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November 16, 2009

Audit Case Number
2010-FO-0003

TO: Anthony P. Scardino, Acting Deputy Chief Financial Officer, F

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

SUBJECT: Additional Details to Supplement Our Report on HUD's Fiscal Years 2009 and 2008 Financial Statements

HIGHLIGHTS

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. Our report on HUD's fiscal years 2009 and 2008 financial statements are included in HUD's Fiscal Year 2009 Performance and Accountability Report. This report supplements our report on the results of our audit of HUD's principal financial statements for the fiscal years ending September 30, 2009, and September 30, 2008. Also provided are assessments of HUD's internal controls and our findings with respect to HUD's compliance with applicable laws, regulations, and government-wide policy requirements and provisions of contracts and grant agreements.¹ In addition, we

¹ Additional details relating to the Federal Housing Administration (FHA), a HUD component, are not included in this report but are included in the accounting firm of Urbach Kahn and Werlin LLP's audit of FHA's financial statements. That report has been published in our report, Audit of Federal Housing Administration Financial Statements for Fiscal Years 2009 and 2008 (2010-FO-0002, dated November 13, 2009).

Additional details relating to the Government National Mortgage Association, (Ginnie Mae), another HUD component, are not included in this report but are included in the accounting firm of Carmichael Brasher Tuvell and Company's audit of Ginnie Mae's financial statements. That report has been published in our report, Audit of Government National Mortgage Association Financial Statements for Fiscal Years 2009 and 2008 (2010-FO-0001), dated November 06, 2009).

plan to issue a letter to management on or before January 16, 2010, describing other issues of concern that came to our attention during the audit.

What We Found

In our opinion, HUD's fiscal years 2009 and 2008 financial statements were fairly presented. Our opinion on HUD's fiscal years 2009 and 2008 financial statements is reported in HUD'S Fiscal Year 2009 Performance and Accountability Report. The other auditors and our audit also disclosed the following 11 significant deficiencies in internal controls related to the need to:

- Adequately monitor Office of Community Planning and Development (CPD) grantees' compliance with program regulations;
- Continue improvements in the oversight and monitoring of subsidy calculations, intermediaries' program performance, and Housing Choice Voucher program funds;
- Improve the processes for reviewing obligation balances;
- Comply with Federal financial management systems requirements;
- Further strengthen controls over HUD's computing environment;
- Improve personnel security practices for access to the Department's critical financial systems;
- Strengthen the Government National Mortgage Association's (Ginnie Mae) monitoring and management controls in regard to the Mortgage-Backed Securities program;
- Implement short-term capacity management plans for Federal Housing Administration (FHA) systems;
- Effect FHA modernization to address system risks;
- Address increased risk to management's estimate of the Loan Guarantee Liability brought about by economic conditions and inherent model design risks; and
- Enhance user access management processes for the FHA subsidiary ledger.

Our findings include the following four instances of noncompliance with applicable laws and regulations:

- HUD did not substantially comply with the Federal Financial Management Improvement Act regarding system requirements;
- HUD did not substantially comply with the Antideficiency Act;
- FHA's Mutual Mortgage Insurance fund capitalization was not maintained at a minimum capital ratio of two percent, which is required under the Cranston-Gonzalez National Affordable Housing Act of 1990; and
- Ginnie Mae did not comply with the Federal Information Management Security Act.

The audit also identified \$199.1 million in excess obligations recorded in HUD's records. We also are recommending that HUD seek legislative authority to implement \$ 317 million in offsets against public housing agencies' (PHA) excess unusable funding held in Net Restricted Assets Accounts at the PHAs. These amounts represent funds that HUD could put to better use.

What We Recommend

Most of the issues described in this report represent long-standing weaknesses. We understand that implementing sufficient change to mitigate these matters is a multiyear task due to the complexity of the issues, insufficient information, technology systems funding, and other impediments to change. In this and in prior years' audits of HUD's financial statements, we have made recommendations to HUD's management to address these issues. Our recommendations from the current audit, as well as those from prior years' audits that remain open, are listed in appendix B of this report.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3.

HUD's Response

The complete text of the agency's response can be found in appendix E. This response, along with additional informal comments, was considered in preparing the final version of this report.

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Internal Control

Significant Deficiency: Office of Community Planning and Development (CPD) Needs to Adequately Monitor Grantees' Compliance with Program Requirements

CPD seeks to develop viable communities by promoting integrated approaches that provide decent housing and a suitable living environment and expand economic opportunities for low- and moderate-income persons. The primary means toward this end is the development of partnerships among all levels of government and the private sector, including for-profit and nonprofit organizations. To carry out its mission, CPD utilizes a mixture of competitive and formula-based grants. Program offices have a responsibility to ensure that the funds provided are adequately monitored to ensure that programs are meeting their goals and objectives in accordance with program requirements.

Grantee oversight is an ongoing process that assesses the quality of a program participant's performance over a period of time. Monitoring provides information about program participants that is critical for making informed judgments about program effectiveness and management efficiency. Consistent monitoring efforts also help to identify instances of fraud, waste, and abuse within HUD's programs and facilitate the correction of control deficiencies before they materially affect the achievement of the organization's objectives.

Based upon our review of HUD's HOME, Community Development Block Grant (CDBG), and Homeless Assistance programs, we noted control deficiencies regarding monitoring of timely obligation and expenditure of grant funds. The combination of the control deficiencies we noted during our audit have adversely affected the organization's ability to meet its internal control objectives, which are to determine grantee compliance with applicable laws and regulations, to timely identify deficiencies, and to design corrective actions to improve or reinforce program participant performance.

Compliance With Obligation Requirements by State CDBG Programs Not Consistently Monitored or Enforced

CPD did not consistently monitor and ensure that CDBG non-entitlement funds were obligated and announced in accordance with the timeliness requirements in the Code of Federal Regulations (CFR). Part 570 of the CFR requires that States obligate and announce 100 percent of their annual grants (excluding State administration) to units of general local government within 15 months of the State signing its grant agreement with HUD.

CPD completed its latest timeliness review of obligations for grant years 2000-2004 in 2006. It did not begin its review of the programs' timeliness requirement for grant years 2005-2007 until September 2008, which is still ongoing. No review had been performed for States that signed grant agreements in 2008.

The results of the review for grant years 2000-2004 were published in CPD Notice 06-12, dated November 2, 2006. CPD's review revealed that for grant years 2000-2004, 25 of 50 States had not met the 100 percent standard for obligating and announcing their grants to the local governments within 15 months of HUD's date of award for at least 1 of the years reviewed. We determined that over the course of these 5 years, about \$53 million was not distributed in a timely manner. In our initial discussions, CPD was unsure of the follow-up and/or remedial actions taken by the field offices regarding States that were in noncompliance with the distribution requirements. Documentation was later provided by CPD for a sample of 6 of the 25 States, indicating that field offices did perform follow-up regarding their noncompliance.

CPD's policy is to review data from the Line of Credit Control System (LOCCS) and the Grants Management Process (GMP) System within 15 months after the beginning of each State's program year and request field offices to verify that States have obligated and announced funds in compliance with the timely distribution requirement. We found that the data used by CPD to determine compliance with the timeliness requirements were sometimes incomplete or contained errors. CPD's ability to monitor the obligation requirement appeared to have been hampered because the data used to measure compliance with this requirement were not maintained in one system. Officials added that the timely distribution requirement was only one element subject to monitoring review and may or may not have been included in any given monitoring review conducted by a field office.

When States do not obligate and announce grant funds in a timely manner, units of local government cannot make the most effective and efficient use of their funding. In addition, noncompliance with the timely obligation requirement may indicate that there are other performance issues within the State. As a result, a State's annual funding amount for the following grant year may need to be reduced or suspended.

We recommend that CPD follow existing policies and regulations regarding annual review of the distribution requirements for the State program and followup with remedial actions against States that are in noncompliance. In addition, we recommend that the office ensure that the most complete and accurate data are used to conduct the review and to consider modifying an existing system that would create an automated process to house all of the data needed for the review.

Subgrantees and Community Housing Development Organizations for the HOME Program Do Not Always Expend Grant Funds in a Timely Manner

The HOME Expiring Funds Report maintained by the Office of Affordable Housing Programs, dated September 24, 2009, contained unexpended HOME Investment Partnerships Program (HOME) funds on grants from 1992 through 2001 that totaled \$24.7 million. We found that these funds had accumulated mainly due to poorly performing community housing development organizations (CHDO) and subgrantees that did not expend funds in a timely manner. We also found that these funds had accumulated due to the programs' cumulative accounting requirements that allow one grantee's poor performance within a participating jurisdiction to be hidden or go undiscovered.

HOME program regulations state that funds that are not expended in a timely manner can be reallocated in the next year's formula allocation to further the mission of the program. It is the field offices' responsibility to ensure that funds from fiscal years 2001 and earlier that were not spent in a timely manner are recaptured and used in the next year's formula allocation.

HOME program regulations do not penalize or highlight poorly performing subgrantees or CHDOs for two reasons. First, the commitment, reservation, and disbursement deadlines are determined on an aggregate/cumulative basis versus a grant year basis. This process has created a situation in which older funds can remain available for drawdown because compliance with the disbursement deadline is determined cumulatively. Therefore, if a subgrantee or CHDO is not performing as it should, or not spending funds to complete its projects, the cumulative program requirements may allow one grantee's poor performance to be hidden or go undiscovered.

Second, the funds that are subgranted or reserved to a CHDO are held to the five year disbursement deadline, but it is the participating jurisdiction that is ultimately responsible for meeting the disbursement deadline. Only the participating jurisdiction can draw funds, not the subgrantee or CHDO. In addition, it appears that the large number of subgrantees and CHDOs per participating jurisdiction within the HOME program makes it difficult for the field offices to sufficiently monitor the status of subgranted funds.

Since \$24.7 million in HOME grant funds for fiscal years 2001 and earlier has been reserved or committed but not expended, these funds had not been used to expand the supply of decent, safe, sanitary, and affordable housing for low- and very low-income families.

We recommend 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 \$24.7 million should be deobligated. We also recommend that CPD develop a policy that would track expenditure deadlines for funds reserved and committed to CHDOs and subgrantees separately.

Funds From Expired Contracts Not Always Recaptured for Homeless Assistance Programs

Reports from HUD's Financial Data Mart show approximately \$48 million in undisbursed obligations recorded for expired contracts that were funded with grants during 1997-2001 for homeless assistance programs. These contracts expired on or before September 30, 2009. Of the \$48 million, approximately \$6 million relates to contracts that expired 90 days before the fiscal year-end. CPD's Funds Control Plan allows a 90-day closeout period for expired contracts.

According to the Appropriations Law, these funds are available until expended and do not return to the U.S. Treasury when the contracts expire. However, the field offices are responsible for reviewing the status of contracts and recommending that funds that have been obligated but not disbursed in the appropriate timeframes be deobligated and included in the next year's Continuum of Care competition to be redistributed to eligible grantees. The competitive programs under homeless assistance include (1) Shelter Plus Care, (2) Supportive Housing, and (3) Section 8 Moderate Rehabilitation Single Room Occupancy.

CPD officials stated that when a contract expires, the excess funding should be locked, and the grantees should have no access to the funds. CPD has instructed the field offices to review these contracts and recommend that the remaining funds be recaptured. Special emphasis has been placed on this review process before the annual funding competition. However, the field offices have been overwhelmed with American Recovery and Reinvestment Act of 2009 (Recovery Act) funding requirements and other requirements. As a result, many of these expired contract reviews have not been performed.

In addition, it appears that it is difficult for CPD to consistently track contract expiration dates because there is no report that shows all of the necessary information. Project data from the Financial Data Mart must be merged with LOCCS data because LOCCS stores the contract expiration dates.

The \$42 million identified as excess funding on expired contracts can be included in the next year's Continuum of Care competition as announced in the notice of funding availability and redistributed to eligible grantees. The excess funds should be recaptured and used to further accomplish the objectives of the program, which are to reduce the incidence of homelessness in Continuum of Care communities by assisting homeless individuals and families to move to self-sufficiency and permanent housing.

We recommend that CPD develop a policy to ensure that an annual review of the status of each of its homeless assistance contracts is conducted, which may include recommending deobligation and recapture of excess funds when applicable. To effectively track its homeless assistance program expiration dates,

we recommend that CPD develop the management reports needed to effectively track its homeless assistance program expiration dates. We also recommend that field offices review the status of the identified contracts and recapture up to the \$42 million identified in undisbursed obligations for expired contracts that were funded with grants during 1997-2001 for homeless assistance programs and consider such funds for inclusion in the fiscal year 2010 Continuum of Care competition.

Completed Projects for the HOME Program Not Always Closed Out in IDIS in a Timely Manner

The Open Activities Report is issued monthly and used by CPD field offices and participating jurisdictions within the HOME program to review open activities in the Integrated Disbursement and Information System (IDIS). Open activities are those that have not been closed in the system.

A review of HUD's Open Activities Report, dated August 31, 2009, showed 5,972 of 29,216 open activities (20 percent), in which the participating jurisdiction had made its final draw but the activity was still listed on the Open Activities Report. Thus, these projects had not been closed in the system although all funds had been drawn. HOME program regulations require participating jurisdictions to enter project completion information into IDIS within 120 days of making a final draw for a project. A similar finding² was reported by the Office of Inspector General (OIG) concerning HUD's needs to improve efforts to require participating jurisdictions to cancel HOME fund balances for open activities.

The Open Activities Report also allows participating jurisdictions to view activities that have been open for several years with little or no HOME funds drawn. Field offices can use this report as a desk-monitoring tool to view each participating jurisdiction's open activities in need of completion or possibly cancellation in IDIS. If the report indicates that funds have not been drawn for an extended period, the field office can use the report to follow up with the participating jurisdiction to determine the reason for the slow progress on the project and whether it should be cancelled.

However, it appeared that the field offices were not using the Open Activities Report to follow up with participating jurisdictions on slow-moving projects listed on the report. It also appeared that participating jurisdictions were not using the report as a reference to determine projects that should be cancelled or closed in IDIS. The report was created to alleviate the widespread problem of participating jurisdictions not entering project completion data into IDIS in a timely manner.

² OIG audit report entitled "HUD Lacked Adequate Controls to Ensure the Timely Commitment and Expenditure of HOME Funds (2009-AT-0001, dated September 28, 2009).

Participating jurisdictions that do not enter completion data in a timely manner are in violation of the HOME regulations. Failure to enter project completion data in IDIS negatively affects a participating jurisdiction's score on several HOME performance SNAPSHOTS indicators, understating actual accomplishments and reducing the participating jurisdiction's statewide and national overall rankings.

The widespread failure of participating jurisdictions to enter completion and beneficiary data in a timely manner results nationally in underreporting of actual HOME program accomplishments to Congress and the Office of Management and Budget (OMB) and may negatively impact future funding for the program.

We recommend that CPD require field offices to monitor participating jurisdictions to ensure that project completion information and beneficiary data are complete, accurate, and entered into IDIS monthly and to follow up with participating jurisdictions on slow-moving projects to determine the reason for the delay. We also recommend that CPD require participating jurisdictions to have a quality control systems in place to ensure that the required project completion information and beneficiary data are complete, accurate, and entered into IDIS monthly.

Significant Deficiency: HUD Management Must Continue To Improve Oversight and Monitoring of Subsidy Calculations, Intermediaries' Performance, and Utilization of Housing Choice Voucher Funds

Under the provisions of the U.S. Housing Act of 1937, HUD provides housing assistance funds through various grant and subsidy programs to multifamily project owners (both nonprofit and for profit) and housing agencies. These intermediaries, acting for HUD, provide housing assistance to benefit primarily low-income families and individuals (households) that live in public housing, Section 8 and Section 202/811 assisted housing, and Native American housing. In fiscal year 2009, HUD spent about \$29 billion to provide rent and operating subsidies that benefited more than 4.7 million households.

