OFFICE OF AUDIT
FINANCIAL AUDITS DIVISION
HEADQUARTERS

OFFICE OF THE CHIEF FINANCIAL OFFICER
WASHINGTON, DC

ADDITIONAL DETAILS TO SUPPLEMENT OUR REPORT ON HUD'S FISCAL YEARS 2012 AND 2011 FINANCIAL STATEMENTS

2013-FO-0003 NOVEMBER 15, 2012

Issue Date: November 15, 2012

Audit Report Number: 2013-FO-0003

TO: David P. Sidari, Acting Chief Financial Officer, F

/s/

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

SUBJECT: Additional Details To Supplement Our Report on HUD's Fiscal Years 2012 and 2011 Financial Statements

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General (OIG), final results of our review of HUD's fiscal years 2012 and 2011 financial statements.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8L, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at http://www.hudoig.gov.

If you have any questions or comments about this report, please do not hesitate to call me at 202-402-8216.

November 15, 2012

Additional Details To Supplement Our Report on HUD's Fiscal Years 2012 and 2011 Financial Statements

Highlights

Audit Report 2013-FO-0003

What We Audited and Why

We are required to annually audit the consolidated financial statements of the U.S. Department of Housing and Urban Development (HUD) in accordance with the Chief Financial Officers Act of 1990 as amended. This report supplements our report on the results of our audit of HUD's principal financial statements for the fiscal years ending September 30, 2012 and 2011. Also provided are assessments of HUD's internal controls and our findings with respect to HUD's compliance with applicable laws, regulations, and governmentwide policy requirements and provisions of contracts and grant agreements. In addition, we plan to issue a letter to management on or before January 14, 2013, describing other issues of concern that came to our attention during the audit.

What We Recommend

Current and prior-year recommendations are after each finding and in the Follow-up On Prior Year Audits section of this report. We identified $107.7 million in excess obligations, and are recommending that HUD seek legislative authority to implement $628 million in offsets against public housing agencies' excess Section 8 funding.

What We Found

In our opinion, HUD's fiscal years 2012 and 2011 financial statements were fairly presented. Our opinion is reported in HUD's fiscal year 2012 Agency Financial Report. The other auditors and our audit disclosed one material weakness and seven significant deficiencies in internal controls, and three instances of noncompliance with applicable laws and regulations as follows:

- Achieving substantial compliance with FFMIA [Federal Financial Management Improvement Act] continued to challenge HUD.
- There were weaknesses in the monitoring of PIH's [Office of Public and Indian Housing] program funds.
- HUD's internal control over financial reporting had serious weaknesses.
- CPD's [Office of Community Planning and Development] information and communication systems had weaknesses.
- HUD's oversight of the administrative control of funds process had weaknesses.
- Deficiencies existed in the monitoring of HUD's unliquidated obligations.
- Controls over HUD's computing environment had weaknesses.
- Portfolio management of FHA systems needs improvement.
- HUD did not substantially comply with the Federal Financial Management Improvement Act.
- HUD did not substantially comply with the Antideficiency Act
- FHA did not comply with the Cranston-Gonzalez National Affordable Housing Act of 1990

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BACKGROUND AND OBJECTIVE

We are required by the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994 and implemented by Office of Management and Budget (OMB) Bulletin 07-04, Audit Requirements for Federal Financial Statements, to audit the U.S. Department of Housing and Urban Development's (HUD) principal financial statements or select an independent auditor to do so. The objective of our audit was to express an opinion on the fair presentation of these principal financial statements.

Management is responsible for

* Preparing the financial statements in conformity with accounting principles generally accepted in the United States of America;
* Establishing, maintaining, and evaluating internal controls and systems to provide reasonable assurance that the broad objectives of the Federal Financial Management Improvement Act of 1996 (FFMIA) are met; and
* Complying with applicable laws and regulations.

In auditing HUD's principal financial statements, we were required by Government Auditing Standards to obtain reasonable assurance about whether HUD's principal financial statements were presented fairly, in accordance with generally accepted accounting principles, in all material respects. We believe that our audit provides a reasonable basis for our opinion.

In planning our audit of HUD's principal financial statements, we considered internal controls over financial reporting by obtaining an understanding of the design of HUD's internal controls, determined whether these internal controls had been placed into operation, assessed control risk, and performed tests of controls to determine our auditing procedures for the purpose of expressing our opinion on the principal financial statements. We are not providing assurance on the internal control over financial reporting. Consequently, we do not provide an opinion on internal controls. We also tested compliance with selected provisions of applicable laws, regulations, and government policies that may materially affect the consolidated principal financial statements. Providing an opinion on compliance with selected provisions of laws, regulations, and government policies was not an objective, and, accordingly, we do not express such an opinion.

This report is intended solely for the use of HUD management, OMB, and Congress. However, this report is a matter of public record, and its distribution is not limited.

INTERNAL CONTROL

Material Weakness: Achieving Substantial Compliance With FFMIA Continued To Challenge HUD

In fiscal year 2012, HUD made limited progress in bringing its financial management systems into substantial compliance with FFMIA.[1] In this regard, the Office of Inspector General (OIG) continues to report that HUD's financial management systems did not substantially comply with FFMIA. Specifically, as reported in prior years, OIG noted inherent limitations and weaknesses in HUD's agencywide financial management systems in reasonably ensuring compliance with Federal financial management system requirements. In addition, as reported since fiscal year 2009,[2] OIG reported that the Office of Community Planning and Development's (CPD) grants management systems did not comply with FFMIA.

Because of inherent system limitations and weaknesses, HUD's financial management systems could not be readily accessed and used by financial and program managers without extensive manipulation and excessive manual processing. This situation could negatively impact management's ability to perform required financial management functions and efficiently manage financial operations of the agency, which could translate to lost opportunities for achieving mission goals and improving mission performance.

Financial System Weaknesses Prevented HUD From Achieving Substantial Compliance With Federal Financial Management System Requirements

As reported in previous audits of HUD's financial statements, in fiscal year 2012, there continued to be instances of noncompliance with Federal financial management system requirements. These instances of noncompliance gave rise to significant management challenges that have (1) impaired management's ability to prepare financial statements and other financial information without extensive compensating procedures and (2) resulted in the lack of reliable, comprehensive managerial cost information on its activities and outputs. In addition, since bringing the OMB Circular A-127 review in house in 2007, HUD had reduced the number of reviews completed per year from three in fiscal year 2009 to none in fiscal year 2012. Further, OIG noted that HUD Central Accounting Processing

[1] Public Law 104-28, dated September 30, 1996
[2] Audit report 2010-FO-0003, Additional Details To Supplement Our Report on HUD's Fiscal Year 2009 and 2008 Financial Statements, dated November 16, 2009

System (HUDCAPS) obligation balances could not be traced to the HUD Integrated Acquisition Management System (HIAMS), which rendered the system FFMIA noncompliant.

<u>HUD lacked an integrated financial management system</u>. Since fiscal year 1991, OIG has annually reported on the lack of an integrated financial system, which impeded HUD's ability to generate and report the information needed to both prepare financial statements and manage operations on an ongoing basis accurately and in a timely manner. A financial management system includes the core financial systems and the financial portions of mixed systems necessary to support financial management, including automated and manual processes, procedures, and controls, data, hardware, software, and support personnel dedicated to the operation and maintenance of system functions.

In fiscal year 2012 our review identified several instances where the lack of an integrated financial management system adversely impacted internal controls over financial reporting. These control deficiencies are detailed in Significant Deficiency 2: HUD's Internal Control Over Financial Reporting Had Serious Weaknesses.

- To prepare consolidated departmentwide financial statements, HUD required the Federal Housing Administration (FHA) and the Government National Mortgage Association (Ginnie Mae) to submit financial statement information on spreadsheet templates, which were loaded into a software application. In addition, all consolidating notes and supporting schedules had to be manually posted, verified, reconciled, and traced. In fiscal year 2012, our review found that HUD consolidation process did not completely eliminate $829 million in probable Ginnie Mae claims and FHA loss payables.

- The methodology for calculating the allowance for loss for loan receivables found that HUD did not always re-evaluate its methodology to consider changes in relevant factors, did not obtain input from the applicable program office, or utilized a loss rate that could not be supported based on previous write-offs and collections. Re-evaluations of the Flexible Subsidy and Section 202 loan receivable loss rates resulted in adjustments of $527.8 million.

- In our test of completeness of Accounts Receivable, we noted that HUD did not always record amounts it was owed by others which were identified in OIG audits, repayment agreements, or its own program monitoring activities. Our review noted a potential total of $77.4 million in funds that HUD did not accrue account receivables in the accounting records.

As reported in Significant Deficiency 4: HUD's Oversight of the Administrative Control of Funds Process Had Weaknesses, HUD has not fully implemented a compliant Administrative Control of Funds process. HUD's lack of compliance with its own funds control processes that ensures that its obligations and expenditures stay within its authorized budget limits and comply with the Anti-Deficiency Act or OMB A-11 requirements. As a result, HUD could not assure that obligations and costs are in compliance with applicable law, assets are safeguarded from waste, loss, unauthorized use, or misappropriation, and revenues and expenditures are properly recorded and accounted for.

To overcome these deficiencies with respect to internal controls over financial reporting, HUD continued to rely on extensive compensating procedures in the preparation of its annual financial statements and other financial reports that were costly, labor intensive, and not always efficient.

HUD's financial systems did not provide managerial cost data. In fiscal year 2006, the U.S. Government Accountability Office (GAO) reported[3] that HUD's financial systems did not have the functionality to provide managerial cost accounting across its programs and activities. This lack of functionality resulted in the lack of reliable and comprehensive managerial cost information on its activities and outputs. HUD lacked an effective cost accounting system that was capable of tracking and reporting the costs of HUD's programs in a timely manner to assist in managing its daily operations. This condition rendered HUD unable to produce reliable cost-based performance information.

Annual scheduled A-127 reviews were not completed. Since bringing the OMB Circular A-127 review in house in 2007, HUD had reduced the number of reviews completed from three in fiscal year 2009 to none in fiscal year 2012. In fiscal year 2010, HUD had planned to conduct an A-127 review of one core financial system and five financial management systems each year in response to an OIG audit recommendation. During our review in fiscal year 2012, OIG determined that HUD had not implemented its annual scheduled A-127 reviews. For example, the FHA-SL core system review, which began in 2010, had been in draft form since 2011 and was not complete as of September 30, 2012. In addition, the Ginnie Mae Financial and Accounting System core system review, which began in 2012, was in process and new reviews of systems had not been completed.

HUDCAPS obligation balances could not be traced to HIAMS. In fiscal year 2006,[4] OIG audited the HUD Procurement System (HPS) and the Small Procurement System (SPS) and determined the systems to be noncompliant with Federal financial management requirements. The Office of the Chief

[3] GAO-06-1002R, Managerial Cost Accounting Practices, dated September 21, 2006
[4] Audit report 2007-DP-0003, Review of HUD's Procurement Systems, issued January 25, 2007

Procurement Officer (OCPO) worked to improve those applications and to implement HIAMS as a replacement application between fiscal years 2007 and 2011. OCPO began a phased implementation of HIAMS in October of 2011. The implementation was completed in January 2012.

OIG performed a limited review of the implementation of HIAMS and found that obligation balances in HIAMS were inaccurate and did not match the balances in HUDCAPS. As of September 28, 2012, obligation balances differed between HIAMS and HUDCAPS for 2012 and 2013 fiscal year funds by a net amount of more than $8.1 million. Obligation balances from fiscal years 2009 through 2011 funds differed by a net amount of more than $5.1 million. The net amounts reflected a higher balance in HUDCAPS, indicating that there were obligation balances from HPS and SPS that were not transferred successfully to HIAMS. There were, however, some instances in which the discrepancy indicated an obligation balance in HIAMS that was not reflected in HUDCAPS. Additional discrepancies indicating balances in HIAMS with a missing obligation or line number totaled an additional $2 million and funds within HIAMS not marked to interface with HUDCAPS totaled another $359,304. HUD's system of record for obligation data is HUDCAPS; therefore, HUDCAPS is considered to have the correct obligation balances.

Because HPS and SPS did not contain the same level of contract data that is required in HIAMS, OCPO developed a data cleanup and transfer process that used a combination of electronic and manual migration of data from the legacy systems to HIAMS. Due to the legacy systems' limitations in capturing subaccount line data, the contracting officials used hardcopy award documents to manually enter the appropriate subaccount line data into the HIAMS application. OCPO did not establish adequate data validation procedures or perform adequate testing of the manually entered data.

OMB Circular A-127 requires that all data transfers to the core financial system be traceable to the transaction source. The transaction source data are now maintained within HIAMS, which became the system of record for the contract information transferred to it when OCPO completed implementation of the system. Obligation data in HUDCAPS were not traceable to HIAMS. OMB Circular A-123 requires management to establish and maintain effective internal controls (either manual or electronic) to ensure the reliability of the financial data reported by the agency. The reconciliation of the data needs to be completed for HUD to have that assurance. The HIAMS to HUDCAPS interface program was properly prohibiting actions (that is, obligation of funds or contract modifications) from being taken regarding these contracts until the data matched. As a result, HIAMS did not comply with the requirements of FFMIA for fiscal year 2012.

HUD's Plans To Implement a Departmentwide Core Financial System Were Suspended

As noted earlier, OIG has annually reported on the lack of an integrated core financial system in its audits since fiscal year 1991. HUD uses five separate financial management systems to accomplish the core financial system functions. HUD initiated the Integrated Financial Management Improvement Project in an effort to modernize HUD's financial management system. The initial vision document was initiated in 2003 and issued in 2004, and functional documents were created. However, progress was suspended due to a contract protest and OMB involvement. The contract was awarded in 2010.

The original scope of the Project was to encompass all of HUD's financial systems, including those supporting FHA and Ginnie Mae. However, the inclusion of the FHA and Ginnie Mae portions was put on hold as a result of review by OMB before the execution of the contract. The first phase of the Project was to replace two of the five financial management systems, resulting in the creation of the new Integrated Core Financial System (ICFS). Based on the contract, the implementation date for ICFS was March 2012. This date was not met, and ICFS was not implemented.

In March 2012, HUD's Deputy Secretary stopped work on the Project, and HUD began reevaluating its options for the Project. Sponsorship of the Project was transferred from the Office of the Chief Financial Officer (OCFO) to the HUD Deputy Secretary. The Deputy Secretary and a working group comprised of OCFO, the Office of the Chief Information Officer, and OCPO continued reassessing their options for the Project through the end of the fiscal year. They are jointly working to determine the best path forward which minimizes risks and achieves a cost effective solution. Consideration is being made toward a shared service solution with other agencies and other alternatives. To date, HUD has spent more than $35 million on the Project and does not have an integrated core financial system.

CPD's Grant Management Systems Did Not Substantially Comply With FFMIA

CPD's information systems did not comply with internal control and Federal accounting standards as required by FFMIA.

Use of FIFO caused IDIS to be noncompliant with FFMIA. The Integrated Disbursement Information System (IDIS) Online used a first-in, first-out (FIFO) technique to disburse the formula grants administered by CPD. IDIS was created to manage the formula grants before the enactment of the Chief Financial Officers

(CFO) Act of 1990, the Federal Managers' Financial Integrity Act of 1982 (FMFIA), and FFMIA. These three public laws required agencies to submit annual audited financial statements in accordance with applicable Federal accounting standards and implement internal controls to ensure that (1) resource use was consistent with laws, regulations, and policies; (2) resources were safeguarded against waste, loss, and misuse; (3) reliable data were obtained, maintained, and disclosed in reports; and (4) agencies' Federal financial management systems complied with computer security requirements, internal control requirements, core financial system requirements, Federal accounting standards, and the application of the U.S. Government Standard General Ledger (USSGL) at the transaction level. As the system was owned and used by CPD for the purpose of administering grants, the determination of whether the system complied with these public laws was not a priority of the program office. Further, it was the responsibility of OCFO to assess the compliance of agency financial management systems with these laws. After the enactment of these public laws, all changes necessary to ensure that the system complied with these requirements were not made. OIG determined that the use of the FIFO technique did not comply with Federal accounting standards or budgetary internal control requirements. The use of FIFO by the system made IDIS noncompliant with OMB Circular A-127, Federal Financial Management Systems Requirements.

FFMIA required all financial management systems to follow FFMIA section 803(a) requirements. All systems must comply with computer security and internal control requirements. However, only core financial systems must comply with Financial Systems Integration Office core financial system requirements and accounting standards and apply the USSGL at the transaction level. A mixed system is an information system that can support both financial and nonfinancial functions. Mixed systems do not have to record transactions using USSGL accounts; however, data coming from the mixed system must be posted to the core financial system using proper USSGL accounts and accounting standards. IDIS Online was the mixed system used by CPD for the management of CPD's formula grant programs.[5] Grantees made grant disbursement requests, which served as the financial portion of IDIS that was interfaced with HUD's core financial systems,[6] which must be posted to the core financial system using proper USSGL accounts and accounting standards.

[5] IDIS supports the four CPD formula grant programs: Community Development Block Grant (CDBG), HOME Investment Partnerships (HOME), Emergency Shelter Grants, and Housing Opportunities for Persons With AIDS and the related American Recovery and Reinvestment Act of 2009 programs: CDBG-Recovery, Tax Credit Assistance Program (TCAP), and Homelessness Prevention and Rehabilitation Program (HPRP).
[6] The payment requests from the systems are interfaced with HUD's Line of Credit Control System (LOCCS), which interfaces into HUD's core financial systems and is used to disburse funds. LOCCS then interfaces with PAS and HUDCAPS, the accounting systems used to generate the financial statements, to provide the disbursement information.

