

Agency Comments on Disclaimer of Opinion



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
THE DEPUTY SECRETARY
WASHINGTON, DC 20410-0050

February 29, 2000

MEMORANDUM FOR: Susan Gaffney, Inspector General

FROM: Saul N. Ramirez, Jr.

A handwritten signature in black ink, appearing to read "Saul N. Ramirez, Jr.", written over the printed name.

SUBJECT: HUD comments on OIG Audit of HUD's FY 1999 Financial Statement

These comments are for publication in the OIG's final report on HUD's Fiscal Year 1999 Financial Statement.

The Office of Inspector General (OIG) is declining to issue an audit opinion on HUD's FY 1999 Financial Statements. OIG's failure to issue an audit opinion is wrong on the merits, violates professional standards and audit guidelines, and demonstrates bad faith by the OIG. HUD rejects the OIG audit report.

The OIG asserts that an audit opinion is impossible because of a purported lack of progress in reconciling HUD balances with Treasury's reporting balances. As the OIG is well aware, the reconciliation process was occasioned by HUD's upgrade to a new general ledger system as part of its ongoing modernization of its financial management systems -- an action recommended by both OIG and GAO. More importantly, OIG has known since September of last year how HUD proposed to deal with the reconciliation process after the upgrade to the new system, but *never* suggested that HUD's plan would necessitate a disclaimer from the OIG, despite weekly meetings between HUD staff and OIG auditors. Instead, in violation of professional audit practice, OIG waited until the eleventh hour to advise HUD that this would be the primary basis for a disclaimer. Then, again in violation of audit procedures and despite the OIG's written assurance to the contrary, repeated efforts by HUD staff and OMB officials to present the necessary information were rejected by the OIG. An OMB official responsible for reviewing the audit process has stated that the Inspector General's actions were a clear departure from the usual practices followed by Inspectors General.

Following are HUD's general objections to the OIG audit process:

- **OIG was fully advised for months of HUD's plans for handling reconciliations and never objected**

As the OIG is aware, HUD undertook a major financial systems restructuring last year with the creation of the HUDCAPS accounting system. Part of this effort contemplated converting data from the old PAS accounting system to the new HUDCAPS general ledger. During this process, HUD prepared cash [SF-224] reports to the Department of the Treasury. The fund balances as reported by Treasury reports were in turn audited successfully by the General Accounting Office. After HUDCAPS went on-line in May of 1999, HUD began converting financial data contained in PAS to HUDCAPS. Based on OIG's participation in weekly Department-wide senior management staff meetings dating back to September of 1999 during which the financial conversion process was discussed in detail, OIG has long known that HUD will complete the necessary reconciliations in the next few months. During all that time, OIG never indicated that this process would prevent the issuance of an unqualified opinion. OIG has now, at the eleventh hour, taken the position that the current state of the HUDCAPS, PAS and Treasury reporting balances reconciliation process precludes OIG from expressing an opinion on HUD's financial statements. OIG's belated position on this issue is unfair to the agency and, as a matter of professional auditing standards, substantively incorrect.

- **OIG can indeed express an unqualified opinion on the financial statements.**

Ever since the OIG advised HUD for the first time on February 23, 2000 that it may not be able to express an unqualified opinion on the financial statements, HUD has undertaken substantial efforts to assess its fund balance with Treasury to ensure that agency records agree with those that are officially kept by Treasury and audited by GAO. HUD has assembled documented support for HUDCAPS reconciliation differences to provide OIG with auditable information to further alleviate OIG's concerns. As a result, HUD has the information that will enable the completion of the audit and stands ready to present it to OIG, OMB and GAO.

- **OIG has refused to receive HUD's documentation, or even meet with agency, OMB or GAO officials.**

HUD has made repeated efforts to convey the information necessary to complete the audit. As the Secretary's designated CFO representative discussed with OIG auditors James Heist and Kathy Kuhl Inclan, HUD stands ready to present OIG with additional documentation her staff has obtained which supports HUD's receipt of an unqualified audit opinion as well as information concerning the fund balance reconciliations which identify and explain our outstanding differences with Treasury. However, these senior OIG audit staffers refused to meet with the agency's Chief Financial Officer representative at all on Friday, February 25, 2000, stating that OIG's work was done, the audit was completed and there was no time to do any further work. The next day, Mr. Heist persisted in his refusal to meet with the Secretary's CFO representative when she again endeavored to explain HUD's reconciliation work.

Even when senior HUD officials spoke directly to OIG officials on Monday, February 28, 2000 -- at a meeting arranged but not attended by OMB due to OIG's insistence that OMB and

GAO not be present – Ms. Kuhl Inclan and Mr. Heist unequivocally refused to engage in a substantive conversation regarding the fund balance reconciliations. OIG was **not** willing to consider the reconciliations as part of OIG’s audit report because in Ms. Kuhl Inclan’s words (spoken two days **before** the March 1 deadline) “the audit has already been completed” – belying the written statements in the draft report of February 25th which characterized the OIG’s audit work as “ongoing.”

The OIG’s refusal to cooperate has left the agency in a tenuous position -- with only days to go before an audit deadline, the OIG has again violated the fundamental professional practice of timely communication and cooperation with a client. Entreaties from the General Accounting Office and the Office of Management and Budget to urge the OIG to participate in the audit process in a professional manner have not persuaded OIG staff to properly consider the information that OIG itself has requested.

- **OIG has clearly violated Generally Accepted Auditing Standards**

Despite HUD’s good faith efforts at reconciling our differences, the OIG has persisted in refusing to comport with the generally accepted auditing standards. For example, the Statement on Auditing Standards Section 325, entitled “Communication of Internal Control Related Matters Noted in an Audit,” states at paragraph 18: “Because timely communication may be important, the auditor may choose to communicate **significant matters during the course of the audit** rather than after the audit is concluded. The decision on whether an interim communication should be issued would be influenced by the **relative significance of the matters noted and the urgency of corrective follow-up action.**” (emphasis added)

There can be no more “significant matters” than those which might lead to a disclaimer regarding a client’s financial statement. OIG and HUD had conducted audit meetings since September of 1999 during which time all matters were discussed – including HUD’s efforts to reconcile accounts information submitted monthly to Treasury as audited by GAO to HUDCAPS. At no time during this process did OIG suggest that this issue could preclude an unqualified opinion. Indeed, on February 28, 2000, Ms. Kuhl Inclan conceded as much in her conversations with senior HUD officials.

Notwithstanding the significance of this matter and the professional obligation of timely communication, OIG did not inform HUD until February 23, 2000 – **one week** before the March 1, 2000 deadline – that OIG would refuse to express an opinion regarding HUD’s financial statements due to the fund balance reconciliation issue. Once HUD was belatedly advised that its reconciliation process – which OIG has been aware of for several months – was being cited as the basis for a threatened disclaimer only a week before the audit deadline, HUD aggressively pursued a solution. Recognizing the urgency of taking corrective action, HUD has done so. Yet OIG officials refuse to audit this work.

- **The OIG’s refusal to issue an audit opinion will impose significant additional costs on taxpayers.**

The OIG’s failure to comply with audit requirements will force HUD to incur more costs, as taxpayer funds will have to be directed toward a re-audit of HUD’s financial statements in order

to establish a beginning balance for FY 2000. In order to alleviate further problems, HUD intends to pursue a process which is genuinely independent, and free from bias and political influences. Until this documentation is audited, the audit of HUD's financial statements is not complete and OIG has improperly refused to issue an audit opinion. When HUD's financial statements are in fact completely audited and a draft audit report is provided to the agency, HUD will provide comprehensive comments in response to that report. In the meantime, HUD will seek an objective, independent review of the agency's financial statements.

- **The conduct of OIG reflects bad faith**

Had OIG expressed its inability to render an opinion sooner than a week before the audit deadline and two days before its draft report, HUD would have been able to provide the OIG with the information necessary to complete the audit well before now. Yet despite an auditor's duty to communicate significant matters to a client so that, as here, corrective actions may result; despite OIG's eleventh-hour insistence that review of this information is a condition precedent to auditing HUD's financial statements; despite HUD's timely provision of support for reconciliation differences to further alleviate OIG's concerns; despite the fact that the audit period has yet to expire; despite several efforts by HUD, OMB and GAO to urge OIG to continue -- not foreclose -- the audit process, OIG continues to insist that the audit process is over, the report published, the matter concluded. There appears to be no rational basis for OIG's refusals, leading to the obvious inference that the OIG has no intention of discharging its responsibilities in accordance with the professional practices as referenced above and further outlined in OMB Bulletin No. 98-08: Audit Requirements for Federal Financial Statements.

These actions by the OIG renew questions about the Inspector General's impartiality and objectivity. Just two weeks ago, the Inspector General testified before a Congressional committee regarding OIG's most recent audit of the agency. One member of Congress found the Inspector General's written testimony to be "unprofessional" and "overly personalized". The Congressman went on to say, "I believe we can make more progress if all concerned can regard your assessments as objective, balanced and fair." Another member criticized the tone of the Inspector General's testimony as "snide." This is not the first time that OIG actions have come under Congressional scrutiny. Many members of Congress have raised questions about the Inspector General's ability to render fair assessments of HUD management actions, and the apparent politicization of the audit process. Indeed, the Inspector General and OIG senior audit staff are currently subject to several Congressional reviews and an investigation by the President's Council on Integrity and Efficiency regarding the OIG's injection of politics into the audit process. By discarding professional audit guidelines and departing from generally accepted audit practices, the OIG only further raises doubt about the credibility of its audit process.