Since 1996, we have reported on weaknesses with the monitoring of the housing assistance program's delivery and the verification of subsidy payments. We focused on the impact these weaknesses had on HUD's ability to (1) ensure intermediaries are correctly calculating housing subsidies and (2) verify tenant income and billings for subsidies. During the past several years, HUD has made progress in correcting this deficiency. In 2009, HUD continued utilizing the comprehensive consolidated reviews in the Office of Public and Indian Housing's (PIH) efforts to address public housing agencies' (PHA) improper payments and other high-risk elements. HUD's continued commitment to the implementation of a comprehensive program to reduce erroneous payments will be essential to ensuring that HUD's intermediaries are properly carrying out their responsibility to administer assisted housing programs according to HUD requirements.

The Department has demonstrated improvements in its internal control structure to address the significant risk that HUD's intermediaries are not properly carrying out their responsibility to administer assisted housing programs according to HUD requirements. HUD's increased and improved monitoring has resulted in a significant decline in improper payment estimates over the last several years. However, HUD needs to continue to place emphasis on its on-site monitoring and technical assistance to ensure that acceptable levels of performance and compliance are achieved and periodically assess the accuracy of intermediaries rent determinations, tenant income verifications, and billings.

Tenant income is the primary factor affecting eligibility for housing assistance, the amount of assistance a family receives, and the amount of subsidy HUD pays. Generally, HUD's subsidy payment makes up the difference between 30 percent of a household's adjusted income and the housing unit's actual rent or, under the Section 8 voucher program, a payment standard. The admission of a household to these rental assistance programs and the size of the subsidy the household receives depend directly on the household's self-reported income. However, significant amounts of excess subsidy payments occur because of errors in intermediaries' rent determinations and undetected, unreported, or underreported income. By overpaying rent subsidies, HUD serves fewer families. Every dollar paid in excess subsidies represents funds that could have been used to subsidize other eligible families in need of assistance.

HUD's Gross Estimate of Erroneous Payments Increased in Fiscal Year 2009

The estimate of erroneous payments that HUD reports in its Performance and Accountability Report relates to HUD's inability to ensure or verify the accuracy of subsidy payments being determined and paid to assisted households. This year's contracted study of HUD's three major assisted housing programs estimated that the rent determination errors made by the intermediaries resulted in substantial subsidy overpayments and underpayments. The study was based on analyses of a statistical sample of tenant files, tenant interviews, and income verification data for activity that occurred during fiscal year 2008. However, the amounts reported in the study have been adjusted due to recent program structure changes.

The Public Housing programs switched to Asset Management and began calculating formula income for PHAs as noted in 24 CFR 990.195 *Calculating Formula Income*. This change eliminated the 3 types of improper payment errors for the Public Housing program. This new process was implemented in January 2007. Therefore for FY 2007 this process was in place for the last 3 quarters of the year and HUD subsidy errors occurred only in the first quarter. Errors could still be made by PHAs in their calculation of the amount of tenant rent or tenants could still be under reporting their income, however beginning January 2007 this no longer affected HUD's subsidy. The Quality Control (QC) study and Income Match Reporting study estimated these errors for the entire fiscal year because this information is useful to management of both PIH and the PHAs. However, based on the conversion to asset management and the change in calculating

formula income becoming effective in January 2007, none of the amounts calculated in the QC study for the Public Housing Administrator, Income Reporting, and Billing errors will be reported for FY 2008 as this change was in effect for all of FY 2008. In addition, the establishment of a budget based funding methodology was implemented for the Housing Choice Voucher Program to eliminate the opportunity for billing errors in that program. Budget based means that each PHA will have a set annual budget for vouchers to serve their clients' needs. The PHA will receive the annual budget in 12 equal monthly payments – thus eliminating the need to bill HUD and eliminating the Housing Choice Voucher Program Billing Error.

The estimate of erroneous payments is reported in HUD's Fiscal Year 2009 Performance and Accountability Report as Other Accompanying Information and will reflect the adjusted error estimates. Based on the previously mentioned program structure changes, HUD is reporting subsidy payment inconsistencies in which HUD incorrectly paid \$592 million in annual housing subsidies. This is a 12 percent decrease in the gross erroneous payments in comparison to the prior year.

The estimate of erroneous payments this year also includes overpaid subsidies from underreported and unreported income and intermediaries' billings errors. HUD estimated that housing subsidy overpayments from tenants misreporting their income totaled an additional \$364 million in overpayments during Fiscal year 2008 before making adjustments for the program structure changes. However, during our testing of the initial error estimate results, we found additional cases resulting in valid errors. In addition, we also determined that the contractor performing the review of the income match was not following the rules properly for some of the cases. As a result, the contractor re-reviewed the cases to apply the rules correctly and issued a revised income match report with a total estimate of \$416 million. Therefore, including the subsidy error associated with the income from these cases and making adjustments for the program structural changes, the revised estimate is \$370.7 million.

HUD did not conduct a billings study during fiscal year 2009. Therefore, the results of prior year's study will carryover for this year's billings error estimate and have been adjusted according to the previously mentioned program structural changes. Based on the payment errors that were identified for the Office of Housing's project-based Section 8 housing program, HUD reported an estimated \$59 million in program billings errors for fiscal year 2006. In addition, PIH's billings error estimate has been reduced to zero for the Housing Choice Voucher program. Additionally, the operating subsidy estimate was reduced to zero for the PIH billings estimate based on the previously mentioned structural changes. Therefore, only the Office of Housing's estimate of \$59 million will be included in the estimate of erroneous payments for billings errors.

In totality, HUD has increased the combined gross improper rental housing assistance payment estimates to \$1.022 billion in Fiscal Year 2008. This is a total increase of 3 percent in comparison to the prior year estimates of \$993 million.

Need To Continue Initiatives To Detect Unreported Tenant Income

The computer matching agreement between HUD's Office of Housing and the Department of Health and Human Services (HHS) for use of the National Directory of New Hires in the Enterprise Income Verification system (EIV) was finalized in fiscal year 2008. HUD successfully expanded its computer matching program with the HHS data to all of its rental assistance programs (public housing, housing vouchers, and project-based housing) when HUD's project-based program gained access to the HHS database on January 15, 2008. The other programs had gained access previously. HUD had intended to issue a final rule mandating the use of this matching data by the end of calendar year 2008. However, the final rule revising HUD's public and assisted housing program regulations to implement the up-front income verification process for program participants was published on January 27, 2009. Consequently, the final rule was scheduled to become effective on September 30, 2009, but it has now been postponed and will not become effective until January 31, 2010. This rule would require the use of HUD's EIV system by PHAs and owners and management agents.

EIV is a web-based system that compiles tenant income information and makes it available online to HUD business partners to assist in determining accurate tenant income as part of the process of setting rental subsidy. Currently, EIV matches tenant data against Social Security Administration information, including Social Security benefits and Supplemental Security Income, and with the HHS National Directory of New Hires (NDNH) database, which provides information such as wages, unemployment benefits, and W-4 ("new hires") data, on behalf of PIH and Multifamily Housing programs. The EIV System is available to PHAs nationwide and to Owner Administered project-based assistance programs and they are encouraged to use and implement the EIV System in their day-to-day operations.

During our fiscal year 2008 audit, we noted that the Department was also in the process of implementing the Multifamily Housing Error Tracking Log (ETL) initiative. The ETL initiative was supposed to document whether and to what extent owners are accurately, thoroughly, and clearly determining family income and rents in the Office of Multifamily Housing Subsidy Programs, and was to track the specific dollar impact of income and rent discrepancies and the corresponding resolution of such errors. However, we determined during our fiscal year 2009 audit that ETL has not been implemented yet. In addition, it has been renamed *ISERS (Integrated Subsidy Error Reduction System)* and is currently going through the procurement process.

Need To Continue Progress on RHIP Initiatives

HUD initiated the RHIP as part of an effort in fiscal year 2001 to develop tools and the capability to minimize erroneous payments. The type of erroneous payments targeted includes the excess rental subsidy caused by unreported and underreported tenant income. Since our last report, HUD has continued to make progress in addressing the problems surrounding housing authorities' rental subsidy determinations, underreported income, and assistance billings. However, HUD still needs to ensure that it fully uses automated tools to detect rent subsidy processing deficiencies and identify and measure erroneous payments.

Monitoring of Intermediaries' Performance

During fiscal year 2006, HUD implemented a 5-year plan to perform consolidated reviews to reinforce PIH's efforts in addressing PHAs' improper payments and other high-risk elements. These reviews were also implemented to ensure the continuation of PIH's comprehensive monitoring and oversight of PHAs. The 5-year plan required HUD to perform tier 1 comprehensive reviews on approximately 20 percent or 490 of the PHAs that manage 80 percent of HUD's funds. According to the Fiscal Year 2009 Management Plan directive, PIH identified 100 PHAs that receive 80 percent of HUD's funding for the priority tier 1 comprehensive reviews. Tier 2 reviews, chosen by field offices based on availability of resources, are optional comprehensive reviews of the remaining PHAs. The comprehensive reviews included rental integrity monitoring (RIM), RIM follow-up on corrective action plans, EIV implementation and security, Section 8 Management Assessment Program (SEMAP) confirmatory reviews, SEMAP quality control reviews, exigent health and safety spot checks, Management Assessment Subsystem certifications, and civil rights limited front-end reviews.

Documentation provided during our review showed that 105 Tier I reviews were performed during fiscal year 2009. Because of the deficiencies identified in the consolidated reviews, corrective action plans were implemented at 12 PHAs from Tier I reviews completed as of June 30, 2009. More corrective action plans may be implemented from reviews completed in the last quarter. At the end of our fieldwork, six PHAs had corrective action plans still open. Additionally, from prior Tier I reviews, we noted that corrective action plans for 5 PHAs were still open. HUD must continue to ensure that corrective action plans are implemented and closed out, thereby ensuring that the systemic errors identified during the reviews have been corrected.

In prior years, we reported that information contained in the PIH Inventory Management System (PIC-IMS) was incomplete and/or inaccurate because housing authority reporting requirements were discretionary. As a result PHAs

have been mandated to submit 100 percent of their family records to HUD. HUD annually evaluates those PHAs not meeting the 95 percent requirement. In fiscal year 2009, there were 190 PHAs of 3,121 that did not meet the minimum reporting rate. We performed spot checks at the Chicago, San Francisco, and Atlanta PIH field offices and found that for the most part, PHAs were meeting HUD's reporting requirements. Since HUD uses the tenant data from its PIC-IMS for the income-matching program and program monitoring, it is essential that the database have complete and accurate tenant information. Therefore, until a more efficient and effective means of verifying the accuracy of the data is developed, HUD needs to continue to emphasize the importance of accurate reporting and proactively enforce sanctions against those PHAs that do not follow the requirement.

HUD has made substantial progress in taking steps to reduce erroneous payments. However, it must continue its regular on-site and remote monitoring of the PHAs and use the results from the monitoring efforts to focus on corrective actions when needed. We are encouraged by the on-going actions to focus on improving controls regarding income verification, as well as HUD's plans regarding corrective action plans, consolidated reviews, and the continual income and rent training for HUD staff, owners, management agents, and PHAs.

Monitoring Public Housing Agencies' Utilization of Excess Funds

Congress, in an attempt to limit the cost of the Housing Choice Voucher program and to provide flexibility to the PHAs in the administration of available program funding, enacted provisions in the fiscal year 2005 Appropriation Act (Public Law 108-447) that significantly changed the way HUD provides and monitors the subsidies paid to PHAs. Starting January 1, 2005, Congress changed the basis of the program funding from a "unit-based" process to a "budget-based" process that limits the Federal funding to a fixed amount.

Under the legislation, HUD distributes Federal funding using a formula based on the prior-year cost that is self-reported by housing agencies in the Voucher Management System (VMS). HUD records the funding allocated to the PHA as an expense and no longer records a receivable for any under-utilized funds because the PHAs retain and are expected to use the funds in their entirety for authorized program activities and expenses within the time allowed. Program guidance states that any budget authority provided to PHAs that exceeds actual program expenses for the same period must be maintained in a housing agencies' net restricted assets account (NRA). Although these funds are retained by the PHA and not HUD, HUD relies on the PHAs for maintaining the excess budget authority reserve available for program cost increases. If the excess budget authority accumulated in the PHAs' NRA account is not needed to lease up to 100 percent of the vouchers, then the excess funds are considered "unusable" according to program regulations. According to HUD's records, as of June 30,

2009, the PHAs' NRA account showed a total of \$840 million in total excess funding. Of the \$840 million, \$317 million has been categorized as unusable.

HUD has the responsibility to ensure that these funds are properly accounted for and are used for authorized program activities. HUD is also responsible for monitoring intermediaries' performance. Consequently, the VMS cost data are critical to (1) determining over- and under utilization of funds and excess budget authority available for cost increases and budget offsets and (2) evaluating PHAs' performance in ensuring that funds are used to serve the maximum number of families.

In our fiscal year 2008 report,³ we recommended increased monitoring efforts regarding the excess budget authority held by PHAs to include the \$1.9 billion NRA account balance as part of HUD's on-site monitoring review of PHAs. In addition, we recommended seeking legislative authority for offsetting \$1.4 billion in PHAs' unusable excess budget authority. During April 2009, HUD completed a \$780 million offset from those PHAs having large NRA balances.

HUD's monitoring of the PHAs' expenditures and excess budget authority is a critical internal control to ensure the accuracy of the estimated annual \$15 billion for the Housing Choice Voucher program and to ensure an adequate level of reserves for PHAs' operations. HUD's Real Estate Assessment Center performs a desk review of the PHAs' financial statements but does not validate and ensure the accuracy the PHAs' NRA excess funds.

In conjunction with our audit, we learned that more than 370 PHAs were requesting additional funding in fiscal year 2009. The extra funding would be needed to cover anticipated funding shortfalls, which placed many families at risk of losing the subsidy. We performed reviews of the accounting records at 11 PHAs from the list of 370 PHAs. For the 11 PHAs, we tested whether HUD's calculated NRA balances as of December 2008 were in agreement with PHAs' records and whether excess funds were available for program use. Our review showed differences between PHAs' actual NRA balances and HUD's calculated NRA balances for all 11 PHAs reviewed.

Our review of the DeKalb, GA, PHA showed that the PHA NRA balance was \$5 million or \$4 million less than HUD's \$9 million NRA calculated balance. DeKalb officials explained that excess funding from the NRA was used to cover administrative fee increases incurred for processing a higher than expected number of portability and disaster vouchers. In addition, DeKalb indicated that expenditures in VMS were understated by \$2.5 million, causing a reduction of the funding received for 2009.

³Additional Details to Supplement Our Report on HUD's Fiscal Year 2008 and 2007 Financial Statements, 2009-FO-0003, dated November 14, 2008

The San Francisco PHA showed an NRA balance of \$17 million, or \$2 million higher than HUD's \$15 million calculated NRA. This difference was a result of the PHA using \$2 million less from its NRA to cover the 2008 budget offset.

For the nine other PHAs reviewed, we found that two PHAs showed \$1 million and \$8 million more in their respective NRA accounts than HUD recorded. The remaining seven PHAs showed less funding in their NRA accounts than HUD estimates, ranging from \$214,000 to \$18 million.

We attribute the differences in the HUD-calculated NRAs to the following factors:

- VMS has no mechanism to (1) compare what the PHAs spend and receive in administrative fee expenses and (2) capture transfers between housing assistance and the funds for administrative fees,
- PHAs lacked an understanding of how to report expenditures in VMS,
- HUD failed to detect PHAs' noncompliance with financial requirements due to its delays in implementing procedures for validating and reconciling the NRA, and
- HUD did not include the NRA balances as part of its on-site monitoring review of PHAs. HUD's Quality Assurance Division plans to include NRA validation procedures in fiscal year 2010.

Regarding the funding shortfalls at the 370 PHAs, the following factors contributed to the shortfalls:

- The current state of the economy with higher than expected unemployment rates has resulted in less income earned by families, thereby shifting a larger share of the rent to be paid by the PHAs and resulting in funds being consumed more rapidly than anticipated;
- PHAs were not always aware of the cost-saving measures available to them. For example, decreasing rent payment standards, changing tenant income standards, lowering utility payments, and restructuring repayment agreements could result in cost savings to the PHAs;
- PHAs' lacked knowledge or misunderstood program rules for allowing the use of administrative fee reserves for housing assistance in helping to alleviate their funding shortfalls; and
- There were inaccuracies between the PHAs' actual NRA per book balance and the calculated NRA balance used by HUD to process the funding offsets; and
- Some PHAs did not have the excess funding available for program use to supplement the funding offsets.