OIG communicated IDIS's noncompliance in fiscal year 2009 to CPD. During the fiscal year 2009 audit,[7] OIG found IDIS noncompliant with FFMIA as a result of the deficiencies identified in internal control and the improper use of an accounting method for disbursing and recording grant disbursements.

GAO's Title 2[8] recognized that the accounting for a Federal assistance award begins with the execution of an agreement or the approval of an application in which the amount and purposes of the grant, the performance periods, the obligations of the parties to the award, and other terms are established and creates a legal obligation to disburse the assistance funds.

CPD formula grants are mandated through Congress's appropriation. Before the grantee's receipt of its annual allocation of the appropriation, it first had a consolidated plan and annual action plan, which identified its proposed use of the funds approved by HUD. After both plans were approved, both parties executed an obligation agreement. The agreements identified the amounts and purposes of the grant, the obligations of the parties to the award, and other terms and served as the legal point of the obligation. In essence, the approved plans served as an addendum to the obligation agreement, since the agreement could not be executed without the plans and once the plan is approved, HUD is mandated by the appropriation to provide the funds to the grantee. In addition to the legal point of obligation, the execution of the agreement initiated a financial transaction and required CPD to record an obligation in its financial accounting records and to identify a related budget fiscal year source of funding for the agreement in accordance with Federal budgetary accounting laws and accounting standards, which it used to record the obligation. The budget fiscal year defined the source of funds and established the timeframes for suballocation, expenditures, and when the funds would be returned to the U.S. Treasury if not expended. This source, identified at point of obligation at the initiation of the financial transaction event, is required by budgetary internal controls to remain constant and used to record other financial transaction events related to the obligation, such as suballocations and disbursements initiated by the grantee. IDIS's use of FIFO created financial transaction events inconsistent with the actual events of the obligation and inconsistent with the financial transactions recorded by the grantee, which initiated and was aware of the actual event.

Budget controls are part financial reporting and part compliance controls and provide reasonable assurance that budgetary transactions, such as obligations and outlays, are properly recorded, processed, and summarized to permit the

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[7] Audit report 2010-FO-0003, Additional Details To Supplement Our Report on HUD's Fiscal Years 2009 and 2008 Financial Statements, issued November 16, 2009

[8] Accounting Principles, Standards, and Requirements; Title 2 Standards Not Superseded by FASAB [Federal Accounting Standards Advisory Board] Issuances, from GAO Policy and Procedures Manual for Guidance of Federal Agencies

preparation of the financial statements, primarily the statement of budgetary resources, in accordance with U.S. generally accepted accounting principles (GAAP). In fiscal year 2009, we found that the design and implementation of adequate budget controls in IDIS was deficient as a result of CPD's decision to record grant disbursements from the oldest budget fiscal year appropriation funding source available at the time of the disbursement request without regard for the original source of funding or accounting obligation that was recorded. CPD refers to this practice as FIFO. This process results in a mismatching of accounting obligations and recorded outlays.

The logic used by IDIS, as directed by CPD, to select one source of funds and obligation to record a disbursement, rather than properly identifying and matching the disbursement to the source of funds and obligation agreement, demonstrated an internal control deficiency. Arbitrarily liquidating the funding from the oldest available budget fiscal year appropriation source for the fund type associated with the activity is not in line with budgetary internal control requirements. While this may have been the simplest way to manage grants at the start of the programs, it was before the enactment of the Federal financial management acts, and it ignored the requirements put in place by the public laws to implement accountability, consistent financial reporting, and Federal financial reporting requirements.

During the fiscal year 2010 audit,[9] HUD provided OIG with a legal opinion as a basis to support the use of FIFO. However, the legal opinion only supported HUD's compliance with legally obligating the funds and the disbursement of the funds in accordance with the appropriation's purpose. It was unsupported regarding the appropriateness of the use of FIFO as an accounting method in relation to the accounting obligation and related disbursements. To that end, OIG continued to find IDIS noncompliant with FFMIA since the system continued to use FIFO to record obligation disbursements. OIG made four recommendations[10] to CPD. Based on CPD's understanding that OIG would obtain an opinion from GAO, CPD's management decision was to wait to hear from GAO before proceeding further. OIG has since communicated that a legal opinion regarding the use of FIFO as an appropriate accounting method for recording disbursements will not be sought; however, CPD has not updated its management decision; therefore, no recommendations have been implemented by CPD.

HUD's use of FIFO was not supported by accounting standards. OCFO was responsible for overseeing all financial management activities relating to the programs and operations of the agency and developing and maintaining an integrated agency accounting and financial management system, including financial reporting and internal controls, which comply with applicable accounting principles, standards, and requirements and internal control standards,

[9] Audit report 2011-FO-0003, Additional Details To Supplement Our Report on HUD's Fiscal Years 2010 and 2009 Financial Statements, issued November 15, 2010

[10] See Follow-up of Prior Year Audits section of this report, recommendations 7a-7d.

as well as any other requirements applicable to such standards. Additionally, OCFO was responsible for directing, managing, and providing policy guidance and oversight of agency financial management personnel, activities, and operations, including the approval and management of agency financial management systems design or enhancement projects. When OIG found additional deficiencies in internal control, deficiencies in the system's computer security, and the continued use of FIFO during the fiscal year 2011 audit,[11] it reported the system as noncompliant with FFMIA for the third year and made three recommendations to OCFO.

During the fiscal year 2012 audit, OCFO attempted to implement the three recommendations from the fiscal year 2011 audit regarding IDIS. When OIG reviewed OCFO's evidence to provide closure of two of the recommendations, it determined that evidence was not supported by Federal financial accounting standards, as specifically requested, referenced prior work completed, which OIG noted was inadequate, and referenced legal opinions and appropriations law. OIG communicated to OCFO that the review did not satisfy the recommendations and asked OCFO to reopen the two recommendations.

During fiscal year 2012, OIG performed additional procedures in an attempt to quantify the effects of using FIFO to record financial transactions, by comparing the information in IDIS to the grantee's records, which is required to be maintained using generally accepted accounting principles. While the results did not specifically quantify the effects of using FIFO, it did find a projected irreconcilable net difference of $671.5 million between the grantees' records of the total obligation balance as of July 31, 2012, and IDIS, and an irreconcilable absolute difference of $1.3 billion. In addition, we found an irreconcilable projected absolute difference of $560.4 million between the grantees' records of disbursements made between October 1, 2011, and July 31, 2012, and IDIS. To allow for possible effects from record-posting delays, we also computed and compared the balances at the beginning of the fiscal year by adding disbursements recorded between October 1, 2011, and July 31, 2012, to the obligation balances on July 31, 2012. In this third calculation, we found a projected irreconcilable net difference of $589.6 million and an irreconcilable absolute difference of $1.6 billion between grantees and IDIS. This last comparison was found to have the most precision and least variance of the three. These differences indicated that the data reported in IDIS, and in the case of disbursements, data initiated by the grantee, was inconsistent with the information reported by the grantees maintained using generally accepted accounting principles.

Based upon the system's continued use of FIFO and no additional action taken by HUD to provide a supporting accounting basis for the use of FIFO, it remained noncompliant.

[11] Audit report 2012-FO-0003, Additional Details To Supplement Our Report on HUD's Fiscal Years 2011 and 2010 Financial Statements, issued November 15, 2011

Although OIG reported internal control deficiencies and reported IDIS noncompliant with FFMIA, OMB A-127, and Federal financial accounting standards in fiscal years 2009, 2010, 2011, and 2012, the system is still reported by the OCFO as compliant in HUD's Agency Financial Report, due to HUD's disagreement with OIG. In addition, HUD failed to report to OMB the disagreement with the OIG on the system's compliance with OMB A-127 for fiscal years 2010, 2011, and 2012, as required by the circular.

Internal controls within DRGR remained ineffective. In an audit conducted in fiscal year 2011,[12] we determined that CPD management did not maintain effective internal controls over financial reporting within the Disaster Recovery Grant Reporting (DRGR) information system. Our review found that DRGR did not have a sufficient data modification process in place to protect financial transaction data and audit trails from being overwritten. Specifically, CPD allowed DRGR grantee users to modify voucher transactions (financial events or transactions) to reflect changes to program cost allocation information among activities (the allocation of funds drawn for specific activities). As a result, reconciliation between DRGR and HUD's core financial applications was cumbersome and time consuming. The situation was further aggravated because (1) DRGR did not maintain the full voucher number for payment transactions recorded in HUD's Line of Credit Control System (LOCCS), (2) CPD allowed revision of all or part of the original distribution, (3) CPD did not require grantees to record a reason or justification for making the change within DRGR, (4) CPD allowed voucher modifications to be made until the grant was closed out, and (5) CPD did not require grantee users to obtain approval from HUD for each modification transaction. Transaction-level data detailing how grantees use funding provided by HUD was not transferred to HUD's core financial applications. The detailed financial transaction data were only maintained within DRGR; therefore, DRGR was the financial management systems of record for these data, since only summary information was transferred and maintained in the core financial systems. We followed up on the status of these weaknesses during fiscal year 2012 and determined that corrective actions had not been completed; therefore, the control deficiencies continued to exist. Corrective actions were scheduled to be completed within fiscal year 2013.

CPD Section 108 Loan Guarantee Program Accounting Was Not Automated

HUD did not adequately design or implement financial management requirements for the Section 108 program in its departmentwide financial management system.

[12] Audit report 2012-DP-0001, Audit Report on the Fiscal Year 2011 Review of Information Systems Controls in Support of the Financial Statements Audit, issued February 14, 2012

Section 108 did not have a computerized system to perform its financial management process. This program was not maintained either in the Program Accounting System (PAS) or LOCCS. Instead, the program relied on spreadsheets to account for more than $2 billion in loan guarantees. Also, there was no automated input interface to obtain associated grant data from IDIS. Additionally, when a CPD grantee did not make a bond payment, CPD instructed OCFO's Accounting, Monitoring, and Analysis Division to make a manual deduction of funds available in the line of credit for the CDBG grant.

FFMIA requires that the agency implement and maintain financial management systems that substantially comply with Federal financial management system requirements. OMB Circular A-127, Financial Management Systems, defines a core financial system as an integrated information system that may perform all financial functions including general ledger management, funds management, payment management, receivable management, and cost management and support the preparation of financial statements.

Without integrated automated core financial management systems to record detailed program transactions, the Loan Guarantee program is unable to appropriately monitor loan commitment, note issue, or amount repayment, which may result in unreliable data that could affect the financial statements.

Conclusion

FFMIA requires HUD to develop and maintain financial management systems that can generate reliable, useful, and timely information for managing current operations to make fully informed decisions and to ensure accountability on an ongoing basis. During fiscal year 2012, as in prior years, HUD made limited progress in bringing the financial management systems, including IDIS, Section 108, DRGR, and HIAMS, in fiscal year 2012, into compliance with FFMIA. HUD continued to not meet current requirements. In this regard, OIG continues to report that HUD's financial management systems did not substantially comply with FFMIA.

Recommendations

We recommend that the Office of the Chief Financial Officer

1.a. Reopen recommendation 1B of audit report 2012-FO-003, which required OCFO to determine whether the methodology used by CPD for assigning and disbursing budget fiscal year funding sources to activities within IDIS was in accordance with Federal financial accounting standards and whether the budgetary and internal controls over financial reporting were adequately designed and provided reasonable assurance that misstatements, losses, or noncompliance material in relation to the financial statements would be prevented or detected in a timely manner. Specifically, HUD should prepare an analysis of how the use of FIFO is appropriate and compliant with Federal financial accounting standards, without respect to appropriation law and programmatic rules.

1.b. Reopen recommendation 1C of audit report 2012-FO-0003, which required OCFO, in coordination with CPD, to develop modifications to IDIS and DRGR to correct the unacceptable errors or discontinue the use of these systems for any financial and budgetary information. Specifically, HUD should develop a plan to ensure that accounting transactions and events within IDIS (commitments, activity, funding, and disbursements) comply with Federal financial accounting standards and budgetary internal control requirements.

1.c. Ensure that Section 108 Loan Guarantee program financial management system requirements are incorporated into HUD's core financial system improvement program to get more transparent and complete information for financial and management reports.

Significant Deficiency 1: There Were Weaknesses in the Monitoring of PIH and Multifamily Housing's Program Funds

In fiscal year 2012, HUD's Office of Public and Indian Housing (PIH) and Multifamily Housing spent more than $30 billion through public housing agencies' (PHA) intermediaries to provide operating subsidies and rental assistance that could benefit an estimated 4.6 million households. HUD continued experiencing weaknesses with the monitoring of these PHAs. HUD needs to ensure that PHAs (1) correctly calculate housing subsidies by corroborating the tenant income and reasonable market rent rates; (2) use leasing capacity and funds efficiently; and (3) promote decent, sanitary, and safe housing opportunities as well as other community initiatives. Although there was some improvement from previous years, PHAs continued to make significant amounts of improper payments in their rental housing assistance programs. Additionally, they continued to hold large amounts of reserves despite efforts to reduce and control the funding provided.

Significant Improper Payments in Rental Housing Programs Continued in Fiscal Year 2011

HUD' fiscal year 2012 study of the fiscal year 2011 estimated that errors were made by the intermediaries and tenants intentionally underreported income in three major rental housing assistance programs, resulting in improper subsidy payments. The study was based on analyses of a statistical sample of tenant files, tenant interviews, and income verification data for the intermediaries' activity. HUD's study showed that the intermediaries' error rates for the major program components tested were overpayments of $469.4 million, or 12 percent, and underpayments of $225.7 million, or 13 percent. In total, the administrative errors made by the intermediaries during 2011 resulted in a combined total gross improper payment of $695.1 million.

Additionally, a second HUD study[13] on Tenants Income reported an estimated $428.4 million in subsidy costs that could have been saved if the tenants accurately reported their total income earned. HUD did not conduct a study to estimate the error from the multifamily project owners billing to HUD for fiscal year 2011, but used the $106 million estimated billing error[14] to arrive at the total gross error amount of $1.23 billion in improper payments. According to HUD's fiscal year 2012 agency financial report, the overall error rate is 3.9 percent; which is significantly lower than the 12 and 13 percent error rates of three major programs reported in the study. Lastly, HUD reported that it conducted a survey

[13] Quality Control Study for Rental Assistance Subsidy Determinations for fiscal year 2011 by ICF Macro, October 8, 2012

[14] The billing error estimate was derived from the most recent billing error estimates for the Public Housing Program and the Owner-administered Project-based Assistance programs.

of all program and administrative activities for potential indicators of significant improper payments, but did not disclose that Ginnie Mae's mortgage security guarantee program was excluded from the survey. HUD assumed that this program is not subject to IPERA requirements because it did not receive appropriated funds. However, HUD's risk assessments included FHA's guarantee programs which do not receive appropriated funds as well. This indicates a lack of consistency in the scope of the survey.

Our fiscal year 2012 improper payment audit report[15] found that in general, HUD's Fiscal Year 2011 Agency Financial Report and Accountable Official Report plans for addressing improper payments complied with Improper Payments Elimination and Reduction Act (IPERA), Executive Order 13520, and 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. We reported that HUD's risk assesment 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 found that additional improvements were needed to strengthen HUD's improper payment reduction strategies and enhance the accuracy of HUD's estimated improper payment rate for rental housing assistance programs.

Public Housing Agencies Continued To Hold a Large Excess of Reserves

The Section 8 Housing Choice Voucher program is HUD's largest housing assistance program, with an annual appropriation of around $18 billion for calendar year 2012, and provided assistance to more than 2 million families through the first 6 months of 2012. The annual appropriation acts require HUD to distribute the full amount of funding appropriated using a formula based on the housing agencies' self-reported prior-year costs, which are reported and tracked in the Voucher Management System. Program guidance states that any budgetary authority provided to PHAs that exceeds actual program expenses for the same period must be accounted for and maintained as restricted cash and made available for housing assistance. These funds were designated as the PHA's net restricted assets (NRA).

In 2012, HUD received the authority for an offset of $650 million to the PHAs' renewal funding to reduce the NRA reserves. In addition, HUD will begin reducing the outlays and transition the custody of PHAs' NRA funds from PHA

[15] Audit report 2012-FO-0005, Annual Evaluation of HUD's Compliance With the Reporting Requirements of the Improper Payments Information Act of 2002, Executive Order 13520, and OMB Circular A-123 Implementing Guidance

custody to HUD. Although the funds were still available for PHA use, the PHA will have to request and justify to HUD any increases of advances. Cash management procedures[16] will help mitigate the risk associated with PHAs accumulation of fund surpluses by safeguarding them at HUD, but would not control the accumulation of PHAs fund reserves in HUD's books. Because this practice has not been fully implemented, the full impact of this significant change could not be evaluated.

However, as of June 30, 2012, PHAs had not maximized leasing rates or used all available resources. This condition contributed to an accumulation of $628 million in excess NRA. This calculation was based on our examination of 2,297 PHAs contained in the NRA monitoring report as of June 30, 2012, which reported having a combined NRA balance of $1.43 billion. Based on our analysis of the unit-leased voucher utilization rates of PHAs, we observed that PHAs were not fully using resources or assisting the maximum number of families. PIH should request the authority needed to perform recurring offsets of PHAs' renewal funding with excessive NRA amounts such as the $628 million identified.

