comment 1

used as a model for other Federal agencies in their attempt to comply with improper payment law requirements. It may have even been used by OMB in their IPERA implementing guidance to determine the eight risk factors listed above. Even though this methodology was developed a number of years ago, it is not outdated and is in compliance with the current implementing guidance. Therefore, we request that this finding and the related recommendation be eliminated from your final report.

The draft report also states that, "other corrective actions are needed to address controls over reducing improper payments." PIH has strong internal controls in place and will continue to develop improved internal controls and corrective actions to address the two most common administrative errors (consistency and transcription) which are captured under the following publicly-reported OMB-approved supplemental measures:

1) PIC Reporting Rate

2) Income Discrepancy Rate

3) Failed Identity Verification (invalid SSNs) Rate

PIH also has an additional supplemental measure of overdue annual re-examinations which is not publicly-reported. PIH internally tracks and monitors PHA performance under this additional supplemental measure and it has led to a marked decline in improper payments stemming from overdue annual re-examinations. As of October 31, 2011, the number of families with an overdue annual re-examination decreased substantially from the Quality Control (QC) study-reported rate of 2 percent to 0.55 percent.

It should be noted that as a result of PIH's ongoing remote monitoring and dissemination of deficiency notices to affected PHAs, the national PIC Reporting rate has averaged 99 percent and the number of administrative errors made on the Form HUD-50058 has decreased by 59 pecent since October 1, 2010, and through the period ending December 31, 2011, as evidenced by the increase in number of corrected form HUD-50058s (31,702) successfully submitted to PIC.

Finally, because of PIH's ongoing remote monitoring efforts and PIH deficiency notification efforts, PHAs have implemented corrective actions to address administrative errors and PIH has documented the recovery of over $3.8 million in improper payments made on behalf of deceased tenants. PIH remains committed to its remote monitoring efforts now and into the future, as evidenced by the completion of over 1,800 PHA reviews covering deficiencies identified in fiscal years 2012 and 2011.

Comment 2

Management also strongly disagrees with the statement that HUD's error estimate could be slightly understated. HUD excluded Moving To Work (MTW) PHAs from the study because these designated PHAs have statutory authority to implement alternative rent structure and policy that differ from the current standard policy. The current structure of the MTW demonstration program requires the signing of an MTW agreement between the PHA and HUD. The agreement sets MTW PHA's funding at a pre-determined level. Any rent determination error made by MTW PHAs will not affect HUD's subsidy, and therefore it is not possible for HUD to make an improper payment.

Comment 3

There is no reason to include MTW PHAs in our quality control review of Rental Housing Assistance Program (RHAP) payments since an error in HUD's subsidy is not possible. MTW PHAs are part of HUD's RHAP structure and therefore should remain in management's calculation of the improper payment rate for the RHAP.

With regard to administration fees and other program expenses, one would need to obtain information from all 4,100 PHA financial statements. This would not be an efficient use of staff resources and we believe that eliminating these fees from our RHAP improper payment rate determination would not have a significant impact on the error rate. Based on these two points, we request that this finding and the related recommendation be eliminated from your final report.

The following comment was received from PIH Management: The report states the IG's concern with the methodology used in the independent QC study. We share the IG's concern. Therefore it is PIH's opinion that the QC may need to be suspended in the future, pending further review, and that a new study may need to be developed.

PIH is working with all relevant parties to continue to improve our monitoring and sampling of those areas. PIH's efforts have already provided a significant reduction in improper payments over the years and such progress speaks for itself. Error calculations are at an all-time low for those areas where PIH has focused on improper payment reduction and all progress has continued to hold steady over the course of the past four years. PIH will continue to develop improved ways at both calculating and determining error rates as well as taking appropriate action once an error is found.

Thank you and your audit team for the opportunity to comment on your draft report. We appreciate your assistance toward improving HUD's efforts to implement IPERA. If you have any questions on our comments, please contact Jerry Vaiana on extension 8106.

OIG Evaluation of Auditee Comments

Comment 1 HUD's response does not provide adequate justification to warrant removing the finding from the report. This issue was discussed with HUD during the audit and the information provided was considered in the formulation of the finding and drafting of the report. As noted in the report, HUD's current risk assessment methodology did not use the dollar amount as recommended by OMB. Rather HUD used numeric ranking factors, which did not result in a dollar value of potential improper payments. As a result, HUD was not able to compare the dollar amount of estimated improper payments to guidance's criteria which may have resulted in additional programs requiring further analysis.

Comment 2 PIH has agreed to OIG's ecommendations in this area. We appreciate their efforts at improving the improving operations and commend their success at reducing improper payments.

Comment 3 HUD's response does not provide adequate justification to warrant removing the finding from the report. HUD's inclusion of all direct and indirect expenditures in the error rate calculation resulted in incorrect error rate when only a subs et of one of program components' direct costs were tested. According to OMB Circular A-123 Appendix C, the testing results to a particular component should not be extrapolated to other components. Accordingly, this finding and related recommendation remains.

Appendix B

SUPPLEMENTARY BACKGROUND INFORMATION

Under OMB Circular A-123, appendix C, part III, the implementing guidance for E.O. 13520, the required annual report is referred to as the accountable official annual report. E.O. 13520 also requires agencies with high-priority programs to develop supplemental targets semiannually or annually to reduce improper payments in high-priority programs. OMB Circular A-123, appendix C, part III, states that the supplemental measures should focus on higher risk areas and report on root causes or errors that agencies can resolve through corrective actions.

On April 14, 2011, OMB issued governmentwide guidance on the implementation of the Improper Payments Elimination and Recovery Act. This guidance is contained in parts I and II of appendix C, "Requirements for Effective Measurement and Remediation of Improper Payments," of OMB Circular A-123, Management's Responsibility for Internal Controls. Significant components of OMB's guidance include

- Describing alternative improper payment measurements,
- Expanding payment recapture audits to all types of payments and activities with more than $1 million in annual outlays if cost effective,
- Improving corrective action plans and incorporating lessons learned from implementation of the Improper Payments Elimination and Recovery Act,
- Distributing funds recovered through payment recapture audits for authorized purposes, and
- Establishing compliance reviews and requirements for agencies deemed noncompliant.