HUD responded to the reported shortfalls by providing PHAs with technical assistance on cost-saving measures and a reconciling of PHAs' accounting records to HUD's calculated NRA balance. After HUD's review, a majority of the PHA requests for additional funding were denied because HUD found that the

PHAs were either over leasing vouchers or had sufficient funding. However, HUD did identify 104 PHAs that needed \$42.4 million in additional funding. HUD plans to provide additional funding (1) using \$11 million left over from the \$100 million set aside in the 2009 Appropriation Act (PL 111-18), (2) by obtaining authorization from OMB to use part of the advance fiscal year 2010 appropriation, and (3) shifting \$30 million from the remaining administrative fee reserves in HUD's books. HUD is continuing to evaluate the financial status of the PHAs and making adjustments as needed. In regard to the \$317 million in excess funding categorized as unusable, we recommend that HUD seek legislative authority to perform additional offsets on PHAs having excess funding at year-end. In addition, as recommended in last year's audit, (1) efforts to reconcile the NRA accounts should start earlier in the year to ensure that PHAs have funds available for program use, and (2) HUD needs to increase its on-site monitoring by including the validation of the NRA as part of the VMS reviews.

Significant Deficiency: HUD Needs To Improve Its Processes for Reviewing Obligation Balances

HUD needs to improve controls over the monitoring of obligation balances to ensure that they remain needed and legally valid as of the end of the fiscal year. HUD's procedures for identifying and deobligating funds that are no longer needed to meet its obligations were not always effective. This has been a long-standing weakness.

Annually, HUD performs a review of unliquidated obligations to determine whether the obligations should be continued, reduced, or canceled. We evaluated HUD's internal controls for monitoring obligated balances and found that HUD has made progress in implementing improved procedures and information systems. However, additional improvement is needed. Our review of the 2009 year-end obligation balances showed that timely reviews of unexpended obligations for Section 8 project-based, Sections 202 and 811, rental assistance payment, rent supplement, interest reduction payment program, and administrative and other program obligations were not being performed. As a result, \$132.4 million in excess funds had not been recaptured.

In addition, we identified more than \$ 1.7 billion in obligations tied to more than 3,500 capital advances or contracts awarded under Section 8 project-based and Sections 202 and 811 programs that were reported in the subsidiary ledgers with no contract expiration dates. As a result, there was no assurance that these contracts, as recorded in the system of record, were all active and that obligations associated with these contracts were all valid. We recommend that HUD design and implement procedures to ensure that an expiration date is entered into the subsidiary ledger and perform a detailed review of these contracts to determine whether they are active contracts. Excess funds associated with contracts, later determined to be expired, should be recaptured. Also, we recommend that HUD implement a long-term financial management strategy and improvement plan to better manage and accurately report its obligation balances.

Project-Based Section 8 Contracts

HUD's systems and controls for processing payments, monitoring, budgeting, accounting, and reporting for Section 8 project-based contracts needs to be improved. HUD has been hampered in its ability to estimate funding requirements, process timely payments to project-based landlords, and recapture excess funds in a timely manner. This problem is evidenced in HUD's long-term challenges in paying Section 8 project-based landlords on a timely basis; properly monitoring, budgeting, and accurately accounting for contract renewals; and reporting obligation balances.

HUD administers 18,235 housing assistance payments contracts to provide about 1.25 million low-income housing units. A total of 14,459 contracts, covering more than 1 million housing units, are currently subject to annual renewal. In fiscal year 2008, obligations incurred for the 14,459 renewed contracts totaled more than \$6 billion. HUD's estimated \$9.6 billion in budget authority for Section 8 project-based contracts in fiscal year 2009 included \$2.0 billion in supplemental Recovery Act funds and a \$221 million carryover from prior years.

Section 8 budget authority is generally available until expended. As a result, HUD should periodically assess budget needs and identify excess program reserves in the Section 8 programs as an offset to future budget requirements. Excess program reserves represent budget authority originally received, which will not be needed to fund the related contracts to their expiration. While HUD had taken actions to identify and recapture excess budget authority in the Section 8 project-based program, weaknesses in the review process and inadequate financial systems continued to hamper HUD's efforts. There was a lack of automated interfaces between the Office of Housing subsidiary records and HUD's general ledger for the control of program funds. This condition necessitated that HUD and its contractors make extensive use of ad hoc analyses and special projects to review Section 8 contracts for excess funds, which has hampered HUD's ability to identify excess funds remaining on Section 8 contracts in a timely manner.

We have been reporting weaknesses in HUD's financial management systems areas for many years, including making a recommendation that HUD develop a long-term financial management system solution to automate and streamline its processes. This year, as part of HUD's effort to improve the quality of services within the rental housing assistance business areas, HUD conducted a study of its performance gap and developed a long-term information technology (IT) strategy and improvement plan to address the performance gap. However, as of the end of fiscal year, it had not been implemented. Meanwhile, the shortcomings in the financial management system continued to impair HUD's abilities to properly monitor and accurately account for contract renewals and report obligation

balances. This problem is evidenced by the deficiencies found during our current review.

This fiscal year, the Office of Housing recaptured approximately \$288.7 million in unliquidated obligation balances from 7,969 contracts in the Section 8 project-based program. Our review of the Section 8 project-based contracts showed an additional 692 contracts that had expired on or before January 1, 2009, or were inactive with available contract/budget authority. These 692 contracts had \$75.3 million in excess funds potentially available for recapture.

In addition, our review result raised concerns about the reliability of Program Accounting System (PAS) data in providing accurate information with regard to Section 8 project-based obligations and recapture of expired obligations balances. Specifically, we noted that

- Contracts with 562 funding lines/increments and obligation balances totaling more than \$130 million were reported in PAS with no contract expiration dates. As a result, there is no assurance that these 562 contracts are active and the remaining obligation balances associated with these contracts remain legally valid. HUD needs to review these contracts and recapture any excess funds on contracts determined to be expired. These funds, up to \$130 million, could be put to better use to fund projects that require funding.
- Contracts with 325 funding lines/increments, expiration dates before January 1, 2009, and totaling more than \$70 million were reported in PAS. Review of these contracts by Office of Housing staff disclosed that the contracts were “fully disbursed,” thus overstating the PAS obligation balance by the same amount. Funds associated with these contracts should be reviewed and adjusted in PAS accordingly. These funds, up to \$70 million, could be put to better use to fund other projects requiring funding.

Supportive Housing for the Elderly and Disabled - Sections 202 and 811 Programs

HUD is required by the Federal Managers’ Financial Integrity Act to establish internal controls to ensure that obligations are properly accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over its obligations. Our review, however, showed that HUD’s subsidiary ledger supporting the obligation balances did not provide reliable or complete information with regard to capital advances and/or contracts awarded under the Sections 202 and 811 programs. As a result, there was no assurance provided by the information system of record that information on program obligations was accurately reported and legally valid.

HUD’s Sections 202 and 811 programs provide affordable housing and supportive services for elderly families and families with disabilities. These programs

provide capital advances to private nonprofit organizations to finance the construction of new facilities or acquisition or rehabilitation of existing facilities. The capital advance is interest free and does not have to be repaid if the housing remains available for very low-income elderly or disabled families for at least 40 years.

After the facility has been constructed and occupied, HUD provides additional project rental assistance contract (PRAC) funds to owners to cover the difference between the HUD-approved operating cost for the project and the tenants' contribution toward rents.

Funds for the capital advance and PRAC are obligated when the Section 202 or 811 agreement letter is signed by the hub/program center director and the sponsor(s). An authorized signature memorandum from the Assistant Secretary for Housing/Federal Housing Commissioner or designee to the Fort Worth Accounting Center completes the obligation. The Fort Worth Accounting Center verifies that funds are in LOCCS and records the obligation in PAS. Generally, funds appropriated for capital advance and PRAC are available for three years. After three years, the funds expire and will not be available for obligation, thus necessitating the need to track funds obligated under the program.

At the beginning of fiscal year 2009, the Sections 202 and 811 programs had unliquidated obligation balances of \$ 3.7 billion and 1.0 billion, respectively. We reviewed the PAS subsidiary ledger supporting the current Sections 202 and 811 program unliquidated obligation to determine whether unliquidated program obligations reported were valid and whether invalid obligations had been cancelled and recaptured in PAS. We found that HUD's PAS subsidiary ledger did not provide reliable information with regard to capital advances and/or contracts awarded under the Sections 202 and 811 programs. Specifically, we found that

- Obligations data totaling \$ 20.2 million associated with 1,232 contracts were reported in PAS as expired as of January 1, 2009. Funds associated with these expired contracts could be deobligated and put to better use to fund other projects that required funding.
- Obligations data totaling more than \$1.6 billion associated with 3,500 contracts for capital advances and other grants were reported in PAS with no contract expiration dates. As a result, there was no assurance that obligations on these contracts were accurately reported and legally valid. Funds associated with expired contracts could potentially be deobligated and put to better use to fund other projects that required funding.

The deficiencies in the Sections 202 and 811 programs occurred because of limited resources. In addition, expiration dates on capital advances and grants were not entered into the subsidiary ledger because of a lack of understanding that once funds are obligated for capital advances and grants, they remain available to the project. HUD needs to allocate additional resources to Sections 202 and 811

programs and develop and implement procedures to ensure that information on program obligations was accurately reported and legally valid.

Section 236 Interest Reduction Program

The Section 236 Interest Reduction Program (IRP) was created in 1968; however, new program activity ceased in the mid-1970s. The multifamily activities carried out by this program include making interest reduction payments directly to mortgage companies on behalf of multifamily project owners. The contracts entered into were typically up to 40 years, and HUD was required to fund these contracts for their duration. At the time it entered into the contracts, HUD was to record obligations for the entire amount. The obligations were established based upon permanent indefinite appropriation authority. This budget authority is included in the statement of budgetary resources and other consolidated financial statements as “other programs.”

Although the Section 236 IRP is not a major program, program deficiencies have been reported by OIG in prior reports on the financial statements. The Offices of Housing and the Chief Financial Officer have been hampered by historically poor record keeping in their attempt to accurately account for unexpended Section 236 budget authority balances and estimated future payments. These estimated payments were the basis for HUD’s recorded obligation balances necessary to fully fund the contracts to their expiration. HUD adjusts the recorded obligations as it proceeds through the term of the contracts to reflect best estimates of the financial commitment. Factors that can change the budgetary requirements over time include contract terminations, refinancing, and restructuring of the contracts.

In recent years, OIG noted that HUD had made a series of corrective actions to address these deficiencies. However, improvement in the timing of its quarterly reconciliation is needed to ensure that Section 236 IRP obligations are valid and can be more accurately estimated and reported.

In fiscal year 2009, we identified 37 inactive Section 236 IRP contracts with more than \$49.6 million in excess contract and budget authority that could be deobligated. These 37 contracts had been prepaid and terminated from the program. HUD processed adjustments to deobligate more than \$26.2 million for 5 of the 37 terminated projects. HUD agreed and processed adjustments to deobligate an additional \$23.4 million for the remaining 32 terminated projects in this fiscal year.

HUD took corrective action to develop and implement revised quarterly reconciliation procedures in the third quarter of the current fiscal year.

Rent Supplement and Rental Assistance Payments

HUD was not recapturing excess undisbursed contract authority from the rent supplement and rental assistance payments programs in a timely manner. Although, HUD continues to make progress in this area, improvement is still needed to ensure the timely recapture of excess funds.

The rent supplement and rental assistance payments programs have been in existence since the mid 1960's and 1970's, respectively. The rent supplement program and rental assistance payments operate much like the current project-based Section 8 rental assistance program. Rental assistance is paid directly to multifamily housing owners on behalf of eligible tenants

HUD's subsidiary ledgers show, on a fiscal year basis, the amount authorized for disbursement and the amount that was disbursed under each project account. Funds remain in these accounts until they are paid out or deobligated by HUD. If the funds are not paid out or deobligated, the funds remain on the books, overstating the needed contract authority, the excess of which should be recaptured. Our prior audit reports showed that these funds were not being recaptured in a timely manner.

In response to our concern, in fiscal year 2006, HUD developed and implemented procedures to review quarterly and annually the programs and associated contract authority requirements. Although progress has been made in this area, improvement in the timing of its recently revised quarterly reconciliation review is still needed to ensure the timely recapture of excess funds.

We performed a review in fiscal year 2009 of unliquidated obligations for the multifamily projects' accounts under the rent supplement and rental assistance programs. Our review found \$11.2 million in undisbursed contract authority from prior fiscal years on 259 multifamily projects that should be recaptured. HUD later determined that more than \$4.7 million of the \$11.2 million could be recaptured this year.

Administrative/Other Program Obligations

Annually, the Chief Financial Officer forwards requests for obligation reviews to various administrative and programs offices. The focus of the review is on administrative and program obligations that exceed threshold amounts established by the Chief Financial Officer. In this year's review, the focus is on administrative obligations that exceeded a balance of \$17,000 and program obligations that exceeded \$217,000. Excluding the Section 8 and Sections 235

and 236 programs, which undergo separate review processes, HUD identified 1,184 obligations with remaining balances totaling \$22.1 million for deobligation. We tested the 1,184 obligations HUD identified to determine whether the associated \$22.1 million had been deobligated in HUD's Central Accounting System and PAS. We found that, as of September 30, 2009, a total of 820 obligations with remaining balances totaling \$8.8 million had not been deobligated. HUD has initiated the process of closing these contracts, and the associated funding should be recaptured in fiscal year 2009.

With respect to project-based Section 8 contracts, we recommended in our audit of HUD's fiscal year 1999 financial statements that systems be enhanced to facilitate timely closeout and recapture of funds. In addition, we recommended that the closeout and recapture process occur periodically during the fiscal year and not just at year-end. Implementation of the recommendations and the long-term financial management system improvement plan is critical so that excess budget authority can be recaptured in a timely manner and considered in formulating requests for new budget authority.

With respect to Sections 202 and 811 programs, we recommend that HUD develop and implement procedures for entering contract expiration dates into the subsidiary ledger. The procedures should include entering contract expiration dates and performing a detailed review of more than 3,500 contracts identified in our review to determine whether more than \$1.7 billion in obligations associated with these contracts are all active and valid. Excess funds associated with contracts later determined to be expired should be recaptured or deobligated. These funds could be put to better use to fund other projects that need funding.

For HUD's administrative and other program funds, HUD needs to promptly perform contract closeout reviews and recapture the associated excess contract authority and imputed budget authority. In addition, HUD needs to address data and system weaknesses to ensure that all contracts are considered in the recapture/shortfall budget process including Section 236 IRP, rent supplement, and rental assistance payment programs.

Significant Deficiency: HUD Financial Management Systems Need To Comply With Federal Financial Management System Requirements

In fiscal year 2009 we determined that HUD's Office of Community Planning and (CPD) formula grant process specifically is not compliant with Federal financial management requirements, in addition to our prior year finding that HUD is not in full compliance with Federal financial management requirements generally. CPD formula grant management process was found not compliant due to the HUD grant management system implemented design which

can shift the funding year source entered by grantee to the oldest funds available in the system. HUD is required by federal financial management requirements to be able to reconcile the performance data entered by the grantee in the grants management system to the accounting and budget information in other financial management systems. However, according to CPD the funding year information entered by the grantee is not provided in the interface to the disbursing financial management application or the core financial system. Also, HUD has not completed development of an adequate integrated financial management system. HUD is required to implement a unified set of financial systems. This requirement includes the financial portions of mixed systems encompassing the software, hardware, personnel, processes (manual and automated), procedures, controls, and data necessary to carry out financial management functions, manage financial operations of the agency, and report on the agency's financial status to central agencies, Congress, and the public. As currently configured, HUD financial management systems do not meet the test of being unified. The term "unified" is defined as meaning that systems are planned for and managed together, operated in an integrated fashion, and linked electronically to efficiently and effectively provide agency-wide financial system support necessary to carry out the agency's mission and support the agency's financial management needs.