The MTW Demonstration Program Lacked Procedures To Ensure Reliable Performance Reporting

The Moving To Work Demonstration program (MTW) was established to give public housing agencies and HUD the flexibility to design and test innovative, locally designed strategies in pursuit of the national goal of delivering rental assistance more efficiently. The program's intent is to pursue three statutory objectives: (1) reduce cost and achieve greater cost effectiveness in Federal expenditures; (2) give incentives to families with children when the head of household is working, seeking work, or preparing for work by participating in job training, educational programs, or programs that assist people in obtaining employment and becoming economically self-sufficient; and (3) increase housing choices for low-income families. Interest in participation in MTW has expanded such that the number of MTW PHAs increased from 30 in fiscal year 2010 to 35 in fiscal year 2012. However, HUD's internal controls were not sufficient to capture and evaluate agencies' performance and use of funds toward meeting the MTW requirements above.

[16] HUD issued PIH Notice 2011-67 "Implementation of New Cash Management Requirements for the Housing Choice Voucher Program" to control disbursement of funds to PHAs to ensure that PHAs do not receive federal funds before they are needed as required by Section 2025 of Treasury Financial Manual, Vol. 1, Part 6.

HUD did not establish monitoring tools necessary to ensure that the MTW[17] statutory goals were met. Additionally, HUD did not finalize or implement performance measures and the methodology needed to evaluate performance of PHAs in achieving the program goals. HUD also did not establish adequate tools to verify the reliability of reported program data.

We reviewed a sample of five MTW PHAs participating in the program and found that the reported financial and performance information in their 2011 annual report did not agree with the information reported in HUD's systems. Specifically, for four[18] of the five[19] PHAs reviewed, the cumulative net difference between their audited financial reports and HUD's MTW report for total revenues and expenditures was more than $142 million. The MTW agency reports also implied a cumulative net loss of more than $41 million. However, the audited financial report showed a net surplus of more than $101 million for the same timeframe.

Additionally, the audited financial data for the five PHAs showed that the PHAs received cumulative revenues of more than $1.9 billion for the MTW program in their respective 2011 fiscal years but used a total of less than $1.8 billion on the program. As a result, there was an inefficient use of funds of an average of 93.6 percent and a surplus accumulation of nearly $122 million in MTW funding. That surplus amount was retained by the PHAs, thereby increasing their program reserves. Further, the overall utilization rate for the MTW available units and vouchers for the five PHAs' respective 2011 fiscal years was only 91.7 percent.[20]

Also, HUD's review checklists for the MTW annual plans and MTW reports lacked written procedures and tests to verify and ensure that the actual program data reported were reliable and adequate to measure progress toward the program objective. The review system implemented by the MTW program office did not have a standard documentation process or a standard review process to ensure that comprehensive reviews were conducted, as the review checklists were not required to be completed and retained. Further, the financial information and program results contained in the MTW reports were presented differently among

[17] 42 U.S.C. (United States Code) 1437f, Section 101, as amended, established MTW to give public housing agencies and HUD the flexibility to design and test innovative, locally designed strategies in pursuit of the national goal of delivering rental assistance more efficiently.
[18] The remaining PHA did not separate its MTW expenses from the total PHA expenses for the fiscal year in its MTW report as required. Therefore, the information selected in this section was not included in our review.
[19] The five PHAs reviewed were (1) Chicago Housing Authority, (2) Massachusetts Department of Housing and Community Development, (3) Oakland Housing Authority, (4) Philadelphia Housing Authority, and (5) Atlanta Housing Authority.
[20] OMB Circular A-123, section I, states, "The proper stewardship of Federal resources is an essential responsibility of agency managers and staff. Federal employees must ensure that Federal programs operate and Federal resources are used efficiently and effectively to achieve desired objectives."

PHAs because HUD did not implement standardized reporting requirements.[21] As a result, there was not always sufficient documentation from which to draw comparative conclusions on MTW PHA performance.

The discrepancies identified were an indication that one of the information sources was unreliable or the systems and reports were not measuring and reflecting the same program information. Thus, HUD could not verify the data reported. As a result, information users had no assurance that the reported results of the program were accurate and could not ensure that the program met the statutory objective in an effective and efficient manner.

While each MTW PHA's program and agreement are different, HUD's lack of a standardized reporting process hindered its ability to effectively analyze and use the reported information to make assessments and determinations for the entire program. The program office's ability to address these issues was hindered by a lack of staffing and other resources necessary to accomplish its oversight responsibilities. During the last 2 years, HUD has increased the number of participating MTW PHAs by more than 16 percent. However, staff and program resources were not increased to meet the level of effort required.

In a fiscal year 2012 review of MTW,[22] GAO made the following recommendations: that HUD (1) improve its guidance on reporting performance information, (2) develop a plan for identifying and analyzing standard performance data, (3) establish performance indicators, (4) systematically identify lessons learned, (5) clarify key terms, (6) implement a process for assessing compliance with statutory requirements, (7) perform annual assessments of program risks, and (8) verify the accuracy of self-reported data. HUD generally or partially agreed with seven of the recommendations. HUD disagreed with GAO's recommendation that it create overall performance indicators. GAO believed, however, that they were critical to demonstrating program results and, thus, maintained its recommendation.

Conclusion

HUD continued its efforts to reduce its identified improper payments in fiscal year 2012 to $695 million. Our review of HUD's fiscal year 2011 agency financial report and accountable official report plans determined that they were compliant with IPERA requirements. We did note some technical changes that should be made to HUD's risk assessment processes.

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[21] OMB Circular A-123, section I, part A, states, "…management should have a clear, organized strategy with well-defined documentation processes that contain an audit trail, verifiable results, and specify document retention periods so that someone not connected with the procedures can understand the assessment process."
[22] GAO-12-490, Opportunities Exist to Improve Information & Monitoring, issued April 19, 2012

Based on our review of the use of budgetary authority, we observed that if a PHA maintains its leasing rate at a high percentage of annual revenues but under 100 percent of revenues, its program reserves will grow despite the use of fiscal responsibility and prudence. In prior years, we have recommended and PIH has attempted obtaining congressional authority to perform recurring offsets of renewal funding against amounts deemed excessive NRA, but Congress has not granted that authority. We observed that the NRA will continue to accumulate, and program funds will not be used for their intended purpose. It is for this reason that PIH should continue seeking congressional authority to perform offsets at its discretion to ensure proper management and oversight of the voucher program as it is designed.

Our review showed that HUD did not properly evaluate MTW PHAs' progress in achieving program goals or verify the reliability of reported MTW data. HUD did not establish necessary monitoring tools to properly evaluate performance goals and statutory objectives and verify the accuracy of reported data. HUD also lacked the standardized reporting processes to assess performance or sufficient staffing to perform monitoring activities. The result of the lack of procedures was illustrated in the utilization rate and the amount of excess reserves that could have been used to assist families in accordance with statutory objectives. HUD should finalize and implement performance measures and the methodology needed to perform these actions to ensure that statutory objectives were consistently met by the MTW PHAs.

Recommendations

We recommend that the Assistant Secretary of Public and Indian Housing

2.a. Request that Congress include in the appropriations bill an offset of renewal funding for the Housing Choice Voucher program of $628 million or the amount of reserves in excess of 6 percent of the PHAs' annual budgetary authority as of December 31, 2012.

2.b. Continue to request the congressional authority to annually perform offsets of amounts of excessive NRA as determined appropriate by the program office to maintain and maximize the effectiveness and integrity of the Housing Choice Voucher program.

2.c. Develop, implement, and document methodologies to calculate and track performance measures to enable comparability of data among MTW PHAs and ensure the reliability of reported data.

2.d. Develop, implement, and document standardized reporting requirements for the MTW data and results for all MTW PHAs.

2.e. Update the MTW plan and report review procedures to include steps to verify the reliability of presented data against HUD systems and retain all supporting documentation as evidence of controls performed.

2.f. Ensure that the staffing and funding levels for the MTW program office are adequate to provide proper oversight of the program.

Significant Deficiency 2: HUD's Internal Control Over Financial Reporting Had Serious Weaknesses

In fiscal year 2012, OIG identified weaknesses in HUD's control over its financial reporting process. For example, OIG found that (1) the allowance for loss on Section 202 flexible subsidy and Section 312 direct loan receivables was not routinely evaluated for reasonableness, (2) HUD did not always record receivables in the accounting records when a determination was made that funds were owed to HUD and required repayment, and (3) intraentity transactions between HUD's component entities were not properly eliminated before consolidation.

This condition occurred because of a weak financial management governance structure, lack of clear accounting policy guidance, and poor accounting monitoring controls. As a result of our audit, significant adjustments were made to the flexible subsidy and Section 202 allowance for loss accounts in the amount of $515 million and $12.8 million in HUD's books in fiscal year 2012. With regard to accounts receivable, we identified a potential $77.4 million in accounts receivable not included in HUD's consolidated financial statements. Lastly, intraentity transactions between FHA and Ginnie Mae were not eliminated before consolidation. Given these weaknesses in HUD's internal controls, HUD lacked assurance that its internal controls could prevent and detect errors in its accounting records adequately and in a timely manner.

Flexible Subsidy, Section 202, and CPD Section 312 Direct Loan Allowance for Loss Rates Need To Be Reevaluated

We reviewed the allowance for loss methodology and rates for three direct loan programs that reported balances under the "loans receivable" line item on the consolidated balance sheet. OCFO used a 90 percent allowance for loss rate for flexible subsidy loans, which was the recommended rate in fiscal year 2001 and had not been reevaluated with Office of Housing input since then to consider changes in relevant factors. Our review of writeoffs and foreclosures for the flexible subsidy loan program over the past 10 years indicated that the 90 percent rate was unsupported. For Section 202 loans, OCFO had developed a methodology for calculating the allowance for loss rate but had done so without input from the Office of Housing. According to OCFO, the methodology and rates used had not been reviewed by the Office of Housing to determine whether they were appropriate and considered relevant factors. Lastly, for CPD Section 312 loans, OCFO was using a 95 percent allowance for loss rate. Our review of writeoffs and collections indicated that the 95 percent rate was unsupported and may have understated the associated receivable.

The Loan Receivable Net Realizable Value Was Understated

Statement of Federal Financial Standards (SFFAS) 2, Accounting for Direct Loans and Loan Guarantees, states that reestimates should be completed each year and should consider risk factors such as loan performance, economic conditions, and newly developed events that may affect loan performance; characteristics of borrowers; and value or changes in value of collateral.

Reevaluations with program office input over these three loan programs were not completed due to the lack of formal policies issued by OCFO and were not detected in ordinary management and financial reporting processes. OCFO did not have a formal policy requiring an annual reevaluation of allowance for loss methodologies and rates for all loan portfolios and accounts receivable balances. As a result, the net realizable value for the flexible subsidy loans was misstated.

In coordination with the Office of Housing, OCFO revised the allowance for loss methodologies and rates for the flexible subsidy and Section 202 loan programs. These revised methodologies and rates resulted in adjustments to the flexible subsidy and Section 202 allowance for loss accounts in the amount of $515 million and $12.8 million, respectively. Additionally, the redrafted allowance for loss methodologies for the flexible subsidy and Section 202 loan programs included the requirement that the rates be reevaluated annually.

Recognition of Accounts Receivables Was Not Always Timely

HUD did not always record a receivable when sustained OIG audit recommendations, final program monitoring letters, or repayment agreements required funds to be repaid. The majority of repayments were recorded as receivables on the date the funds were collected. Receivables should be recognized on the date the funds are determined to be owed to HUD in accordance with GAAP.

We reviewed 24 OIG audit reports with a total of $78 million in outstanding sustained costs due to HUD to determine whether OCFO properly accrued receivables in compliance with GAAP. There were 16 reports with recommendations totaling $72.6 million that had not been recorded as a receivable in the general ledger as of September 30, 2012. HUD did not accrue 8 of the16 totaling $1.7 million, which were under repayment agreements from prior fiscal years.

We also sampled 55 receivables, worth $25.5 million, collected during fiscal year 2012. Eleven of these collected receivables totaling $3.5 million originated from program monitoring findings, and six totaling $1.3 million were in accordance with established repayment agreements. Collections for all 17 transactions occurred between 116 and 2,976 days after the receivable event occurred. However, HUD did not accrue any of the receivables until the payment collection date. For those that had repayment agreements in place, we determined that there had been no accruals for the balance recorded in the accounting records as of September 30, 2012.

According to SFFAS 1, a receivable should be recognized when a Federal entity establishes a claim to cash against other entities, such as a payment due date. If the exact amount is unknown, a reasonable estimate should be made. HUD's Debt Collection Handbook 1900.25, REV-4, specifies that funds are often determined to be owed to HUD during routine monitoring and accounting activities, sustained audit findings, and investigations. The funds are recognized as a receivable when the monitor or other person discovering the funds owed is required to notify the action official for the program activity. For example, when an OIG audit report recognizes that disallowed costs are due to HUD, the debt is treated as a receivable when a management decision is reached. Also, HUD's Audit Management System Handbook 2000.06, REV-4, states that the Assistant Chief Financial Officer for Accounting is responsible for establishing procedures for ensuring that the amounts due to HUD are appropriately accounted for and collected. The action official should notify the accounting office of any audit reports with disallowed costs due HUD and any modifications to costs and monitor the costs.

HUD Lacked Controls Over Repayment of Funds

Our review found that adequate controls were not in place to ensure that the accounting center was notified of the funds to be repaid at the time repayment was recognized, either through a sustained OIG audit recommendation, final program monitoring letter, repayment agreement, or other binding document. Additionally, some of HUD's program offices did not consider the return of funds to be a receivable. Therefore, they did not have procedures or think they needed to report these owed funds to the accounting center for proper recording.

As a proactive measure regarding OIG audit recommendation costs, OCFO issued a memorandum in April 2012 to all assistant secretaries, action officials, and audit liaison officers to remind them of their responsibility to comply with the policies and procedures contained in the Audit Management System Handbook, specifically section 5-7, Detailed Cost Information. OCFO also updated HUD's Debt Collection Handbook to clarify that disallowed costs from OIG audits are considered receivables as of the management decision date. Further, the Audit Resolution and Corrective Action Tracking System (ARCATS), used to track

OIG audit recommendations, was being modified to send notifications to the appropriate individuals and now produces a real time report, which identifies all open audit recommendations with disallowed costs due to HUD.

Intraentity Transactions Between HUD's Component Entities Were Not Properly Eliminated Before Consolidation

During our fiscal year 2012 audit, OIG found that HUD failed to eliminate intraentity transactions[23] between FHA and Ginnie Mae, as component organizations, to arrive at the consolidated amounts in accordance with A-136 and Federal Accounting Standards Advisory Board requirements. Specifically, HUD did not ensure that claim receivable and payable transactions between FHA and Ginnie Mae were properly accounted for and reported by the component organizations to OCFO to reasonably ensure that these transactions would be eliminated during financial statement consolidation.

For example, as noted in the table below, OIG noted[24] three intragovernmental receivable line items due from FHA in Ginnie Mae's financial statements in which FHA had no intragovernmental payable with a Ginnie Mae provision or the provision was not properly separated from the liability with the public in FHA's financial statements. For each of these receivables, Ginnie Mae assumed full collectability of the receivable amounts from FHA. Therefore, all three Ginnie Mae receivables in substance were valid claims for cash against FHA. Consistent with the GAAP concept, it is OIG's position that the substance and not the form should be reported by HUD in its books for these transactions.

Table 1

Ginnie Mae receivables	Balances as of 9/30/12 (in millions)	Balances as of 10/1/11 (in millions)
Mortgages held for investment[25]	$6,210	$5,886
Advances against defaulted mortgage-backed securities pools[26]	829	568
Short sale claims receivable[27]	20	26

[23] The claims transactions between FHA and Ginnie Mae represent an intraentity activity.
[24] On October 24, 2012, Ginnie Mae provided OIG with the account balances for the mortgages held for investment and advances against defaulted mortgage-backed securities pools accounts that pertained to FHA. Due to the timing of the audit report, these numbers were strictly Ginnie Mae management's representations.
[25]The mortgage held for investment account represents the value of defaulted loans that Ginnie Mae acquired from defaulted issuers' portfolios to effectively manage the portfolio.
[26] The foreclosure claims receivable represents the amount of principal and interest receivable on foreclosed-upon properties that have not been conveyed to FHA.
[27] The short sale claims receivable is the difference between the proceeds received from the sale of FHA-insured loans and the total contractual amount of mortgage loan and interest incurred by the borrower.

In accordance with OMB A-136, HUD is required to present its entity receivables and payables, net of intraentity transactions, to reflect consolidated totals. Additionally, intragovernmental receivables and payables should be reported separately from the receivables and payables to the public in accordance with SFFAS.

OCFO did not adequately monitor the appropriateness and completeness of the component entities' quarterly financial report submissions to reasonably ensure that intraentity claims receivable and payable between Ginnie Mae and FHA were properly accounted for and reported on a consolidated basis. According to OCFO, Ginnie Mae and FHA did not report their intraentity claims payable and receivable in the "F" file,[28] which prevented them from eliminating these intraentity transactions upon consolidation. We noted that OCFO did not provide guidance to their components on this matter.

Conclusion

HUD's loan receivable net realizable value and account receivable balances were misstated as of September 30, 2012. Additionally, intraentity transactions were not properly eliminated in the consolidated financial statements. To ensure that the net realizable value of loans and accounts receivable is accurately reported, accounts receivable are properly accrued, and intraentity transactions are properly eliminated on HUD's financial statements, OCFO needs to develop and implement financial management policy and controls to ensure that errors in accounting records are prevented or detected in a timely manner.

Recommendations

We recommend that the Office of the Chief Financial Officer

3.a. Develop and implement formal financial management policies and procedures regarding GAAP-compliant fiscal yearend consolidation.

3.b. Revise HUD's Debt Collection Handbook 1900.25, REV-4, to include comprehensive procedures to ensure that amounts to be repaid from program monitoring findings, repayment agreements, and other binding documents are communicated to the accounting center for timely accrual of receivables.

