



Issue Date December 7, 2010

Audit Report Number 2011-FO-0004

TO: Douglas A. Criscitello, Chief Financial Officer, F

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

SUBJECT: Annual Evaluation of HUD's Compliance With Presidential Executive Order 13520, Reducing Improper Payments

HIGHLIGHTS

What We Audited and Why

We conducted an annual limited scope review of the U.S. Department of Housing and Urban Development's (HUD) compliance with Presidential Executive Order (EO) 13520, Reducing Improper Payments. We performed this annual review because it was required under section 3(b) of the order. Our objective was to review HUD's improper payment internal control policies, procedures, practices, and estimation methodology to assess its level of compliance with the order.

What We Found

HUD was in general compliance with EO 13520 annual reporting requirements. We generally concluded that HUD's ongoing efforts in mitigating the risks of improper payments in the rental housing assistance programs were progressing in a positive direction. However, we noted some areas in which HUD could make enhancements related to disclosure and procedural issues. We also noted specific areas for improvements which would strengthen HUD's improper payment reduction strategies.

What We Recommend

Based on the results of the review, we recommend that the Chief Financial Officer consider full disclosure of the error estimates related to public housing through a footnote disclosure in the performance accountability report and accountable official's report under EO 13520. Additionally, we made some recommendations to improve HUD's improper payment reduction strategies, including those related to the issue of overdue tenant recertifications, monitoring controls, and HUD's improper payment estimation methodology.

Auditee's Response

We discussed our results with HUD during the audit and at the exit conference on November 2, 2010. We provided HUD with a copy of the draft report on October 27, 2010 and requested written comments by November 20, 2010. We received the response on December 3, 2010. HUD concurred on two of five of the audit recommendations. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

TABLE OF CONTENTS

Background and Objective	4
Results of Audit	
Finding 1: HUD Generally Complied With EO 13520 Annual Reporting Requirements but Its Transparency and Payment Reduction Strategies Had Weaknesses	6
Scope and Methodology	11
Internal Controls	12
Appendixes	
A. Auditee Comments and OIG's Evaluation	13

BACKGROUND AND OBJECTIVE

As the stewards of taxpayer dollars, the U.S. Department of Housing and Urban Development (HUD), the public housing agencies, and program administrators are accountable for how they spend those funds, as well as for safeguarding them against improper payments—payments that should not have been made or that were made for incorrect amounts.

In November 2002, Congress passed the Improper Payments Information Act of 2002 (IPIA). The major objective of the legislation was to enhance the accuracy and integrity of Federal payments. This legislation, in conjunction with the implementing guidance¹ from the Office of Management and Budget (OMB), requires executive branch agency heads to review their programs and activities annually, identify those that may be susceptible to significant improper payments, estimate amounts improperly paid, and report on the amounts of improper payments and actions to reduce them. Since the passage of IPIA, HUD has identified and reported in its annual performance accountability reports several HUD programs that are susceptible to significant erroneous payments, such as the Community Development Block Grant Entitlement and State/small cities programs (CDBG program) and public housing, tenant-based voucher and project-based assistance program (collectively referred to as HUD's rental housing assistance programs). Except for the CDBG program (excluded from annual improper payment reporting since March 2007), HUD has continued to report erroneous payments for its rental housing assistance programs. In general, beneficiaries pay 30 percent of their adjusted income as rent, and HUD payments cover the remainder of the rental cost (or the operating cost in the case of public housing). HUD determined the following three major components of potential errors and improper payments in the rental housing assistance programs:

1. Program administrator error – The program administrator's failure to properly apply income exclusions and deductions and correctly determine income, rent, and subsidy levels;
2. Tenant income reporting error – The tenant beneficiary's failure to properly disclose all income sources and amounts upon which subsidies are determined; and
3. Billing error – Errors in the billing and payment of subsidies due between HUD and third-party program administrators and/or housing providers.