HUD's financial systems, many of which were developed and implemented before the issue date of current standards, were not designed to perform or provide the range of financial and performance data currently required. The result is that HUD, on a department-wide basis, does not have unified and integrated financial management systems that are compliant with current Federal requirements or provide HUD the information needed to effectively manage its operations on a daily basis. This situation could negatively impact management's ability to perform required financial management functions; efficiently manage the financial operations of the agency; and report, on a timely basis, the agency's financial results, performance measures, and cost information.

CPD Formula Grants Reporting is not in Compliance with FFMA

HUD's design and implementation of the integrated financial management system that supports the CPD formula grant programs is not in compliance with federal financial management system requirements. The system does not provide the required information related to the source and use of formula grants funding at the transaction level. Federal financial management requirements expect that budget, performance, and financial information are drawn from the same source, apply consistent U.S. Standard General Ledger (USSGL) elements throughout the recording, performance measurement, and financial reporting cycles. Federal accounting standards require that cost information developed for different purposes are drawn from a common data source and output reports should be reconcilable to each other.

HUD uses its Integrated Disbursement and Information System (IDIS Online) to support the financial management of CPD's formula grant programs. Grantees use

the system to track and drawdown CPD funds, report program income, and record the results of CPD-funded activities. Annually, the grant recipient, based on a Consolidated Plan, records information on approved activities in IDIS Online. The fiscal year appropriation associated with a particular activity should be accounted for within the system. As the grantees provide services or accomplish activities, they report specific activity accomplishment information to the IDIS Online system and create requests for reimbursement. While a grantee's program year may not line up with a federal fiscal year due to when agreements are signed, the achievements, and projects and activity costs recorded in IDIS Online must be reconcilable with the appropriation year in which the funding was approved.

When processing a payment request for a given activity, IDIS Online selects the oldest available funding source for the fund type associated with that activity. CPD refers to this accounting practice as FIFO (first in first out). This method of disbursement is used for all CPD formula grants. IDIS Online then interfaces with Line of Credit Controls System (LOCCS), which is one of HUD's core financial systems, to disburse the funds. LOCCS then passes the disbursement information to Program Accounting System (PAS), which is the accounting system used to generate the financial statements.

Since disbursements for activity performance and accomplishments reported in IDIS are not reconcilable to appropriation specific accounting information in LOCCS or PAS, the system is not in compliance with FFMIA. The Chief Financial Officers Act of 1990 requires the agency to develop and maintain an integrated agency accounting and financial management system, including financial reporting and internal controls to incorporate integration of accounting and budgetary information. In addition, OMB A-127 requires that financial events be recorded by agencies throughout the financial management system applying the requirements of the USSGL at the transaction level. It further states that to be compliant with this requirement, the financial management systems must have transaction detail supporting USSGL accounts available in the financial management systems and directly traceable to specific USSGL account codes.

HUD Required To Implement a Compliant Financial Management System

The Federal Financial Management Improvement Act of 1996 (FFMIA) requires, among other things, that HUD implement and maintain financial management systems that substantially comply with Federal financial management system requirements. The financial management system requirements also include implementing information system security controls. These requirements are detailed in the Federal Financial Management System Requirements series issued by the Joint Financial Management Improvement Program/Financial System Integration Office (JFMIP/FISO). The requirements are also included in OMB

Circular A-127, “Financial Management Systems.” Circular A-127 defines a single integrated financial management system as a unified set of financial systems and the financial portions of mixed systems (e.g., acquisition) encompassing the software, hardware, personnel, processes (manual and automated), procedures, controls, and data necessary to carry out financial management functions, manage the financial operations of the agency, and report on the agency’s financial status.

As in previous audits of HUD’s financial statements, in fiscal year 2009, there continued to be instances of noncompliance with Federal financial management system requirements. These instances of noncompliance have given rise to significant management challenges that have (1) impaired management’s ability to prepare financial statements and other financial information without extensive compensating procedures, (2) resulted in the lack of reliable, comprehensive managerial cost information on its activities and outputs, and (3) limited the availability of information to assist management in effectively managing operations on an ongoing basis.

HUD’s Financial Systems Not Adequate

As reported in prior years, HUD does not have financial management systems that enable it 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. To prepare consolidated department-wide 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. To overcome these systemic deficiencies with respect to preparation of its annual financial statements, HUD was compelled to rely on extensive compensating procedures that were costly, labor intensive, and not always efficient.

Due to a lengthy HUD Integrated Financial Management Improvement Project (HIFMIP) procurement process and lack of funding for other financial application initiatives, there were no significant changes made in fiscal year 2009 to HUD’s financial management processes. As a result, the underlying system limitations identified in past years remained. The functional limitations of the three applications (HUD’s Central Accounting and Program System (HUDCAPS), LOCCS and PAS) performing the core financial system function for HUD are dependent on its data mart and reporting tool to complete the accumulation and summarization of data needed for U.S. Department of the Treasury and OMB reporting.

HUD's Financial Systems Lacking Managerial Cost Data

In fiscal year 2006, the Government Accountability Office (GAO) reported in GAO-06-1002R Managerial Cost Accounting Practices that HUD's financial systems did not have the functionality to provide managerial cost accounting across its programs and activities. This lack of functionality has resulted in the lack of reliable and comprehensive managerial cost information on its activities and outputs. HUD lacks an effective cost accounting system that is capable of tracking and reporting costs of HUD's programs in a timely manner to assist in managing its daily operations. This condition renders HUD unable to produce reliable cost-based performance information.

HUD officials have indicated that various cost allocation studies and resource management analyses are required to determine the cost of various activities needed for mandatory financial reporting. However, this information is widely distributed among a variety of information systems, which are not linked and, therefore, cannot share data. This situation makes the accumulation of cost information time consuming, labor intensive, and untimely and ultimately makes that cost information not readily available. Budget, cost management, and performance measurement data are not integrated because HUD

- Did not interface its budget formulation system with its core financial system;
- Lacks the data and system feeds to automate a process to accumulate, allocate, and report costs of activities on a regular basis for financial reporting needs, as well as internal use in managing programs and activities;
- Does not have the capability to derive current full cost for use in the daily management of HUD operations; and
- Requires an ongoing extensive quality initiative to ensure the accuracy of the cost aspects of its performance measures as they are derived from sources outside the core financial system.

While HUD has modified its resource management application to enhance its cost and performance reporting for program offices and activities, the application does not use core financial system processed data as a source. Instead, HUD uses a variety of applications, studies, and models to estimate the cost of its program management activities. One of these applications, Total Estimation and Allocation Mechanism/Resource Estimation and Allocation Process (TEAM/REAP), was designed for use in budget formulation and execution, strategic planning, organizational and management analyses, and ongoing management of staff resources. It was enhanced to include an allocation module that added the capability to tie staff distribution to strategic objectives, the President's Management Agenda, and HUD program offices' management plans.

Additionally, HUD has developed time codes and an associated activity for nearly all HUD program offices to allow automated cost allocation to the program office activity level. HUD has indicated that the labor costs that will be allocated to these activities will be obtained from the HUD payroll service provider. However, because the cost information does not pass through the general ledger, current Federal financial management requirements are not met.

Financial Systems Not Providing for Effective and Efficient Financial Management

During fiscal year 2009, HUD's financial information systems did not allow it to achieve its financial management goals in an effective and efficient manner in accordance with current Federal requirements. To perform core financial system functions, HUD depends on three major applications, in addition to a data warehouse and a report-writing tool. Two of the three applications that perform core financial system functions require significant management oversight and manual reconciliations to ensure accurate and complete information. HUD's use of multiple applications to perform core financial system functions further complicates financial management and increases the cost and time expended. Extensive effort is required to manage and coordinate the processing of transactions to ensure the completeness and reliability of information.

Additionally, the interface between the core financial system and HUD's procurement system does not provide the required financial information. The procurement system interface with HUDCAPS does not contain data elements to support the payment and closeout processes. Also, the procurement system does not interface with LOCCS and PAS. Therefore, the processes of fund certification, obligation, deobligation, payment, and closeout of transactions that are paid out of the LOCCS system are all completed separately, within either PAS or LOCCS. This lack of compliance with Federal requirements impairs HUD's ability to effectively monitor and manage its procurement actions.

HUD Planning To Implement a Department-wide Core Financial System

HUD plans to implement a commercial Federal certified core financial system and integrate the current core financial system into one department-wide core financial system. HUD is initiating business process reengineering work to ensure a smooth transition to a single integrated core financial system. FHA and Ginnie Mae have already implemented a compatible and compliant system to

support the transition to the enterprise core financial system. HUD plans to select a qualified shared service provider to host the enterprise system and integrate the three financial systems (HUD, FHA, and Ginnie Mae) into a single system by fiscal year 2015. Achieving integrated financial management for HUD will result in a reduction in the total number of systems maintained, provide online, real-time information for management decision making, enable HUD to participate in E-Government initiatives, and align with HUD's IT modernization goals.

However, HIFMIP, launched in fiscal year 2003, has been plagued by delays, and implementation of the core financial system has not yet begun. HIFMIP was intended to modernize HUD's financial management systems in accordance with a vision consistent with administration priorities, legislation, OMB directives, modern business practices, customer service, and technology. HIFMIP will encompass all of HUD's financial systems, including those supporting FHA and Ginnie Mae. HUD had intended to begin the implementation in fiscal year 2006. Due to delays with the procurement process, however, HUD anticipates that it will not be able to begin the implementation of its core financial system until fiscal year 2010. Until its core financial system is implemented, we believe that the following weaknesses with HUD's financial management systems will continue:

- HUD's ability to prepare financial statements and other financial information requires extensive compensating procedures.
- HUD has limited availability of information to assist management in effectively managing operations on an ongoing basis.

Significant Deficiency: Controls Over HUD's Computing Environment Can Be Further Strengthened

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 HUD's computer systems on which HUD's financial systems reside. 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 Management Program

HUD has made significant progress with implementing security management as it relates to the Federal Information Security Management Act of 2002 (FISMA). For instance, HUD developed guidance for its Blackberry users, conducted regular meetings with information systems security officers to discuss current issues and trends, and improved its process for monitoring and correcting information security weaknesses by more effectively using the plans of action and milestones. However, additional progress is needed. Specifically, in fiscal year 2009, we found that

- HUD did not properly categorize those systems containing personally identifiable information (PII). HUD's inventory of automated systems was not current and did not contain all systems with PII.
- HUD did not properly report 5 of 34 category I⁴ security incidents to the proper authorities within the mandated timeframes.

Security Controls Over HUD's Web Applications

We audited security controls over HUD's Web applications⁵ and identified weaknesses in the areas of security configurations and technical controls. For instance, HUD did not ensure that access controls followed the principle of least privilege for Web application configurations. Weak Web application security configurations disclose potentially sensitive information that may enable a malicious user to devise exploits of the application and the resources it accesses. This weakness could also potentially expose sensitive or confidential information as well as useful information that may enable a malicious user to devise effective and efficient exploits of the application and the resources it accesses.

HUD did not adequately implement controls to ensure confidentiality and privacy for Web applications. These weaknesses were not exploitable vulnerabilities, but they were a violation of security policy because the configurations potentially allowed access to data that are required to be confidential by law. When weak privacy controls exist, they breach confidentiality requirements to protect sensitive information. An attacker can take advantage of these vulnerabilities to discover and access sensitive and confidential data. Further, HUD did not adequately review Web applications for vulnerabilities and patch them. Exploiting vulnerabilities can breach confidentiality requirements to reveal sensitive information.

Disaster Recovery Grant Reporting System

⁴ In this category, an individual gains logical or physical access without permission to a Federal agency network, system, application, data, or other resource.

⁵ Audit Report No. 2009-DP-0006, Review of HUD's Web Application Systems, issued September 29, 2009

We audited selected controls within the Disaster Recovery Grant Reporting System (DRGR)⁶ related to Neighborhood Stabilization Program (NSP) funding. We found that (1) access control policies and procedures for DRGR violate HUD policy, (2) the system authorization to operate is outdated and based upon inaccurate and untested documentation, (3) CPD did not adequately separate the DRGR system and security administration functions, and (4) CPD has not sufficiently tested interface transactions between DRGR and LOCCS. As a result, CPD cannot ensure that only authorized users have access to the application, user access is limited to only the data that are necessary for them to complete their jobs, and users who no longer require access to the data in the system have had their access removed. Further, the failure to sufficiently test interface transactions between DRGR and LOCCS leaves HUD with limited assurance that the \$5.9 billion in NSP funding was accurately processed.

Recovery Act Management and Reporting System

Our review of HUD's management procedures, practices, and controls related to the Recovery Act Management and Reporting System (RAMPS)⁷ found that while HUD has taken actions to comply with the reporting requirements under the Recovery Act, it did not fully comply with the reporting requirements to ensure that the recipients' use of all recovery funds is transparent to the public and that the public benefits of these funds are reported clearly, accurately, and in a timely manner.

We reviewed the April 30 and July 15, 2009, National Environmental Policy Act (NEPA) reports and found that HUD program offices did not have existing systems to collect the NEPA data, were not able to use the newly developed RAMPS system, or were not provided training on how to use the system. As a result, HUD was not able to provide the NEPA status to the public in an accurate and timely manner for more than \$2.9 billion in obligated funds. Additionally, HUD did not complete required security and privacy documents before or during the early phase of system development. HUD did not follow Federal and HUD security policies for implementing these security requirements for RAMPS. As a result, HUD officials could not ensure that all security controls were in place, implemented correctly, and operating as intended.

Security Controls Over HUD's Databases

During fiscal year 2008, we evaluated security controls over HUD's databases.⁸ We identified security configuration and technical control deficiencies within HUD's database security controls in the areas of (1) passwords, (2) system patches, and (3) system configuration. We followed up on the status of these weaknesses during fiscal year 2009 and determined that technical control deficiencies relating to database passwords and database patches have been reviewed and corrected as the Office of the Chief Information Officer (OCIO) deemed appropriate. OCIO has not yet implemented secure configuration baselines for databases and the reviews for monitoring

⁶ Audit Report No. 2009-DP-0007, Review of Selected Controls within the Disaster Recovery Grant Reporting System, issued September 30, 2009.

⁷ Audit Report No. 2009-DP-0008, Audit Report on the Review of Recovery Act Management and Reporting System (RAMPS), issued September 30, 2009

⁸ Audit Report No. 2008-DP-0007, Evaluation of HUD's Security Controls over Databases, issued September 11, 2008

those configurations. This corrective action is not scheduled to be completed until December 31, 2010.

HUD's Procurement System

We audited HUD's procurement systems in fiscal year 2006.⁹ Through actions taken during fiscal years 2007, 2008, and 2009, the Office of the Chief Procurement Officer (OCPO) has made progress toward resolving the issues identified during the audit. However, two significant recommendations made in the audit report remain open, and the procurement systems continue to be noncompliant with Federal financial management requirements. OCPO has yet to complete the corrective actions for the known open information security vulnerabilities. In addition, OCPO has not yet implemented functionality to ensure that there is sufficient information within HUD's current procurement systems to support the primary acquisition functions of fund certification, obligation, deobligation, payment, and closeout. OCPO plans to replace the current acquisition systems and during fiscal year 2009, obtained \$3.7 million in funding to purchase a commercial off-the-shelf application. The acquisition of the new application is anticipated to be complete by June 30, 2010. However, full funding to complete the project has not been obtained; therefore, it is unclear when the new application will be fully implemented.

HUD's Financial Systems

As part of our review of HUD's information systems controls, we evaluated information security controls over the Nortridge Loan System (NLS), HUDCAPS, and Hyperion. We identified control weaknesses that could negatively affect the integrity, confidentiality, and availability of computerized financial data within two of HUD's financial systems—NLS and HUDCAPS. We also followed up on previously identified control weaknesses within LOCCS.