3.c. Develop and implement formal financial management policies and procedures to require an annual evaluation by OCFO and applicable program

[28] The "F" file contains transactions with HUD and its components, including other Federal agencies.

offices of all allowance for loss rates and other significant estimates currently in use to ensure appropriateness.

3.d. Develop and implement internal procedures within the accounting centers to ensure that amounts owed to HUD from OIG audit recommendations, program monitoring findings, repayment agreements, and other binding documents are properly accounted for, collected, and reported.

3.e. For OIG audit recommendations with costs that have not been finalized at the management decision date, develop a methodology to calculate an appropriate estimate of the anticipated amount owed to ensure that an appropriate account receivable amount is accrued.

3.f. Establish an appropriate allowance for loss methodology and adjustment for receivables established due to OIG audit recommendations, program monitoring findings, repayment agreements, and other binding documents.

Significant Deficiency 3: CPD's Information and Communication Systems Had Weaknesses

The Office of Community Planning and Development's (CPD) information and communication systems did not collect and disseminate timely, reliable and relevant information to those charged with making informed decisions. Based upon our review of CPD's programs and internal controls implemented to monitor grantee compliance with program regulations, we noted that even though improvements had been made, the computer information systems did not have reliable information and some processes had ineffective means of sharing and processing information. Prior year recommendations remained unimplemented and control deficiencies regarding the programs' compliance with internal handbooks and OMB regulations continued to exist.

New Controls Brought Improvement

Based upon our review of several yearend reports from the Office of Affordable Housing Programs (OAHP), improvements have been made since the prior year. Our fiscal year 2011 audit reported that the HOME Open Activities Report, dated September 30, 2011, contained 6,994 of 21,121 open activities (33 percent) in which the participating jurisdiction had made its final draw but the activity was still listed on the report as open[29]. These activities were not completed in the system because the completion and beneficiary information was not entered, although all of the $782.5 million in funds had been drawn. HOME program regulations required participating jurisdictions to enter project completion information into IDIS within 120 days of making a final draw for a project. Similar findings were reported in fiscal years 2009[30] and 2010.[31]

As a result of the prior OIG findings, OAHP implemented a new policy during fiscal year 2012 in which participating jurisdictions with at least one HOME activity in final draw status were not able to set up new activities or commit funds to activities (other than those in final draw for more than 120 days) until the activities identified as being in final draw status for more than 120 days were either completed or otherwise taken out of final draw status.

[29] Audit report 2012-FO-0003, Additional Details To Supplement Our Report on HUD's Fiscal Years 2011 and 2010 Financial Statements, issued November 15, 2011
[30] Audit report 2010-FO-003, Additional Details To Supplement Our Report on HUD's Fiscal Years 2009 and 2008 Financial Statements, issued November 16, 2009
[31] Audit report 2011-FO-0003, Additional Details To Supplement Our Report on HUD's Fiscal Years 2010 and 2009 Financial Statements, issued November 15, 2010

Although this new policy was implemented, our review of the HOME Open Activities Report, dated September 30, 2012, showed 718 of 15,474 open activities (5 percent) and $80.9 million in disbursed funds for activities in which the participating jurisdiction had made its final draw but had not entered the completion and beneficiary information into the system. Jurisdictions that do not enter completion data in a timely manner or within 120 days of making the final draw are in violation of HOME regulations. Of the 718 activities, 80 activities were in final draw status for 120 days or more and had disbursed $15.6 million of the $80.9 million. The widespread failure of participating jurisdictions to enter data in a timely manner resulted nationally in underreporting of actual HOME program accomplishments to Congress and OMB and may negatively impact future funding for the program.

OIG also reported in 2011 that the September 30, 2011, HOME Open Activities Report showed 307 activities, which were funded between April 2000 and September 2010, that had a funded and remaining balance of $63.9 million, as no draws had been made against the activities since they were initially funded. The report further showed 190 activities funded between 1999 and 2009 in which the percentage of amounts drawn on the activity was less than 50 percent or less. These activities had incurred no drawdowns on the funds since 2009 and had balances of $24 million still available for draw. OIG reported that these activities appeared to be stalled. Similar findings were reported in fiscal year 2010. When we reviewed the September 30, 2012 Open Activities report, we noted only 9 activities which were funded between November 2008 and September 2010 that had a funded and remaining amount of $598,200 as no draws had been made against the activities since they were initially funded. There were not any activities funded between April 2000 and November 2008 that did not have any draws since they were initially funded. The September 30, 2012 report also showed only 69 activities funded between 2000 and 2009 wherein the percentage of amounts drawn on the activity was less than 50 percent. These activities had incurred no draw-downs on the funds since 2009 and had balances of $13.2 million still available for draw. There were not any activities funded in 1999 that did not have a draw since 2009 and had less than 50 percent drawn.

As a response to the OIG findings, OAHP implemented a new policy in 2011 in which activities with commitments in IDIS that were more than 12 months old with no funds disbursed were automatically canceled in the system and were reported on the monthly HUD Initiated Activity Cancellation Report. The cancellation of the activities could potentially affect the grantee’s compliance with HOME statutory commitment requirements. After our review in fiscal year 2011, OIG reported that the new report would take into account only those activities that appeared to have never started and those that had been started and not progressed would be ignored and recommended that OAHP address those activities.

Responding to OIG's recommendations, OAHP implemented a policy during fiscal year 2012, wherein activities with some disbursements, but no disbursements for the previous 12 months or more, would be placed in the infrequent draw status. The grantee would be unable to start a new activity or increase commitments on other activities and unless the grantee provided an explanation for the lack of recent disbursements and the status of the activity. As of September 30, 2012, there were 1,129 activities included in the infrequent draw status which had already disbursed $159.1 million; however, these activities still had $52.9 million remaining to be disbursed. In addition, there were 483 activities in danger of being placed in the infrequent draw status within the next 30 to 90 days. In other words, the activities did not have any disbursements within the last 9 to 11 months. These 483 activities had disbursed $81.7 million and still had $21.4 million remaining to be disbursed. Identifying and canceling inactive activities in a timely manner allows funds to be recommitted to new activities.

Also, during the fiscal year 2011 audit, we reviewed the HOME Expiring Funds Report as of September 30, 2011, and identified 68 participating jurisdictions and 124 recipients with $16.3 million in unexpended grants funded with no-year expiration funds and dated from 1992 through 2001, and $9.9 million of the $16.3 million was uncommitted.

In our review of the HOME Expiring Funds Report as of September 30, 2012, we identified 35 participating jurisdictions and 46 recipients with $7.6 million in unexpended grants funded with no-year expiration funds and dated from 1992 through 2001, and $1.6 million of the $7.6 million was uncommitted.

Table 2

	As of 09/30/11		**As of 09/30/12**	
Fiscal year	**Available to commit**	**Available to draw**	**Available to commit**	**Available to draw**
1992	$40,324	$62,269	$-	$73,765
1993	357,438	655,751	86,762	455,098
1994	640,551	1,730,511	-	713,662
1995	911,566	1,340,591	10,533	778,314
1996	981,750	2,000,826	4,596	397,929
1997	578,613	945,841	32,331	317,706
1998	1,749,007	2,325,634	100,027	659,592
1999	1,557,579	1,882,625	449,324	1,149,584
2000	869,221	1,696,771	61,483	1,049,957
2001	2,288,614	3,707,930	920,235	2,030,138
Total	$9,974,663	$16,348,750	$1,665,290	$7,625,745

These no-year funds had accumulated due to (1) poorly performing community housing development organizations (CHDO) and subgrantees of the participating jurisdictions that did not expend funds in a timely manner, (2) a cumulative review method that allowed poor performance to go undetected, and (3) a recapture policy for noncompliant participating jurisdictions that recaptured funds from a current funding source. Current HOME program regulations did not penalize or highlight poorly performing grantees, subgrantees, or CHDOs.

During our fiscal year 2009 audit,[32] we identified unused funds from fiscal years 2001 and earlier and pointed out that it was the field offices' responsibility to ensure that the funds that were not spent in a timely manner were recaptured and used in the next year's formula allocation. We recommended that CPD ensure that field offices encourage participating jurisdictions to review the expiring funds report, as well as the performance of CHDOs and subgrantees, to determine whether the unused funds should be deobligated. We also recommended that CPD develop a policy that would track expenditure deadlines for funds reserved and committed to CHDOs and subgrantees separately. While, these recommendations remain open[33], the Proposed HOME Regulation published in the Federal Register on December 16, 2011 makes several changes to the requirements of CHDOs and funding awarded to CHDOs. For example, general CHDO reservations would be eliminated and PJs would be required to commit CHDO set-aside funds to specific CHDO projects within 24 months. In addition, HUD would deobligate CHDO set-aside funds not expended within five years of obligation to the PJ. These changes were proposed and not yet published in a Final Rule.

The System Used To Communicate Results and Status of Onsite Monitoring Was Not Effective

During the fiscal year 2011 audit[34], a review of several key elements of the grantee monitoring process established under CPD's Office of Field Management revealed that the CPD field offices, which are responsible for conducting monitoring reviews of CPD program grantees, did not always follow the CPD Monitoring Handbook or the annual risk assessment notice. The review also revealed that the Grants Management Process (GMP) information system[35] was not always updated to reflect the current status of the monitoring reviews.

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[32] Audit report 2010-FO-0003, "Additional Details To Supplement Our Report on HUD's Fiscal Year 2009 and 2008 Financial Statements, dated November 16, 2009

[33] See Follow-up of Prior Year Audits section of this report, recommendation 12b

[34] Audit report 2012-FO-0003, "Additional Details To Supplement Our Report on HUD's Fiscal Year 2011 and 2010 Financial Statements, dated November 15, 2011

[35] The GMP system is a computer-based information system that is used to provide a documented record of conclusions and results.

Our review conducted during fiscal year 2012 demonstrated that the previous year's conditions continued to exist. We found that although required by the handbook, (1) field offices did not send a notification letter to the grantee more than 14 days before the monitoring, (2) monitoring report letters were sent to the grantee after the 60-day deadline, and (3) follow-up was not always completed after findings were communicated to the grantee to ensure completion of the action plans or repayment of ineligible costs identified.

The deadlines and responsibilities outlined in the CPD Monitoring Handbook help to provide an effective system of monitoring internal controls. They include providing timely and relevant information to those charged with making decisions as well as timely follow-up for deficiencies identified and a process to ensure collections of ineligible costs identified. However, all field offices had not implemented the internal controls outlined in the handbook, which led to properly designed controls being ineffective. Not following the handbook prohibits the field offices from identifying instances of noncompliance and potential fraud, waste, and abuse by program participants and prohibits the grantees from rectifying deficiencies in a timely manner. The recommendations from the prior year to ensure that the CPD Monitoring Handbook is followed, the information in GMP is accurate, and findings are closed and funds are collected had not been implemented.[36]

CPD Did Not Have a System in Place To Ensure Compliance With OMB Circular A-133

CPD did not have a process in place to ensure that the CPD field offices and OAHP carried out the cognizant oversight or Federal awarding agency for audit responsibilities in accordance with OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and OMB Memorandum 10-14, Updated Guidance on the American Recovery and Reinvestment Act. Internal control procedures did not exist to effectively monitor the field offices' compliance with the CPD memorandum issued to the field office directors regarding their responsibilities for Single Audit Act audits. Policies and procedures did not exist to ensure OAHP's compliance with the Single Audit Act audit requirements for the American Recovery and Reinvestment Act program, Tax Credit Assistance Program (TCAP). In addition, CPD did not have a tracking and reporting mechanism for accurately monitoring and reporting Single Audit Act follow-up results. Management decisions for findings were not made, and corrective actions were not initiated within 6 months of receipt of the audit report, and, therefore, CPD and ultimately HUD were not in compliance with the Single Audit Act.

[36] See Follow-up of Prior Year Audits section of this report, recommendations 3a-3d.

CPD did not have an effective monitoring procedure in place to ensure or determine whether field offices complied with OMB Circular A-133 requirements. The method used was the quality management reviews, conducted through the Office of Departmental Operations and Coordination, in which field offices were reviewed on a rotational basis, approximately once every 4 years.

Over the last 2 years, during the reviews, 43 percent of the field offices reviewed (4 of 10 field offices in fiscal year 2010 and 5 of 11 field offices in fiscal year 2011 for a total of 9 of 21) cited 10 findings and deficiencies (1 field office had 2 findings) related to the inadequate review, documentation, or follow-up of Single Audit Act reports or management decisions and, thus, noncompliance with OMB Circular A-133.

In addition, the findings and observations made during the reviews were closed before it could be determined whether the actions taken corrected identified deficiencies or produced improvements. CPD's policy was to wait until those field offices were selected again for a review to determine whether the policies were in place and working as intended, which could take up to 4 years.

In fiscal year 2011,[37] OIG reported that OAHP did not have policies and procedures in place to ensure compliance with the Single Audit Act requirements for TCAP. OAHP also did not have adequate internal controls in place to monitor TCAP grantees for compliance with the program regulations or to ensure onsite monitoring of the $2.082 billion disbursed of the $2.244 billion in grants awarded. Since OAHP lacked staff, expertise, and funding to perform onsite monitoring reviews, OAHP planned to use the grantee' onsite monitoring and reviews of the Single Audit Act reports as a monitoring tool.

During fiscal year 2012, OAHP implemented corrective actions in response to OIG's recommendations[38] and obtained the results of the onsite monitoring planned or performed by the TCAP grantees and confirmed that grantees had policies and procedures in place to conduct onsite monitoring. OAHP also decided on a process for reviewing Single Audit Act audits of TCAP grantees quarterly beginning on March 31, 2012, and to take immediate action, as appropriate, on any findings, so that findings would be resolved within 3 months of OAHP's initial review. However, OIG noted that the review of the Single Audit Act audits generally took place in August of 2012, although some grantees had reported findings in the Federal Audit Clearinghouse (FAC) as early as 2011. In addition, audit findings were not resolved within 3 months in accordance with the policy or within 6 months after the filing date in the Clearinghouse as required by OMB regulations.

[37] Audit report 2012-FO-0003, Additional Details To Supplement Our Report on HUD's Fiscal Years 2011 and 2010 Financial Statements, issued November 15, 2011

[38] See Follow-up of Prior Year Audits section of this report, recommendations 3e-3g.

Without a system in place to obtain and track the information, CPD could not ensure that field offices or offices at headquarters complied with the Single Audit Act requirements. Management was not obtaining the audit reports from the FAC in a timely manner and resolving the findings within the required timeframe.

Effective Information Systems Are Necessary

In our review of the key internal control and compliance components within CPD, we noted instances in which the information and communication adversely affected the success of the internal controls implemented. The basis of an information system is the sharing and processing of information and ideas. Computer information systems did not have reliable information, and some processes had ineffective means of sharing and processing information.

In our review of the onsite monitoring of internal controls performed by CPD field offices, we noted that the GMP system used to collect and store the results of the monitoring and the status of findings did not contain complete and accurate information. To that end, it was unclear whether deficiencies or instances of noncompliance, which were identified during the onsite monitoring, continued to exist or had been corrected. In addition, as some of the onsite monitoring procedures resulted in the grantee's having to return funds, it was also unclear as to how many funds were due to HUD and the programs. Without proper follow-up by the program when instances of noncompliance were identified and funding was requested to be returned, grantees did not have an incentive to implement the corrective actions they agreed to or repay funds. Those responsible for following up with the grantees cannot efficiently allocate their resources if they cannot determine where attention is needed.

In our review of CPD's compliance with OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and OMB Memorandum 10-14, Updated Guidance on the American Recovery and Reinvestment Act, we noted that a system to collect information, quickly act upon the information obtained, and record and store the status of the actions taken by CPD to perform its responsibilities in accordance with the requirements was not in place. To that end, when compliance was tested, CPD was not compliant.

CPD's computer information system, IDIS Online, has been reviewed by OIG in prior years. IDIS Online is significant as it is used to manage all of CPD's formula grant programs, which have received approximately $32.7 billion over the last 5 years, including $4.75 billion received under the American Recovery and Reinvestment Act of 2009. In our reviews of IDIS Online, we identified instances in which the information in the system was not always reliable and did not have adequate internal controls. In addition, we reported IDIS noncompliant with Federal financial system requirements in this report under Material Weakness 1: Achieving Substantial Compliance with FFMIA Continued to

Challenge HUD, due to the system's use of the FIFO technique, which CPD described as follows:

> The FIFO technique is applied to funds having the same grant program, source of funds, recipient of funds, and type of funds. The grant year is used to order the funds from oldest year to newest year. When a grantee commits funds to an activity (by funding an activity using the activity funding function), the funds are committed from the oldest funds having the same source of funds, recipient of funds, and type of funds. The grantee is unaware of the year from which the funds are committed. Similarly, when a grantee draws funds, the funds are drawn from the oldest funds having the same source of funds, recipient of funds, and type of funds.

The $7.6 million identified as of September 30, 2012, which was unused from grants dating between 1992 and 2001, also accumulated due to a cumulative calculation that allowed poor performance to go undetected and a recapture policy for noncompliant participating jurisdictions that recaptured funds from a current funding source.

The commitment, reservation, and disbursement deadlines were determined on an aggregate or cumulative basis versus a grant-year basis. This cumulative process was used as a result of the system's use of FIFO to commit funds, which does not allow grantees to determine their commitments on a grant-year basis. As commitments were recorded on a FIFO basis, if a grantee was determined to be noncompliant, because of the system's use of FIFO, it was difficult if not impossible to identify and recapture the uncommitted funds from the grant year in question because those uncommitted funds would be committed to other warranted agreements and would cause those agreements to be unfairly canceled. Therefore, compliance was tested on a cumulative basis, and recaptures were made from uncommitted funds, which were typically current funds, as the older funds were used for commitments on a FIFO basis.