Despite the errors in reducing improper payments, agencies reported nearly \$100 billion in improper payments for fiscal year 2009 according to OMB. In response to this unprecedented level of improper payments, Presidential Executive Order (EO) 13520, which was designed to further intensify efforts to reduce improper payments by boosting transparency and holding the agencies accountable for reducing improper payments in their respective programs, was signed on November 20, 2009. In accordance with this order, each agency's Inspector General was required to review and issue a report containing its recommendations, if any, for modifying the

¹ Since the passage of IPIA, OMB has issued three separate memorandums, which are implementing guidance for the IPIA and section 831 of the Defense Authorization of Fiscal Year 2002. These memorandums are M-03-07, Programs to Identify and Recover Erroneous Payments to Contractors (January 16, 2003); M-03-12, Allowability of Contingency Fee Contracts for Recovery Audits (May 8, 2003); and M-03-13, Improper Payments Information Act of 2002 (May 21, 2003). All three memorandums are now consolidated into appendix C to OMB Circular A-123.

agency's methodology, improper payment reduction plans, and program access and participation plans.

Our audit objective was to review HUD's improper payment internal control policies, procedures, practices, and estimation methodology to assess its level of compliance with this order.

RESULTS OF AUDIT

Finding 1: HUD Generally Complied With EO 13520 Annual Reporting Requirements but Its Transparency and Payment Reduction Strategies Had Weaknesses

Our limited scope review found that HUD was in general compliance with EO 13520 annual reporting requirements. We generally concluded that HUD's ongoing efforts in mitigating the risks of improper payments in the rental housing assistance programs were progressing in a positive direction. However, HUD should consider disclosing the public housing error estimate amounts as a footnote disclosure in the performance accountability report and accountable official's report for transparency. We also noted areas for improvement to strengthen HUD's improper payment reduction strategies.

In accordance with section 3(b) of EO 13520, we were asked to review HUD's improper payment statistical estimation methodology, reduction plans, and program access participation plans. Summarized below are some of the observations we noted during our review along with specific areas for improvements.

Opportunities To Strengthen Transparency and Enhance HUD's Improper Payment Reduction Strategies

- **Full disclosure of HUD's statistical estimates of erroneous payments in the Office of Public and Indian Housing's (PIH) rental assistance program** – HUD's statistical estimates of erroneous payments related to the PIH rental assistance program were not fully disclosed. In our view, HUD's statistical estimate of rent errors in the PIH programs² would need to be disclosed in the report to provide the required transparency. This disclosure would be consistent with the objective of the order and OMB guidance. Additionally, because the calculation of the operating subsidy is dependent on the housing authority's anticipated income such as rent income, we believe that a footnote disclosure in the accountable official report and performance accountability report should be considered. If this rent income was calculated based on an incorrect rent amount (over/under collection of rent due from tenants), it could have an impact on the authority's future operating subsidies since the authority could receive more or less than the share of the operating fund that it is eligible to receive under the program.

² HUD's undisclosed statistical estimate of program errors (i.e., rent determination errors and underreporting of income) in the public housing programs was \$154 million (13 percent of gross erroneous payments) and \$229 million (18 percent of gross erroneous payments) in fiscal years 2008 and 2009, respectively.

Under IPIA, HUD is required to estimate the annual amount of significant improper payments³ and report the estimates, along with plans to reduce the improper payments, to the President and Congress. Beginning in fiscal year 2008, HUD decided not to report estimates of erroneous payments in public housing programs in HUD's annual performance accountability report, although its own independent studies⁴ reported that significant errors were still being made by the housing authorities in calculating rent amounts due from the tenants or tenants could still be underreporting their income. HUD explained that since the budget-based funding methodology⁵ was implemented in January 2007, the rent determination errors would no longer have an effect on HUD's annual rental housing subsidy cost because these errors would be borne by the housing authority and, thus, HUD's subsidy payment would remain unchanged. Under budget-based funding methodology, the housing authority is entitled to get the operating subsidy in 12 equal monthly payments.