Loan Accounting System/Nortridge Loan System

HUD's Loan Accounting System utilizes an off-the-shelf program entitled the Nortridge Loan System (NLS). HUD utilizes this application to maintain loan portfolio information for the Section 202 Housing for the Elderly and Handicapped Loan Program and the Flexible Subsidy Program. During fiscal year 2009, we reviewed access controls for this application and found that controls needed to be strengthened. We determined that controls over the NLS user recertification process were not effective to ensure that all users with access to the production data were properly recertified. In addition, HUD did not appropriately separate the functions of system administration and system security within NLS. By not ensuring that the access levels of all NLS users were reviewed, HUD was unable to ensure that users only had access to the data that were necessary for them to complete their jobs, that only authorized users had access to the system, and that users who no longer required access to the data in the system had their access removed. Inadequately segregated duties increase the risk that erroneous or fraudulent transactions could be processed, that improper program changes could be implemented, and that

⁹ Audit Report No. 2007-DP-0003, Review of HUD's Procurement Systems, issued January 25, 2007

computer resources could be damaged or destroyed. OCFO provided documentation to support completion of planned corrective actions. We are reviewing this documentation.

HUDCAPS

HUDCAPS is part of HUD's core financial system. It captures, reports, controls, and summarizes the results of the accounting processes including budget execution and funds control, accounts receivable and collections, accounts payable, and general ledger. In our fiscal year 2007 audit, we found that OCFO granted two contracted developers above-read access to the HUDCAPS production data stored within the mainframe environment without documenting either their acceptance of the risks associated with or the justification for this access level. The documentation to support this access was not maintained by the system owner, and acceptance of the risks associated with this access level was not documented in the system security plan. Additionally, neither of the two developers received the required level of background investigation. One developer received only a minimum background investigation. The other developer was not investigated at all. OCFO has completed actions to address these issues.

During audit work completed in fiscal year 2009, however, we found that HUD did not take steps to ensure that IT contractors were properly rescreened to ensure their continued eligibility to access sensitive systems and application data in accordance with HUD guidelines. Specifically, HUD did not initiate updated background investigations for contractor personnel with access to HUDCAPS every five years as required by HUD policy. As of December 2008, OCFO had not initiated updated background investigations for 10 of the 20 contractors with above-read access to the HUDCAPS application. The background of one contractor employee had not been reassessed since 1975. Background investigations ensure, to the extent possible, that employees are suitable to perform their duties. By not performing required background screenings, HUD increased its risk that unsuitable individuals would have access to sensitive systems and data.

LOCCS

During our fiscal year 2007 audit, we found that the controls over the LOCCS user recertification process were not effective to verify the access of all users. Systemic deficiencies led to the omission of more than 10,000 users from the LOCCS recertification process. An additional 199 users had last recertification dates within the application before March 31, 2006, indicating that they also were not included in the fiscal year 2007 recertification process. During fiscal year 2008, OCFO made improvements to this process by generating a report from the system that allowed it to identify users that only had approving authority within the application for the user recertification process. During fiscal year 2009, OCFO made additional adjustments to the report it created. Our review of the data from both 2008 and 2009 again identified LOCCS users that were not recertified by the system. As a result, we concluded that further improvements are necessary to ensure that all users of LOCCS are recertified in accordance with HUD policy and that the corrective action taken in response to our 2007 finding did not fully address the problem.

IBM Mainframe z/OS Operating System

In fiscal year 2008, we found that HUD had not ensured that (1) the account and sensitive access privileges of a departed user were removed from the IBM mainframe and (2) libraries and data files within the IBM mainframe environment were adequately secured. These weaknesses could lead to unauthorized individuals using system software to circumvent security controls to read, modify, or delete critical or sensitive information and programs.

During our fiscal year 2009 review, we determined that HUD had removed the account and sensitive access privileges of a departed user from the IBM mainframe. However, HUD had not completed the task of securing libraries and data files within the IBM mainframe environment.

Software Configuration Management

We previously reported that the configuration management¹⁰ plan for Institution Master File (IMF) contained outdated information. We also reported that HUD did not ensure that its IT support contractor provided the proper version of a configuration management tool used by five of its applications. Without updated configuration management documentation, HUD risks that outdated policies and plans may not address current risk and, therefore, be ineffective.

HUD has not yet fully resolved the issue of the outdated version of the configuration management tool. HUD has made progress in updating the configuration management plan for IMF. However, configuration management plans for several FHA applications identified in our fiscal year 2007 review still have not been updated to include reported issues such as incomplete or outdated information.

As part of our fiscal year 2009 audit, we reviewed the configuration management plan for the Integrated Disbursement and Information System OnLine (IDIS OnLine). This configuration management plan also lacked information and contained outdated information. Details of this finding will be included in our report for our fiscal year 2009 review of information systems controls in support of the financial statements audit to be issued during 2010.

Contingency Planning

Since 2006, we have reported that HUD's disaster recovery plan contained outdated information. We recommended that HUD regularly review its disaster recovery plan to ensure that the document reflects current conditions. HUD explained that a contract modification was required to update the listing of critical applications and planned to accomplish this modification by December 31, 2007. During our fiscal year 2009 review, we found that HUD had updated listings for the recovery team and critical applications. However, the disaster recovery plan still contained conflicting information. Additionally, we found that disaster recovery exercises did not fully test system functionality because critical applications were not verified through transaction and batch processing and the exercises did not include recovery of all applications that interface with the critical systems. By not having current information in the disaster

¹⁰ Configuration management is the control and documentation of changes made to a system's hardware, software, and documentation throughout the development and operational life of the system.

recovery plan and fully testing system functionality during disaster recovery exercises, HUD cannot ensure that its systems and applications will function as intended in an actual emergency.

In 2008, we reported that contingency planning at third-party business sites was inadequate. Staffs were unfamiliar with or had limited knowledge of contingency planning requirements, and documentation was not readily available for use in case of emergency. We determined that HUD had not specified contingency planning, continuity of operations, or disaster recovery requirements in its agreements with third-party business partners. Such information is usually included in the terms and conditions of a contract or service-level agreement with the external business partner. Consequently, third-party business partners developed limited contingency planning policies that did not meet HUD or National Institute of Standards and Technology (NIST) requirements. Management generally agreed that corrective action was needed, but had not yet taken action on any of OIG's recommendations.

Physical Security

This year, we performed on-site reviews of physical security controls in place at the network operations center and the data center, both maintained by HUD's two IT infrastructure contractors. We concluded that physical security and environment controls at these facilities were generally in place. We did not identify any significant control weaknesses.

During fiscal year 2008, we evaluated how HUD's third-party business partners¹¹ compensate for the lack of physical security controls when information is removed from, maintained, or accessed from outside the agency location. We reported that physical security at the third-party business sites we visited was inadequate and weaknesses existed at those sites. We found instances in which servers were located in common areas (i.e., lunch rooms, halls), case binders with PII were left unattended, no guard or receptionist was at the entrance, access doors were unlocked, and encryption of data residing on laptops or portable devices was not a requirement. HUD had not specified the level of security controls and included it in the terms and conditions of the contract or service-level agreement with the external business partner. As a result, third-party business partners have developed various IT security controls and policies that do not meet HUD or Federal requirements and, therefore, cannot be relied upon to provide adequate protection of HUD's sensitive data. Management generally agreed that corrective action was needed but had not taken action on any of OIG's recommendations.

¹¹ Third-party business partners are external business partners who contract to do business with HUD such as housing authorities and mortgage lenders who use the PIH Inventory Management System (PIH-IMS), Tenant Rental Assistance Certification System (TRACS), and Computerized Homes Underwriting Management System (CHUMS).

Significant Deficiency: Weak Personnel Security Practices Continue To Pose Risks of Unauthorized Access to HUD's Critical Financial Systems

For several years, we have reported that HUD's personnel security practices regarding access to its systems and applications were inadequate. Deficiencies in HUD's IT personnel security program were found, and recommendations were made to correct the problems. However, the risk of unauthorized access to HUD's financial systems remains a critical issue. We followed up on previously reported IT personnel security weaknesses and deficiencies and found that deficiencies still existed. Specifically,

- Since 2004, we have reported that HUD did not have a complete list of all users with above-read access at the application level. Those users with above-read access to sensitive application systems are required to have a background investigation. Our review this year found that HUD still did not have a central repository that lists all users with access to HUD's general support and application systems. Consequently, in fiscal year 2009, HUD still had no central listing for reconciling that all users who have access to HUD's critical and sensitive systems have had the appropriate background investigation.

While HUD's implementation in 2007 of the Centralized HUD Account Management Process (CHAMP) was a step toward improving its user account management practices, CHAMP remains incomplete and does not fully address OIG's concerns. Specifically, we noted that

- CHAMP does not contain complete and accurate data. OCIO did not electronically migrate data from the HUD Online User Registration System (HOURS) into CHAMP. Instead, it chose to enter the legacy data manually. However, this process had not been completed. In a July 2008 audit report, we recommended that all offices within HUD provide the historical information necessary to populate CHAMP. OCIO agreed with our recommendation, and corrective action is scheduled for completion in December 2009.
- CHAMP does not contain a mechanism to escalate or reassign tasks that have not been completed within a specified timeframe. In a July 2008 audit report, we recommended that OCIO develop and implement such a mechanism. OCIO agreed with the recommendation, and corrective action is scheduled for completion in December 2009.
- HUD did not conduct a security categorization and a risk assessment for CHAMP as required by Federal Information Processing Standards (FIPS) Publications (PUB) 199 and 200. HUD's OCIO chose not to conduct a security categorization and risk assessment for CHAMP because it believed that these items were not

required for CHAMP, which is listed as a process rather than a system. HUD also believed that since CHAMP was exclusively owned by its IT contractor, it was not subject to the requirements of a security categorization and a risk assessment. Without a security categorization and risk assessment of CHAMP, HUD cannot know the full extent of risks that the CHAMP process is vulnerable to or whether adequate levels of security controls have been put into place to protect data and applications impacted by CHAMP. OIG recommended that OCIO conduct a security categorization and a risk assessment for CHAMP. OCIO agreed with this recommendation; however, corrective action had not been taken.

- Reconciliations to identify users with above-read (query) access to HUD mission-critical (sensitive) applications but without appropriate background checks were not routinely conducted. Officials from the Office of Security and Emergency Planning (OSEP) and OCIO asserted that with the implementation of CHAMP and the new security manager computer system, it would be impossible for an employee or contractor to obtain access to any of HUD's systems without the appropriate background investigation. Thus, the reconciliation was no longer needed.

Contrary to OSEP and OCIO's assertions, a reconciliation performed by OSEP for second quarter 2009 identified 27 persons with the incorrect level of background investigation, including three persons with no record of a background investigation having been performed. In addition, although the HUD Personnel Security/Suitability Handbook contains policies to suspend, deny, and terminate access of users who do not meet its standards, we found no evidence that HUD OCIO had taken actions regarding users without appropriate background investigations having access to HUD's sensitive systems. As a result, HUD cannot ensure that its critical and sensitive information can be protected from unauthorized access, loss, misuse, modification, or improper disclosure.

We remain concerned because the reconciliation included users of only one of HUD's mission-critical systems. We previously reported that users of HUD's general support systems on which these mission-critical applications reside were not included in the reconciliations because they were not classified as mission critical. Having access to general support systems typically includes access to system tools, which provide the means to modify data and network configurations. We identified IT personnel, such as database administrators and network engineers, who had access to these types of system tools but did not have appropriate background checks. These persons were not identified as part of the CHAMP reconciliation process.

Compliance With Laws and Regulations

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

FFMIA requires auditors to report whether the agency's financial management systems substantially comply with the Federal financial management systems requirements and applicable accounting standards and support the U.S. Standard General Ledger (SGL) at the transaction level. We found that HUD was not in substantial compliance with FFMIA because HUD's financial management system did not substantially comply with Federal financial management system requirements.

During fiscal year 2009, HUD 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 as 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 agency-wide financial system support necessary to carry out the agency's mission and support the agency's financial management needs.

HUD is required by OMB Circular A-127 to perform reviews of all HUD financial management systems within a three year cycle. For the current three fiscal year cycle, fiscal year 2007 to 2009, HUD only completed 7 of 40 required financial management system reviews.

Federal Financial Management System Requirements

In its Fiscal Year 2009 Performance and Accountability Report, HUD reported that 2 of its 40 financial management systems did not comply with the requirements of FFMIA and OMB Circular A-127, Financial Management Systems. Although 38 individual systems had been certified as compliant with Federal financial management systems requirements, HUD had not adequately performed independent reviews of these systems as required by OMB Circular A-127. Collectively and in the aggregate, deficiencies continued to exist.

We continue to report as a significant deficiency that *HUD financial management systems need to comply with Federal financial management systems requirements*. The significant deficiency addresses how HUD's financial management systems remain substantially noncompliant with Federal financial management requirements.

FHA's auditor reports as significant deficiencies that *(1) financial system capacity limitations could impact business processing, (2) effective FHA modernization is necessary to address systems risks, and (3) FHA should enhance the general*

ledger system user access management processes. These significant deficiencies address the challenges in FHA's capacity to simultaneously address various system modernization initiatives and control deficiencies affecting the reliability and completeness of FHA's financial information.

We also continue to report as significant deficiencies that (1) *controls over HUD's computing environment can be further strengthened* and (2) *weak personnel security practices continue to pose risks of unauthorized access to the Department's critical financial systems.* These significant deficiencies discuss how weaknesses with general controls and certain application controls and weak security management increase risks associated with safeguarding funds, property, and assets from waste, loss, unauthorized use, or misappropriation.

In addition, OIG audit reports have disclosed that security of financial information was not provided in accordance with OMB Circular A-130, Management of Federal Information Resources, appendix III, and FISMA.

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

HUD Did Not Substantially Comply With the Antideficiency Act

Although HUD's OCFO has improved its process for conducting, completing, reporting, and closing the investigation of potential Antideficiency Act (ADA) violations in a timely manner, continued improvement is still needed. Our review determined that there were six ADA violations that had not been reported immediately to the President through OMB, Congress, or GAO, as required by 31 U.S.C. (United States Code) 1351.1517(b) (Antideficiency Act). In addition, one potential ADA violation has been under review for two years without a final determination as to whether or not a violation had occurred.

OCFO is responsible for investigating and reporting on violations of the ADA. Last year's audit concluded that OCFO was not conducting, completing, reporting, and closing the investigation of potential ADA violations in a timely manner. As of the end of the fiscal year 2008 audit, six cases were determined by OCFO investigators to be ADA violations that warranted reporting, but the six violations had not been reported as required. Follow-up on these six cases during our current audit showed that four of the six ADA violations were reported to the President, Congress, and GAO on December 31, 2008. The remaining two ADA violations remained unreported. These two cases had been under investigation for four years and in report stage for one year. There are an additional four cases, which were determined by OCFO investigators to be ADA violations in 2009, which had not been reported as of the end of the 2009 audit. Three of these cases have been under investigation since 2006 and one since 2008.

OCFO has made progress in closing out its case backlog. As of the end of fiscal year 2009, OCFO had closed 13 cases determined not to be ADA violations. However, our 2009 audit

found that one investigation had not been conducted or closed in a timely manner. This case has been under investigation since 2007 as OCFO continues to collect additional financial data for review and analysis. To date, the investigator has not made a final determination as to whether or not it is an ADA violation. In addition, there have been three new ADA cases, which opened in January and June 2009, that were still in the preliminary data collection stage of the investigation, as of September 30, 2009.

Appendix A

Objectives, Scope, and Methodology

Management is responsible for

- * Preparing the principal financial statements in conformity with generally accepted accounting principles;
- * Establishing, maintaining, and evaluating internal controls and systems to provide reasonable assurance that the broad objectives of Federal Managers' Financial Integrity Act 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 are free of material misstatements and presented fairly in accordance with generally accepted accounting principles. 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.