In fiscal year 2012, OIG selected a statistical sample of grantees and contacted the grantees to determine the difference between the system's use of FIFO and the method used by the grantee to record information in its accounting records. The projected results found several irreconcilable differences, which were reported in this report under Material Weakness 1: Achieving Substantial Compliance With FFMIA Continued To Challenge HUD. OIG made recommendations regarding the use of FIFO, which had not been implemented or adequately addressed.[39]

[39] See Follow-up of Prior Year Audits section of this report, recommendations 7a-7d and recommendations 1a and 1b under Material Weakness: Achieving Substantial Compliance With FFMIA Continued To Challenge HUD in this report.

In fiscal year 2011[40], OIG reported that CPD did not adequately use IDIS to provide oversight of activities under its CDBG program. As a result, HUD was unaware of how grantees used almost $67 million that was provided to them to fund more than 1,300 activities that they later canceled in IDIS. In addition, HUD lacked adequate oversight of almost $3 billion used to fund more than 20,000 long-standing open activities that grantees had reportedly not completed for up to 11 years. Further, IDIS did not support internal control activities to help ensure that agency objectives were met and ensure that resources used were safeguarded against waste, loss, and misuse. The recommendations that OIG included in the report had not been implemented, and, thus, the conditions existed in fiscal year 2012. OIG also reported in fiscal year 2011 that IDIS Online maintained a record of the last change only and did not maintain an audit trail.

Conclusion

Improvements had been made; however, $7.6 million in HOME grant funds that was made available between 1992 and 2001 was not used to expand the supply of decent, safe, sanitary, and affordable housing for low- and very low-income families. In addition, there was $80.9 million in disbursed funds for which the participating jurisdiction had made its final draw but had not entered the completion and beneficiary information into the system. Therefore, it could not be determined whether the funds were used to meet the program objectives.

Information is needed to achieve objectives. Pertinent information should be identified, captured, and distributed in a form and time frame that permits people to perform their duties efficiently. Effective communications should occur in a broad sense, with information flowing down, across, and up the organization. Moreover, effective information technology management is critical to achieving the useful, reliable, and continuous recording and communication of information.

For CPD to run and control its operations, it must have relevant, reliable, and timely information and communications relating to internal as well as external events. Operating information is needed to determine whether CPD is achieving its compliance requirements under various laws and regulations. Financial information is needed for both external and internal uses and is required to develop financial statements for periodic external reporting and on a day-to-day basis to make operating decisions, monitor performance, and allocate resources. Unimplemented recommendations made by OIG demonstrate the continued existence of deficiencies.

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[40] Audit report 2012-FO-0003, Additional Details To Supplement Our Report on HUD's Fiscal Years 2011 and 2010 Financial Statements, issued November 15, 2011

Recommendations

We recommend that the Office of Community Planning and Development

4.a. Establish a tracking and reporting mechanism for accurately monitoring and reporting Single Audit Act follow-up results at the individual recommendation and aggregate levels, in accordance with the Audits Management System Handbook, to ensure that the 6-month requirements of OMB Circular A-133 are met.

4.b. Develop internal controls to review field office compliance more frequent than every 4 years, especially when findings have been identified in the past, and to ensure that action plans operate effectively and have addressed the deficiencies noted so that noncompliance is not repeated during the next quality management review.

Significant Deficiency 4: HUD's Oversight of the Administrative Control of Funds Process Had Weaknesses

HUD needs to improve its accounting and administrative control of funds to ensure that (1) all programs that incurred obligations or disbursements have acceptable funds control plans; (2) the funds control plans are complete, accurate, and updated in a timely manner; and (3) the program offices comply with their funds control plans. During our review, we identified a number of program codes that did not have funds control plans. Additionally, we noticed that certain funds control plans listed as allotment holders individuals who were either (a) no longer with HUD due to retirement or reassignment, or (b) no longer the designated allotment holder because the function was reorganized. We noted that OCFO did not ensure an effective administrative control of funds process as required by HUD's Policies Handbook 1830.2. Incomplete implementation of administrative control of funds has been a long-standing issue, which has been reported since fiscal year 2005 in our audit reports and management letters.

Some HUD Programs Operated Without Funds Control Plans, or Plans Were Not Complete, Accurate, or Updated

HUD had not fully implemented a compliant administrative control of funds process to ensure that its obligations and expenditures were within authorized budget limits and complied with the Antideficiency Act (ADA). Our fiscal year 2012 review found that several HUD program offices were operating without compliant funds control plans for all of their activities.

The Federal Managers' Financial Integrity Act of 1982 (FMFIA) provides that internal accounting and administrative controls of each executive agency must be established to ensure that (1) obligations and costs comply with applicable law; (2) funds, property, and other assets are safeguarded against waste, loss, unauthorized use or misappropriation; and (3) revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability for the assets.

HUD's Policies Handbook 1830.2 set forth the authorities and responsibilities for administering control of HUD's funds. The handbook states that Congress has vested overall responsibility for establishing an effective administrative control of funds process with OCFO. It provides the internal guidance for the preparation of the funds control plans to comply with the provisions of ADA and FMFIA as well as the overall process for reviewing and approving the funds control plans. It states that before the Chief Financial Officer may issue an advice of allotment to an allotment holder, he or she must provide (1) certification of knowledge and acceptance of responsibility to ensure that he or she has established and will properly execute a funds control plan that provides reasonable assurance that obligations and expenditures will not exceed the authorized limits of the funds allotted to him or her and (2) submission of an acceptable funds control plan. It also states that OCFO will conduct periodic reviews of compliance with funds control plans to ensure that adequate funds control is being applied in actual practice.

Between October 1, 2011, and March 31, 2012, HUD disbursed nearly $45.9 million from programs without having an associated funds control plan in place.

Table 3		
Program office	**No. of programs with missing plans**	**Amount disbursed without plan**
CPD total	12	$10,070,701
Housing total	21	13,784,430
PD&R* total	1	9,763,613
PIH total	18	12,276,992
Grand total	52	$45,895,736

*Office of Policy Development and Research

Other funds control plans were not complete, accurate, and updated in a timely manner. We reviewed 24 of the 40 funds control plans in the “Salaries and Expenses Approved Plans” folder on HUD’s funds control plan Sharepoint site. Our review found that four of the plans were dated from fiscal years 2008 to 2010 and listed as the allotment holder individuals who were no longer with HUD due to retirement or reassignment or because the function was reorganized. All of these circumstances should have required an updated funds control plan.

Funds Control Plan Reviews Were Not Performed

HUD did not ensure compliance with funds control plans review requirements. HUD’s Policies Handbook 1830.2 states that OCFO will conduct periodic reviews of compliance with funds control plans to ensure that adequate funds control is applied in actual practice. Our audit found that in fiscal year 2012, HUD did not perform any compliance reviews of its funds control plans. HUD staff indicated that this was a management decision because it was a priority to ensure that staff would be available for ADA investigations. Our review of three of eight ADA investigation case files indicated that the program office staff cited OCFO failures in updating funds control plans as the reason for the potential violations.

We also noted that the OCFO Funds Control Assurance Division (FCAD) did not make an annual call to program allotment holders to obtain updates to funds control plans for the 2011 and 2012 budget fiscal years.

Conclusion

HUD did not design or implement effective controls over its funds control plan processes. As a result, in fiscal year 2012, HUD did not have adequate assurance that (1) obligations and costs complied with applicable law; (2) funds, property, and other assets were safeguarded against waste, loss, unauthorized use, or misappropriation; and (3) revenues and expenditures applicable to agency operations were properly recorded and accounted for. Additionally, HUD did not always comply with its own requirements regarding disbursing funds without a compliant funds control plan and did not review funds control plans for compliance.

Recommendations

We recommend that the Chief Financial Officer

5.a. In coordination with the Office of the Deputy Secretary, emphasize the importance of financial management for the administrative control of funds.

5.b. Work with program offices to follow HUD’s Policies Handbook 1830.2 procedures to ensure that funds control plans are complete, accurate, and updated in a timely manner throughout the appropriation life cycle.

5.c. Perform compliance reviews of all approved funds control plans on a 5- year cycle.

Significant Deficiency 5: Deficiencies Existed in the Monitoring of HUD's Unliquidated Obligations

HUD's processes for monitoring its unliquidated obligations and deobligating balances tied to invalid obligations had improved; however, deficiencies still existed. Specifically, we identified $91.7 million in invalid obligations previously not identified by HUD and $16 million in obligations HUD determined needed to be closed out and deobligated during the fiscal year that were still on the books as of September 30, 2012. These deficiencies were attributed to ineffective monitoring efforts, the implementation and lack of familiarity with a new procurement system, and the inability to quickly process contract closeouts. As a result, HUD's unpaid obligation balances were potentially overstated by $107.7 million.

Homeless Obligations Were Not Closed in Accordance With Funds Control Plans

Expired Shelter Plus Care and Supportive Housing Program grants were not closed within the 90-day period after the expiration date as required by the programs' funds control plans. The Office of Special Needs Assistance Programs (SNAPS) implemented a new program and deobligated contracts that expired before June 30, 2011. The approximately 1,800 contracts that expired between July 1, 2011, and June 30, 2012, with remaining undisbursed obligation balances of $50.6 million were not closed, and the balances were not recaptured.

The OIG reported $97.8 million in unexpended balances on approximately 3,400 expired contracts during the fiscal year 2010 audit,[41] as well as an additional 1,400 expired contracts with $32 million in unexpended balances during the fiscal year 2011 audit.[42] As a result of the OIG findings, internal control policies to review and close out expired contracts and monitor contracts soon to expire were drafted but were not finalized or implemented. In addition, SNAPS implemented a new program as a result of the enactment of the Homeless Emergency Assistance and Rapid Transition to Housing Act of 2009. Despite not having formal policies, as of September 30, 2012, SNAPS had closed approximately 3,250 contracts from 2010 and deobligated $86.2 million and closed approximately 850 contracts from 2011 and deobligated $17.4 million. During fiscal year 2012, the program office's focus was on implementing the new program and deobligating the old balances identified in fiscal years 2010 and

[41] Audit report 2010-FO-0003 – Additional Details To Supplement Our Report on HUD's Fiscal Years 2010 and 2009 Financial Statements, issued November 15, 2010

[42] Audit report 2011-FO-0003 – Additional Details To Supplement Our Report on HUD's Fiscal Years 2011 and 2010 Financial Statements, issued November 15, 2011

2011; therefore, it did not concentrate efforts and resources on the contracts that were currently expiring.

The Expired Grants With an Available Balance report as of September 30, 2012, showed that $50.6 million in undisbursed obligations remained on more than 1,800 expired Shelter Plus Care and Supportive Housing Program grants.

Invalid Obligations Were Not Deobligated by September 30

Each year OCFO coordinates a review of HUD's unliquidated obligations. For this review, OCFO establishes thresholds to ensure that at least 95 percent of HUD's obligations are reviewed. For fiscal year 2012, program obligations exceeding $243,000 and administrative obligations exceeding $23,000 were required to be reviewed.

During the fiscal year 2012 review, 1,283 obligations with remaining balances totaling $38 million were marked for deobligation. By September 30, 2012, HUD had deobligated 948 of these obligations, leaving 335 invalid obligations with remaining balances totaling $14 million on HUD's books. While the deobligated actions accounted for 74 percent of the total actions, the amount remaining obligated accounted for 37 percent of the invalid obligations. HUD's inability to process all of the close-outs and deobligations by the end of the fiscal year can be attributed to the following factors. First, HUD is not effectively reviewing and closing out contracts throughout the year; therefore, the program offices marked a large number of obligations for deobligation during the annual review. Second, HUD placed a higher priority on processing new awards and obligations than processing close-outs and deobligations. Therefore, HUD was unable to process all of the necessary contract close-outs and deobligations before the end of the fiscal year on top of their regular workload. Of the 335 obligations remaining on HUD's books at year-end, 284 had not been forwarded from the program offices to the appropriate office, either the OCPO for administrative obligations or the OCFO for program obligations, for close-out and deobligation. As a result, HUD's unliquidated obligation balances were overstated by $14 million. HUD has initiated the process of closing these obligations, and the associated funding should be recaptured during fiscal year 2013.

HUD's Administrative Obligations Were Not Effectively Monitored

HUD's administrative obligations are a result of contracts entered into for the goods and services necessary to operate, such as employee training, printing services, subscriptions, IT support, and other service contracts. HUD did not effectively monitor these obligations to determine that a bona fide need still existed and the obligations were still valid. Our review identified 3,227 administrative obligations with remaining balances totaling $33.6 million with no activity since fiscal year 2010. Of these, 508 with remaining balances totaling $2.5 million were tied to funds that were canceled on September 30, 2012.

Through a review of HUD's funds control plans, we noted that several of HUD's program offices relied on the OCFO-coordinated unliquidated obligations review to monitor their administrative obigations. Administrative obligations that fell under $23,000 were not required to be reviewed during the fiscal year 2012 review. Of the obligations we identified as inactive, 1,040 were under the $23,000 threshold and not reviewed. Additionally, since the OCFO-coordinated review is performed annually, any obligations that become invalid during the period between the end of the review and the end of the fiscal year would not be identified until the following fiscal year.

As a result, HUD's September 30, 2012, obligation balances were potentially overstated by $31.1 million. Additionally, because most of HUD's administrative obligations are made using annual appropriations, by not periodically reviewing their validity throughout the fiscal year, HUD may lose the opportunity to use funds tied to obligations that become invalid during the year

Inactive and Expired Section 202 and 811 Obligations Were Not Identified

HUD's Sections 202 and 811 programs provide affordable housing and supportive services for the elderly and persons with disabilities. Generally, funds appropriated for Section 202 and 811 programs are available for obligation for 3 years. After 3 years, the funds expire and are not available for obligation, necessitating the need to track funds obligated under these programs.

During fiscal year 2012, HUD did not adequately monitor and deobligate unliquidated balances from expired and inactive Section 202 and 811 obligations. We reviewed the subsidiary ledger supporting the unliquidated obligations to determine whether the reported obligations were valid and whether any invalid obligations had been canceled and deobligated. Our review identified $8.8 million tied to 90 obligations that had either expired or were no longer needed. HUD initiated the closeout of these obligations, and the associated balances should be recaptured during fiscal year 2013.

Emergency Homeowners' Loan Program Deobligations Were Not Completed

The Emergency Homeowners' Loan Program authorized approved homeowners to receive a maximum of $50,000 in assistance in the form of a declining balance, nonrecourse, zero-interest, subordinate secured loan with a term of up to 7 years. In fiscal year 2011, HUD initially obligated $205.2 million for the credit subsidy portion of the direct loans issued by HUD, which were for 5,823 initially approved borrowers. During fiscal year 2012, many of the 5,823 initially approved borrowers were found to be ineligible during the secondary approval process. Additionally, over the course of the year, some of the borrowers who passed the secondary approval process exited the program because they no longer needed assistance, had received the maximum benefit of $50,000, or were terminated for nonpayment of the borrowers' portion of the mortgage. As of June 30, 2012, there was approximately $90 million in obligations that had to be deobligated due to these circumstances. As of September 30, 2012, $2 million remained to be deobligated for borrowers who were no longer eligible to receive assistance.

Other Inactive Housing Program Obligations Were Identified

We reviewed the subsidiary ledgers supporting the obligation balances in treasury account fund symbols (TAFS) 0303 and 0319 to determine whether the reported balances were valid. These TAFS mainly contain funds used for Section 8 project-based obligations; however, they also contain funds for several small grant and other assistance programs. Within these small programs, our review identified 69 expired or inactive obligations with remaining balances totaling $1.2 million. This condition can be attributed to a lack of effective monitoring due to these small programs' no longer receiving appropriations and HUD's focus on its larger obligation balances. As a result, HUD's unliquidated obligation balances were potentially overstated by $1.2 million.

Conclusion

HUD's processes for monitoring the validity and need for its unliquidated obligations were not fully effective during fiscal year 2012. As a result, we identified $91.7 million tied to expired or inactive obligations. Additionally, HUD was not able to close out all of the obligations it had identified as invalid by the end of the fiscal year. As a result, $16 million in invalid obligations was still on HUD's books at yearend. In total, HUD's unliquidated obligation balances were potentially overstated by $107.7 million.

Recommendations

We recommend that the Office of Community Planning and Development

6.a. Review the status of these expired contracts, which make up the $50.6 million, and recapture excess funds for the contracts that have not been granted extensions.

6.b. Review the 270 obligations with remaining balances totaling $432,147 and close out and deobligate amounts tied to obligations that are no longer valid or needed.

We recommend that the Office of the Chief Financial Officer

6.c. Issue a memorandum to the program offices, instructing them to institute periodic reviews of their administrative obligations (more frequently than once a year) and to document their monitoring efforts in their funds control plans.

6.d. Review the 65 obligations with remaining balances totaling $11,404,776 and close out and deobligate amounts tied to obligations that are no longer valid or needed.

We recommend that the Office of the Chief Human Capital Officer

6.e. Review the 714 obligations with remaining balances totaling $8,428,808 and close out and deobligate amounts tied to obligations that are no longer valid or needed. Additionally, the $448,022 in five obligations marked for deobligation should be deobligated.

We recommend that the Office of the Chief Information Officer

6.f. Review the 357 obligations with remaining balances totaling $6,832,833 and close out and deobligate amounts tied to obligations that are no longer valid or needed. Additionally, the $618,560 in 45 obligations marked for deobligation should be deobligated.