- **Other required actions prescribed by OMB** – OMB Memorandum 10-13, Issuance of Part III to OMB Circular A-123, appendix C, dated March 22, 2010, identifies certain actions that each reporting agency is required to take to comply with IPIA requirements, including the following provisions:
 - ✓ Section B (2) (k) of the OMB memorandum requires HUD to document its analysis to support its basis for choosing its supplemental targets. We requested this information from HUD, but it could not provide the requested documentation. Without this analysis, it would be difficult to independently assess the reasonableness of HUD's supplemental targets.⁶
 - ✓ Section B(2)(h) of the OMB memorandum states that HUD should establish 3-year supplemental targets for high-priority programs as required by part II of appendix C

³ OMB Memorandum 10-13, Issuance of Part III to OMB Circular A-123, appendix C, section A(b), defines improper payments as “any payment that should not have been made or that was made in an incorrect amount” under statutory or other legally applicable requirements. The term “payment” means any payment that is derived from Federal funds or other Federal sources or made by a Federal agency, a Federal contractor, or a governmental or other organization administering a Federal program or activity.

⁴ HUD's quality control rental assistance subsidy determinations studies provide national estimates of the extent, severity, costs, and sources of rent errors in tenant subsidies for the public housing agency-administered public housing and Section 8 Housing Choice Voucher and Moderate Rehabilitation programs and the owner-administered Section 8 and Sections 202 and 811 programs with project rental assistance contracts or project assistance contracts. There have been a total of seven HUD studies performed by the contractor, Policy Development Research, to date—the 2000 baseline and fiscal years 2003, 2004, 2005, 2006, 2007, and 2008 studies.

⁵Regulations at 24 CFR (Code of Federal Regulations) Part 990 establish a new formula for distributing operating subsidies to public housing agencies. The amount of operating subsidy that a public housing agency is eligible for is the difference between the formula expenses and formula income.

⁶Under EO 13520, agencies with high-error programs are required to establish semiannual or more frequent measurements for reducing improper payments. The supplemental measures are intended to provide more information on high-risk areas and report on root causes of errors that agencies can resolve through corrective actions.

to Circular A-123. In the accountable official report, HUD had only established supplemental targets for 1 year instead of 3 years as required.

- **Strengthen transparency of estimation methodology** – Because the statistical estimation methodology seeks to achieve two competing goals (pulling an equal number of tenants from each delivery system and accurately representing Section 8 subsidies as a whole), an external metric is needed to confirm the representativeness of the results. In pulling equal numbers, the sample selection method gives equal weights to each of the three Section 8 delivery methods (vouchers, public housing agencies, and private projects) despite the fact that they represent different numbers of clients (roughly 1.8, 0.9, and 1.3 million, respectively). The effects of this method are offset later with compensating weights applied to each tenant sampled. Given the interplay of factors affecting these weights, HUD needs a tool to confirm that their net effect is as expected.

The equal treatment of the three delivery systems may, to some degree, increase the prominence of urban counties during selection because urban counties make heavier use of public housing agencies, compared to their lesser role nationwide. Cross checks are needed to detect any significant urban tendency or possible effects thereof.

- **HUD’s assurance that improper payment monitoring controls⁷ are working** – A significant portion of HUD’s supplemental improper payment reduction strategy, which HUD established in response to EO 13520, was largely dependent on the monthly and quarterly monitoring plans. However, we found no evidence showing that HUD’s implementation of the monitoring plan had been tested or was being considered for testing as part of its annual OMB Circular A-123 assessment reviews. In accordance with OMB Circular A-123, it is HUD’s responsibility to establish effective internal controls over financial reporting⁸ and ensure that these controls are always working properly.
- **Overdue tenant recertifications** – HUD had no immediate plans to address any issue related to tenant overdue recertifications. In accordance with OMB Memorandum M-10-13, section B (2) (f), HUD should use “high impact” and “more control” as considerations when establishing supplemental measures. In our view, HUD should consider establishing new supplemental measures (in addition to what it already has) to address the issue of tenant overdue recertifications for the following reasons:

⁷ In response to EO 13520, HUD established monthly and quarterly monitoring plans, as supplemental measures, to identify areas in which technical assistance, guidance, and/or training may be needed to ensure the housing authority’s compliance with PIH requirements and the reduced occurrence of improper payments associated with the risk factors. HUD established six PIH supplemental measures (Public and Indian Housing Center reporting rate, Enterprise Income Verification (EIV) system rate, failed identity verification rate, deceased single member households rate, and income discrepancy rate) and four Office of Housing supplementary measures (EIV access rate, EIV usage rate, failed identification verification rate, and deceased tenant rate).

