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TO: Carin M. Barth, Chief Financial Officer, F

FROM: 
Randy W. McGinnis, Director, Financial Audits Division, GAF

SUBJECT: **Additional Details to Supplement Our Report on the U.S. Department of Housing and Urban Development's (HUD) Fiscal Year 2004 Financial Statements**

HIGHLIGHTS

What We Audited and Why

We are required to annually audit the consolidated financial statements of HUD in accordance with the Chief Financial Officers Act of 1990, as amended. This report supplements our report on the results of our efforts to audit HUD's principal financial statements for the fiscal year ended September 30, 2004, and to provide additional details on material weaknesses and reportable conditions with HUD's internal controls and our findings with respect to HUD's compliance with applicable laws, regulations, and provisions of contracts and grant agreements¹.

Our report on HUD's fiscal year 2004 financial statements is included in HUD's Fiscal Year 2004 Performance and Accountability Report. For fiscal year 2004, OMB directed agencies to complete their Performance and Accountability Reports and submit them to the President, OMB and the Congress by November 15, 2004, thereby requiring that we complete our work by that date.

¹Additional details relating to the Federal Housing Administration, a HUD component, are not included in this report but are included in the accounting firm of KPMG LLP's audit of FHA's financial statements. Their report has been published in our report entitled, "Audit of Federal Housing Administration Financial Statements for Fiscal Years 2004 and 2003" (2005-FO-0002, dated November 15, 2004)

We completed an audit of the Government National Mortgage Association's (Ginnie Mae) fiscal year 2004 financial statements. Our report on Ginnie Mae, another HUD component, included an unqualified opinion on Ginnie Mae's financial statements along with no material weaknesses or reportable conditions with its internal controls, or material instances of non-compliance. Our report is entitled, "Audit of Government National Mortgage Association Financial Statements for Fiscal Years 2004 and 2003" (2005-FO-0001, dated November 12, 2004)

What We Found

We were unable to express an opinion on HUD's fiscal year 2004 principal financial statements and the reasons are detailed in our report that is included in HUD's Fiscal Year 2004 Performance and Accountability Report. In that report, we also addressed three material weaknesses related to the need for HUD to:

- comply with Federal financial management system requirements, including the need to enhance the Federal Housing Administration's (FHA) information technology systems to more effectively support FHA's business and budget processes;
- improve oversight and monitoring of subsidy calculations and intermediaries' program performance; and
- improve FHA's management review over the Credit Reform estimation process.

We also reported on seven reportable conditions in internal controls related to the need to:

- improve quality control over performance measures data reliability;
- strengthen controls over HUD's computing environment;
- improve personnel security practices for access to the Department's critical financial systems;
- improve processes for reviewing obligation balances;
- improve controls for developing estimates of budget authority required for the Section 236 Interest Reduction Program;
- more effectively manage controls over the FHA systems' portfolio; and
- place more emphasis on monitoring lender underwriting, continue to improve early warning processes, and establish effective loan portfolio risk assessment tools for the single-family insured mortgages.

In addition, HUD did not substantially comply with the Federal Financial Improvement Act regarding system requirements and applicable accounting standards. The audit also identified over \$708 million in excess obligations recorded in HUD's records, which represent funds that HUD could put to better use. Had we completed our audit, we might have found additional matters we would have reported.

What We Recommend

Most of the issues described in this report represent long-standing weaknesses that will be difficult to resolve. In this and in prior year's audits of HUD's financial statements, we have made recommendations to HUD management to address these issues. Our recommendations from the current audit, as well as those from prior years' audits that remain open, are listed in Appendix B of this report.

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

HUD's Response

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

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HUD's Internal Control Environment

HUD Continues to be Impacted by Weaknesses in the Control Environment

Most of the material weaknesses and reportable conditions discussed in this report are the same as those included in prior years' reports on HUD's financial statements. HUD still needs to address the issues that fundamentally impact its internal control environment. The issues are Department-wide in scope and must be corrected for HUD to more effectively manage its programs. As discussed below, HUD's ability to address its problems will substantially improve if it completes the efforts to:

- deploy a reliable financial management system that meets its program and financial management needs and complies with Federal requirements, and
 - identify staffing resource requirements with the proper skill mix.
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Financial Systems

The most critical need faced by HUD in improving its control environment is to complete development of an adequate integrated financial management system. The lack of an integrated financial system in compliance with Federal financial system requirements has been reported as a material weakness since fiscal year 1991. Over the years, the Department's plans to implement an integrated financial management system have experienced significant schedule delays, changes in direction, and cost overruns. To correct financial management deficiencies in a Department-wide manner, HUD initiated a project to design and implement an integrated financial system consisting of both financial and mixed systems. HUD has completed the required initial studies and analyses.