We considered HUD's internal control over required supplementary stewardship information reported in HUD's Fiscal Year 2009 Performance and Accountability 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 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 2009 Performance and Accountability 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, executing transactions in accordance with budget authority, compliance with laws and regulations, and safeguarding assets;
- * 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; government-wide 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 the Federal Managers' Financial Integrity Act;
- * Considered compliance with the process required by the Federal Managers' Financial Integrity Act 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 the Federal Managers' Financial Integrity Act. 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 procedures 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 such that there is more than a reasonable possibility that a misstatement of the entity's financial statements will not be prevented or detected.. It is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

A material weakness is a significant deficiency, or combination of significant deficiencies, that result in 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.

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

Appendix B

Recommendations

To facilitate tracking recommendations in the Audit Resolution and Corrective Action Tracking System (ARCATS), this appendix lists the newly developed recommendations resulting from our report on HUD'S fiscal year 2009 financial statements. Also listed are recommendations from prior years' reports that have not been fully implemented. This appendix does not include recommendations pertaining to FHA and Ginnie Mae issues because they are tracked under separate financial statement audit reports of that entity.

Recommendations From the Current Report

With respect to the significant deficiency that the Office of Community Planning and Development (CPD) needs to improve its oversight of grantees, we recommend that CPD

- 1.a. Follow existing policies and regulations to conduct an annual review of whether the States obligated and announced 100 percent of their grant award within 15 months of signing the grant agreement with HUD.
- 1.b. Follow existing policies and regulations that require follow-up and remedial action against States that are in noncompliance.
- 1.c. Ensure that the most complete and accurate data is used to conduct the review of the timeliness requirement for the State Community Development Block Grant (CDBG) program.
- 1.d. Consider modifying an existing system to create an automated process that will house all of the data needed to review the timeliness requirement for the State CDBG program to create a more effective and efficient process.
- 1.e. 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.
- 1.f. 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.
- 1.g. Ensure that its field offices review the status of the identified contracts and recapture up to the \$42 million identified in undisbursed obligations for expired contracts that were funded with grants during 1997-2001 for homeless assistance programs and consider the funds for inclusion in the fiscal year 2010 Continuum of Care competition.

- 1.h. Develop policy and procedures that ensure an annual review of the status of each of its homeless assistance contracts and recommend deobligations and recapture of excess funds when applicable.
- 1.i. Develop the management reports needed to effectively track its homeless assistance program contract expiration dates.
- 1.j. Require field offices to monitor participating jurisdictions to ensure that project completion information and beneficiary data are complete, accurate, and entered into HUD's Integrated Disbursement and Information System (IDIS) monthly for the HOME program.
- 1.k. Require participating jurisdictions for the HOME program to have quality control systems in place to ensure that the required project completion information and beneficiary data are complete, accurate, and entered into IDIS monthly.
- 1.l. Require field offices to follow up with participating jurisdictions on slow-moving projects to determine the reason for the delays in the HOME program.

With respect to the significant deficiency that HUD management must continue to improve oversight and monitoring of subsidy calculations, intermediaries' performance, and Housing Choice Voucher funds, we recommend that the Office of Public and Indian Housing, in coordination with the Office of General Counsel,

- 2.a. Seek legislative authority to implement \$317 million or the balance categorized as unusable as of December 2010 in offsets against public housing agencies' (PHA) excess unusable funding held in the net restricted assets account.
- 2.b. Seek legislative authority to retain such funding offsets as a resource to create reserves that will enable HUD to quickly reallocate resources where needed to supplement any future deficiencies and/or to provide funding required due to a late enactment of appropriation.

With respect to the significant deficiency that HUD management must continue to improve oversight and monitoring of subsidy calculations, intermediaries' performance, and Housing Choice Voucher funds, we recommend that the Office of Public and Indian Housing

- 2.c. Develop a mechanism in the Voucher Management System that enables HUD to (1) track and compare what the PHAs spend and receive in administrative fee expenses and (2) capture transfers between housing assistance and the funds for administrative fees, resulting in better estimates of net restricted assets account calculated balances.
- 2.d. Develop procedures to validate the net restricted assets account balances as part of its on-site monitoring review of PHAs and initiate reviews earlier in the year to ensure that excess funding in PHAs' net restricted assets account is accurate before funding decisions are made.

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,

- 3.a. Deobligate the \$8.8 million in administrative and program unliquidated obligations that were marked for deobligation.
- 3.b. Promptly perform contract closeout reviews and recapture of invalid obligations.

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 Office of Housing,

- 3.c. Deobligate \$4.7 million in excess unexpended rental assistance and rent supplement funds identified by HUD's fiscal year 2009 financial statement audit.
- 3.d. Fully implement quarterly scheduled recapture review and reconciliation procedures to ensure that excess undisbursed contract authority from rental assistance payments and rent supplement projects is recaptured in a timely manner.
- 3.e. Deobligate \$23.4 million in excess unexpended Section 236 funds identified by HUD's fiscal year 2009 financial statement audit.
- 3.f. Fully implement the revised quarterly contract reconciliation procedure to ensure that Section 236 obligations reported are valid and can be more accurately estimated and reported.
- 3.g. Review supporting contracts to support \$75.3 million in undisbursed Section 8 project-based contract/budget authority associated with 692 expired or inactive contracts that we identified during our review or recapture funds if they cannot be supported.
- 3.h. Enter expiration dates and perform a detailed review of 562 Section 8 project-based contracts with no expiration dates reported in the Program Accounting System (PAS) to determine whether they are active contracts. Excess funds associated with contracts later determined to be expired should be recaptured. These funds could be put to better use to fund other projects that need funding.
- 3.i. Section 8 project-based contracts with 325 funding lines/increments, expiration dates before January 1, 2009, and totaling more than \$70 million reported in PAS should be reviewed and adjusted accordingly in PAS. These funds, up to \$70 million, could be put to better use to fund other projects requiring funding.
- 3.j. Implement a long-term financial management strategy and improvement plan and address data and systems weaknesses to ensure that all Section 8 project-based contracts are considered in the recapture/shortfall budget process.

- 3.k. Research the expired Sections 202 and 811 contracts identified in our audit to determine whether these are active contracts and/or recapture up to \$20.2 million associated with these expired contracts if they cannot be supported.
- 3.l. Allocate additional resources to Sections 202 and 811 programs and design and implement procedures to ensure that expiration dates are entered into the PAS subsidiary ledger.
- 3.m. Enter expiration dates and perform a detailed review of approximately 3,500 Sections 202 and 811 contracts with no expiration dates reported in PAS to determine whether they are active. Excess funds, associated with contracts reported in PAS with no expiration dates that are later determined to be expired, should be recaptured. These funds could be put to better use to fund other projects that needed funding.

With respect to the significant deficiency that HUD's Financial Management Systems Need to Comply with Federal Financial Management System Requirements, we recommend that the Office of Community Planning and Development:

- 4.a. Ensure that its programs are accounting for and reporting their financial and performance information in accordance with federal financial management system requirements.

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

- 5.a. Complete the investigations and determine whether or not ADA violations have occurred, and if an ADA violation has occurred, immediately report to the President, Congress, and GAO.
- 5.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.
- 5.c. Develop and establish timeframes for reporting ADA violations once it is determined a violation exists.

Unimplemented Recommendations From Prior Years' Reports

Not included in the recommendations listed above 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.

OIG Report Number 2009-FO-0003 (Fiscal Year 2008 Financial Statements)

With respect to the significant deficiency that HUD management must continue to improve oversight and monitoring of subsidy calculations and intermediaries' program performance and promote full utilization of Housing Choice Voucher funds, we recommend that the Office of Public and Indian Housing, in coordination with the Office of General Counsel,

- 1.a. Seek legislative authority to eliminate or modify the leasing restrictions placed on the Housing Choice Voucher program (Final Action Target Date is December 31, 2011; reported in ARCATS as recommendation 1B).

With respect to the significant deficiency that HUD management must continue to improve oversight and monitoring of subsidy calculations and intermediaries' program performance and promote full utilization of Housing Choice Voucher funds, we recommend that the Office of Public and Indian Housing,

- 1.b. Increase the monitoring efforts over the Net Restricted Asset Account held by PHAs (Final Action Target Date is December 31, 2011; reported in ARCATS as recommendation 1C).

With respect to HUD's substantial noncompliance with the Federal Financial Management Improvement Act, we recommend that the Chief Financial Officer,

- 2.a. Develop a plan to comply with OMB A-127 review requirements, which results in the evaluation of all HUD financial management systems within a 3-year cycle (Final Action Target Date is November 30, 2009; reported in ARCATS as recommendation 3A).

Appendix C

Federal Financial Management Improvement Act Noncompliance, Responsible Program Offices, and Recommended Remedial Actions

This appendix provides details required under Federal Financial Management Improvement Act (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 the foregoing 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

1. HUD's annual assurance statement, issued pursuant to Section 4 of the Financial Manager's Integrity Act, will report two nonconforming systems.¹²

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:

<u>Responsible office</u>	<u>Number of systems</u>	<u>Nonconforming systems</u>
Office of Housing	18	0
Office of the Chief Financial Officer	12	0
Office of Administration	2	0
Office of the Chief Procurement Officer	2	2
Office of Community Planning and Development	3	0
Office of Public and Indian Housing	2	0
Government National Mortgage Association	1	0
Totals	<u>40</u>	<u>2</u>

The following section outlines HUD's plan to correct noncompliance with OMB Circular A-127 as submitted to us as of September 30, 2009, and unedited by us.

¹² The two nonconforming systems are A35-HUD Procurement System and P035-Small Purchase System.

**OFFICE OF THE CHIEF PROCUREMENT OFFICER
REMEDIATION PLAN AS of 09/30/2009**

**A35 HUD Procurement Systems (HPS)
P035 Small Purchase System (SPS)**

Noncompliance Issue(s)	Tasks/Steps (including Milestones)	Target Completion Dates	Actual Completion Dates
INTERNAL CONTROLS			
INTERMEDIATE RESOLUTION PLAN			
1. HUD's Procurement Systems Do Not Have Adequate Controls for Monitoring the Procurement Process	1A Review transactions of the four contracting officers who input records in excess of their contract authority and take actions as appropriate. <ul style="list-style-type: none"> • OCPO researched the transactions in question to determine if the obligations were appropriate or not. • OCPO determined that the transactions were properly executed by contracting officers acting within their authority. No further action is necessary. 	12/23/2006	12/14/2006
	1B Implement system controls to ensure that contracting officers are not able to exceed their procurement authority. <ul style="list-style-type: none"> • The OCPO will implement procurement authority control procedures. • The OCPO will include validation of contracting officer authority as part of each Procurement Management Review. 	3/31/2007	12/14/2006
	1C Implement controls to ensure that contracting officers are required to either input or approve all transactions that record funds through the HUDCAPS interfaces. <ul style="list-style-type: none"> • The OCPO will implement procedural controls to require contracting officers to validate transactions in HPS. 	3/31/2007	4/25/07
	1D Modify the systems to make the contracting officer field mandatory. <ul style="list-style-type: none"> • The OCPO will include validation of contracting officer authority as part of each Procurement Management Review. 	1/08/2007	1/08/2007 On-Going
	1D Modify the systems to make the contracting officer field mandatory. <ul style="list-style-type: none"> • The OCPO will implement procedures for electronic records, which are recorded in HPS, are reviewed to ensure that a Contracting Officer is identified for each record. • The OCPO will implement validation of the contracting officer identification as part of each Procurement Management Review. (See 1B bullet 2 above. Validation of contracting authority is the same as implementation of task) 	4/30/2007 Revised— 11/30/2008 1/8/2007	4/25/2007 6/20/2008 1/08/2007 On-Going

Noncompliance Issue(s)	Tasks/Steps (including Milestones)	Target Completion Dates	Actual Completion Dates
2. HUD Procurement Systems' Separation of Duties Controls Were Bypassed	2A Ensure that system administration and security administration functions are separate <ul style="list-style-type: none"> The OCPO will formally appoint separate individuals to act as security administrator and system administrator for each OCPO system and that the individuals will not be performing conflicting duties. 	4/16/2007	05/01/2007
	2B Ensure that staff are not assigned conflicting duties, that separate functions are performed by separate individuals, and that the concept of least privilege is applied. <ul style="list-style-type: none"> OCPO will determine if multiple system profiles are actually a valid requirement on an individual basis in HPS. The goal is to eliminate all unnecessary and redundant profiles in HPS and that the individuals will not be performing conflicting duties. <ul style="list-style-type: none"> The OCPO will Identify users with multiple HPS profiles The OCPO will deactivate unnecessary/redundant profiles 	2/15/2007	12/21/2006
	NOTE: While we can separate the duties procedurally, the separation cannot be enforced in HPS or SPS without reprogramming.	07/31/2007	07/19/2007
	2C Implement formal policies and procedures to recertify the access granted to users at least annually. <ul style="list-style-type: none"> The OCPO will develop and implement formal procedures for granting access by using the concept of least privilege to OCPO systems, as well as annual user access reviews by: <ul style="list-style-type: none"> Revise system access request forms Revise process in which user requests system access Revise procedure in which system access is granted Develop formal procedure to enforce annual user access review 	1/31/2007	12/31/2006
	2D Create and implement routing functionality within the Small Purchase System to allow users to be granted access to more than one office or region. <ul style="list-style-type: none"> OCPO recommends implementing the following tasks to alleviate the routing issue. OCPO will determine if multiple SPS system profiles are actually a valid requirement on an individual basis. The goal is to eliminate all unnecessary and redundant profiles in 	2/28/2007	1/31/2007
		3/31/2007	1/31/2007
		06/30/2007	07/18/2007

Noncompliance Issue(s)	Tasks/Steps (including Milestones)	Target Completion Dates	Actual Completion Dates
	SPS. <ul style="list-style-type: none"> ○ The OCPO will identify users with multiple SPS profiles ○ The OCPO will restructure the issuing office hierarchy to alleviate the necessity of multiple profiles for a given user. 	2/15/2007 11/30/2007	12/21/2006 12/14/2007
3. HUD's Procurement Systems Do Not Contain Sufficient Financial Data to Allow It to Effectively Manage and Monitor Procurement Transactions	3A Perform a cost benefit analysis to determine whether it is more advantageous to modify or replace the procurement systems to ensure compliance with Joint Federal Management Improvement Program Requirements. <ul style="list-style-type: none"> • The OCPO will perform a cost benefit analysis to replace the OCPO systems. 3B Implement functionality to ensure that there is sufficient information within HUD's procurement systems to support the primary acquisition functions of fund certification, obligation, deobligation, payment, and closeout. <ul style="list-style-type: none"> • Based on the availability of funds, OCPO will replace its systems with COTS software to ensure identified issues with security controls are addressed. • Milestones – Not later than <ul style="list-style-type: none"> • Develop Independent Government Estimate • Conduct Market Research • Source Selection • Roll-out pilot of production system 	05/31/2008 5/4/2007 04/6/2007 7/31/2010 1/31/2012	2/12/2008 05/03/2007 04/06/2007 TBD TBD
SECURITY CONTROLS			
4. The Office of the Chief Procurement Officer Did Not Design or Implement Required Information Security Controls	4A Obtain the training and or resources necessary to develop or perform compliant (1) information system categorization analyses; (2) risk assessments; (3) security plans; (4) contingency plans and tests; (5) monitoring processes, which include applicable Federal Information Processing Standards Publication 200 managerial, operational, and technical information security controls; and (6) evaluations of the managerial, operational, and technical security controls. <ul style="list-style-type: none"> • OCPO will ensure that training or other resources are obtained to develop or perform required managerial, operational, and technical security controls. <ul style="list-style-type: none"> ○ Update Risk Assessments ○ Update Security Plans ○ Update Annual Contingency Plans and Tests ○ Monitoring processes, which includes 	 12/31/2008 12/31/2008 12/31/2008 09/01/2008	 08/31/2007 08/31/2007 12/13/2007 On Going 08/29/2008