We recommend that the Office of Public and Indian Housing

6.g. Review the 310 obligations with remaining balances totaling $1,264,887 and close out and deobligate amounts tied to obligations that are no longer valid or needed.

We recommend that the Office of Policy Development and Research

6.h. Review the 151 obligations with remaining balances totaling $227,803 and close out and deobligate amounts tied to obligations that are no longer valid or needed.

We recommend that the Office of Departmental Operations and Coordination

6.i. Review the 13 obligations with remaining balances totaling $165,952 and close out and deobligate amounts tied to obligations that are no longer valid or needed.

We recommend that the Office of General Counsel

6.j. Review the five obligations with remaining balances totaling $129,389 and close out and deobligate amounts tied to obligations that are no longer valid or needed. Additionally, $2,275 in three obligations marked for deobligation should be deobligated.

We recommend that the Office of Fair Housing and Equal Opportunity

6.k. Review the 70 obligations with remaining balances totaling $117,227 and close out and deobligate amounts tied to obligations that are no longer valid or needed. Additionally, $95,857 in three program obligations marked for deobligation should be deobligated.

We recommend that the Office of Housing

6.l. Review the 588 obligations with remaining balances totaling $1,912,078 and close out and deobligate amounts tied to obligations that are no longer valid or needed. Additionally, $10,565,965 in 209 administrative obligations and $145,006 in eight program obligations marked for deobligation should be deobligated.

6.m. Coordinate with OCFO to deobligate the $8,126,604 tied to 52 inactive or expired funding lines.

6.n. Have the Procurement Management Division review and if necessary recapture $626,613 tied to 38 inactive or expired funding lines.

6.o. Review the 69 inactive or expired obligations with $1,202,207 in remaining balances and coordinate with OCFO to deobligate any funds that are determined to be expired or inactive after review.

6.p. Deobligate the $2 million in remaining loan obligations for ineligible borrowers under the Emergency Homeowners' Loan Program.

We recommend that the Department of Equal Employment Opportunity

6.q. Deobligate $54,982 in three administrative obligations marked for deobligation during the departmentwide open obligations review.

We recommend that the Office of the Secretary

6.r. Review the 54 obligations with remaining balances totaling $113,215 and close out and deobligate amounts tied to obligations that are no longer valid or needed.

We recommend that the Office of the Chief Procurement Officer

6.s. Review the 75 obligations with remaining balances totaling $52,078 and close out and deobligate amounts tied to obligations that are no longer valid or needed.

We recommend that the Office of Healthy Homes and Lead Hazard Control

6.t. Review the 20 obligations with remaining balances totaling $11,630 and close out and deobligate amounts tied to obligations that are no longer valid or needed.

We recommend that the Office of Field Policy and Management

6.u. Review the 17 obligations with remaining balances totaling $8,277 and close out and deobligate amounts tied to obligations that are no longer valid or needed.

We recommend that the Office of Strategic Planning and Management

6.v. Review the 10 obligations with remaining balances totaling $5,527 and close out and deobligate amounts tied to obligations that are no longer valid or needed.

Significant Deficiency 6: Controls Over HUD's Computing Environment Had Weaknesses

HUD's computing environment, data centers, networks, and servers provide critical support to all facets of its programs, mortgage insurance, financial management, and administrative operations. In prior years, we reported on various weaknesses with general system controls and controls over certain applications as well as weak security management. These deficiencies increase risks associated with safeguarding funds, property, and assets from waste, loss, unauthorized use, or misappropriation.

We evaluated selected information systems general controls of the computer systems on which HUD's financial systems reside. We also followed up on the status of previously reported application control weaknesses. Our review found information systems control weaknesses that could negatively affect HUD's ability to accomplish its assigned mission, protect its data and IT assets, fulfill its legal responsibilities, and maintain its day-to-day functions. Presented below is a summary of the control weaknesses found during the review.

Security Implemented on HUD's IBM Mainframe Lacked Some Configuration and Technical Controls

During our audit of IBM mainframe security controls for compliance with HUD IT policies, Federal information system security requirements, and Federal financial management requirements,[43] we identified security configuration and technical control deficiencies. Specifically, the mechanisms in place for tracking users and system activities and associating them with events and security violations were not sufficient. Also, HUD's IT support contractor did not perform a comprehensive annual review to include all required controls for proper account management.

Additionally, we found that access controls over the IBM mainframe were not always in place. Access to privileged functions and security-relevant information was not restricted to authorized personnel, separation of duties for information system functions among users was not adequate, and appropriate access levels were not properly enforced on the IBM mainframe for sensitive system files and functions. We also determined that authentication controls on the IBM mainframe did not meet Federal requirements for proper display of a systems use notification message and password complexity.

[43] Audit report 2012-DP-0004, Security Implemented on HUD's IBM Mainframe Lacked Some Configuration and Technical Controls, a limited distribution report, issued August 24, 2012

HUD's Mobile Devices Had Weaknesses

We reviewed controls over HUD's mobile devices[44] and identified security and management control weaknesses that could put HUD's computing IT infrastructure at risk. Specifically, HUD did not complete a risk assessment to ensure that the impact of mobile devices and their associated vulnerabilities was adequately addressed. Additionally, HUD did not complete the development of policies and procedures governing the security and management of mobile devices. Also, we determined that management controls, such as security configuration settings and monitoring of mobile device use, were not effectively implemented. Lastly, not all hardware or software used by HUD's mobile devices were Configuration Change Management Board[45] approved.

Security Management Program Needed Improvement

During fiscal year 2011, we evaluated HUD's entitywide information system security program.[46] We reported that although HUD had some components of a comprehensive security environment, there were several areas that needed improvement. HUD's remote access procedures were weak. Additionally, all staff with login privileges did not receive security awareness training. HUD's contingency planning program lacked the appropriate structure, and a continuous monitoring strategy had not been established for HUD. Also, risk management was insufficient to address HUD's missions and goals. Lastly, the capital planning and investment control process did not comply with Federal guidance.

We followed up on the status of these weaknesses during fiscal year 2012 and determined that HUD had made some progress in remediating these weaknesses. For instance, HUD had developed a process to ensure that the mission-critical systems list remained current and improved security training to ensure that users were aware of their responsibilities. HUD also maintained records of vendors that supply essential hardware, software, and other components for its IT support contract. However, additional improvements are needed for HUD's computer security environment. Corrective action had not been completed for 7 of 10 recommendations made for this audit report.

[44] Audit Report No. 2012-DP-0005, Review of Controls Over HUD's Mobile Devices, a limited distribution report, issued September 28, 2012
[45] The Configuration Change Management Board was established to ensure that all changes made to the HUD IT infrastructure and system development platforms take place through a rational and orderly process. The IT infrastructure platform consists of the hardware, software, and telecommunications networks that provide the operating IT environment for HUD. The system development platform includes the software specifically used to develop systems and applications. It also includes development standards and processes.
[46] Audit report 2012-DP-0003, Enterprisewide Improvements Are Needed in HUD's Computer Security Environment, issued March 23, 2012

Upgrades to the IBM Mainframe Operating System and Database Software Were Not Performed

We previously reported that HUD's IT support contractor did not perform preventive maintenance on the IBM mainframe system software to keep products up to date and available for support and enhancements.[47] Software patches were not always installed, and software versions were not always upgraded to the minimum level that is supported by IBM.

We followed up on the status of these weaknesses during fiscal year 2012 and determined that HUD had made progress in remediating these weaknesses. CICS[48] upgrades were performed, and progress was made toward upgrading the DB2[49] environment. HUD planned to complete corrective actions for the remaining weaknesses by November 30, 2012.

The DRGR System Needed Improvements

We audited HUD's DRGR system during fiscal year 2011[50] to determine whether adequate controls were in place to safeguard, accurately track, and report $1.93 billion in American Recovery and Reinvestment Act of 2009 funds allocated to CPD's Neighborhood Stabilization Program 2. We found that the improvements CPD had made to the DRGR system were beneficial to the overall assurance that the system's data were properly maintained, safeguarded, and in compliance with Federal regulations. However, for HUD to address Recovery Act requirements for accurate data, additional improvements should be made to the system. We recommended that CPD modify the DRGR system to improve its application controls. We followed up on the status of these weaknesses during fiscal year 2012 and determined that most corrective actions had been completed. The remaining corrective action is related to the system's audit logging capabilities. The addition of these controls would provide individual accountability and after-the-fact investigation of security incidents. HUD was scheduled to complete this corrective action by November 21, 2012.

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[47] Audit report 2011-DP-0001, HUD Did Not Properly Manage HITS Contracts and Contractors To Fully Comply With Contract Requirements and Acquisition Regulations, issued October 6, 2010
[48] CICS is a transaction manager designed for rapid, high-volume online processing.
[49] DB2 is a relational database management system.
[50] Audit report 2011-DP-0008, The Disaster Recovery Grant Reporting System That Maintained Recovery Act Information Had Application Security Control Deficiencies, issued July 28, 2011

Configuration Management Weaknesses

During fiscal year 2011, we reviewed the configuration management plan and selected controls for the DRGR system.[51] We noted that (1) the configuration management plan for DRGR contained outdated information, (2) user identification and passwords in the DRGR testing environment were not adequately protected, (3) DRGR test documents contained inaccurate or incomplete information, (4) the DRGR application contractor did not follow HUD's software configuration management policies, and (5) not all of the software products used by DRGR were approved by the Configuration Change Management Board. HUD expected to complete the corrective actions for these weaknesses by February 2013.

Contingency Planning and Physical Security Had Weaknesses

During the 2012 disaster recovery exercises, we determined that HUD's IT support contractor did not use secure containers to protect digital media during transport. An unencrypted magnetic tape containing major application data was transported in a server box from the data center to the disaster recovery site. We discussed this condition with HUD officials during the exercise, and actions were taken to ensure that the media were not transported back to the data center unprotected. The tape in question was locked in the secure cage at the disaster recovery site and will be returned securely during the next disaster recovery test using newly developed procedures.

Conclusion

HUD's computing environment provides critical support to all facets of its programs, mortgage insurance, financial management, and administrative operations. During fiscal year 2012, as in prior years, we continued to identify information systems control weaknesses that could negatively affect HUD's ability to accomplish its assigned mission, protect its data and IT assets, fulfill its legal responsibilities, and maintain its day-to-day functions. As a result, OIG continues to report a significant deficiency for HUD's computing environment.

[51] Audit report 2012-DP-0001, Audit Report on the Fiscal Year 2011 Review of Information Systems Controls in Support of the Financial Statements Audit, issued February 14, 2012

Recommendations

Recommendations were included in separate OIG audit reports. Therefore, no recommendations are reported here.

COMPLIANCE WITH LAWS AND REGULATIONS

In fiscal year 2012, we found instances in which HUD did not ensure that transactions were executed in accordance with laws governing the use of budget authority and with other laws and regulations that could have a direct and material effect on the financial statements and any other laws, regulations, and governmentwide policies identified in OMB audit guidance.

HUD Did Not Substantially Comply With the Federal Financial Management Improvement Act

OIG's FFMIA Compliance Determination

As reported in prior years and in fiscal year 2012, OIG determined that HUD's financial management systems did not substantially comply with FFMIA because of certain weaknesses in HUD's agencywide financial management systems, including IDIS, DRGR, and HIAMS. HUD, on an entitywide basis, made limited progress as it attempted to address its financial management deficiencies to bring the agency's financial management systems into compliance with FFMIA. Deficiencies remained, and HUD's financial management systems continued to not meet current requirements and were not operated in an integrated fashion and linked electronically to efficiently and effectively provide agencywide financial system support necessary to carry out the agency's mission and support the agency's financial management needs. These matters are further described as a material weakness in the Internal Control section of this report.

According to Section 803 of FFMIA, HUD's financial management systems are required to substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the U.S. Standard General Ledger at the transaction level. OIG used OMB's Implementation Guidance for the Federal Financial Management Improvement Act, dated January 9, 2009, to determine compliance.

In fiscal year 2012, although HUD issued a qualified statement of assurance that its internal controls over operations (Section 2) and financial management systems (Section 4) met the objectives of FMFIA, HUD determined that its financial management systems were in substantial compliance with FFMIA as of September 30, 2012.

HUD's FFMIA Compliance Determination

In its Fiscal Year 2012 Agency Financial Report, HUD reported that 3 of its 39 financial management systems did not comply with requirements of FFMIA and OMB Circular A-127. Although 36 individual systems had been certified as compliant with Federal financial management system requirements, HUD had not completed any A-127 reviews in the last 3 years and relied upon the results of OMB Circular A-123 and Federal Information Security Management Act annual internal control reviews for individual applications. Refer to the material weakness finding in the Internal Control section for more details. In addition, OIG reported IDIS as a non-FFMIA-compliant system in fiscal years 2010 and 2011 and HIAMS in fiscal year 2012. However, HUD continued to report IDIS as a compliant system in its Agency Financial Report. Since 2010, HUD had not communicated in a formal letter to OMB the differences in FFMIA compliance determination between OIG and HUD regarding the IDIS system, although such communication is required according to OMB Circular A-127.

We have included the specific nature of noncompliance issues, responsible program offices, and recommended remedial actions in appendix B of this report.

Conclusion

OIG reviewed HUD's compliance with Section 803 of FFMIA as of September 30, 2012. In fiscal year 2012, HUD, on an entitywide basis, made limited progress as it attempted to address its financial management deficiencies to bring the agency's financial management systems into compliance with FFMIA. In this regard, OIG continued to report that HUD's financial management systems did not substantially comply with FFMIA as of September 30, 2012.

HUD Did Not Substantially Comply With the Antideficiency Act

HUD's compliance with ADA[52] still needs improvement. For the fourth consecutive year, our review found that none of the six ADA cases identified as a potential deficiency in fiscal year 2009 was reported to the President through OMB, Congress, or GAO as required. In two of the six cases, we found that the status of the violation had changed from prior years. However, in all six cases, OCFO had not completed its review. Therefore, we found no improvement in HUD's process for conducting, completing, reporting, or closing potential ADA violation investigations.

HUD Had Not Made Progress in Reporting ADA Violations as Required

We have reported in prior year reports that HUD continues to show no substantial improvement to its process for conducting, completing, reporting, and closing the investigation of potential ADA violations. Since FY 2009, we have reported HUD's failure to report six cases identified as a potential deficiency to the President through OMB, Congress, or GAO as required or determine that no violation had occurred.[53]

Insufficient policies and procedures, the lack of adequate oversight, and limited staffing were factors in delaying the completion of the investigative process. These factors also impaired the process of completing the preliminary investigation process and, thereby, impacted HUD's ability to promptly resolve internal control issues that caused the potential ADA violations.

OIG made two recommendations in prior years that remain open. Specifically, recommendations 2010-FO-0003-005-A and 2010-FO-0003-005-B were overdue for the implementation of the corrective action as of September 30, 2012. Therefore, OIG has no new recommendations in fiscal year 2012.

HUD's Process for Investigation of ADA Violations Needs Improvement

HUD's policies and procedures for investigating potential ADA violations were ineffective in facilitating the investigative process to ensure that potential ADA violations were reported in a timely manner. We also determined that the

[52] 31 U.S.C. 1341, 1342, 1350, 1517, and 1519 (2000)
[53] Audit report 2010-FO-0003, Additional Details To Supplement Our Report on HUD's Fiscal Years 2009 and 2008 Financial Statements, , dated November 16, 2009

structure of the ADA investigative team, the independence of the individuals involved in the investigations, and the management review process were inconsistent with quality standards for investigations.

Specifically, the Council of the Inspectors General on Integrity and Efficiency (CIGIE) Quality Standards for Investigations[54] states, "In all matters relating to investigative work, the investigative organization must be free, both in fact and appearance, from impairments to independence; must be organizationally independent; and must maintain an independent attitude." However, our review of the OCFO's ADA investigations found that a member of the review team for a not yet reported ADA violation appeared to have involvement in the actions leading to the ADA violation.

The U.S. Department of Veterans Affairs and HUD and the Independent Agencies Appropriations Act, 2003[55] gave HUD's Chief Financial Officer, in consultation with the HUD budget officer, the "sole authority" to investigate potential or actual violations under ADA and all other statutes and regulations related to the obligation and expenditure of funds made available in any act. Further, the Appropriations Act provided that the Chief Financial Officer must determine whether violations occurred and submit the final reports required by law. However, we found that two investigations opened in fiscal year 2012 involved OCFO staff. Therefore, we had concerns about the planning, execution, reporting, and managing of the ADA investigation.

The investigative process was inefficient and ineffective primarily because the Chief Financial Officer lacked the resources and staffing to follow established timelines for ADA investigations. We found that in fiscal year 2012, OCFO created an ADA Investigations Task Force to assist in completing long outstanding ADA investigations. However, only one member of the Task Force had training beyond the Principles of Federal Appropriations Law training conducted by GAO. Therefore, we also had concerns about the qualifications of the Task Force participants.

Conclusion

OCFO is responsible for conducting investigations and reporting on ADA violations. HUD's continued delay in completing ADA investigations and reporting known violations results in ADA violators avoiding timely reprimands or punishments and prevents timely correction of violations. In addition, HUD's process for conducting ADA investigations needs improvement. As a result,

[54] CIGIE Quality Standards for Investigations, dated November 15, 2011, section B. Independence. CIGIE standards replaced all references to the President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency.
[55] Public Law No. 108-7, Div. K, 117 Stat. 11, 474 (2003)

ADA investigations were generally not completed within 1 year as set forth in the ADA Case Processing Timeline policy. The established policies and procedures should be amended to include independence of the investigative team and management.