HUD's most significant system deficiency has existed in FHA, where FHA's financial management system's environment needed enhancements to more effectively support FHA's insurance, cash management, and budget processes. FHA's fiscal year 2003 implementation of the FHA Subsidiary Ledger automated many previously manual processes used to (1) consolidate the accounting data received from the various FHA operational legacy systems and (2) prepare summary entries for posting to the FHA Subsidiary Ledger. Despite this improvement, weaknesses still exist. FHA continues to conduct some day-to-day business operations with legacy-based systems, limiting FHA's ability to integrate its financial processing environment.

Resource Management

In addition to improving its financial systems, HUD will need to more effectively manage its limited staff resources. Many of the weaknesses discussed in this report, particularly those concerning HUD's oversight of program recipients, are exacerbated by HUD's resource management shortcomings. However, we have not categorized resource management as a separate internal control reportable condition because the effect on HUD's financial statements can be appropriately characterized as a contributing cause for internal control weaknesses described in other sections of our report.

To operate properly and hold individuals responsible for performance, HUD needs to know that it has the right number of staff with the proper skills. To address staffing imbalances and other human capital challenges, the Department implemented the Resource Estimation and Allocation Process and the Total Estimation and Allocation Mechanism as a baseline and validation component for staffing requirements. In addition, HUD has taken steps to institute a strategic human capital management planning process to include (1) completion of a workload analysis in HUD's four core program offices which produced plans to address skill and staffing gaps, and (2) strengthening management controls over staffing actions and authorized staffing levels. The next step is to apply these principles and controls as decisions are made to hire new staff.

Other Control Environment Issues

In addition to system and resource management issues, in prior years, we reported on other issues that HUD needed to address that we believed impacted its ability to effectively manage its programs. Presented below is a discussion of the material weaknesses and reportable conditions relating to the Department's control environment.

Material Weakness

Financial Management Systems are Not Substantially Compliant with Federal Financial System Requirements

The Federal Financial Management Improvement Act requires that we report on whether the financial management systems substantially comply with the:

1. Federal financial management systems requirements, contained in OMB Circular A-127, and in the Joint Financial Management Improvement Program functional requirements documents;
2. Applicable Federal accounting standards; and

3. Standard General Ledger at the transaction level.

Besides requiring agencies to record and classify their transactions in accordance with the Standard General Ledger, these criteria require that the core financial management system be integrated through automated interfaces with other agency systems (financial, program, or a mixture of both) so that transactions are entered only once. The components of the integrated financial management system, which should be electronically linked include:

- the core financial system that provides for the agency's standard general ledger, payment, receipt, cost, funds management, and reporting;
- other financial or program systems or a mixture of both that support the agency's ability to manage and operate its mission programs and/or financial operations;
- systems shared with other government agencies, such as the U.S. Treasury; and
- an agency executive information system (e.g., data warehouse) that provides financial and program management information to all management levels.

Based on the criteria above, HUD did not have a Department-wide integrated financial management system for fiscal year 2004. For example, each of the Department's components maintains their own core financial system and there is little or no integration of data except when consolidated financial statements are prepared. In order to prepare consolidated department wide financial statements, HUD requires that FHA, Ginnie Mae, and the Office of Federal Housing Enterprise Oversight submit financial statement line level spreadsheet templates, which are loaded into a software application. In addition, all the consolidating notes and supporting schedules must be manually posted, verified, reconciled, and traced. This is a labor-intensive process with heavy reliance on the OIG to detect errors. There is no integration between the accounting and reporting functions for preparing consolidated financial statements. This is a weakness in internal controls over the process of preparing consolidated financial statements. This weakness in internal controls, for material misstatements in the financial statements, has not been reduced to a relatively low level.

As reported in prior fiscal years, we found deficiencies in several supporting financial management systems. These deficiencies are as follows:

- Sub-ledger activities do not automatically post to the Department's general ledger. Transaction data is passed manually or via sequential system batch processes before it posts to the general ledger. This increases the possibilities for error and builds in significant time delays before information is available.