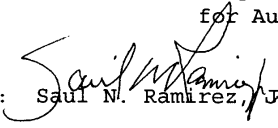
Agency Comments on Draft Internal Control and Compliance Report



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
THE DEPUTY SECRETARY
WASHINGTON, D.C. 20410-0050

FEB 18 2000

MEMORANDUM FOR: Kathryn Kuhl-Inclan, Assistant Inspector General
for Audit, GA

FROM:  Saul N. Ramirez, Jr., Deputy Secretary, SD

SUBJECT: Draft Report on HUD's Fiscal Year 1999 Financial
Statements - Internal Control and Compliance
Sections

Thank you for the opportunity to provide comments on the subject document, in accordance with your request of February 9, 2000. The rigor of the independent annual financial statement audit process is valuable in determining the adequacy of HUD's financial management practices, and in identifying areas of needed improvement.

Departmental management generally agrees with the draft report's conclusions on the state of HUD's internal controls and compliance for the fiscal year (FY) 1999 period of the audit. However, we found that the substantive progress made towards correcting the long-standing material weaknesses and reportable conditions cited in OIG's FY 1998 audit report is obfuscated in the FY 1999 draft audit report by:

- broad negative captions and statements that aren't supported by the details and specific conclusions contained in the report,
- frequent, and often lengthy, references to past problem statements, with an unbalanced presentation of details on specific corrective actions taken to improve HUD's general control environment and controls in major program areas, and

- a need for further acknowledgment of known subsequent events to address material weaknesses and reportable conditions that existed in FY 1999.

For example, our analysis of the OIG's current position on the 8 material weaknesses and 12 reportable conditions from the FY 1998 audit, as summarized in Attachment No. 1, is contrary to the draft FY 1999 report's lead summary statement that: "*Most of the material weaknesses and reportable conditions discussed in this report are the same as those included in prior years' reports on audits of HUD's financial statements.*" While this is a misleading statement from a pure numbers perspective, we are more concerned that this and other broad negative statements in the draft are misleading from a substantive perspective.

In several open weakness areas, OIG focuses on the facts that either old program processes were not fully carried-out as interim processes in FY 1999, or that new processes were not yet implemented or fully implemented in FY 1999, but fails to comment on the adequacy of the major structural changes put in place in FY 1999 to address these control weakness areas for the future. For example, a common theme in several of the open material weakness and reportable condition issues discussed in the draft is that HUD's internal control systems do not provide reasonable assurance that:

- housing quality standards are met,
- program beneficiaries and costs are in accordance with tenant income eligibility requirements, and
- other program statutory and regulatory requirements are adhered to.

In this context, the draft report gives insufficient recognition to the fact that HUD's new physical inspection processes were clearly established and substantially applied to a large portion of HUD's housing portfolio during FY 1999, with a full baseline on HUD's housing portfolio nearly complete in February 2000. The design of HUD's large-scale tenant income computer matching verification process was substantively completed in FY 1999, with full implementation planned for FY 2000. Regarding the multifamily financial compliance and performance assessment processes, the system was in production to collect financial statement information in FY 1999, and the assessment, compliance referral and follow-up aspects of the

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system and process were completed and placed into operation in early FY 2000. The four components of the Public Housing Assessment System (PHAS) were also substantively developed, tested and used in FY 1999, with full implementation scheduled by regulation for mid-FY 2000. I ask that these and other substantive FY 1999 accomplishments and known subsequent events be put in proper perspective, in terms of strengthening HUD's internal control systems.

Further detailed comments on the draft report are provided for your consideration in Attachment No. 2. I look forward to your final report. If your staff should have any questions on our comments, please have them contact James M. Martin, Deputy Assistant Chief Financial Officer for Financial Management, on 708-0614 extension 3706. Should you need any further information to fully complete your audit process by the statutory deadline on March 1st, please do not hesitate to contact me directly.

Attachments

Attachment No. 1

**COMPARISON OF OIG & MANAGEMENT POSITIONS ON
MATERIAL WEAKNESSES & REPORTABLE CONDITIONS
February 18, 2000**

1998 OIG/FMFA Status	1999 OIG Draft Position Per Consolidated F/S Audit	1999 Management FMFA Position
MW1 - Financial Management Systems	MW1 - Retained	MW1 - Retain/Report/Track
MW2 - Resource Management	Eliminated*	MC1 - Downgrade/Report/Track
MW3 - Tenant Income Verification	MW2 - Retained	MW2 - Retain/Report/Track
MW4 - MF Monitoring	MW3 - Retained	MW3 - Retain/Report/Track
MW5 - FHA Resource Management	Eliminated (Dropped from FHA)	Combined with MC1
MW6 - FHA Early Warning/Loss Prevention	Dropped (Still an FHA RC)	MC2 - Downgrade/Report/Track
MW7 - FHA Federal Basis Accounting	Combined with MW1 (FHA MW)	Combine with MW1
MW8 - FHA Financial Management Systems	Combined with MW1 (FHA MW)	Combine with MW1
RC1 - Management Control Program	Eliminated*	MC3 - Retain/Report/Track
RC2 - Performance Measures	RC1 - Retained	MC4 - Retain/Report/Track
RC3 - Project-Based Subsidy Payments	RC2 - Retained	MC5 - Retain/Report/Track
RC4 - PHA Monitoring	RC3 - Retained	MC6 - Retain/Report/Track
RC5 - CPD Monitoring	Dropped	
RC6 - General Systems Security	RC4 - Retained	MC7 - Retain/Report/Track
RC7 - Personnel Security Over Systems	RC5 - Retained	MC8 - Retain/Report/Track
RC9 - Obligation Balances	RC6 - Retained	MC9 - Retain/Report/Track
RC10 - MF Notes	Dropped	
RC11 - SF Property Inventory	Dropped (FHA RC)	MC10 - Retain/Report/Track
RC12 - FHA Systems Controls	Dropped	
--	(FHA RC Added on SF Notes)	MC11 - Retain/Report/Track
8 - Material Weaknesses (MW)	3 - Material Weaknesses (MW)	3 - Material Weaknesses/ Nonconformances
12 - Reportable Conditions/Management Concerns (RC or MC)	6 - Reportable Conditions(RC) 3 - FHA RCs	11 - Management Concerns (MC)
20 - TOTAL Focus Areas	12 - TOTAL Focus Areas	14 - TOTAL Focus Areas

*- OIG's draft report indicates they no longer consider HUD's resource management issue as having a material impact on the financial statements, but caution that resource management deficiencies limit HUD's ability to provide adequate controls to address material weaknesses and reportable conditions in other areas.. They reference the need to complete or fully implement ongoing corrective actions to strengthen resource management.

** - The difference between the remaining 12 Total OIG items and the 14 Total management items is that management will continue to report and track further corrective actions on the Resource Management and the Management Control Program activities as MCs.

Attachment No. 2

Detailed Comments on OIG Draft 1999 Internal Control & Compliance Report

Comment Number	Draft Report Reference	Management Comments for OIG's Consideration
1.	Page 1, Side-Caption	Revise the side caption to read "HUD Improves Its Control Environment" or "HUD Continues to Address Weaknesses in the Control Environment," to better reflect progress made and OIG's conclusions to eliminate or downgrade some MWs
2.	Page 1,	The first paragraph and related 4 bullets are repeated verbatim from the 98 audit summary of HUD's control environment, and do not attempt to fully or fairly reflect the progress made in carrying-out HUD's reform plans and specific corrective actions in 99. Suggest the whole section be revised to simply state what OIG's FY 98 audit indicated HUD needed to do in 99, and then summarize OIG's assessment of progress made in 99. From management's perspective, we have completed planned organizational changes, improved financial management and program systems support for operations, and made substantive progress in carrying-out operational changes to strengthen controls over major programs, within existing resource constraints.
3.	Page 2, Side-Caption	<p>Revise the Material Weakness heading to read: "HUD's Financial Systems are Not Fully Compliant with Federal Financial Standards"</p> <p>As general comments on this captioned section, give the Department credit for FY 99 activities to improve systems consolidation and advance the Financial Systems Integration plan. These activities could not begin until after FY 98 financial records were closed and mock testing/production simulation on the closed out FY 98 records could be completed, leaving, in effect, a massive undertaking to be accomplished in less than 9 months. These activities included the conversion of FY 98 ending balances of the Program Accounting System (PAS) general ledger to HUDCAPS under a Departmental Standard Budget structure that includes source year accounting; the conversion of existing FY 98 year end HUDCAPS subsidiary records for Section 8 to the new HUDCAPS general ledger and budget structure; posting of all held FY 99 PAS transactions to HUDCAPS through the new interface in a "catch up" mode; conversion of subsidiary support for Housing's Section 8 ACC contracts from PAS/LOCCS to HUDCAPS; the conversion of remaining PAS subsidiary records data structure to support Budget Fiscal Year (BFY) accounting requirements of HUDCAPS and Hyperion Enterprise application "rebuild" to import and use general ledger data from HUDCAPS in the new source year accounting structure</p>
4.	Page 2, 3 rd , 4 th & 5 th paragraphs	Delete paragraphs 3, 4 and 5, related to historical perspectives on HUDCAPS, as unnecessary and not related to the 99 audit.
5.	Page 3, 1 st Paragraph, 1 st Sentence	Revise the sentence to read: "We have determined that, as implemented, the HUDCAPS core financial system does not fully comply with federal financial system requirements, due to the lack of FHA financial data integration." - to clarify the nature and scope of the noncompliance issue.
6.	Page 4, Last Paragraph	Consolidate issues concerning the PAS/HUDCAPS interface in the section titled "PAS to HUDCAPS Interface" at the bottom of page 40.