Noncompliance Issue(s)	Tasks/Steps (including Milestones)	Target Completion Dates	Actual Completion Dates
	<p>applicable Federal Information Processing Standards (FIPS) Publication 200 managerial, operational, and technical information security controls; and</p> <p>The OCPO continues to work the OCIO to monitor the above mentioned areas on an annual basis through updates to the Contingency plans, Security Plans, and BIA.</p> <ul style="list-style-type: none"> ◦ Evaluations of the managerial, operational, and technical security controls. The OCPO continues to work the OCIO to evaluate the above mentioned areas on an annual basis. <p>4B Complete the corrective actions for the known open information security vulnerabilities or develop mitigation strategies if new system development is underway.</p> <ul style="list-style-type: none"> • OCPO will ensure it develops mitigation strategies for the known open information security vulnerabilities. ◦ Review vulnerabilities NOTE: Vulnerability scans were requested by OCPO 09/09/2009 through OIT and security office – estimated scan date by 12/31/2009 ◦ Develop mitigation strategy NOTE: Upon completion of the scans, mitigating strategies will be developed for known vulnerabilities. Completion time is dependent on the number of vulnerability discovered <p>4C Designate a manager to assume responsibility for ensuring the Office of the Chief Procurement Officer’s compliance with federal certification and accreditation process requirements and to provide “continuous monitoring” of the office’s information systems security.</p> <ul style="list-style-type: none"> • OCPO will designate a manager responsible for ensuring compliance with information systems security and federal certification and accreditation process. • OCPO will work with OCIO to define roles and responsibilities and to ensure that appropriate resources are provided to perform required monitoring and certification and accreditation. <p>4D Reevaluate the HUD Procurement System and Small Purchase System application systems’</p>	<p>09/01/2008</p> <p>11/30/2008 Requested an Extension— 12/31/2009</p> <p>TBD See Note</p> <p>1/15/2007</p> <p>2/1/2007</p>	<p>On Going</p> <p>08/29/2008 On Going</p> <p>TBD</p> <p>03/13/2007</p> <p>2/1/2007</p>

Noncompliance Issue(s)	Tasks/Steps (including Milestones)	Target Completion Dates	Actual Completion Dates
	<p>security categorization in light of Office of Management and Budget guidance on personally identifiable information.</p> <ul style="list-style-type: none">OCPO will reevaluate the HUD Procurement System and Small Purchase System application systems' security categorization in light of Office of Management and Budget guidance on personal identifiable information. <p>4E Perform a business impact analysis for the procurement systems. Based on the results of the impact analysis, determine what actions HUD can take to limit the amount of time needed to recover from the various levels of contingencies that can occur and include the determined actions in the contingency plans for the systems.</p> <ul style="list-style-type: none">OCPO will develop a business impact analysis for the procurement systems and revise the contingency plan based on the BIA.<ul style="list-style-type: none">Develop business impact analysesIncorporate BIA into contingency plans	<p>8/31/2007</p> <p>4/30/2007 9/30/2007</p>	<p>8/31/2007</p> <p>06/06/2007 12/13/2007</p>

2. Our audit disclosed significant deficiencies regarding the security over financial information. Similar conditions have also been noted in other OIG audit reports. We are including security issues as a basis for noncompliance with FFMIA because of the collective effect of the issue and noncompliance with Circular A-130, appendix 3, and the Federal Information Security Management Act (FISMA). The responsible office, nature of the problem, and primary causes are summarized below:

<u>Responsible office</u>	<u>Nature of the problem</u>
Office of Housing and OCIO	<p>Financial system capacity limitations could impact business processing.</p> <p>To address the degradation on processing performance and high workload on business-critical housing systems, HUD increased capacity on the Unisys host platform. In addition, HUD upgraded network circuits and expanded Internet capacity critical to supporting FHA business activities.</p> <p>HUD also planned to migrate several large applications from the Unisys mainframe platform to an “open systems” platform in 2009; however, the implementation did not occur as scheduled. Additional application and processing changes, (e.g., improved batch process scheduling and search databases) were also implemented to optimize the use of the processing resources.</p> <p>Throughout 2009, FHA and HUD closely monitored system use levels and increased data/processing capacity. HUD also recently contracted for the delivery of a new, larger mainframe (scheduled for full implementation November 30, 2009) to replace the existing IBM mainframe. FHA believes system use is now within acceptable levels, and management projects gradual declines in business volume for the next few years.</p> <p>The Office of the Chief Information Officer (OCIO) developed an informal written short-term capacity management plan at the end of fiscal year 2009 that identifies the actions that have been taken and future activities required. However, because this growth in volume developed so quickly, the plan does not document (1) use benchmarks and required responses and (2) clear organizational and staff roles and responsibilities. Without a formalized plan, FHA and OCIO may not be able to sufficiently address further capacity issues effectively or in a timely manner, which may impact FHA’s ability to process and record financial transactions reliably and in a timely manner.</p>
	<p>These conditions occurred because of the increase in loan application and endorsement volume. And the Unisys mainframe began to approach its operating capacity in the fall of 2008.</p>
Office of Housing and OCIO	<p>Effective FHA modernization is necessary to address systems risks.</p> <p>In 2009, HUD commissioned a study to develop an IT strategy and improvement plan, which would identify strategic IT solutions to meet the agency’s long-term programmatic objectives. This study served as a comprehensive IT systems risk assessment for FHA and thoroughly illustrates the many inefficiencies and limitations of the current system architecture. It examined operations at other Federal agencies and several mortgage, banking, and mortgage insurance operations. The study</p>

Responsible office

Nature of the problem

recommended 33 technology and architecture approaches and 25 specific initiatives, including replacement of several of FHA’s largest and most critical business systems. Critical objectives of the initiatives were to

- Improve fraud detection
- Improve risk management and loss mitigation
- Improve program operations
- Limit mission constraints related to dated technology

Each initiative was reviewed, evaluated, and prioritized based on established risk criteria. The efforts to address these system recommendations are expected to take several years and cost hundreds of millions of dollars. FHA has taken a first step by appointing a full-time project management officer. In fiscal year 2010, FHA plans to perform a comprehensive risk assessment to ensure that this plan is consistent with the current OCIO strategic plan. Given their current state, FHA’s financial systems will continue to require expensive maintenance and monitoring and are likely to pose increasing risks to the reliability of FHA’s financial reporting and business operations until the modernization efforts are completed. The proposed plan should include an effective implementation plan and leadership team to ensure that the current systems are replaced within a timeframe that does not put FHA’s financial operations at further risk.

These conditions occurred because FHA did not conduct a risk assessment of the various system initiatives and required corrective actions in connection with the OCIO strategic plan and the IT strategy and improvement plan.

Office of Housing and OCIO

FHA should enhance the general ledger system user access management processes.

As indicated in the FHA Office of Housing IT strategy and improvement plan, “FHA IT systems are a significant constraint on FHA’s ability to rapidly and effectively adjust to this new environment. Over the last decade, little investment has been made in modernizing FHA’s technology.” An initial step of system modernization was implemented in fiscal year 2009, with the integration of the Multifamily Endorsement/Premium and Claims processes into FHASL. During this implementation, additional developers and end-users were provided access to FHASL environments to perform various development activities, testing, and training functions. We noted that developers had access to the production environment in a greater than read-only capacity and end-users had access to the development environment. Additionally, we noted that four employees had excessive rights within the Multifamily Premiums module of FHASL (i.e., endorsement entry, premium reviewer, termination clerk, and mortgage servicer role) and compensating controls preventing the same user from performing incompatible functions on the same transaction were not effective. While granting these access levels may appear to improve the efficiency of system implementation, it increases the risk of transactions being inappropriately authorized and processed.

Responsible office

Nature of the problem

The monitoring of user business process functions within an application, audit logging, is essential in ensuring that only personnel with proper access rights are performing job functions. During fiscal year 2009, we noted that limited audit logging is performed over business functions; and the data elements that are being logged do not appear to be consequential to the process. Additionally, the audit logs produced are not reviewed to ensure that appropriate actions have been taken as required by HUD policy. A plan has been developed by the system owner that incorporates identifying the data elements to be audited, selecting the capture mechanism, defining reports and filters, and establishing the review process; however, this plan has not been implemented completely. The recording of auditable events and the periodic review of audit logs is essential to mitigate the risk of unauthorized access attempts or inappropriate personnel actions.

A final component of user access management is the process of removing access no longer required by users. One method for completing this process is the disabling or removal of accounts after a specified period of inactivity. HUD policy mandates that inactive users be deleted after 90 days of inactivity. We noted that approximately 30 user accounts with active access to FHASL had not logged into the application in more than 90 days. FHASL is configured to have passwords automatically expire after 90 days of inactivity; however, these accounts are not permanently locked and can be reset by the user contacting the Help Desk. Accounts are manually deleted if they have been inactive for more than twelve months since the beginning of the previous year. In this situation, users do not have the ability to contact the Help Desk to reactivate their accounts. We noted that this process is manual because FHASL does not have an automated mechanism for disabling or removing accounts. By not disabling unused accounts timely, there is an increased risk that accounts may be used to gain unauthorized access to FHASL.

These conditions occurred because HUD's management did not consistently enforce policies and procedures.

OCIO

Weaknesses existed in HUD's security management program. Specifically,

- HUD did not properly categorize those systems containing personally identifiable information (PII). HUD's inventory of automated systems was not current and did not contain all systems with PII.
- HUD did not properly report 5 of 34 category I security incidents to the proper authorities within the mandated timeframes.

These conditions occurred because HUD's management did not consistently enforce policies and procedures.

OCIO

Weaknesses existed in security controls over HUD's Web applications and identified weaknesses in the areas of security configurations and technical

Responsible office

Nature of the problem

controls.

For instance, HUD did not ensure that access controls followed the principle of least privilege for Web application configurations. Weak Web application security configurations disclose potentially sensitive information that may enable a malicious user to devise exploits of the application and the resources it accesses. This weakness could also potentially expose sensitive or confidential information as well as useful information that may enable a malicious user to devise effective and efficient exploits of the application and the resources it accesses.

HUD did not adequately implement controls to ensure confidentiality and privacy for Web applications. These weaknesses were not exploitable vulnerabilities, but they were a violation of security policy because the configurations potentially allowed access to data that are required to be confidential by law. When weak privacy controls exist, they breach confidentiality requirements to protect sensitive information. An attacker can take advantage of these vulnerabilities to discover and access sensitive and confidential data. Further, HUD did not adequately review Web applications for vulnerabilities and patch them. Exploiting vulnerabilities can breach confidentiality requirements to reveal sensitive information.

These conditions occurred because HUD’s management did not consistently enforce policies and procedures.

OCIO

Weaknesses existed in controls over HUD’s Disaster Recovery Grant Reporting System (DRGR) related to the Neighborhood Stabilization Program (NSP) funding.

We found that (1) access control policies and procedures for DRGR violated HUD policy, (2) the system authorization to operate is outdated and based upon inaccurate and untested documentation, (3) CPD did not adequately separate the DRGR system and security administration functions, and (4) CPD had not sufficiently tested interface transactions between DRGR and the Line of Credit Control System (LOCCS). As a result, CPD cannot ensure that only authorized users have access to the application, user access is limited to only the data that are necessary for them to complete their jobs, and users who no longer require access to the data in the system have had their access removed. Further, the failure to sufficiently test interface transactions between DRGR and LOCCS leaves HUD with limited assurance that the \$5.9 billion in NSP funding was accurately processed.

These conditions occurred because HUD’s management did not consistently enforce policies and procedures.

OCIO

Weaknesses existed in HUD’s management procedures, practices, and controls related to the Recovery Act Management and Reporting System (RAMPS)

We found that while HUD has taken actions to comply with the reporting requirements under the Recovery Act, it did not fully comply with the

Responsible office

Nature of the problem

reporting requirements to ensure that the recipients' use of all recovery funds is transparent to the public and that the public benefits of these funds are reported clearly, accurately, and in a timely manner.

We reviewed the April 30 and July 15, 2009, National Environmental Policy Act (NEPA) reports and found that HUD program offices did not have existing systems to collect the NEPA data, were not able to use the newly developed RAMPS system, or were not provided training on how to use the system. As a result, HUD was not able to provide the NEPA status to the public in an accurate and timely manner for more than \$2.9 billion in obligated funds. Additionally, HUD did not complete required security and privacy documents before or during the early phase of system development. HUD did not follow Federal and HUD security policies for implementing these security requirements for RAMPS. As a result, HUD officials could not ensure that all security controls were in place, implemented correctly, and operating as intended.

These conditions occurred because HUD's management did not consistently enforce policies and procedures.

OCIO

Weaknesses still existed in security controls over HUD's databases.

During fiscal year 2008, we evaluated security controls over HUD's databases. We identified security configuration and technical control deficiencies within HUD's database security controls in the areas of (1) passwords, (2) system patches, and (3) system configuration. We followed up on the status of these weaknesses during fiscal year 2009 and determined that technical control deficiencies relating to database passwords and database patches had been reviewed and corrected as the Office of the Chief Information Officer (OCIO) deemed appropriate. OCIO has not yet implemented secure configuration baselines for databases and the reviews for monitoring those configurations. This corrective action is not scheduled to be completed until December 31, 2010.

These conditions occurred because HUD's management did not consistently enforce policies and procedures.

OCPO

Control weaknesses still existed for HUD Procurement System (HPS) and HUD Small Purchase System (SPS). Specifically,

Two significant recommendations made in the audit report remained open, and the procurement systems continued to be noncompliant with Federal financial management requirements. The Office of the Chief Procurement Officer (OCPO) has yet to complete the corrective actions for the known open information security vulnerabilities. In addition, OCPO had not implemented functionality to ensure that there is sufficient information within HUD's current procurement systems to support the primary acquisition functions of fund certification, obligation, deobligation, payment, and closeout. OCPO plans to replace the current acquisition systems and during fiscal year 2009, obtained \$3.7million in funding to purchase a commercial off-the-shelf application. The acquisition of the new application is

Responsible office

Nature of the problem

anticipated to be complete by June 30, 2010. However, full funding to complete the project had not been obtained; therefore, it is unclear when the new application will be fully implemented.

These conditions occurred because OCPO had not been able to secure funding to complete the planned corrective action.

OCIO and OCFO

Control weaknesses that could negatively affect the integrity, confidentiality, and availability of computerized financial data within three of HUD's financial systems – Nortridge Loan System (NLS), HUD's Central Accounting and Program System (HUDCAPS), and Line of Credit Control System (LOCCS) - still existed. Specifically,

Access controls over HUD's NLS needed to be strengthened. We determined that controls over the NLS user recertification process were not effective to ensure that all users with access to the production data were properly recertified. In addition, HUD did not appropriately separate the functions of system administration and system security within NLS. By not ensuring that the access levels of all NLS users were reviewed, HUD was unable to ensure that users only had access to the data that were necessary for them to complete their jobs, that only authorized users had access to the system, and that users who no longer required access to the data in the system had their access removed. Inadequately segregated duties increase the risk that erroneous or fraudulent transactions could be processed, that improper program changes could be implemented, and that computer resources could be damaged or destroyed. OCFO provided documentation to support completion of planned corrective actions.

In fiscal year 2009, we found that HUD did not take steps to ensure that IT contractors were properly rescreened to ensure their continued eligibility to access sensitive systems and application data in accordance with HUD guidelines. Specifically, HUD did not initiate updated background investigations for contractor personnel with access to HUDCAPS every 5 years as required by HUD policy. As of December 2008, OCFO had not initiated updated background investigations for 10 of the 20 contractors with above-read access to the HUDCAPS application. The background of one contractor employee had not been reassessed since 1975. Background investigations ensure, to the extent possible, that employees are suitable to perform their duties. By not performing required background screenings, HUD increased its risk that unsuitable individuals would have access to sensitive systems and data.

Again in fiscal year 2009, we were able to identify LOCCS users that were not recertified by the system. As a result, we concluded that further improvements are necessary to ensure that all users of LOCCS are recertified in accordance with HUD policy and that the corrective action taken in response to our 2007 finding did not fully address the problem.

These conditions occurred because HUD's management did not consistently enforce policies and

Responsible office

Nature of the problem

procedures.

OCIO

Weaknesses still existed in security controls over HUD's IBM mainframe.

In fiscal year 2009, we determined that HUD had not completed the task of securing libraries and data files within the IBM mainframe environment.