Recommendations

We recommend that the Office of the Chief Financial Officer

7.a. Establish policies and procedures for ensuring that investigators and all individuals involved in the review or concurrence process do not have any personal or external impairment that would affect their independence and objectivity in conducting ADA reviews and investigations.

7.b. For current and future investigations, determine the qualifications and independence of personnel used at each stage of the investigation.

7.c. Issue a legislative request for funding for additional staffing or to have ADA investigations conducted by an independent external organization.

SCOPE AND METHODOLOGY

We considered internal controls over financial reporting by obtaining an understanding of the design of HUD's internal controls, determined whether these internal controls had been placed into operation, assessed control risk, and performed tests of controls to determine our auditing procedures for the purpose of expressing our opinion on the principal financial statements. We also tested compliance with selected provisions of applicable laws, regulations, and government policies that may materially affect the consolidated principal financial statements.

We considered HUD's internal control over required supplementary stewardship information reported in HUD's Fiscal Year 2012 Agency Financial Report by obtaining an understanding of the design of HUD's internal controls, determined whether these internal controls had been placed into operation, assessed control risk, and performed limited testing procedures as required by AU section 558, Required Supplementary Information. The tests performed were not to provide assurance on these internal controls, and, accordingly, we do not provide assurance or an opinion on such controls.

With respect to internal controls related to performance measures to be reported in the Management's Discussion and Analysis and HUD's Fiscal Year 2012 Agency Financial Report, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions as described in section 230.5 of OMB Circular A-11, Preparation, Submission, and Execution of the Budget. We performed limited testing procedures as required by AU section 558, Required Supplementary Information, and OMB Bulletin 07-04, Audit Requirements for Federal Financial Statements, as amended. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

To fulfill these responsibilities, we

* Examined, on a test basis, evidence supporting the amounts and disclosures in the consolidated principal financial statements;
* Assessed the accounting principles used and the significant estimates made by management;
* Evaluated the overall presentation of the consolidated principal financial statements;
* Obtained an understanding of internal controls over financial reporting (including safeguarding assets) and compliance with laws and regulations (including execution of transactions in accordance with budget authority);
* Tested and evaluated the design and operating effectiveness of relevant internal controls over significant cycles, classes of transactions, and account balances;
* Tested HUD's compliance with certain provisions of laws and regulations; governmentwide policies, noncompliance with which could have a direct and material effect on the determination of financial statement amounts; and certain other laws and regulations specified in OMB Bulletin 07-04, as amended, including the requirements referred to in FMFIA;

* Considered compliance with the process required by FMFIA for evaluating and reporting on internal control and accounting systems; and
* Performed other procedures we considered necessary in the circumstances.

We did not evaluate the internal controls relevant to operating objectives as broadly defined by FMFIA. We limited our internal control testing to those controls that are material in relation to HUD's financial statements. Because of inherent limitations in any internal control structure, misstatements may, nevertheless, occur and not be detected. We also caution that projection of any evaluation of the structure to future periods is subject to the risk that controls may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

Our consideration of the internal controls over financial reporting would not necessarily disclose all matters in the internal controls over financial reporting that might be significant deficiencies. We noted certain matters in the internal control structure and its operation that we consider significant deficiencies under OMB Bulletin 07-04 as amended.

Under standards issued by the American Institute of Certified Public Accountants, a significant deficiency is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance.

A material weakness is a deficiency or combination of deficiencies in internal controls, such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented or detected and corrected on a timely basis.

Our work was performed in accordance with generally accepted government auditing standards and OMB Bulletin 07-04 as amended. 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 objective(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

FOLLOW-UP ON PRIOR YEAR AUDITS

Not included in the recommendations listed after each finding are recommendations from prior years' reports on HUD's financial statements that have not been fully implemented based on the status reported in ARCATS. HUD should continue to track these under the prior years' report numbers in accordance with departmental procedures. Each of these open recommendations and its status is shown below. Where appropriate, we have updated the prior recommendations to reflect changes in emphasis resulting from recent work or management decisions.

Additional Details to Supplement Our Report On HUD's Fiscal Years 2011 and 2010 Financial Statements, 2012-FO-0003

With respect to the significant deficiency that HUD needs to improve the process for reviewing obligation balances, we recommend that CPD

1.a. Review the status of each of its homeless assistance contracts that make up the $32 million OIG identified as excess funding and recapture excess funds for expired contracts that have not been granted extension. (Final action target date was September 28, 2012; reported in ARCATS as recommendation 2B.)[56]

1.b. Fully implement the internal control procedures and control activities that were drafted as a result of the fiscal year 2010 audit finding, which include specific policies, procedures, and mechanisms, including appropriate documentation of extensions granted and follow-up efforts with the grantees to obtain the closeout documents, to ensure that grants are closed out within the 90-day period after the contract expiration or after the extension period so that remaining balances are periodically recaptured. (Final action target date was June 30, 2012; reported in ARCATS as recommendation 2C.)[56]

With respect to the significant deficiency that HUD needs to improve the process for reviewing obligation balances, we recommend that the Office of Housing, in coordination with the Chief Financial Officer,

2.a. Recapture the $3.8 million tied to the 78 inactive or expired obligations for the Section 202 and 811 programs. (Final action target date is December 31, 2012; reported in ARCATS as recommendation 2D.)

[56] As of the date of this report, this unimplemented recommendation had a corrective action plan that was overdue for completion. OIG has performed audit follow-up activities to determine the status of the corrective action plan and is working with HUD to ensure that it is completed and the recommendation is addressed.

With respect to the significant deficiency that HUD needs to improve the process for reviewing obligation balances, we recommend that the Office of the Chief Procurement Officer, in coordination with the Office of Housing,

2.b. Review and if necessary close out the 76 obligations with remaining balances totaling $991,000 that were forwarded by the Office of Housing Assistance and Grants Administration. (Final action target date is January 8, 2013; reported in ARCATS as recommendation 2E.)

With respect to the significant deficiency that HUD needs to improve the process for reviewing obligation balances, we recommend that the Chief Financial Officer, in coordination with PIH,

2.c. For the Office of Public Housing Investment grants,
   i) Close out the 34 predevelopment grants and recapture $24 million in unpaid obligations in LOCCS and
   ii) Perform a review of the 170 grants coded PDEV, LBAC, and COMP and any other grants not subject to or obligated before the Quality Housing Work and Responsibility Act of 1998 to ensure that the grants were obligated properly and not transferred to LOCCS; correct any inaccuracies; and ensure that the accounting records are complete. (Final action target date was January 15, 2013; reported in ARCATS as recommendation 2F.)

2.d. For the Office of the Chief Financial Officer (in regard to Office of Public Housing Investment grants),
   i) Perform a $2 million downward and withdrawal adjustment for the unliquidated obligations that are unsupported in the Non-PAS program ledger or provide evidence of the grants for the unpaid obligations and
   ii) Perform a $2.3 million downward and withdrawal adjustment for the duplicated grants. (Final action target date was July 2, 2012; reported in ARCATS as recommendation 2G.) [56]

2.e. For the Office of Public Housing Investment grants,
   i) Improve the PIH and Chief Financial Officer internal control environment to ensure that all grants in appropriation 0304 have a program office responsible for their administration and oversight and periodically conduct reviews of all predevelopment grants;
   ii) For those low-rent grants without supporting documentation, obtain a statement from the field office directors certifying that no documentation is available to support the obligations as evidence to process the grants' closeout and recapture; and
   iii) Improve the open obligation review process by including all PIH programs in the open obligation review and include quality control testing in the obligation reviews performed by the program offices. (Final action target date was January 15, 2013; reported in ARCATS as recommendation 2H.)

2.f. For the Section 8 Housing Choice Voucher tenant-based program,
   i) Develop formal written procedures to review the program obligations,
   ii) Deobligate $18.3 million in expired contracts, and
   iii) Include the Section 8 tenant-based program obligations in the departmental open obligation review process. (Final action target date is December 31, 2012; reported in ARCATS as recommendation 2I.)

With respect to the significant deficiency that CPD needs to improve its oversight of grantees, we recommend that CPD

3.a. Ensure that field offices have developed and implemented control activities, which are documented and can be periodically tested and monitored by the Office of Field Management, to ensure that the field offices have a system to ensure compliance with the requirements within the biennial risk analysis process in Notices for Implementing Risk Analyses (CPD Notice 09-04) for Monitoring Community Planning and Development Grant Programs and the CPD Monitoring Handbook. (Final action target date is December 31, 2012; reported in ARCATS as recommendation 3D.)

3.b. Review information within the GMP system for consistency and completeness and follow up with field offices when information is incomplete or inconsistent among the risk analysis, work plans, and completed monitoring efforts. (Final action target date is December 31, 2012; reported in ARCATS as recommendation 3E.)

3.c. Ensure that all required information has been updated and entered into GMP after the due dates for submissions have passed and follow up with field offices that have not entered their information. (Final action target date is December 31, 2012; reported in ARCATS as recommendation 3F.)

3.d. Follow up on information in GMP to ensure that findings that had questioned costs have been repaid and noncompliance and internal control deficiencies have been addressed. (Final action target date is December 31, 2012; reported in ARCATS as recommendation 3G.)

3.e. Develop, document, and implement internal control procedures for OAHP's review to ensure that grantees comply with the terms of the grant agreement, which require the grantees to perform monitoring procedures. (Final action target date was October 19, 2012; reported in ARCATS as recommendation 3H.) [56]

3.f. Develop, document, and implement internal control procedures for the review and resolution of audit findings identified in the A-133 single audit reports as reported in the FAC, including measures to ensure that all grantees have reported to the FAC. (Final action target date was October 31, 2012; reported in ARCATS as recommendation 3I.)

3.g. Maintain documentation readily available to support OAHP's compliance with the requirements of OMB Memorandum M-10-14. (Final action target date is September 17, 2013; reported in ARCATS as recommendation 3J.) [56]

With respect to the significant deficiency that HUD needs to improve its administrative control of funds, we recommend that OCFO

4.a Establish and implement procedures to ensure that all program codes that disburse HUD's funds have complete and approved funds control plans before the funds can be disbursed. (Final action target date was June 30, 2012; reported in ARCATS as recommendation 4A.) [56]

4.b Establish and implement procedures to ensure that the funds control plans are updated to include the new program codes and new appropriation requirements. (Final action target date was August 31, 2012; reported in ARCATS as recommendation 4B.) [56]

4.c Develop and implement a 3-year cycle of funds control compliance reviews for all approved funds control plans by completing the assessments of one-third of approved funds control plans each fiscal year. (Final action target date was June 30, 2012; reported in ARCATS as recommendation 4C.) [56]

With respect to the significant deficiency that HUD needs to continue improving its oversight and monitoring of subsidy calculations, intermediaries' performance, and use of Housing Choice Voucher and operating subsidy program funds, we recommend that PIH

5.a. Conduct remote monitoring and onsite monitoring as necessary to ensure that PHAs 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. (Final action target date is December 31, 2012; reported in ARCATS as recommendation 5A.)

5.b. Office of Housing report on income discrepancies at the 100 percent threshold level as a supplemental measure; assign staff to review the deceased single-member household and income discrepancy reports at least quarterly and follow up with owners and management agents (O-A) listed on these reports; and include in the contract between HUD and O-As a provision for improper payments that requires to resolve in a timely manner income discrepancies, failed identity verifications, and cases of deceased single-member households. (Final action target date is April 1, 2014; reported in ARCATS as recommendation 5B.)

With respect to HUD's substantial noncompliance with the laws and regulations governing claims of the U.S. Government, we recommend that the Office of Housing

6.a. Draft and issue guidance regarding collection procedures for delinquent flexible subsidy loans and ensure that the policy is communicated to each applicable project manager and implemented after issuance. (Final action target date is March 1, 2013; reported in ARCATS as recommendation 7A.)

Additional Details to Supplement Our Report On HUD's Fiscal Years 2010 and 2009 Financial Statements, 2011-FO-0003

With respect to the significant deficiency that HUD's financial management systems need to comply with Federal financial management system requirements, we recommend that CPD

7.a. Cease the changes being made to IDIS for the HOME program related to the FIFO rules until the cumulative effect of using FIFO can be quantified on the financial statements. (Final action target date was June 21, 2012; reported in ARCATS as recommendation 1A.) [56]

7.b. Change IDIS so that the budget fiscal year source is identified and attached to each activity from the point of obligation to disbursement. (Final action target date was June 21, 2012; reported in ARCATS as recommendation 1B.) [56]

7.c. Cease the use of FIFO to allocate funds (fund activities) within IDIS and disburse grant payments. Match outlays for activity disbursements to the obligation and budget fiscal source year in which the obligation was incurred and in addition, match the allocation of funds (activity funding) to the budget fiscal year source of the obligation. (Final action target date was June 21, 2012; reported in ARCATS as recommendation 1C.) [56]

7.d. Include as part of the annual CAPER [consolidated annual performance and evaluation report] a reconciliation of HUD's grant management system, IDIS, to grantee financial accounting records on an individual annual grant basis, not cumulatively, for each annual grant awarded to the grantee. (Final action target date was June 21, 2012; reported in ARCATS as recommendation 1D.) [56]

With respect to the significant deficiency that HUD needs to improve the process for reviewing obligation balances, we recommend that the Chief Financial Officer, in coordination with the appropriate program offices,

8.a. Review the 510 obligations that were not distributed to the program offices during the open obligations review and deobligate amounts tied to closed or inactive projects, including the $27.5 million we identified during our review as expired or inactive. (Final action target date was October 31, 2011; reported in ARCATS as recommendation 2C.) [56]

With respect to the significant deficiency that HUD needs to improve the process for reviewing obligation balances, we recommend that CPD

8.b. In coordination with the Chief Financial Officer, develop and publish written guidance and policies to establish a benchmark for field directors to use to determine the validity of the open obligation. The guidance should include specific procedures for open obligation amounts in which the obligation was made before a specified amount of time, as well as disbursement inactivity beyond a specified amount of time. (Final action target date was October 31, 2011; reported in ARCATS as recommendation 2G.) [56]

8.c. In coordination with the Chief Financial Office, develop procedures to periodically evaluate HUD's program financial activities and operations to ensure that current accounting policies are sufficient and appropriate and to ensure that they are implemented and operated by program and accounting staff as intended. (Final action target date was October 31, 2011; reported in ARCATS as recommendation 2H.) [56]

With respect to the significant deficiency that HUD needs to improve the process for reviewing obligation balances, we recommend that the Chief Financial Office, in coordination with PIH,

8.d. Recapture the full amount of obligations from these 434 PIH low-rent grants totaling $174 million and return to the U.S. Treasury the total balance of budgetary resources from invalid grants. (Final action target date was June 30, 2012; reported in ARCATS as recommendation 2N.) [56]

With respect to the significant deficiency that CPD needs to improve its oversight of grantees, we recommend that CPD

9.a. Review the status of each of its homeless assistance contracts that make up the $97.8 million OIG identified as excess funding and recapture excess funds for expired contracts that have not been granted extensions. (Final action target date was March 16, 2012; reported in ARCATS as recommendation 4A.) [56]

9.b. Investigate the progress of the 350 stalled activities with funding dates of 2005 and prior in which the percentage of amounts drawn on the activity was 50 percent or less with a remaining undrawn amount $27.5 million and recapture those amounts in which the activity can be canceled. (Final action target date was February 2, 2012; reported in ARCATS as recommendation 4F.) [56]

With respect to the significant deficiency that HUD needs to improve its administrative control of funds, we recommend that OCFO

10.a Establish and implement procedures to ensure accuracy and completeness of ARRA funds control plans. (Final action target date was December 30, 2011; reported in ARCATS as recommendation 5B.) [56]

10.b Conduct periodic reviews of the program offices' compliance with requirements of the funds control plans. (Final action target date was December 30, 2011; reported in ARCATS as recommendation 5D.) [56]

With respect to the significant deficiency that HUD needs to improve its administrative control of funds, we recommend that OCFO, in coordination with the appropriate program offices,

10.c Develop and implement funds control plans for any program found to be without an up-to-date funds control plan. (Final action target date was December 30, 2011; reported in ARCATS as recommendation 5J.) [56]

With respect to HUD's substantial noncompliance with ADA, we recommend that the Chief Financial Officer, in coordination with the appropriate program offices,

11.a Complete required steps on the six known potential ADA issues and report those determined to be violations immediately to the President, Congress, and GAO as required by 31 U.S.C. (United States Code) and OMB Circular A-11. (Final action target date was December 30, 2011; reported in ARCATS as recommendation 6A.)[53]

11.b Investigate the potential ADA violation and other interagency agreements that were similarly executed. If the investigation determines that an ADA violation occurred, immediately report it to the President, Congress, and GAO as required by 31 U.S.C. and OMB Circular A-11. (Final action target date was December 30, 2011; reported in ARCATS as recommendation 6B.) [56]

11.c Develop or, when appropriate, modify and implement measures to prevent future potential ADA violations resulting from contracts funded over multiple fiscal years. (Final action target date was December 30, 2011; reported in ARCATS as recommendation 6C.) [56]

Additional Details to Supplement Our Report On HUD's Fiscal Years 2009 and 2008 Financial Statements, 2010-FO-0003

With respect to the significant deficiency that the CPD needs to improve its oversight of grantees, we recommend that CPD

12.a Determine whether the $24.7 million in unexpended funds for the HOME program from fiscal years 2001 and earlier that are not spent in a timely manner should be recaptured and reallocated in next year's formula allocation. (Final action target date was April 1, 2011; reported in ARCATS as recommendation 1E.) [56]

12.b Develop a policy for the HOME program that would track expenditure deadlines for funds reserved and committed to community housing development organizations and subgrantees separately. (Final action target date was September 30, 2011; reported in ARCATS as recommendation 1F.) [56]

With respect to HUD's substantial noncompliance with ADA, we recommend that the Chief Financial Officer, in coordination with the appropriate program offices,

13.a Complete the investigations and determine whether ADA violations have occurred and if an ADA violation has occurred, immediately report to the President, Congress, and GAO. (Final action target date was March 11, 2011; reported in ARCATS as recommendation 5A.) [56]

13.b Report the six ADA violations immediately to the President, Congress, and GAO, as required by 31 U.S.C. and OMB Circular A-11, upon receiving OCFO legal staff concurrence with the investigation results. (Final action target date was March 16, 2011; reported in ARCATS as recommendation 5B.) [56]

APPENDIXES

Appendix A

SCHEDULE OF FUNDS TO BE PUT TO BETTER USE

Recommendation number	Funds to be put to better use 1/
2.a.	$ 628M
6.a.	50.6M
6.b.	432,147
6.d.	11,404,776
6.e.	8,876,830
6.f.	7,451,393
6.g.	1,264,887
6.h.	227,803
6.i.	165,952
6.j.	129,389
6.k.	213,084
6.l.	12,623,049
6.m.	8,126,604
6.n.	626,613
6.o.	1,202,207
6.p.	2M
6.q.	54,982
6.r.	113,215
6.s.	52,078
6.t.	11,630
6.u.	8,277
6.v.	5,527
Total	$ 733,590,443

1/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified.