⁸ Part II, section B, of the circular defines internal controls over financial reporting as controls which ensure the safeguarding of assets from waste, loss, unauthorized use, and misappropriations well as compliance with laws and regulations pertaining to financial reporting.

- ✓ HUD's 2009 quality control for rental assistance subsidy determinations reported that 2 percent of the households/tenants living in PIH-administered housing projects had failed to submit their annual recertifications on time in the past 2 years and would not likely change unless HUD required housing authorities to tighten up their process in this area;
- ✓ HUD has the information system and infrastructure in place to identify and track those tenants with overdue recertifications, and, therefore, this issue is controllable with reliable data and appropriate data analytical techniques in place (more control); and
- ✓ Overdue recertifications produced rent calculation errors because rents used in the determination of rent subsidies were based on out-of-date information, and the potential dollar impact of improper payment risk could be significant in our estimation (high impact).

Conclusion

HUD generally complied with the annual reporting requirements of EO 13520, but improvements could be made. EO 13520 mandates that every Federal agency ensure that every effort is made to confirm that the right recipient receives the right payment for the right reason at the right time. To ensure the transparency and integrity of the program, HUD should consider full disclosure of the public housing error estimates in the performance accountability report and continue to strive to report its progress in reducing improper payment risks in its programs completely and accurately.

Recommendations

We recommend that the Chief Financial Officer

- 1a. Consider full disclosure of the error estimates related to public housing through a footnote disclosure in the performance accountability report and accountable official report to comply with the EO and OMB Memorandum M-10-13 requirements.
- 1b. Test the operating effectiveness of monitoring controls related to Office of Public Indian Housing and Office of Housing supplemental measures as part of HUD's annual OMB Circular A-123 assessment reviews.
- 1c. Establish and implement supplemental measures to address the ongoing issue of tenant overdue recertifications in the public housing and public housing voucher programs.

- 1d. Perform the required analysis to document its basis for arriving at annual and quarterly improper payment reduction goals and to establish 3-year supplemental targets to fully comply with EO 13520 and OMB Memorandum M-10-13.
- 1e. Strengthen the transparency of the estimation methodology by incorporating additional information or analysis into the HUD contractor quality control study's final report:
 - i. Provide a table of weights used to document that the results still mirror the proportions of the tenant groups within the population, given the quality control study's heavy use of sampling weights to offset uneven selection probabilities in the sample.
 - ii. Compare the proportions of urban versus rural tenants used in the sample with the proportion of the tenant population as a whole and if a difference is found, add a statistical test to determine whether these two tenant types have a different rate of error.

SCOPE AND METHODOLOGY

In response to section 3(b) of EO 13520, we conducted a limited scope review of HUD's annual compliance with the order and OMB Circular A-123, appendix C, part III. This order and OMB's implementing guidance require us to assess the level of risk associated with HUD's rental housing assistance program and to evaluate the reasonableness of HUD's program error rate estimation methodology, improper payment reduction plans, program access, and participation plans.