7.	Page 5, 1 st Paragraph, Last Sentence	Delete the sentence that starts “In spite of time saved...” as the CFO’s preparation of financial statements is not affected or delayed by when the actual system closing is run.
8.	Page 5, 3 rd paragraph	Keep the lead sentence and replace the remainder of the paragraph with the following: “FHA should work with the Department to correct FHA's general ledger and financial system weaknesses. This joint solution should ensure that FHA is able to perform federal basis financial reporting and proprietary, budgetary and cost accounting. In addition, it should enable FHA to fully comply with the Federal Credit Reform Act. FHA and the Office of the Chief Financial Officer have already begun developing the requirements and implementation plan.”
9.	Page 5, Last paragraph	Remove reference to Travel Management system as a change in scope of the FSI project. Travel management system has been a part of FSI and its predecessors from beginning as demonstrated by its inclusion in the Administrative Accounting system configuration requirement document, page 8-1, dated December 1993.
10.	Page 5, Last paragraph	Delete sentences 4 and 5, given that the Office of Administration has not assumed responsibility for the GMS and EIS from the FSI Project Team.
11.	Page 5, Last paragraph	Regarding the sentence that ends: “... hired a contractor to assist the Department in another effort to redefine the FSI strategy.” - provide clarification that GAO made a finding that the Department did not have a strategy to complete the FSI project and recommended that the Department complete one. As part of the effort to update the FSI project benefit cost study, the Department is also asking for strategy options to be developed so that HUD can make a decision on the most effective and efficient strategy.
12.	Page 5, New Section	Subsequent to OIG’s release of its 2/9/00 draft report, a new finding section was added and provided to management on “Difficulties with FSI implementation prevented proper reconciliation of fund balance with Treasury accounts.” We will respond separately to this new section.
13.	Pages 6-10	Suggest the discussion on resource management and the Management Control Program activities be combined as part of the Internal Control Environment section, given that these areas are no longer separately reported as MWs or RCs. Having separate captioned sections on these areas is confusing, given that all other captioned sections pertain to MWs or RCs.
14.	Page 6, Side-Caption and Related Narrative	<p>The current wording of the side-caption contradicts the OIG’s own conclusion that “HUD 2020 organizational changes are complete...” A more appropriate side-caption would read: “Organizational Changes were Completed to Improve Resource Management.”</p> <p>As a matter of general comment, this whole section should be revised to delete unnecessary historical references and prior OIG report language, and to more clearly focus on what has actually been done and what OIG sees as remaining to be done for HUD to better manage its resources to provide adequate controls. In this regard, OIG should acknowledge and comment on management’s basic strategic objective of increased reliance on automated and remote monitoring techniques, and use of risk-based targeting of HUD’s limited staff resources. The Business and Operating Plan process has also been a significant effort in providing greater accountability at HUD.</p>
15.	Page 6, 1 st paragraph, 2 nd sentence	Delete this sentence as irrelevant. The HUD 2020 Plan has been HUD’s comprehensive strategy to better manage its resources since June 1997, and all elements of the strategy have been put in place and substantively carried-out.

16.	Page 6, 2 nd paragraph, Next to last sentence	Management disagrees with the second half of the OIG's primary conclusion statement on HUD 2020 Reforms, that: "...the major substance of the reform changes, i.e., business/operational changes, is still under development." To the contrary, all aspects of the reform changes have been "developed," and most are in operation and at least partially implemented as of FY 99 or the first part of FY 2000.
17.	Page 7, 1 st bullet paragraph, 2 nd sentence	The bolded heading is misleading and the heading and narrative should be revised to more accurately reflect the fact that REAC has been completely implemented to provide for assessments of the overall physical and financial condition of HUD's housing portfolio. The physical inspection subsystem and process has been operational since October 1998, and a full inspection baseline on the entire public, multifamily and assisted housing property portfolio is nearly complete. Immediate actions were taken on over 10,000 identified life-threatening health and safety violations, and field and Enforcement Center (EC) staff have been acting on projects with low scores. The multifamily financial assessment subsystem was completed in FY 1999, and is now fully operational, with completed assessments and released results on 10,959 projects to date, including 89 compliance deficiency referrals to the EC and another 1,245 referrals to MF field staff. On the public housing side, all four subsystem components of the new Public Housing Assessment System (PHAS) are complete and operational, and producing advisory scores for PIH. The delay in the full implementation of the PHAS was a result of Congressionally mandated industry consultations. Although the PHAS scores are advisory for the first two quarters of FY 2000, the reviews are being done and scores are being generated for field office monitoring purposes.. While the implementation of some of these activities was subsequent to the end of FY 1999, we ask that OIG reflect this known progress in its report.
18.	Page 7, 2 nd bullet,	<p>Add the following sentence (before the last sentence in the second paragraph beginning with, "In addition, delays were encountered..."): "Much of this increase can be attributed to a rise in FY 1999 claims and the start-up time required by the contractors."</p> <p>Also, consider the following general comments: The IG is very critical of FHA's performance in selling REO properties in FY 1999, quoting a draft KPMG audit report that notes growth in the REO inventory during FY 1999. However, the IG fails to acknowledge substantial improvement in several key property disposition performance indicators that also occurred in FY 1999. Once the M&M contractors were fully operational, they sold properties at a higher price and generated higher returns than under the old system. In fact, over the first six months of operation, M&M contractors sold properties at an average price equal to 25 percent higher than one year ago under the old system, and generated an average of 67 percent recovery on claim, an increase of more than 10 percent over the average recovery one year prior. These positive trends were acknowledged in the same KPMG draft audit quoted by the IG.</p> <p>Moreover, the M&M system continues to produce positive performance results. In the first quarter of the current fiscal year, FHA sold more than 20,000 properties, a record pace in sales.</p> <p>Furthermore, in addition to noting this important progress in improving program performance, KPMG also acknowledged that FHA's extensive monitoring and control system for the M&M contracts was effective in detecting problems with one major contractor, and enabled the Department to take appropriate actions to</p>

		<p>terminate those contracts. Since implementation of the M&M initiative in March 1999, FHA has inspected the condition of ten percent of the entire property inventory on a monthly basis, audited ten percent of all property case files and generated a number of daily and weekly property listing, sales and closing reports. This comprehensive and effective monitoring system detected problems with one major contractor immediately upon start of the new initiative, and enabled the Department to take appropriate action, terminating those contracts just five-and-a-half months into the contract period.</p>
19.	Page 7, 3 rd Bullet	<p>Delete the last paragraph on page 7 emphasizing that HUD must finalize and implement plans to permanently organize and staff a Departmental income verification program. REAC, at Headquarters, has staffed a permanent income verification program, and developed and implemented an automated system to facilitate large-scale computer matching income verification. Further, REAC is permanently organizing and staffing income verification functions in the Field. REAC staff completed in February 2000 labor union negotiations for the transfer of over 40 HUD staff in the Chicago and Seattle Income Verification Centers from the Office of Public and Indian Housing to the REAC. These employees, most of whom will be designated quality assurance analysts, will provide overall support for the large-scale computer matching income verification function. Further, REAC has hired one Field auditor, and has published, through the Office of Human Resources, position vacancies for the hiring of additional auditors who will conduct reviews of the effectiveness of public housing agencies, owners and agents (collectively referenced as POAs) in resolving income discrepancies.</p> <p>REAC auditors and quality assurance analysts will monitor POAs' effectiveness in resolving income discrepancies. The POAs will use an automated template to report quarterly on income discrepancy resolution actions. The automated reporting template, which will be standard for all rental assistance programs included in the large-scale matching program, has been developed and tested and will be deployed in March 2000. REAC auditors and quality assurance specialists will use the POA-reported information in planning Field reviews of POAs.</p>
20.	Page 8, Side captioned section	<p>The major procurement reforms cited by the OIG have all been implemented since March 1998 when the CPO function was created. At that time, HUD contracting was considered as a material weakness based on the scope of problems found in the IG's September 1997 report (97-PH-163-0001). In a little over one year later, the National Academy of Public Administration found that "...a series of actions by HUD have resulted in substantial progress towards the goal of developing and implementing a model procurement system" (April 1999 NAPA Report: "HUD Procurement Reform: Substantial Progress Underway"). The broad conclusion now drawn by the Inspector General that "...HUD's overall contracting attitudes and practices had not changed significantly" overlooks the significance of the real strides that have been made and which were acknowledged in very IG report (99-PH-163-0002) used for reference. In the second paragraph of the Executive Summary to that Report, the IG stated "The Department's reform initiatives have laid the groundwork for an effective acquisition process" and later characterized the CPO's efforts as "encouraging". Since the OIG's draft Internal Control & Compliance Report provides no specific support for the broad negative conclusion, it appears unbalanced and unfair.</p>
21.	Pages 9 & 10	<p>The CFO provided comments on the Management Control Program section of the report directly to the OIG under separate cover.</p>