These conditions occurred because HUD's management did not consistently enforce policies and procedures.

OCIO

Weaknesses still existed in security controls over HUD's software configuration management.

We previously reported that the configuration management plan for Institution Master File (IMF) contained outdated information. We also reported that HUD did not ensure that its IT support contractor provided the proper version of a configuration management tool used by five of its applications. Without updated configuration management documentation, HUD risks that outdated policies and plans may not address current risk and, therefore, be ineffective.

HUD had not yet fully resolved the issue of the outdated version of the configuration management tool. HUD had made progress in updating the configuration management plan for IMF. However, configuration management plans for several FHA applications identified in our fiscal year 2007 review still have not been updated to include reported issues such as incomplete or outdated information.

In fiscal year 2009, we found that the configuration management plan for the Integrated Disbursement and Information System OnLine (IDIS OnLine) also lacked information and contained outdated information.

These conditions occurred because management did not consistently enforce policies and procedures.

Responsible office

Nature of the problem

OCIO

Weaknesses still existed in controls over HUD's contingency planning.

In fiscal year 2009, we found that HUD had updated listings for the recovery team and critical applications. However, the disaster recovery plan still contained conflicting information. Additionally, we found that disaster recovery exercises did not fully test system functionality because the critical applications were not verified through transaction and batch processing and the exercises did not include recovery of all applications that interface with the critical systems. By not having current information in the disaster recovery plan and fully testing system functionality during disaster recovery exercises, HUD cannot ensure that its systems and applications will function as intended in an actual emergency.

In 2008, we reported that contingency planning at third-party business sites was inadequate. Staffs were unfamiliar with or had limited knowledge of contingency planning requirements, and documentation was not readily available for use in case of emergency. We determined that HUD had not specified contingency planning, continuity of operations, or disaster recovery requirements in its agreements with third-party business partners. Such information is usually included in the terms and conditions of a contract or service-level agreement with the external business partner. Consequently, third-party business partners developed limited contingency planning policies that did not meet HUD or National Institute of Standards and Technology (NIST) requirements. Management generally agreed that corrective action was needed, but had not taken action on any of OIG's recommendations.

These conditions occurred because management did not consistently enforce policies and procedures and HUD had not specified contingency planning, continuity of operations, or disaster recovery requirements in its agreements with third-party business partners. Consequently, third-party business partners had developed limited contingency planning policies that did not meet HUD or NIST requirements.

OCIO

Weaknesses still existed in controls over HUD's physical security.

In fiscal year 2008, we reported that physical security at the third-party business sites we visited was inadequate and weaknesses existed at those sites. We found instances in which servers were located in common areas (i.e., lunch rooms, halls), case binders with PII were left unattended, no guard or receptionist was at the entrance, access doors were unlocked, and encryption of data residing on laptops or portable devices was not a requirement.

In fiscal year 2009, management generally agreed that corrective action was needed but had not taken action on any of OIG's recommendations.

This condition occurred because HUD had not specified the level of security controls and included it in the terms and conditions of the contract or service-level agreement with the external business partner. As a result, third-party business partners have developed various IT security controls and policies that do not meet HUD or Federal requirements and, therefore, cannot be relied upon to provide adequate protection of HUD's sensitive data.

Responsible office

Nature of the problem

OCIO

Personnel security weaknesses still existed. Specifically,

Since 2004, we have reported that HUD did not have a complete list of all users with above-read access at the application level. Those users with above-read access to sensitive application systems are required to have a background investigation. Our review this year found that HUD still did not have a central repository that lists all users with access to HUD's general support and application systems. Consequently, in fiscal year 2009, HUD still had no central listing for reconciling that all users who have access to HUD's critical and sensitive systems have had the appropriate background investigation.

While HUD's implementation, in 2007, of the Centralized HUD Account Management Process (CHAMP) was a step toward improving its user account management practices, CHAMP remained incomplete and does not fully address OIG's concerns. Specifically, we noted that

- CHAMP does not contain complete and accurate data. OCIO did not electronically migrate data from the HUD Online User Registration System (HOURS) into CHAMP. Instead, it chose to enter the legacy data manually. However, this process had not been completed. In a July 2008 audit report, we recommended that all offices within HUD provide the historical information necessary to populate CHAMP. OCIO agreed with our recommendation, and corrective action is scheduled for completion in December 2009.
- CHAMP does not contain a mechanism to escalate or reassign tasks that have not been completed within a specified timeframe. In a July 2008 audit report, we recommended that OCIO develop and implement such a mechanism. OCIO agreed with the recommendation, and corrective action is scheduled for completion in December 2009.

Responsible office

Nature of the problem

- HUD did not conduct a security categorization and a risk assessment for CHAMP as required by Federal Information Processing Standards (FIPS) Publications (PUB) 199 and 200. HUD's OCIO chose not to conduct a security categorization and risk assessment for CHAMP because it believed that these items were not required for CHAMP, which is listed as a process rather than a system. HUD also believed that since CHAMP was exclusively owned by its IT contractor, it was not subject to the requirements of a security categorization and a risk assessment. Without a security categorization and risk assessment of CHAMP, HUD cannot know the full extent of risks that the CHAMP process is vulnerable to or whether adequate levels of security controls have been put into place to protect data and applications impacted by CHAMP. OIG recommended that OCIO conduct a security categorization and a risk assessment for CHAMP. OCIO agreed with this recommendation; however, corrective action had not been taken.
- Reconciliations to identify users with above-read (query) access to HUD mission-critical (sensitive) applications but without appropriate background checks were not routinely conducted. Officials from the Office of Security and Emergency Planning (OSEP) and OCIO asserted that with the implementation of CHAMP and the new security manager computer system, it would be impossible for an employee or contractor to obtain access to any of HUD's systems without the appropriate background investigation. Thus, the reconciliation was no longer needed.

Contrary to OSEP and OCIO's assertions, a reconciliation performed by OSEP for second quarter 2009 identified 27 persons with the incorrect level of background investigation, including three persons with no record of a background investigation having been performed. In addition, although the HUD Personnel Security/Suitability Handbook contains policies to suspend, deny, and terminate access of users who do not meet its standards, we found no evidence that HUD OCIO had taken actions regarding users without appropriate background investigations having access to HUD sensitive systems. As a result, HUD could not ensure that its critical and sensitive information could be protected from unauthorized access, loss, misuse, modification, or improper disclosure.

Responsible office

Nature of the problem

We remain concerned because the reconciliation included users of only one of HUD's mission-critical systems. We previously reported that users of HUD's general support systems on which these mission-critical applications reside were not included in the reconciliations because they were not classified as mission critical. Having access to general support systems typically includes access to system tools, which provide the means to modify data and network configurations. We identified IT personnel, such as database administrators and network engineers, who have access to these types of system tools but do not have appropriate background checks. These persons were not identified as part of the CHAMP reconciliation process.

These conditions occurred because management did not consistently enforce policies and procedures.

Appendix D

SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

Recommendation number	Ineligible 1/	Unsupported 2/	Unreasonable or unnecessary 3/	Funds to be put to better use 4/
1.e				\$24.7 M
1.g				\$42 M
2.a				\$317 M
3.a				\$8.8 M
3.c				\$4.7 M
3.e				\$23.4 M
3.g				\$75.3 M
3.k				\$20.2 M

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.
- 2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.
- 3/ Unnecessary/unreasonable costs are those costs not generally recognized as ordinary, prudent, relevant, and/or necessary within established practices. Unreasonable costs exceed the costs that would be incurred by a prudent person in conducting a competitive business.
- 4/ 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 E

Agency Comments



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

OFFICE OF THE CHIEF FINANCIAL OFFICER

November 12, 2009

MEMORANDUM FOR: Thomas R. McEnanly, Director, Financial Audits Division, GAF
FROM: Anthony P. Scardino, Acting Deputy Chief Financial Officer, F *APS*
SUBJECT: Management Comments on Draft Report on HUD's Fiscal
Year 2009 Financial Statements – Internal Control and
Compliance Sections

Thank you for the opportunity to comment on the subject Draft report's internal control and compliance sections, as requested in your memorandum which was provided on November 10, 2009. These comments replace those provided in my previous response of November 06, 2009.

Detailed comments regarding technical corrections and requests for clarifications and reconsiderations are provided in the Attachment. In addition to the attached technical corrections and clarification/reconsideration requests, we offer the following comments for your consideration in completing the FY 2009 audit.

Federal Financial Management Improvement Act of 1996 (FFMIA). As in prior years, we continue to take exception to the conclusion that HUD is not in compliance with FFMIA, as HUD continues to fully satisfy OMB's three-part requirement needed to report substantial compliance. Specifically, per OMB Circular A-127, 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.

While we agree our current financial systems configuration could be better integrated to achieve greater efficiencies and eliminate the need for some compensatory controls, the above-required A-127 objectives are met with a low risk of a material misstatement of financial information for management decision making and reporting. The low number of A-127 compliance reviews performed this year is not proof that our systems are not FFMIA compliant. While the low number indicates we are not meeting our numerical quota for performing A-127 reviews, it should be noted that HUD's systems environment has not substantively changed since most of those systems were last reviewed and found to be compliant with FFMIA requirements. The Department also has taken other actions which further mitigate this issue, including a number of ongoing reviews that the Department uses to help identify system deficiencies and procedural weaknesses, e.g., the annual FISMA report and annual A-123 - Internal Controls over Financial Reporting reviews. Additionally, each program office is required to perform a self assessment on each financial management system annually. HUD's compliance is further demonstrated by

consistently achieving a clean audit opinion, meeting accelerated reporting requirements, i.e., 45 days after the end of the fiscal year, and producing quarterly financial statements to meet all Department of Treasury requirements. HUD's financial management systems clearly satisfy OMB's three-part requirement. We have concluded that the problems reported are not sufficient in scope to warrant a statement of non-compliance with FFMIA, and therefore management must continue to report substantial compliance with FFMIA, as we have done in prior years.

HUD also disagrees with that assessment that CPD's formula grants reporting, specifically the integrated financial management system that supports its formula programs, is not in compliance with FFMIA. CPD's system of control for the formula programs, especially for such programs as the expansive Community Development Block Grant program, is in total compliance with FFMIA. This has been supported by external and internal Financial Management Systems A-127 reviews beginning in 2002 to the present. Each year since, through 2009, the main CPD system used in this process, the Integrated Disbursement and Information System (IDIS), has been certified as compliant with all requirements of A-127.

In addition, contrary to statements in the OIG's draft internal control section, CPD does not shift fiscal year (FY) funding data entered by the grantee. As a matter of record, the grantee has the option, when setting up an activity in IDIS, to enter a FY indicator to assist with their own record keeping. HUD/CPD has found that less than 1 percent of grantees actually take advantage of this option. For those that do, we have determined that there is no specific correlation between their FY indicator and the FY of the Federal appropriation, which is a primary reason why CPD does not rely on the grantee to provide such information. Also, when a request for reimbursement is made by the grantee through IDIS, they do not enter any FY indicator.

Anti-deficiency Act Reporting. HUD requests the OIG clarify the report's description of HUD's Compliance with the Anti-deficiency Act (ADA) to clarify the non-compliance with the Act's "reporting" requirements. We share your concern regarding the timeliness of HUD's compliance with the reporting requirements of the ADA, and we appreciate that the OIG recognizes the progress that the OCFO has made in closing out its case backlog. HUD does have an effective process for conducting investigations of potential ADA violations which includes an initial determination of whether a violation occurred, efforts to strengthen internal controls to minimize the risk of future potential violations, and a determination of whether a deficiency appropriation is needed. Those aspects of our process are timely conducted, though we agree that more work needs to be done, and HUD's processing can be improved in terms of more timely closing investigations where no violation has occurred and in reporting on actual violations.

We disagree, however, with the classification of the six violations cited in the Draft report as "known," as the OCFO has not yet obtained a legal determination on these cases. When a legal determination has been made, the case folder will be updated to include the legal determination, and will be presented to the CFO for final review. Accordingly, at this time, it is correct to only list these 6 cases as potential violations. It also should be noted that none of the ADA cases in process required a deficiency appropriation or had an impact on HUD's financial statements.

Erroneous Payments for HUD's Rental Housing Assistance Programs. The Office of the Chief Financial Officer (OCFO) agrees with the facts presented in the updated draft Compliance section of the subject report. However, we believe that the report would be a more balanced representation of HUD's efforts to reduce improper payments in HUD's Rental Housing Assistance Programs if the Office of Inspector General included other pertinent information in this section. For example,

the OIG states that HUD has increased the combined gross improper rental housing assistance payment estimates to \$1.022 billion in FY 2008, which is a total increase of 3 percent in comparison to the prior year estimates. However, there is no mention that the FY 2008 goal was revised downward based on HUD exceeding the revised FY 2007 goal. Further, it is more accurate to portray improper payments as a percentage of expenditures versus a specific dollar value, as this provides a true measure of HUD's progress in addressing improper payments. As example, if the total disbursements for a year significantly increased, HUD could have a higher dollar value of gross improper payments, yet a lower improper payment rate, which would distort the true progress made.

We recommend the OIG include language such as the following to provide a more complete representation of HUD's progress in reducing the rate of erroneous payments for its Rental Housing Assistance Programs:

HUD's FY 2007 goal was originally set at 5.5 percent and during FY 2008 the FY 2007 goal and out-year goals were revised based on program changes made to the Rental Housing Assistance Programs during FY 2007. HUD exceeded the updated FY 2007 goal of 4.6 percent, achieving an improper payment rate of 3.5 percent. During FY 2008, the improper payment rate remained steady at 3.5 percent, thus missing HUD's FY 2008 goal by one-tenth of one percent. Overall, HUD has reduced the rate of erroneous payments from 17.1 percent in FY 2000 to the current rate of 3.5 percent.

On behalf of the Secretary, I want to once more thank you and your audit team for the collaborative and supportive manner in which you worked with HUD management and staff towards bringing yet another audit cycle to a successful conclusion. Working together, we continue to improve HUD's financial management operating environment to serve as a foundation for accomplishing the mission of the Department. If you have any questions on our comments, please feel free to contact me 708-6801.

Attachment

Appendix F

OIG EVALUATION OF AGENCY COMMENTS

With the exception of the report's conclusions related Federal Financial Management Improvement Act (FFMIA) compliance, HUD management generally agrees with our presentation of findings and recommendations subject to detail comments.

The disagreements to our FFMIA compliance conclusions related to formula grant reporting and HUD's integrated financial management system. HUD's Office of Community Planning and Development disagrees that their formula grant reporting is not in compliance with FFMIA. Regarding overall financial management system compliance with FFMIA, HUD agrees that their systems processes can be more efficiently integrated to eliminate the need for existing compensating controls, but feel the existing environment is substantially compliant and not representative of a material risk of misreporting.

We disagree with HUD's conclusions regarding FFMIA compliance. In regards to the CPD formula grants reporting, while FFMIA requires that budget, performance, and financial information should be reconcilable to the grant year funds were approved, our reviews indicated that CPD did not record information in a way that allowed such reconciliations. FFMIA emphasizes the need for agencies to have systems that are able to generate reliable, useful, and timely information for decision-making purposes and to ensure accountability on an ongoing basis. The deficiencies noted in HUD's financial management systems are due to the current financial system being developed prior to the issuance of current requirements. It is also technically obsolete, has inefficient multiple batch processes, and requires labor-intensive manual reconciliations. Because of these inefficiencies, HUD's management systems are unable to routinely produce reliable, useful, and timely financial information. This weakness manifests itself by limiting HUD's capacity to manage with timely and objective data, and thereby hampers its ability to effectively manage and oversee its major programs.

In addition, HUD is not fully compliant with one of the three indicators of compliance with Federal financial management requirements. HUD has significant deficiencies related to security over financial management information systems in accordance with FISMA and OMB Circular A-130 Appendix III. The Department has not met the minimum set of automated information resource controls relating to Entity-wide Security Program Planning and Management.

In regards to Anti deficiency Act Reporting and Erroneous Payments, we reviewed the Department's comments and made clarifying changes to the report.