To complete this work, we interviewed appropriate HUD Office of the Chief Financial Officer officials, program representatives, and HUD quality control and income match studies contractors to gather sufficient information to evaluate HUD's plans. We reviewed HUD's performance accountability report for fiscal years 2007, 2008, and 2009 to validate the information reported in the accountable official's report for fiscal year 2010. We also reviewed the nature, timing, and extent of HUD's improper payment reduction strategies, internal control, policies, procedures, and practices to determine the reasonableness of the its plan. In addition, we reviewed applicable Federal laws, the executive order, and implementing guidance found in OMB Circular A-123, appendix C, that govern actions needed by the agency to address the issue of improper payments. We conducted our review from July to September 2010 at HUD's headquarters in Washington, DC.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

INTERNAL CONTROLS

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

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

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

Relevant Internal Controls

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

- HUD's improper payment internal controls, policies, procedures, and practices and
- Compliance with applicable IPIA laws and regulations.

We assessed the relevant controls identified above.

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

Significant Deficiency

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



APPENDIXES

Appendix A

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT WASHINGTON, DC 20410-3000 CHIEF FINANCIAL OFFICER	DEC 3 2008
MEMORANDUM FOR:	Thomas McEnany, Director, Financial Audits Division, GAF
FROM:	Douglas A. Criscitello, Chief Financial Officer, F 
SUBJECT:	OIG's Draft Report "Annual Evaluation of HUD's Compliance with Presidential Executive Order 13520, Reducing Improper Payments"
<p>This memorandum is in response to the subject draft audit report on HUD's Compliance with Presidential Executive Order 13520, Reducing Improper Payments. We would like to thank you for the time and effort you expended in providing us with your evaluation and conclusion that HUD is in compliance with the requirements of the executive order. Detailed comments addressing each of the draft recommendations are provided in the attachment. We would also like to provide you with the following comments for your consideration in finalizing your report.</p> <p>We do not agree with your assertion that PIH did not fully disclose erroneous payments in the Public Housing Rental Assistance Program. Program structure changes to the Public Housing program that occurred in January 2008, effectively eliminated all three types of improper payments previously reported by HUD. As a result of the change, errors were borne by the PHA and did not affect HUD's subsidy amount. Disclosing the PHA's error amount could result in misinterpretation and cause confusion as to the correct amount of HUD's improper payments.</p> <p>We also disagree with your suggestion for our Quality Control Study for estimating the amount of improper payments in our Rental Housing Assistance Programs. We do not believe that inclusion of the additional information on the estimation methodology would strengthen the transparency of the study's report. The study was designed to be a nationwide study and samples selected are representative of the population. Additional information is available upon request and has always been made available to the OIG.</p> <p>We would again like to thank you and your team for your work and suggestions to assist HUD's compliance with Executive Order 13520. Your assistance is appreciated and we look forward to working with you next year. If you have any questions, please contact Jerry Vaiana, Acting Assistant Chief Financial Officer for Financial Management on extension 8106.</p> <p>Attachment</p>	

**Detailed Comments on OIG's Draft Audit Report
"Annual Evaluation of HUD's Compliance with
Presidential Executive Order 13520, Reducing Improper Payments"**

Following are recommendations presented in OIG's draft report and our detailed comments:

Comment 1

- 1) Consider full disclosure of the error estimates related to public housing through a footnote disclosure in the performance accountability report and accountable official report to comply with the EO and OMB Memorandum M-10-13 requirements.**

CFO RESPONSE: Management does not concur with this recommendation. We are in compliance with the EO and OMB M-10-13 requirements. The error estimates related to public housing are not disclosed in the PAR or Accountable Official Report as a result of program structure changes. These changes were reviewed and accepted by OMB. These structure changes effectively eliminated all three previously reported types of improper payments due to Administrator, Income Reporting, and Billing errors for that program. The effect of these errors is borne by the PHA and HUD's subsidy payment remains unchanged. Nonetheless, HUD retains program oversight responsibility to ensure the proper performance and benefits of the program, and will continue to focus on effective measures to reduce performance errors by PHAs.

Comment 2

- 2) Test the operating effectiveness of monitoring controls related to Office of Public and Indian Housing and Office of Housing supplemental measures as part of HUD's annual OMB Circular A-123 assessment reviews.**

CFO RESPONSE: Management concurs. OCFO will request that the Office of Public and Indian Housing and Office of Housing include implementation of the supplemental measures monitoring plan as part of their annual OMB Circular A-123 assessment reviews.