22.	Page 11, 1 st Bullet	The bullet needs to be revised to recognize the actual status of HUD's physical inspections and the availability of data to measure compliance with housing quality standards. The full baseline is nearly complete.
23.	Page 11, 3 rd Bullet	The last sentence should be corrected to state that official PHAS scores will be generated for PHA fiscal years ending 3/31/00, and thereafter.
24.	Pages 13-17,	<p>Material Weakness: "HUD Needs to Do More to Ensure Subsidies Are Based on Correct Tenant Income" -- Given that OIG acknowledges that "various legal, technical, and administrative obstacles exist that impede HUD, HAs and project owners from ensuring tenants report all income sources during the certification and recertification process." (page 14), and given that OIG cites no other practical alternatives to the HUD developed techniques that operate within existing legal constraints to facilitate the detection, correction, prevention and deterrence of many problems, the OIG's MW caption and much of the discussion of this issue seem unfair and unbalanced, given the substantial actions taken to resolve this MW:</p> <ul style="list-style-type: none"> • a large-scale computer matching income verification program has been implemented; REAC started sending letters to tenants on February 16, 2000, and a large-scale roll-out will start on March 1, 2000, • nationwide computer matching programs have been implemented to provide social security and supplemental security income verification to housing agencies, owners and agents for tenants due recertifications. <p>The section contains numerous statements that unfairly diminish the extent of HUD's progress. For example, the reports states:</p> <ul style="list-style-type: none"> • adequate information technology and human resource infrastructure to support a large-scale matching effort had not been sufficiently developed and implemented (REAC has addressed both of these issues) • the present large-scale matching methodology has not yet been fully tested (significant tests of the computer software has occurred) • the human resource infrastructure has not been fully implemented (REAC has addressed this issue; albeit, full implementation has not occurred) • the current methodology has not been fully tested (significant testing of computer software has occurred and other small scale projects have been conducted using nearly the same methodology) • tenants may receive an income discrepancy letter in error (we acknowledge that this will occur give significant variance in rental assistance program; notwithstanding, REAC has taken actions to minimize the problem, e.g., annualizing household income for use in comparisons to calendar year Federal tax information, using high income thresholds, and providing clear instructions to POAs that will minimize the burden of false positives.) • the project is already more than four months behind its implementation schedule (the system produced matching results in December 1999; REAC, at the request of the Office of Public and Indian Housing, and the Office of Housing deferred sending matching results pending initiation of a training program for POAs, and resolution of issues concerning a Guide containing instructions for resolving income discrepancies.) <p>REAC's full comments on this issue will be provided to the OIG.</p>
25.	Page 16, 1 st full paragraph	<p><i>The income discrepancy thresholds should not be disclosed in the OIG report</i></p> <p>The thresholds should not become public because tenants knowledgeable of the thresholds could in subsequent years avoid detection of underreported income amounts if they know the established threshold used in computer matching. REAC may (or may not) change the thresholds in subsequent years.</p>

26.	Page 18, 1 st side captioned section	<p>This section requires clarification and correction. The April 1, 1998, signed agreement between PIH and the Office of Housing approved a staffing limit of up to 25. It was never anticipated that the voucher processing function would have 25 staff when it was reassigned to the FMC. The April 1998 protocol indicated that the transfer would provide for staff to "...continue to perform their current duties...". The VPC was staffed at the level of 11.</p> <p>The second paragraph is incorrect in stating that the FMC terminated post payment reviews in the first quarter of 1998 and LOCCS reconciliations in the second quarter. In FY98, the voucher processing function was not at the FMC, but still remained at Multifamily Housing. Those actions discussed were taken by MF Housing.</p>
27.	Page 18, Last paragraph	<p>While citing a significant increase in prepayment reviews, the draft report only focuses on the need for increased staff to perform reviews. Yet the report provides no evidence that increased staffing is needed, nor does it offer any specific target for what an adequate number of reviews would be. The report should recognize that the cited increase in prepayment reviews of more than 125% improved HUD's controls over the payment of Project-Based Section 8 contracts.</p>
28.	Page 19, 3 rd full paragraph	<p><i>The post voucher review selection threshold should not be identified in the report, so as not to let owners know tolerable limits they can go down to.</i></p>
29.	Page 19, Last paragraph	<p>The Audit Report attributes the lack of sanctions partly to the existence of some confusion on the part of staff as to who is responsible for this action. This is incorrect. Payments are not suspended because the Office of Housing has not yet finalized a final policy to do so. The FMC, Housing and PD&R have worked on a draft notice concerning suspensions for under-reporting, but it has not yet been issued. Sanctions are more problematic for these contracts because, unlike the situation with ACCs, where we can reduce the HA/CA administrative fee for poor performance, LOCCS only allows us to release the entire payment or hold the entire payment.</p> <p>The OIG is in error in the paragraph stating that the FMC intends to impose sanctions once our automated program for comparing vouchered units to tenant data is in place. The FMC does not have the authority to suspend MF Housing's payments until Housing issues a policy providing FMC that authority.</p>
30.	Page 21, 1 st paragraph	<p>The second sentence, "Weaknesses exist in HUD's control structure..." and this overall section, do not fairly recognize the significant changes made to improve HUD's "structure" for monitoring both insured and subsidized multifamily projects. While those structural changes may not have been fully implemented or applied to all projects in the portfolio as of the end of 1999, they were significant achievements in 1999, and will serve to mitigate risks and eliminate weaknesses in this area in FY2000 and beyond. (see related comment 16, above)</p> <p>Based on the marked improvement the Office of Housing has made in monitoring its multifamily portfolio, mainly through implementation of HUD 2020, Housing no longer considers project monitoring to be a Material Weakness.</p> <p>Under the HUD 2020 reforms, the most important monitoring of Project-Based Section 8 properties is now identical to the monitoring of FHA-insured properties. This unified REAC inspection system, including follow-up by multifamily field offices, was fully implemented during FY 1999, and a complete inspection of the</p>

		<p>multifamily portfolio was well underway. Based on this progress, the draft audit for FHA has downgraded what had been a Material Weakness on project monitoring to a Reportable Condition. Furthermore, due to the Office of Housing’s emphasis on monitoring the Section 8 portfolio, progress on inspections for Section 8 properties was farther advanced by the end of FY 1999 than for FHA-insured properties – almost 90% of the properties inspected by REAC in FY 1999 had Section 8 contracts, while only approximately half were FHA-insured.</p> <p>Therefore, based on the findings in the draft FHA audit of significant improvement in the monitoring of FHA-insured properties, a continued finding of Material Weakness can only be due to monitoring responsibilities that are unique to Section 8 properties. Yet these monitoring responsibilities are already cited separately in the draft HUD audit under the topic “Controls over Project-Based Subsidy Payments Need to be Improved” as a Reportable Condition, not a Material Weakness. HUD questions the appropriateness of citing the same issue twice within the same report, but even accepting this, it is unclear how a finding which is not considered to be a Material Weakness could cause the finding on multifamily monitoring to be changed from a Reportable Condition in the FHA audit to a Material Weakness in the HUD audit.</p>
<p>31.</p>	<p>Page 22, 1st captioned section</p>	<p>Consider that Multifamily did conduct risk-based goal activity under the FY1999 BOP. In order to address the inventory of Secretary-held multifamily notes (a Reportable Condition in the prior year audit), Multifamily Housing included a FY1999 BOP goal to bring 75 percent of the Secretary-held notes that were 3 months or more delinquent under a workout agreement, into foreclosure, or under designation for a note sale). Of the 167 notes in this goal universe, the multifamily field offices brought 137, <u>or 82 percent, under control, exceeding the 75 percent goal</u>. Based on the Secretary-held BOP goal achievement and progress toward renewing note sales activity, the draft FHA audit no longer considers Multifamily’s handling of its Secretary-held inventory to be a Reportable Condition.</p> <p>Furthermore, risk-based goals have also been established for multifamily monitoring. As part of the establishment of REAC, follow-up procedures were created for the field to develop specific action plans for dealing with physical inspection results based on the numeric score. This contradicts the draft report’s implication that the status of a property as troubled is independent of REAC information - in fact classification of properties as high risk is now based on REAC information. Properties that fall into the range of zero to 30 points are referred to the Departmental Enforcement Center for evaluation and acceptance for enforcement action, if appropriate. Relatively high scoring properties, those with above 60 points, require less oversight because of their good performance so the field’s attention is now focused on those properties in the 31-59 range. The lowest scoring of these properties, those in the 31-45 range, require face to face meetings, with detailed repair plan and professional assistance for more costly repair programs (over \$10,000 per unit).</p> <p>In light of the improved capability of obtaining reliable monitoring data, the FY2000 BOP for Multifamily Housing includes a goal (BOP Goal HSG-M-6-2) to bring 95 percent of the properties with REAC scores of 31 - 59 into compliance within 90 days of the date of inspection referral from REAC. Therefore, the Draft ICR concern regarding risk based goals has been clearly addressed.</p> <p>Finally, the Draft ICR makes note of the fact that Housing relies more and more on</p>

		<p>electronic communications (e-mail, web-based information sites, Satellite-based distance learning, conference calls, etc.) as opposed to the handbook issuance procedures of the past. In fact, extensive written protocols and other guidance have been developed and issued to the field for project monitoring under REAC and other HUD 2020 initiatives, and copies have been provided to the IG. Without any specific evidence that these written procedures are not being followed, there currently appears to be no Internal Controls weakness due to this issue</p>
32.	Page 22, 2 nd side captioned section	<p>While the draft report recognizes the significant progress that has been made on physical inspections, there is little recognition of the progress made in financial assessments. To date, more than 10,000 financial statements have been released to the field offices for their follow-up, with nearly two-thirds of these closed. The remainder will be released shortly following training on the use of the statements. Furthermore, despite the impression left by the draft report that no follow-up had been completed during FY 1999, REAC had already begun analysis of financial statements, with many of them resolved because no compliance conditions were found.</p> <p>We note with regard to the Draft ICR comment that fewer management reviews and occupancy reviews of troubled and potentially troubled projects has been done than required by HUD policy that such reviews are not required for each troubled project. The field was instructed in this change in approach by memorandum dated July 1, 1998. In general, the REAC process has supplanted these reviews as an important monitoring tool. Furthermore, it does not make sense, for example, to conduct a management review for a project that is referred to the DEC for evaluation by virtue of its REAC PASS score or by referral by a Hub or Program Center field office. In such a case, an in-depth review is conducted under the auspices of the DEC's due diligence process. Given the combination of increased monitoring through REAC, the DEC, and other initiatives, along with a lack of evidence in the report that the number of reviews performed was inadequate, the Office of Housing believes that the number of management and occupancy reviews performed was in fact adequate.</p>
33.	Page 23, 1 st side captioned section	<p>The draft report does not adequately recognize the progress that has been made on implementing the Contract Administration initiative. Furthermore, the report implies that no reviews of contract administrators were performed. In fact, a significant number of reviews of contract administrators by field offices were performed during FY 1999. This, combined with the direct monitoring of projects performed through REAC and field office follow-up, contradicts the implication of the statement that when "HUD does not monitor the projects directly or indirectly, it adversely impacts HUD's ability to assure the propriety of Section 8 disbursements." In fact, HUD did monitor the projects both directly and indirectly.</p>
34.	Page 23, 2 nd side captioned section	<p>Many of the specific points raised by the IG in this section are not supported by specific evidence or explanations of what monitoring standard would be acceptable. With the extensive improvement in monitoring during FY 1999, it is not accurate to state that there "were various reasons for not monitoring projects" – in fact, projects were monitored, and to a standard far beyond prior years.</p> <p>In addition, the Office of Housing believes the report fails to recognize the significant improvement in monitoring due to improvements in the Real Estate Management System (REMS). The importance of REMS in the oversight and monitoring of the multifamily portfolio cannot be overemphasized because without REMS the</p>