- Current Department financial management systems architecture is composed of “stove pipe” legacy feeder systems. The number of feeder systems also requires numerous reconciliations, results in increased maintenance costs, and may diminish data integrity and accuracy.
- The Department has not met the minimum set of automated information resource controls relating to Entity-wide Security Program Planning and Management. Specifically, the Department is not compliant with Federal requirements in the areas of development and maintenance of Security Plans, Independent Review of Security Plans, and Accreditation and Certification of information systems. Information system control weaknesses could negatively affect HUD’s entity-wide security program and the integrity, confidentiality, and availability of its financial data.
- The Department’s financial reporting and management needs are not fully supported by key Single Integrated Financial System components. Current system components often lack the ability to automatically feed financial information to other system components. For example, the Department’s current financial system: (1) lacks the data and system feeds to automated a process to accumulate, allocate, and report costs of activities on a regular basis for financial reporting needs as well as internal use in managing programs and activities, (2) does not allow cost data to be integrated into the daily management of department operations, and (3) includes key, stand-alone, mixed financial feeder systems. While the Department has several ongoing core financial management systems projects, which will correct these inefficiencies, currently system interfaces are often inefficient requiring users to perform manual analyses, additional reconciliations, and enter duplicative entries.
- The FHA Subsidiary Ledger Project is on schedule and does improve compliance with Federal financial management laws, regulations, and other requirements. However, until the Project is fully deployed, FHA financial systems will continue to have instances where they are not in compliance. Currently FHA’s systems do not provide for:
 1. A fully integrated funds control capability for FHA’s multifamily insurance credit subsidy and Single Family underwriting operations, property management, and acquisition management within the core financial system.
 2. Effective management over the scheduling for payment and reconciliation of Single Family Treasury payments.
 3. Maintenance of Single Family insurance notes as well as account receivables for claims, refunds, adjustments, and indemnifications.
 4. Automated processes for Multifamily Claims accounts payable and payments to claimants.
- HUD does not have an integrated accounting system to support the recording and reporting of commitments for the Section 236 Interest

Reduction Program. As a result, commitments balances were not being timely adjusted and future contract authority requirements were misstated (see report section beginning with “HUD needs to improve the controls over developing estimates for required budget authority for the Section 235 Interest Reduction Program”).

- There is a lack of automated interfaces between the Office of Public and Indian Housing and the Office of Housing subsidiary records with HUD’s general ledger for the control of program funds. This necessitates that HUD and its contractors make extensive use of ad hoc analyses and special projects to review Section 8 contracts for excess funds. This has hampered HUD’s ability to timely identify excess funds remaining on Section 8 contracts (see report sections beginning with “HUD needs to improve processes for reviewing obligation balances”).
- HUD does not have adequate assurance about the propriety of Section 8 rental assistance payments.

HUD’s Actions Planned and Underway to Improve its Financial Management Systems

In fiscal year 2002, the Office of Chief Financial Officer authorized funding to contract out the feasibility and cost-benefit studies to replace HUD’S Central Accounting and Program System and the supporting payments and funds control systems, Line of Credit and Control System and Program Accounting System. In fiscal year 2003, HUD’s Office of the Chief Financial Officer launched the HUD Integrated Financial Management Improvement Project, which will encompass all of HUD’s financial systems, including those supporting FHA and Ginnie Mae. HUD has complete the first phase of the project and has provided resources for project management and initiation of the requirements phase. The Department anticipates that the HUD Integrated Financial Management Improvement Project will result in an implemented integrated core financial system that will summarize financial data, control funds, prepare annual financial statements, and meet all internal and external reporting requirements. When fully implemented, the project will facilitate transactions between HUD partners and integrate front-end and back-end business processes where possible. The Department expects that the new integrated financial management system will ensure full Federal financial management system compliance, correct identified weaknesses, strengthen data integrity, and ensure adequate controls.

FHA has made significant progress in its overall compliance with Federal financial management system requirements. As previously noted, a key milestone was achieved during fiscal year 2003 with the implementation of the FHA financial system’s general ledger module. In fiscal 2004, FHA completed the implementation of its core financial system implementation with the addition of cash management, funds control, and contract modules. By fiscal year 2007, FHA plans to fully integrate program operations with its core financial system,

eliminating some legacy systems and reengineering others in order to implement budgetary controls at the source, further reduce the need for manual processing, and improve financial operations.

OIG's Assessment of HUD's Planned and Completed Actions

In regard to the Subsidiary Ledger Project, FHA needs to continue the progress made with the fiscal year 2003 implementation of the new subsidiary ledger and fiscal year 2004 implementation of funds control, cash management, and contract capability. Phase 3 of the Project began in fiscal year 2004. FHA has begun to review the 20 insurance systems that support FHA operations and their interfaces with the core financial system to determine the software's capability to support the program area's business processes. We will continue to monitor the project in fiscal year 2005.

In regard to HUD's Integrated Financial Management Improvement Project, the Department should continue its efforts to implement a modern, integrated core financial system. As noted above, the Project will enter into the Design Phase in fiscal year 2005 with the objective to (1) define core financial system requirements that will be used to modernize the integrated core financial system, (2) update the Software Development Methodology and Vision documentation, and (3) evaluate commercial off the shelf packages to provide an independent assessment of the package that will best meet the developed requirements. We will continue to monitor HUD's Integrated Financial Management Improvement Project in fiscal year 2005.