Appendix B

FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT NONCOMPLIANCE, RESPONSIBLE PROGRAM OFFICES, AND RECOMMENDED REMEDIAL ACTIONS

This appendix provides details required under FFMIA reporting requirements. To meet those requirements, we performed tests of compliance using the implementation guidance for FFMIA issued by OMB and GAO's Financial Audit Manual. The results of our tests disclosed that HUD's systems did not substantially comply with requirements. The details for our basis of reporting substantial noncompliance, responsible parties, primary causes, and HUD's intended remedial actions are included in the following sections.

Federal Financial Management Systems Requirements

In fiscal year 2010, OIG reported that C04 – Integrated Disbursement & Information System (IDIS) was noncompliant with the requirements of OMB Circular A-127.[57] Additionally, OIG has determined that CPD's financial management systems did not meet the computer system requirements of OMB A-127.[58] However, HUD's annual assurance statement, issued pursuant to Section 4 of the Financial Manager's Integrity Act, will report three nonconforming systems, which do not include IDIS.[59]

The organizations responsible for systems that were found not to comply with the requirements of OMB Circular A-127 based on HUD's assessments are as follows:

Responsible office	Number of compliant systems	Nonconforming systems
Office of Housing	16	0
Office of the Chief Financial Officer	13	0
Office of Chief Human Capital Officer	1	1
Office of the Chief Procurement Officer	1	2
Office of Community Planning and Development	3	0
Office of Public and Indian Housing	1	0
Government National Mortgage Association	1	0
Totals	36	3

[57] Audit report 2011-FO-0003, Additional Details To Supplement Our Report on HUD's Fiscal Years 2010 and 2009 Financial Statements, Significant Deficiency 1: HUD Financial Management Systems Do Not Comply With the Federal Financial Management Improvement Act (FFMIA) of 1996.
[58] Material Weakness: HUD Financial Management Systems Do Not Fully Comply With Federal Financial Management System Requirements – CPD's Grants Management Systems Are Not Compliant With Federal Financial System Requirements.
[59] The three nonconforming systems are (1) A35-HUD Procurement System, (2) P035-Small Purchase System, and (3) D67A-Facilities Integrated Resources Management System.

We have summarized HUD’s plan to correct noncompliance with OMB Circular A-127 as submitted to us as of September 30, 2012.

Facilities Integrated Resources Management System – In fiscal year 2009, OIG identified weaknesses related to HUD’s control over acquisition of accountable equipment and property management system and made four audit recommendations. The Office of Chief Human Capital Officer (OCHCO) is the office responsible for remediating the issues related to the Facilities Integrated Resources Management System (FIRMS). At the beginning of fiscal year 2012, HUD remediated three (1A, 1B, and 2B) of the four audit recommendations. The only recommendation not implemented as of September 30, 2012, was audit recommendation 2A, which deals with system interfaces with the core financial system and the acquisition system. According to OCHCO, FIRMS was not fully operational because the contract had expired and a new procurement contract had not been executed. OCHCO indicated that funding was available and the procurement process was ongoing. No target completion date had been set by HUD for the unimplemented audit recommendation as of September 20, 2012.

HUD Procurement System and Small Purchase System - For several years, HUD reported the HUD Procurement System (HPS) and Small Purchase System (SPS) as noncompliant systems. In fiscal year 2012, OCPO began implementing a new procurement system, the HUD Integrated Acquisition Management System (HIAMS), to replace HPS and SPS. However, as of September 26, 2012, although no new contract actions were being entered, HUD indicated that it would continue to use SPS to issue obligation modifications to existing active purchase orders until all the data have migrated from HPS and SPS to the HIAMS data warehouse and a system interface for migrated SPS action has been developed, tested, and implemented. Target completion was scheduled for the first quarter of 2013, which is the date on which OCPO planned to begin the deactivation phase of the HPS and SPS systems.

Appendix C

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

NOV 9 2012

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

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

SUBJECT: Management Comments on Draft Report on HUD's Fiscal Year 2012 Financial Statements – Internal Control and Compliance Sections

Comment 1

Thank you for the opportunity to comment on the subject draft report's internal control and compliance sections. Detailed comments regarding substantive and technical corrections and requests for clarifications and reconsiderations are provided in the Attachment. This includes responses to each significant deficiency by affected office. In addition to the attached, we offer the following summary comments for your consideration in completing the Fiscal Years (FYs) 2012 and 2011 audit. These comments are limited to the determination of a material weakness by Office of the Inspector General (OIG) based upon a determination of non-compliance with the Federal Financial Management Improvement Act of 1996 (FFMIA).

Comment 2

As in prior years, we continue to take exception to the conclusion that HUD is not in compliance with FFMIA and strongly disagree with OIG's new assertion that this matter rises to the level of a material weakness. We continue to believe HUD substantially satisfied the Office of Management and Budget's (OMB's) three-part requirement needed to report compliance. Agency financial management systems are in substantial compliance with FFMIA when they can prepare financial statements and other required financial and budget reports using information generated by the financial management system(s) which: (1) provide reliable and timely financial information for managing current operations; (2) account for assets reliably so that they can be properly protected from loss, misappropriation, or destruction; and (3) do all of the above in a manner that is consistent with federal accounting standards and the Standard General Ledger at the transaction level.

Comment 3

While the Department is disappointed that a reevaluation and course correction for HUD's Integrated Financial Management Improvement Project (HIFMIP) was necessary prior to its completion, this has no impact on the fact that HUD's existing legacy systems are, in their totality, fully compliant with FFMIA. We acknowledge that human interaction is necessary to make the legacy systems work in tandem. We also readily acknowledge that HUD's legacy systems are old and should be replaced with a state of the art fully integrated core system that can readily capture and present summary and detailed financial data in varying modes and formats, as well as considering the need for managerial cost data and reports. However, acknowledging this need does not negate the fact that HUD's Centralized Accounting Program System (HUDCAPS) when coupled with the Department's inventory of Financial Management Systems form a viable Integrated Financial Management System. The report states that plans to implement a Department-wide Core Financial System were halted. This is not an accurate statement. In actuality an independent assessment of the project determined that a course correction was essential to achieving

Ref to OIG Evaluation	**Auditee Comments**
	a successful outcome. HUD has multiple options under consideration in an effort to limit costs and reduce risks.
Comment 4	Regarding the HUD Integrated Acquisition Management System (HIAMS), concern was expressed in the draft report regarding variances in obligation balances between the new HIAMS and the legacy HUDCAPS. Through the use of the OCFO's Financial Data Mart progress has been made in improving the HIAMS/HUDCAPS financial interface. During the past year, a major effort between the Chief Procurement Officer and OCFO staff was made to reconcile HUDCAPS and HIAMS, utilizing the OCFO Financial Data Mart. As a result, progress was made in improving the HIAMS/HUDCAPS financial interface. On October 12th, a reconciliation of data between both systems effective September 30, 2012, showed a variance of approximately $3 million or 0.313 percent. Even though a difference did exist, the difference was insignificant when compared to all unexpired records. The Obligation data in HUDCAPS is traceable to HIAMS. Each day, HIAMS delivers to the OCFO Financial Data Mart a data file of all HIAMS records. The file is loaded and utilized by software which reconciles the Obligations between both systems to determine any differences. In addition, an automated report is generated to reconcile transactions posted the previous day in HUDCAPS back to HIAMS.
Comment 5	In addition, HUD management does not concur with the OIG's assertion that the Integrated Disbursement and Information System (IDIS) is not compliant with FFMIA. OIG states that the use of the First-In, First-Out (FIFO) methodology employed by IDIS for disbursing formula grant funds administered by the Office of Community Planning and Development (CPD) caused it to be non-compliant with FFMIA. The report also states that FIFO was not supported by accounting standards. The center of this disagreement continues from last year's financial audit, and other audits, regarding whether the FIFO methodology conforms with Generally Accepted Accounting Principles (GAAP). Since OIG first reported this issue in FY 2009 HUD position has been that IDIS and the FIFO method of accounting are clearly in keeping with the flexibility intended by Congress in terms of how formula grant funds are disbursed and tracked by the Department. Moreover, a June 10, 2010 joint memorandum from HUD's General Counsel and Chief Financial Officer addressed to the Inspector General concluded that the use of FIFO to account for formula grant funds represents a reasonable interpretation of the statutory duties imposed on the Secretary. The facts are that formula grant funds are not intended to carry the same restrictions as competitive grants, where specific projects are usually required in order to obtain the grant. These formula grants are tracked more by categorical, authorized uses and can be shifted by the entitlement entity from project to project largely at the will of the entity and without requesting the permission of the Department. The report also discusses many instances of "irreconcilable" differences. The irreconcilable differences discussed in the report are the result of an audit procedure employed by the OIG to obtain grant disbursement and remaining balance information from grantees' accounting records. If the grantee does not use the same FIFO methodology to account for grant funds, we would expect the records to differ. CPD through its IDIS system can account for every dollar disbursed for these formula grant funds. CPD has on numerous occasions told both their grantees and the OIG that HUD's records are the official records for grant balances.
Comment 6	Regarding the Section 108 Loan Guarantee Program Accounting not being automated, while subsidiary accounts are maintained by CPD, this program is accounted for within HUD's financial systems. CPD is currently engaged in efforts to expand the degree to which Section 108 program

Ref to OIG Evaluation **Auditee Comments**

financial information is made available to those systems in an automated mode. The report states that, when a CPD grantee defaults on a bond payment, CPD instructs the CFO Accounting, Monitoring and Analysis Division to make a manual deduction of funds available in the line of credit for the CDBG grant. The point of this statement is unclear and it is inaccurate as to whether a loan is in default. The grant deductions are not made as a result of a default; to the contrary, they are made to avoid a payment default on the guaranteed loan. The deducted grant funds are applied prior to the payment due date under the promissory note that is guaranteed by HUD. If the deductions were not made, the guaranteed loan would be in default and HUD would have to make a payment from the Section 108 financing account. The report also states that, without integrated automated core financial management systems to record detail program transactions, the Loan Guarantee program is unable to appropriately monitor loan commitment, note issue, or amount repayment. As the result, it may cause unreliable data that could affect the financial statements. This statement leaves the wholly untrue impression that loan information is not monitored adequately. Notwithstanding that subsidiary accounts are maintained manually, all loan information (including commitments, guarantees, loan advances, and loan repayments) is maintained accurately and reconciled with control accounts maintained in HUDCAPS and with reports furnished by the Section 108 trustee/fiscal agent.

Comment 7

To reduce the inefficiencies caused by about 75 systems containing financial data, the Deputy Secretary, OCFO, and OCIO are working together to determine the best path forward which minimizes risks and achieves a cost effective solution. This will include the consideration of shared service solutions with other agencies and other alternatives. While we recognize the need to replace HUD's legacy systems and are taking steps to do so, we still recognize that the systems are sufficiently robust to satisfy OMB's three-part requirement and remain within the OMB Circular A-127 indicators of a nominal to moderate risk of misstatement. Consequently, management must again differ from the OIG and continue to report substantial compliance with FFMIA, as we have done in prior years. Therefore, it also follows that we disagree with OIG's assertion that the issues presented rise to the level of a material weakness. We request that OIG consider the points presented in this memorandum and the attached detailed comments and remove the material weakness designation for this issue.

Detailed comments and responses to each of the significant deficiencies are included in the attachment along with technical comments. Also included are responses to some of the new recommendations where positions or actions taken were known at the time of this writing.

In conclusion, I want to personally thank you and your audit team for the collaborative and supportive manner in which you worked with HUD management and staff. We acknowledge the underlying difficulty in determining the accuracy and reliability of the consolidated financial statements and look forward to working with the OIG in the next audit cycle. If you have any questions on our comments, please contact Jerry Vaiana on extension 8106.

Attachment

OIG Evaluation of Auditee Comments

Comment 1

HUD management only provided formal comments related to the material weakness; Achieving Substantial Compliance with FFMIA Continues to Challenge HUD on which they non-concurred.

With regard to the detailed comments' editorial and technical concerns, they were reviewed and considered. OIG made adjustments and corrections throughout the report as appropriate.

Comment 2

We disagree with the CFO's assertion that HUD's financial management system substantially met FFMIA requirements. Determination of whether an agency wide compliance with federal requirements depends upon applying experienced judgment in assessing the financial impact of noncompliance with the individual requirements. Financial impact can affect both accurate financial reporting and proper financial decision making. The state of the financial management systems at HUD have subjected financial reporting and decision making to above normal risks. In fiscal year 2012, HUD's previously reported risks related to lack of an integrated financial management system was heightened by the identification of non recording of certain accounts receivable; inaccurate loan loss calculations; as well as completeness issues related to intra agency elimination, which impacted preparation of the consolidated statements. In fiscal year 2012, we also reported that HUD was unable to fully reconcile procurement system discrepancies, certain obligation and expenditure amounts did not agree with grantee records and that there was not an automated system for a $2 billion loan guarantee program.

Comment 3

We reviewed the report language and made adjustments to reflect HUD's continuing actions regarding its core financial system replacement efforts.

Comment 4

OIG commends the CPO and OCFO for their work to reconcile the obligation balances between HIAMS and HUDCAPS during the past year. We detailed the reconciliation process within the report and utilized the results of that process to document the differences between the two applications on September 28, 2012. We acknowledge that, as the two offices continue work to reconcile the differences, the balances will continue to drop. However, as of September 28, 2012, the differences we reported are valid and no changes to the report are deemed necessary.

Comment 5

HUD disagreed with our positions on CPD grant management issues related to compliance with GAAP and IDIS compliance with federal financial management system requirements.

As HUD noted, OIG reported that the accounting for CPD formula grant was not in accordance with GAAP. This was due in large part to their use of a FIFO methodology, which they have stated relies on using the oldest available funds in accounting for its formula grants. This issue was first identified in fiscal year 2009 and has been repeated in our reports every year since.

As discussed in the Material Weakness, OIG performed additional procedures in an attempt to quantify the effects of using FIFO to record financial transactions, by comparing the information in IDIS to the grantee's records, which is required to be maintained using generally accepted accounting principles. While the results did not specifically quantify the effects of using FIFO, we found projected irreconcilable differences between the grantees' records of the total obligation balance and IDIS, the grantee's records of disbursements and IDIS, and beginning balances. These differences indicated that the data reported in IDIS, and in the case of disbursements, initiated by the grantee, was inconsistent with the information reported by the grantees maintained using generally accepted accounting principles.

HUD's response references a CPA study to support their statement that FIFO is in accordance with GAAP. We reported in audit report 2011-FO-003 the following regarding the results of that study: "While the review found that IDIS provided the required data to HUD's core financial management system; the study itself had limitations. OIG's evaluation of the study's results noted (1) the contractor improperly excluded IDIS as part of HUD's financial management system and subject to the requirements of FFMIA, (2) did not support its conclusion that FIFO was compliant with Federal systems requirements with criteria or procedures, and (3) did not consider the FIFO mismatch effect prior to being posted to the core financial system. The contractor examined IDIS's compliance with Federal financial management requirements after IDIS had inappropriately used FIFO and a budget fiscal year appropriation inconsistent and mismatched from the obligating budget fiscal year appropriation."

In regards to HUD's reference to an OGC opinion, the opinion did not reference and stated that it did not consider accounting guidance in its analysis. In its efforts to support the use of FIFO, HUD has not provided a response indicating how the use of the FIFO methodology is supported by GAAP requirements or federal financial management system requirements.

Comment 6

OIG reviewed HUD's position regarding the details of Section 108 payments and adjusted the wording in the report. However, the main point regarding the

Section 108 program is that the subsidiary ledgers which support the general ledger balances are manually maintained in spreadsheets and account for over $2 billion in loan guarantees. The current process in place lacks the ability to automatically link associated grant data with loan guarantees and perform automated financial management functions such as general ledger, payment, and receivable management.

Comment 7

OIG acknowledges the Department’s renewed effort at designing and implementing a compliant integrated financial management system. As we continue to monitor HUD’s progress, it is our hope that your efforts will be successful.

As noted before, due to the multiple control deficiencies within HUD’s integrated financial management system, there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. Accordingly, we are classifying this issue as a material weakness.

OIG cannot agree to the CFO's request that we revise our report as requested, lowering this issue’s level from a material weakness to a significant deficiency.