		<p>compilation of data and coordination of actions generated by the HUD 2020 centers (esp., REAC, DEC, and FMC) would not have been achievable. The implementation of this system replaced a number of manual and automated systems and for the first time contains all information on MF projects in one place. In Fiscal Year 1999, REMS Phase 3.0 was implemented. REMS Phase 3 provides comprehensive reports capability and coordination with data systems developed by the Real Estate Assessment Center and Departmental Enforcement Center. REMS Phase 3.0, implemented nationwide on Nov 1, 1999, included these primary enhancements:</p> <ul style="list-style-type: none"> • Approximately 30 standard reports and 46 data elements with which to define the scope of each report (selection criteria) • Integration with REAC systems to: <ul style="list-style-type: none"> • display more financial assessment/physical inspection details • create automated follow-up actions for Housing staff • update property address information based on physical inspection • Reserve tracking (requests and balance) • The capability of searching for properties by street address
35.	Page 25, 3 rd paragraph	<p>In reference to the third paragraph, PIH is concerned that the OIG cites that two field offices did not perform a formal risk assessment in FY99. This statement must be clarified. In fact, of those two offices cited, the risk assessment in question was conducted before the close of Fiscal Year 1998 and before the documentation procedures required for the risk assessment had been emphasized. As a result of the FY98 OIG Financial Statement Audit, we discussed with each field office during the weekly video conference calls, the monthly Desk Officer conference calls, and on our routine on-site field office visits, the need and requirement of each field office to document the development and results of their annual risk assessment. In addition, we began developing the National Risk Assessment system to free field office staff of the data gathering and collection burden and to fully account for our national inventory risk which will be detailed below. We asked the field to update their FY99 risk assessment in conjunction with the needs identified by the BOP for FY99 so that all required community-based issues could be resolved. We are confident that even though two field offices may not have formally documented their initial risk assessment approach, high risk community needs were met through the BOP monitoring and technical assistance plans as executed by field office staff.</p>
36.	Page 27, Side captioned section paragraph	<p>The OIG report raises concerns over OPIH's reliance on and use of Independent Auditor (IA) reports, which are now captured and reported on through REAC's Financial Assessment Subsystem for Public Housing (FASS-PH) and the related Public Housing Assessment System (PHAS). OIG's report cites REAC's renewed IA quality assurance function, which is already serving to better assure audit quality. Field- guidance was developed and released on August 10, 1999, illustrating the monitoring and technical assistance actions expected of the field during the current PHAS advisory period. In addition, PIH and REAC created a video tape "PHAS, You and the Seven Day Review" dated December 17, 1999, and provided it to all field offices, which provides further direction on field responsibilities when the PHAS advisory period is lifted and the program begins full implementation.</p>
37.	Page 28, 5 th bullet	<p>Revise the completion date of the module on the next to the last bullet from July 2000 to September 2000.</p>
38.	Page 31	<p>The Office of Administration has numerous detailed comments for OIG's consideration on the Systems and Accounting Issues addressed to them in pages 30</p>

		through 41. Those comments are provided in Attachment No. 3 to the Deputy Secretary's 2/18/00 transmittal memo.
39.	Page 39, 1 st side captioned section	Request that corrective actions implemented in FY 1999 be acknowledged regarding segregation of VEND/VACT access at the Ft. Worth Accounting Center. Paragraph 2 is inaccurate. Subsequent discussions with IG have clarified this paragraph to mean that system administrator profiles were updated to include VEND/VACT access in support of system integration initiatives in FY 99. Prior to FY 99, in response to earlier OIG recommendations, the system administrator's profile did not include access to VEND and VACT.
40.	Page 40, Last sentence	Delete sentence, "Additionally, there is no historical record kept of manual transactions that could be used to provide an audit trail and to identify recurring problem areas that may require system design changes." A log of user issues, that include the interface, was started and maintained as a way to identify and track resolution of specific problems or classes of problems and their solution. To date several enhancements to the interface, to reduce interface errors, have gone into production, and should be acknowledged, and several are still pending. Completed items are on an archive log and current items are on active log. The items are reviewed once a week at HUDCAPS status meeting.
41.	Page 41, 2 nd & 6 th full paragraphs	In the second paragraph, request corrective actions implemented in FY 1999 be acknowledged regarding segregation of VEND/VACT access at the Ft. Worth Accounting Center. In addition, delete second to last sentence regarding CFO research of why two CFO administrators could make changes to VEND, a per previous comment on Page 39 corrections. In the sixth paragraph, recommend that sentence - beginning "These controls ...". end with the word "complete", and delete remainder of sentence.
42.	Page 43, 1 st side captioned section	This section should be rewritten. The two PHAs (Baltimore and Pittsburgh) that have been either sent letters approving an extension of time or were not beyond the 24 month deadline for execution of contractors contract should be excluded. The Baltimore HA was given a time extension in a March 23, 1999 letter which became the effective date of the Grant Agreement. Also, On February 11, 2000, the Pittsburgh HA received an extension period of performance for execution of a contractors contract and for the completion of the physical work. OPIH has been carefully monitoring the progress of each of the HOPE VI grants using the HOPE VI Grants Management system and is fully aware of the Article II(3)(a) provision of the Grant Agreement. However, since each of those sites identified in the Financial Statement Report have been and will continue to be closely monitored through our grants management system, OPHI saw no immediate need to declare those PHAs in Default of the Grant Agreement at this time. Each had submitted revised dates in the Quarterly Report System and their progress has been carefully monitored by OPHI staff. The Office of General Counsel has provided an opinion supporting the fact that the OPHI is not required to issue default for a technical violation of the Grant Agreement. Instead, the decision to issue letters is discretionary. However, OPIH agrees that sending a letter to each PHA in technical violation of the Grant Agreement and reminding them of the violation and either granting them a time extension or placing them in Default is appropriate. OPIH has proceeded to

		prepare and will send time extension letters or letters of default to each of the PHAs listed in the Reportable condition. Furthermore, in order to prevent this reportable condition from occurring again, OPIH has established standard operating procedures to be implemented.
43.	Page 43, 2 nd Side Captioned Section	<p>The findings should be removed. PIH policy and practices with respect to unobligated fiscal year 1997 and prior fiscal years funds are in compliance with the Quality Housing and Work Responsibility Act of 1998. Public Housing, in response to a January 14, 2000, meeting with the OIG on this subject, asked for, received, and forwarded to the OIG, a program counsel review and opinion of the actions required and taken by PIH, up to and including a Federal Register Notice of December 22, 1999, dealing with obligation of FY97 and prior year modernization funds. The February 9, 2000, opinion in summary states that “The December 22, 1999 Federal Register Notice was a clearly legal and reasonable exercise of PIH’s authority to prescribe remedies for violations by PHAs of section 9(j)(4)(B).” Further, in the February 9th opinion, program counsel points out that the OIG draft finding is in error, since the remedies it prescribed are those that can only apply prospectively for funds made available under Section 9 and not retrospectively under Section 14 (i.e., FY97 and prior funds).</p> <p>With respect to the finding that deals with expenditure of fiscal year 1995 and prior years public housing modernization funds, HUD has not taken any actions to enforce what the OIG states are funds that must be expended not later than four years after the date on which funds become available for obligation. This is also not accurate. The program counsel’s February 9th opinion clearly points out that penalties for slow expenditure of funds only applies to funds provided under section 9 and, therefore, are penalties HUD must consider and impose prospectively not retrospectively.</p> <p>For the record, it should be made clear that PIH has been very aggressive in pushing PHAs to obligate and expend funds in the pipeline over the past several years. A listing of actions undertaken is available for OIG’s further consideration.</p>
44.	Page 44, 2 nd paragraph & Page 3, 5 th bullet	FHA would like to emphasize that it effectively forecasts its unexpended Section 8 project-based budget authority. However, improvements are necessary in order to identify and recapture excess Section 8 project-based subsidy on executed contracts.
45.	Page 47, 4 th paragraph, 3 rd sentence	Suggest that the third sentence and remainder of that paragraph be reworded as follows: “The Department did not take these material weaknesses into consideration when reclassifying seven of its legacy systems to conforming with federal financial management systems requirements. These systems were reclassified as a result of HUD putting into place processes to post FHA SGL balances to HUDCAPS. Subsequent to receipt of FHA’s certification that these seven systems were compliant, and after HUD met its reporting requirements to OMB soon thereafter, concerns were raised about the effectiveness of the processes outlined by FHA. HUD plans to complete an independent verification and validation of these seven systems in FY 2000.”
46.	Page 48, 1 st side caption, 3 rd bullet	FHA does not agree with the third Bullet, “refine the methodology for calculating the liability for loan guarantees (SFFAS Number 2, <i>Accounting for Direct Loans and Loan Guarantees</i>),” and is currently discussing the issue with the KPMG auditors. OIG should assess the outcome with KPMG, and reflect any needed changes in the report.
47.	Page 48, 2 nd	FHA does not agree and is currently discussing the issue with KPMG. KPMG