Comment 2

- 3) Establish and implement supplemental measures to address the ongoing issue of tenant overdue re-certifications in the public housing and public housing voucher programs.**

CFO RESPONSE: Management concurs with this recommendation. However, this supplemental measure will be classified as "for internal purposes only". The current supplemental measures which are reported to the general public were established and approved by OMB during FY 2010. OMB requested that we limit our supplemental measures to five. As such, this issue will be addressed internally.

Comment 3

- 4) Perform the required analysis to document its basis for arriving at annual and quarterly improper payment reduction goals and to establish 3-year supplemental targets to fully comply with EO 13520 and OMB Memorandum M-10-13.**

CFO RESPONSE: Management does not concur with this recommendation in its entirety.

PHI has monitored risk areas which impact improper payments for several years now and has documented statistics showing the historical trend related to these risk areas. As such, the

Comment 3

annual and quarterly improper payment reduction goals associated with the newly established and implemented supplemental measures during FY 2010 – **as approved by OMB** (after review, consultation, and negotiation), were determined based on the historical data and took into consideration that 100% goals were unrealistic and established a minimum acceptable level of deficiency. Based on the analysis of fiscal year end results, PIH has established 3-year supplemental targets for fiscal years 2012-2014, in addition to the target goals for FY 2011.

It should further be noted that for the first time, PIH now has a dedicated team to focus on the monitoring of high risk areas that cause improper payments and implement corrective actions to reduce current improper payments and prevent future improper payments.

Multifamily Housing is currently working on establishing 3-year supplemental targets and documentation to support its basis for choosing its supplemental targets.

The OCFO will provide upon request the documentation for its basis for arriving at annual and quarterly improper payment reduction goals for PIH and Multifamily Housing (once established).

5) Strengthen the transparency of the estimation methodology by incorporating additional information or analysis into the HUD contractor quality control study's final report:

- i) Provide a table of weights used to document that the results still mirror the proportions of the tenant groups within the population, given the quality control study's heavy use of sampling weights to offset uneven selection probabilities in the sample.**
- ii) Compare the proportions of urban versus rural tenants used in the sample with the proportion of the tenant population as a whole and if a difference is found, add a statistical test to determine whether these two tenant types have a different rate of error.**

CFO RESPONSE: Management does not concur with this recommendation. The QC study was designed to be national in scope and the samples selected are representative of the selected populations. We believe that it would be imprudent to publish the table of weights with the final report; however, we will make that information available on demand. The table of weights has always been made available to the OIG. The mandate of the QC is not to study rate variations by regions or by any other factor(s). The goal of the study is to derive a national estimate of the nature and the size of the improper payment error rate. Further, we are also bound by the scope of work as contracted.

Comment 4

OIG Evaluation of Auditee Comments

- Comment 1** The intent of the Presidential Executive Order (EO) 13520, in addition to identifying and eliminating significant improper payments, was to adopt a comprehensive set of policies including transparency to allow public scrutiny of significant improper payments throughout the Federal government. While we agree that HUD is in general compliance with EO 13520 and OMB M-10-13, footnote disclosure of the error estimates related to public housing in the PAR or Accountable Official Report will result in the required transparency contemplated by EO 13520.
- Comment 2** HUD OIG recognizes the Department's concurrence with these recommendations and the agreement to implement them.
- Comment 3** HUD OIG acknowledges the Department's successful efforts at reducing improper payments. However, the requirement for disclosing the analysis used to arrive at the annual and quarterly improper payment reduction targets is in OMB Memorandum M-10-13, dated March 22, 2010, section B(2)(k) and is consistent with the intent of EO 13520 which is to provide transparency.
- Comment 4** The inclusion of additional information or analysis into the HUD contractor quality control study's final report as detailed in the audit recommendation will not only enhance the understanding by HUDOIG, but all of the intended users of the report. Additionally, disclosure of this additional information allows the error estimation process to be open and transparent which is consistent with the intent of EO 13520.