	side caption & narrative	asserted that FHA's general ledger was not compliant with the SGL at the transaction level. KPMG's basis for this assertion is the data in the subsidiary system reports used to prepare the financial statements was not maintained at the transaction level. FHA's subsidiary systems do maintain data at the transaction level in compliance with the SGL. However in some instances, because of technical limitations of FHA subsidiary systems, the transaction-level support for previously created reports could not be reproduced.
48.	Page 48, Last sentence	Revise the sentence as follows: "The Department reviewed nine systems with the following results: <ul style="list-style-type: none"> • 6 systems were reclassified as non-financial (MADM is actually comprised of 4 subsystems each of which is included in the inventory) GEMS, IBS, DAPP, M2M, REMS, APPS • 1 was classified as non-compliant SFPCS-Upfront • 2 continued as compliant - HUDCAPS, MACOLA"
49.	Page 49, Last paragraph	Consider the following regarding the CFO's oversight of Departmental systems conformance with FFMIA requirements. The CFO initially relies on program office certification of the systems, however, varying levels of review are conducted during the year. For FY 1999, the CFO reviewed almost of the FMS inventory, including: <ul style="list-style-type: none"> • Conducted IV&V on 9 systems • Conducted in-depth internal review of one system (IDIS) • Reviewed all non-conforming systems (28): requested the program offices prepare or update a remediation plan. As possible, requested additional information re: dates, costs, tasks. A new FMS review guide recommends that all agency financial management systems should be reviewed at least every 5 years. We spearheaded the development of a financial management system review guide that was implemented in the Department in FY 1999. The guide provides substantially more in-depth assessment criteria than was requested from the Program offices in the past. For FY 2000, CFO plans include: <ul style="list-style-type: none"> • Conduct IV&V on about 9 systems (including the 7 housing systems that had been reclassified as compliant). • All new systems reported as of 09/30/1999 Already met with program offices on CFO - TEAM CFO- HTMS Housing - SFPCS-Periodic Talking with CPD about Section 108 (discontinued) and RHEDI (financial or non-financial) • Review any system that's changed classification during FY 2000 • Total number of systems for review will be close to half of FY 2000 inventory.
50.	Page 51, 1.a.	Change wording to say "Direct CFO and FHA to work together to integrate FHA's financial management systems into HUDCAPS including fund control and SGL-compliant financial reporting."
51.	Page 51, 1.b.	Move 1.b. from section 1 under material weakness to section 6 and change wording to "Continue efforts to enhance the PAS/HUDCAPS Interface in order to reduce the number of system rejections."
52.	Page 51, 1.e.	Change recommendation 1.e. to reflect that adjustments to Hyperion should be minimized.
53.	Page 51, 1.f.	Move 1.f. up under 1.a.

54.	Page 52, 3.a.	The Office of Administration has the authority necessary to ensure Department-wide compliance. The Office of Information Technology, through its ADP Security Branch, has responsibility for development and implementation of IT Enterprise-wide operational security standards and procedures. They work closely with the Office of Human Resources staff responsible for the personnel security function to ensure needed background investigations are performed. No additional authority is necessary for these elements to carryout this responsibility. ADP Security Branch will, quarterly/or as requested, provide listings identifying those individuals who should undergo a background investigation, based on the desired access to a mission critical application system. Based on these facts, the Deputy Secretary is requesting that this recommendation be removed.
55.	Page 52, 3.a	This is inconsistent with the text on page 35 which refers to this matter as a Reportable Condition.
56.	Page 52, 3.b.	System Integrity & Quality Assurance Division of the Information Technology Division submits a quarterly list of individuals authorized to access critical HUD systems to the Office of Human Resources Personnel Security Branch (OHRPSB). Effective March 2000, on a monthly basis, the Office of Information Technology will request a list of individuals, from the OHRPSB, who have received new clearances to ensure that only authorized individuals with the appropriate position sensitivity level of clearance have continued system access. Additionally, the Office of Human Resources and the Office of Information Technology are currently working together to establish a complete list of users of sensitive systems and to perform a reconciliation of numbers and forms. After that is accomplished, quarterly reconciliations will be performed to ensure the list is current.
57.	Page 53 - 6b	Delete because the CFO is already tracking problems and has already used tracking mechanism to identify problem areas to be remedied by system design changes.
58.	Page 53, 7.a.	We request the recommendation be amended by rewording it to read "Evaluate the reasons for delay by the public housing agencies with unobligated balances of funds awarded during fiscal year 1996 and prior year and take actions to either waive the regulations and extend the termination date of the grant or terminate the grant as to all further activities and initiate close-out procedures and recapture unobligated funds".
59.	Page 53, 7.c.	We request the recommendation be deleted since it is not needed.
60.	Page 53, 7.f.	FHA would like to emphasize that it effectively forecasts its unexpended Section 8 project-based budget authority. However, improvements are necessary in order to identify and recapture excess Section 8 project-based subsidy on executed contracts. The Office of Housing can identify the amount of excess budget authority on expired Section 8 project-based contracts, however, we will work to make the procedure more timely and accurately.
61.	Page 54, 2.a.	The Department has been working with the National Academy of Public Administrators to design and test a methodology for resource estimation and allocation process (REAP) to link resources to results. NAPA has recommended a methodology which will allow the Department to estimate, allocate, and validate resource management requirements for effective and efficient program administration and management. Working in conjunction with NAPA, senior managers were briefed on REAP CFO staff are presently developing a plan for implementing REAP throughout the Department over the next 12 - 18 months.

62.	Page 56, 6.b.	This action date should have been extended to incorporate the delay in implementation of the PHAS. PIH requested an extension to December 31, 1999, but did not get a response from the OIG. However, if current schedules hold, the PHAS independent assessments will be incorporated in the National Risk Assessment which will be available for testing by June 30, 2000. The specifics of the information included in the National Risk Assessment will be provided if requested. We expect full implementation of the National Risk Assessment program by September 30, 2000, for the FY 2001 BOP development and monitoring plan process.
63.	Page 56, 9.c.	As discussed in Recommendation 3.c above, since January 28, 2000, the Personnel Security Section of OHR has used the Security Control and Tracking System (SCATS) to track the investigation workload. When a background investigation is received in OHR, it is entered into SCATS. The data includes, but is not limited to, name, grade, program, system(s) to be accessed and date of initiation. When the results are received from OPM the completion date is entered. SCATS is expected to meet all of the reporting requirements.
64.	Page 57, 3.a.	PIH requested and was provided assurances that this recommendation was transferred to Housing for final action. We have confirmed that the audit was transferred to Housing on September 21, 1999, in the Departmental Automated Audits Management System (DAAMS). Please adjust your records accordingly based on this information.
65.	Page 58, 5.a.	This condition will need an extension to June 30, 2000, because of the delay in the implementation of PHAS and the new physical inspection scoring criteria, we will need additional time to train PHA and HUD staff of the new requirements. Guidelines and procedures on how to access, interpret and utilize HA information from the REAC was published on August 10, 1999. This guidance will be revised to incorporate new requirements of the final PHAS rule published on January 11, 2000, during the Hub Director's conference to be held in Washington DC during the week of March 13 th , 2000. In addition, we have created a video tape with the REAC "PHAS, You and the Seven Day Review" dated December 17, 1999 and provided it to all field offices, which provides further direction on field responsibilities when the PHAS advisory period is lifted and the program begins full implementation. We have asked the REAC to provide on-site training to field staff to further the education process of the new system which should occur during the third quarter of FY 2000.
66.	Page 58, 7.d.	UNISYS access control has been strengthened by the privatization of files associated with the CHUMS system. This effort is to be completed by June of 2000. All remaining critical systems will have the strengthened security control in place by June of 2000. Non-critical systems will have the strengthened security control implemented by September 2000.
67.	Page 58, 7.f.	The Office of Information Technology deleted and disabled GUEST account on all servers. Servers at Headquarters were completed in July 1999 and the Field Offices were completed in September 1999. This recommendation was closed in the Departmental Automated Audits Management System on October 7, 1999.
68.	Page 59, 7.g.	Strong, six figure passwords have been implemented at Headquarters and the Field Offices as of December 1999. OIT is using a standard Novell file server reporting utility (Security.exe), as reported in the response to recommendation 2.e, which provides summary audit information.

69.	Page 59, 7.j.	<p>As reported in recommendation 2.h., several actions have been taken.. Twenty-one of HUD's mission critical systems are now under configuration management (CM). The current status of the overall effort is as follows:</p> <ul style="list-style-type: none"> • Twelve Hitachi systems have been identified to be placed under Endeavor. Nine systems, including six mission critical systems, are under CM and three are in progress to be completed by June 30, 2000. In addition, five mission critical Hitachi systems are already under configuration management software built into the applications. • Fifteen UNISYS systems have been identified to be placed under CMPlus. Thirteen systems, including five mission critical systems, are under CM and two are in progress to be completed by April 30, 2000. In addition, five mission critical UNISYS systems are already under configuration management software built into the applications. • Seventy-three PC/LAN/Client Server systems have been identified to be placed under PVCS. Thirty-two are under CM and forty-one are candidates for PVCS. OIT and Operations are developing a schedule for implementation. • An additional sixty-seven Lotus Notes systems need to be placed under a different CM product than PVCS. Technical staff have identified CM software available for these systems. Funding for a copy of Team Studio will be requested at the mid-year budget review. <p>Management hopes to achieve the final action target date of 4/16/00, but will request an extension of the target date within the allowable one year deadline of 9/29/00 if necessary, depending upon resource considerations.</p>
70.	Page 59, 8.d.	<p>There is now a complete, non-duplicative alpha list of sensitive system users in HUD, both employees and contractors, provided by IT, totaling 1338. This is significantly below the 8200 number cited by the OIG. Significantly, the 8200 number is based on a report that counts users with access to multiple systems multiple times, and also includes users with "read only " access who do not require background investigations. Approximately 643 forms have been received from individuals NOT on the IT list.</p>
71.	Page 59, 8.e.	<p>OHR is presently provide OIT with a listing of all changes reflected on SF'52's every two weeks. The Office of Administration requests that this recommendation be removed.</p>
72.	Page 59, 9.b.	<p>Software was implemented in August 1999, and the action should be closed.</p>

Attachment No. 3

**Office of Administration Comments
On OIG Draft FY 1999 Internal Control and Compliance Report**

System and Accounting Issues

Hitachi Environment

**See OIG
Comment 1**

There are a number of points with which the Office of Administration takes exception or wishes to request note of improvements. Page 30-31 of the draft report addresses the “Started Tasks”, faulting the ADP Security Office for “. . .not follow(ing) up with a review of the audit trail records to ensure that the use of the default entries were legitimate and present not vulnerabilities.” In fact, each evening audits are run that identify security breaches of Started Tasks, and were there grave security breaches, the system would shut down; an indication of a lesser breach would trigger notification to the appropriate system operators so that actions could be taken.

We are requesting that the following be removed (p.31):

The ADP Security Office did not follow up with a review of the audit trail records to ensure that the use of the default entries were legitimate and presented no vulnerabilities.

And replaced with:

We understand that each evening audits are run that identify security breaches of Started Tasks, and were there grave security breaches, the system would shut down; an indication of a lesser breach would trigger notification to the appropriate system operators so that actions could be taken.

**See OIG
Comment 2**

It should be noted that the discussion regarding “excessive access privileges” should reflect the fact that this issue has been under review for several months, and is being addressed in accordance with the long range security plan.

We are requesting that the following statement be added to the text at the end of paragraph 1 as follows (p.31):

It is noted that the issue of excessive access privileges has been under review for several months and is being addressed with the long range security plan.

**See OIG
Comment 3**

Major improvements have been made regarding access controls over HUD’s general support systems. HUD’s priority, in accordance with PDD # 63, is to prevent outside attacks to cyber/technology resources. To accomplish this effort, the focus has been on fully implementing the security software products on the external resources for the infrastructure. The Office of Information Technology recognizes the need to improve monitoring of these resources and will continue to report findings regularly in CDRL 059, Monthly Security Report, and concur that additional maintenance should be exercised.

However, the technology issued raised concerning the Started Task (STC) and Authorized Program Facility (APF) on the Hitachi platform is a closed vulnerability. The exposure is minimal and the production computer user is not capable of exploiting this weakness. Authorized online users are bound by the security of the general support and application system using profiles, based on separation of duties.

Started Task and APF's are not menu options available to the Hitachi user community. They are secured facilities and operate on demand with the operating systems and its auxiliary components to process and secure data. A disabled STC will not create exposure to data; if any thing, it adds additional security when it is not functional. Glitches or non-performing STC's or APF's do not overflow data into the general user processing business environment. If that were the case, the system would be declared down and corrective actions would commence. HUD's system programmers are the only persons who could cause a "service interrupt". The situation explained in the audit report is not similar to routers or buffers reaching thresholds and spilling sensitive data in unsecured areas.

We are requesting that the following statements be removed from the text (p.31, paragraph 2):

Both of these conditions would allow a perpetrator to place unauthorized programs into the APF. This exposure could result in loss, errors, and damage to HUD's critical financial software and data.

And replaced with:

While the aforementioned weaknesses are noted, it is clear that HUD's own system programmers are the only persons who could cause a "service interrupt".

**See OIG
Comment 4**

Regarding the administration of the Authorized Program Facility, we agree that maintenance should occur on a scheduled basis to prevent such activities. However, the audit report should reflect that there was only one APF out of several hundred in which HUD neglected to apply proper maintenance. Furthermore, the process to allow a perpetrator to place an unauthorized entry is not as simple as implied in the audit. Two external penetration tests were executed, proving that an external hacker could not penetrate the Firewall, which is the first step a perpetrator must accomplish. Additional layers of security, such as HUD's network, mainframe (CA Top Secret Fail Mode enforcement) and file accesses would further prevent a perpetrator. It is acknowledged, however, as with any large scale enterprise operation, that the Department faces the risk of its own authorized users collaborating to bypass security.

*Please add the following sentence following the 6th sentence in paragraph 2, p.31:
However, there was only one APF out of several hundred for which the Department did not apply proper maintenance. Two external penetration tests were executed and precluded an external hacker from penetrating the Firewall, prohibiting any violation of the system.*

UNISYS Environment

**See OIG
Comment 5**

The Office of Inspector General (OIG) Audit 1999-FO-177-0003 addresses various issues that are once again addressed in the section on the UNISYS Environment. Management decisions regarding security enhancement plans, network management packages that alert staff to questionable or unacceptable conditions and configuration management, among other issues, have been accepted by the OIG, with deliverables due on or before 9/30/00. Therefore, to revisit these issues in the current audit is unfairly punitive and misleading.

The statement on page 32 at the end of the paragraph at the top of the page states ". . . the privacy of HUD customers is being compromised, and the sensitive data placed at risk for potential fraudulent activities" is inflammatory and disregards safeguards already put in place with UNISYS 1, and currently underway with improvements to UNISYS 2. We request that this section be removed from the report.

**See OIG
Comment 6** It should be noted that the OIG’s assessment of the Hitachi computing resources “are now protected at the highest level of access security.” All operating system files are protected on the Hitachi, UNISYS 1 & UNISYS 2. As previously referenced, the CHUMS system, running on UNISYS 1, has undergone a review and corrective actions applied to protect the data; such protection for the LOCCS program, running on UNISYS II, is presently underway.

Network Environment

**See OIG
Comment 7** All passwords are encrypted and users cannot log in with unencrypted passwords.

*Please remove the sentence in the 3rd paragraph of p.32 that states:
However, some vulnerabilities that we detected and reported in previous years have not been removed, despite HUD promises to do so. Novell networks were still frequently set to allow users to log in with unencrypted passwords.
And replace this sentence with:
Novell networks only permit users with encrypted passwords to log in, removing a former vulnerability.*

**See OIG
Comment 8** The OIG continues to express concern regarding a lack of control over Novell operating system files, which would permit a person to copy files to hacking programs designed to identify user ID’s and passwords. This concern presumes that authorized personnel, those enabled access inside the Firewall, would exploit this system. It is for this reason that background checks are performed on all HUD employees and contractors as necessary. The threshold of integrity and trust of employees has to be established at some point and given institutional credence in order to accomplish the business of the Department.

*Please remove the statement in the 3rd paragraph of p. 32 that states:
Another weakness we noted is the lack of control over Novell operation system files. Access to these files allows a person to copy system files to hacking program, which are designed to identify user Ids and passwords. This information would allow a person to login as someone else and use that access to read files and even initiate transactions.*

**See OIG
Comment 9** In regard to the concern over a hacker gaining “root access to take control over a system”, it should once again be noted that two external penetration tests were executed, proving that an external hacker could not penetrate the Firewall, which is the first step a perpetrator must accomplish. Therefore, the Office of Administration requests that references addressing concerns regarding “hackers” be removed from the final report.

Please remove paragraph 1 at the top of page 33, that begins with the words, “We also noted some weaknesses . . .” and ends with the words, “take control over a system”. Please remove the word “these” in the first sentence of the 2nd paragraph so the sentence reads, “We detected vulnerabilities by using two automated tools for network security evaluations. And add the sentence, “It is acknowledged the two external penetration tests that were executed demonstrate that an external hacker could not penetrate the Firewall, thus precluding invasion by a perpetrator”. This sentence would then be followed by the present final sentence of paragraph 2 that states, “Given the size and complexity . . . an automated network monitoring package would enable detection”

Disaster Recovery

**See OIG
Comment
10**

The Office of Information Technology does have a Business Resumption Plan (BRP) and can implement it. The Office of Administration will approach the Deputy Secretary as to when it should be tested. It should be noted that all field offices have a BRP; however, these plans are being revised to reflect the concerns and interests of the field as well as to ensure more effective coordination with the program offices and centers.

The last sentence of the second paragraph under this section should be changed to read, "We have been advised that IT staff in the field offices are involved in revising the BRP's to reflect the concerns and interests of the field as well as to ensure more effective coordination with the program offices and centers. This effort will provide the needed technical support to the program areas in the even of a disaster."

Software Change Control

**See OIG
Comment
11**

The Office of Administration takes exception to the statement that the IG has "continually reported" weaknesses in configuration management and that ". . .there is a lack of progress in CM implementation." In fact, as noted in the response to Recommendation 2.h, 21 of HUD's mission critical systems are now under configuration management, an additional 5 are underway, to be completed by 6/30/00, and plans are in place to address the balance of the systems.

The second paragraph in this section on pages 33-34 should be modified to read, "We acknowledge efforts to address these concerns are underway, albeit at a pace slower than would have been preferred. While a workplan for all platforms promised to be completed in 1999, 21 are now under configuration management (CM); an additional two UNISYS systems will be completed by April 30, 2000; three Hitachi systems are in progress to be completed by June 30, 2000; 32 PC/LAN/Client Server systems have been completed under PVCS, and an additional 41 are to be completed. While we have continually reported this significant weakness since 1996, the Department is making every effort under current budgetary constraints to address this issue earnestly."

Personnel Security Over Systems Access Continues to be Inadequate

There are several issues with which the Office of Administration takes issue regarding the matter of Personnel Security:

**See OIG
Comment
12**

- The OIG has incorrectly cited the ". . .Information Security Staff within IT (as) responsible for providing policy guidance on information security". In fact the Chief Information Officer is charged with developing such policy, which the staff within IT implement the policy.

Please clarify this reference in the final report by changing the last sentence in the first paragraph on page 36 to read, "Finally the Chief Information Officer is responsible for providing policy guidance on information security".

**See OIG
Comment
13**

- The backlog of "as many as 8,200 background checks" has been previously reported as being an inflated figure. The complete, non-duplicative alphabetical listing reflects a total of 1338 employees and contractors, as provided by OIT.

Please correct this statement, on page 36, paragraph three, first sentence, to read, "While at the inception of our review, we found a potential backlog of as many as 8200 background checks may have been required, further work on the part of the OHR and OIT staff reduced this backlog to only 1338 employees and contractors."

Please remove the word, "extremely" in the fifth sentence of the same paragraph so that the sentence reads, "As a result, HUD is vulnerable to unauthorized . . ."

Please remove the reference in the final two sentence of that same paragraph to the very narrow issue of the M&M contractor whose contract was terminated. This issue is incendiary on the surface and does not reflect the due haste used to remove the contractor upon determination of ineptitude.

**See OIG
Comment
14**

- A discussion ensues in the draft audit report of the commitment made by the Director of Labor and Employee Relations Division, in response to the OIG Audit 1999-FO-177-0003, 8.d, to have the reconciliation of database background checks completed by 3/31/00. Negative conjecture does not belong in this report; however, funding has been acquired and a contractor has been engaged to process the backlogged case files within a three week period of time to meet or exceed the 3/31/00 target. This effort has been given the highest priority and the Office of Administration requests that the statement be removed from the final report.

Please amend the last two sentences of paragraph four on pages 36-37 to read, "OHR's Director of Labor and Employee Relations Division stated that the current backlog of investigations, due to a peak in workload without the commensurate staff in place, will be eliminated by March 31, 2000 through the successful coordinated efforts to secure funding, a contract for temporary services, and support from OIT. We believe that management has demonstrated the commitment to the Personnel Security program to ensure that this goal will be met."

**See OIG
Comment
15**

- Reference is made in the report to "as many as four different systems and methodologies for logging and tracking background investigations". One tracking system has been adopted, put in place, tested, and has been found to work adequately.

Please remove the comment regarding tracking systems from the final report on page 37, paragraph one, sentence two, or amend the statement to read, "While at one time there may have been as many as four tracking systems in place, management directed the use of one tracking system that provides all the necessary information to permit background investigations to be tracked and progress monitored."

**See OIG
Comment
16**

- Verifiable actions attest to the increased attention and resources that are being devoted to Personnel Security, as coordination and collaboration between the OHR and IT offices have been greatly enhanced. OHR Personnel Security staff are regularly in attendance at the monthly meetings of the Security Administrators; as recently as the January 27, 2000, meeting, Personnel Security was the top agenda item with Queen Mention, of the OIG, in attendance. Considering these ongoing efforts, coupled with the fact that the delivery dates for the management decisions referenced in the 1999 audit not having been tested, it is requested that the "Assessment of HUD's Plans and Completed Actions" be revised to reflect the level of commitment the administration has made to correcting this problem and ensuring that it does not reoccur.

Please remove the first paragraph under this section on the bottom of page 37, and replace it with the following: "HUD has made a commitment to address these issues, demonstrating the leadership and financial commitment to ensure coordination between OHR, IT, the GTR's and the system owners. The database of background investigations has recently been updated and its reliability will be tested in the near future. With these continued efforts, the Department will be in a better position to ensure that only individuals who should have access to critical and sensitive systems have such."



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410-5000

REAL ESTATE ASSESSMENT CENTER

MEMORANDUM FOR: James M. Martin, Deputy CFO for Financial Management, FM

FROM: Barbara L. Burkhalter, Deputy Director, Real Estate Assessment Center

SUBJECT: Comments on Office of Inspector General Draft Report on the
Audit of HUD's Fiscal Year 1999 Financial Statements

The following provides comments on pages 7, and 13 through 17 of the report which discusses Verification of Subsidy Payments.

The last paragraph on page 7 emphasizing that HUD must finalize and implement plans to permanently organize and staff a Departmental income verification program should be deleted. The Real Estate Assessment Center (REAC) at Headquarters has staffed a permanent income verification program, and developed and implemented an automated system to facilitate large-scale computer matching income verification. Further, REAC is permanently organizing and staffing income verification functions in the Field. REAC staff completed in February 2000 labor union negotiations for the transfer of over 40 HUD staff in the Chicago and Seattle Income Verification Centers from the Office of Public and Indian Housing to the REAC. These employees, most of whom will be designated quality assurance analysts, will provide overall support for the large-scale computer matching income verification function. Further, REAC has hired one Field auditor, and has published, through the Office of Human Resources, position vacancies for the hiring of additional auditors who will conduct reviews of the effectiveness of public housing agencies, owners and agents (collectively referenced as POAs) in resolving income discrepancies.

REAC auditors and quality assurance analysts will monitor POAs' effectiveness in resolving income discrepancies. The POAs will use an automated template to report quarterly on income discrepancy resolution actions. The automated reporting template, which will be standard for all rental assistance programs included in the large-scale matching program, has been developed and tested and will be deployed in March 2000. REAC auditors and quality assurance specialists will use the POA-reported information in planning Field reviews of POAs.

While the OIG report on page 15 acknowledges HUD progress in expanding its income matching program, the report on page 16 states that "HUD should continue to explore and evaluate practical and cost effective computer matching techniques and methodologies *that will aid in quantifying*, on a large scale, the extent of abuses and the benefits of a permanent computer matching and income verification process." [emphasis added] We believe that it is more important to take action to detect, correct and deter abuses than to aid in quantifying the extent of abuses, although both are REAC goals. REAC presently is committed to using the large-scale Federal tax information, and social security and supplemental security matching techniques it has developed until some other more viable alternative(s) exist. The OIG report does not cite other practical alternative techniques.

From the perspective of preventing tenant unreported income, the ideal would be on-line automated income verification before a tenant is admitted to rental assistance program or recertified for rental assistance. As a practical matter this is unlikely to occur any time soon, if at all, given legislative concerns that this would violate personal privacy protection.

The HUD OIG acknowledges on page 14, second paragraph, that "various legal, technical and administrative obstacles exist that impede HUD, HAs and project owners from ensuring tenants report all income sources during the certification and recertification process." Despite this, HUD has developed techniques that within existing legal constraints facilitate the detection, correction, prevention and deterrence of many problems.

REAC has taken substantial actions to resolve the material weakness: "HUD Needs to Do More to Ensure That Subsidies Are Based on Correct Tenant Income."

- a large-scale computer matching income verification program has been implemented; REAC started sending letters to tenants on February 16, 2000, and a large-scale rollout will start on March 1, 2000,
- nationwide computer matching programs have been implemented to provide social security and supplemental security income verification to housing agencies, owners and agents for tenants due recertifications.

Given the subjectivity of the "HUD Needs to Do More" language, REAC and the OIG need to meet to discuss specifics on what, if any, additional actions are needed to resolve the material weakness.

The second paragraph on page 17 contains numerous negative comments about the current large-scale computer matching programs. REAC is concerned with the frequent use of terms such as "fully tested" and "fully implemented" in the second paragraph on page 17, and requests that the OIG define the terminology. If read literally, the term "fully" could be interpreted as a never ending process, as business processes frequently are tested, implemented and later refined.

The negative statements in the second paragraph on page 17 about the current large-scale computer matching income verification process seem inconsistent with positive statements on page 15 about HUD progress in expanding its income matching program. The second paragraph of page 17 states in the middle of the paragraph that "REAC has made significant progress" in computer matching and income verification. However, that paragraph contains statements that diminish the extent of that progress. For example, the reports states:

- adequate information technology and human resource infrastructure to support a large-scale matching effort had not been **sufficiently** developed and implemented (REAC has addressed both of these issues)
- the present large-scale matching methodology has not yet been **fully** tested (significant tests of the computer software has occurred)
- the human resource infrastructure has not been **fully** implemented (REAC has addressed this issue; albeit, full implementation has not occurred)
- the current methodology has not been **fully** tested (significant testing of computer software has occurred and other small scale projects have been conducted using nearly the same methodology)
- tenants may receive an income discrepancy letter in error (we acknowledge that this will occur give significant variance in rental assistance program; notwithstanding, REAC has taken actions to minimize the problem, e.g., annualizing household income for use in comparisons to calendar year Federal tax information, using high income

thresholds, and providing clear instructions to POAs that will minimize the burden of false positives.)

- the project is already more than four months behind its implementation schedule (the system produced matching results in December 1999; REAC, at the request of the Office of Public and Indian Housing, and the Office of Housing deferred sending matching results pending initiation of a training program for POAs, and resolution of issues concerning a Guide containing instructions for resolving income discrepancies.)

The income discrepancy thresholds should not be disclosed in the OIG report on page 16, first paragraph in the "HUD's Action Planned and Underway to Verify Tenant Income." The thresholds should not become public because tenants knowledgeable of the thresholds could in subsequent years avoid detection of underreported income amounts if they know the established threshold used computer matching. REAC may (or may not) change the thresholds in subsequent years.

Below are other comments on pages 13 through 17 of the recent draft OIG report on HUD's financial statements:

Page 14, last paragraph. The numbers for inclusion in this paragraph should be based on the statistics provided to the OIG staff during the second week of February 2000.

Page 15, next to last paragraph, second sentence. "Administration" should be changed to "Administrators."

Page 17, first complete sentence. The OIG report states "We are **also** encouraged by the number of on-going actions HUD has taken and continues to pursue to improve reporting rate and data integrity of the MTCS." [emphasis added] A similar favorable statement concerning the large-scale computer matching and income verification projects is not shown in the immediately preceding text that discusses computer matching and income verification. We believe the OIG report may have omitted a statement expressing encouragement by the number and scope of recent large-scale computer matching income verification projects.

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