Reportable Condition

HUD Needs to Improve Controls over Performance Measures Data Reliability

OMB Bulletin 01-09, *Form and Content of Agency Financial Statements*, requires agencies to report performance measures in the management discussion and analysis about the efficiency and effectiveness of their programs. In prior years, we reported on our concerns over performance measure data reliability and questionable data quality and accuracy. The Department has made progress in solving the problems of data quality, timeliness, estimation, and availability of data used for its performance measures. However, there is still work to be done to ensure that these deficiencies are fully resolved. In addition, HUD needs to address data accuracy by providing adequate internal controls over the data used for the performance data. HUD continues to make improvement to its *Performance and Accountability Report* in reporting efficiency and effectiveness of its programs, but as in prior accountability reports, there is a continuing need to improve quality control over data reliability.

OMB Bulletin 01-02, *Audit Requirements for Federal Financial Statements*, requires that we obtain an understanding of controls relevant to the performance

measures included in HUD's Management Discussion and Analysis portion of its *Performance and Accountability Report* and include in our report on internal controls our findings with respect to internal controls that have not been properly designed and placed in operation. In response to the need to ensure data quality over HUD's performance measures, HUD's Office of the Chief Information Officer implemented a data quality project. This project set Department-wide quality standards including data quality certifications for HUD's mission critical data including performance data. The data quality certification is the responsibility of Office of the Chief Information Officer.

The Chief Information Officer has focused current data quality efforts on the certifications of systems that provide data for performance measures. In planning this effort, Office of the Chief Information Officer identified 87 performance measures that require data from internal systems and other internal and external sources. The data for 47 of these measures is derived from 26 of HUD's internal systems for key program areas. During our review, we noted concerns with 22 of the 26 systems² where HUD is continuing to address data quality in some manner. The Office of the Chief Information Officer has certified the data quality for 13 of these systems at the current policy levels for data quality (3-Sigma)³ and has plans to certify nine other systems. However, only four of the systems are certified to the data quality level recommended for performance measurement data (6 Sigma).⁴

In addition, several of Office of the Chief Information Officer certification reports indicated that the program areas did not always access data accuracy, or have an internal process to routinely check the accuracy of the data back to the source. We found that only four systems⁵ had Quality Assessment Plans to routinely access data accuracy back to the source for six of the performance measures. In addition, there was little or no indication where the data accuracy is routinely assessed for data from other internal or external sources for the remaining 40 performance measures. The current data quality assessed in this effort, the data accuracy and the data quality level recommended for performance measurement data is the responsibility of the program areas.

² The program areas' 26 systems include the 13 systems certified at 3-Sigma (PASS, FASS, NASS, HOME, CDBG, 50058, SEMAP, TEAPOTS, TRACS, HUDCAPS, MFIS, SAMS, REMS), four systems certified at 6-Sigma (RASS, CSFSS, CPD/APR & DAP) and nine systems pending certification (Housing Section 202 Conversion Grants Database, PERMS, IBS, HPS, ARCATS, OMHAR, HUD's Application Project Database, HOPE VI, & DECMS).

³ **3-sigma (3σ or 3s):** Three standard deviations used to describe a level of quality in which three standard deviations of the population fall within the upper and lower control limits of quality with a shift of the process mean of 1.5 standard deviations, and in which the defect rate approaches 6.681%, allowing no more than 66,810 defects per million parts. ^{LPE}

⁴ **6-sigma (6σ or 6s):** Six standard deviations used to describe a level of quality in which six standard deviations of the population fall within the upper and lower control limits of quality with a shift of the process mean of 1.5 standard deviations, and in which the defect rate approaches zero, allowing no more than 3.4 defects per million parts. ^{LPE}

⁵ The four systems include RASS, PASS, NASS, and FASS.

The data accuracy assessments are a proactive step to prevent non-accurate data from being entered into information systems. Similar to the data quality process, a data accuracy process is a continuing effort that maintains information accuracy through routine reviews of accuracy checking data back to its source. The frequency of this ongoing process will establish patterns to identify the *causes* of defective data. When deficiencies in data are discovered, immediate steps must be taken to understand the problem that led to the deficiency, to correct the data and fix the problem.

Eliminating the causes of data defects and the production of defective data will reduce the need to conduct further costly data correction activities, such as cleanup efforts the CPD's Integrated Disbursement and Information System has continued to undergo during fiscal year 2004. The Department expects to complete this two-year effort during fiscal year 2005. We previously reported that cleanup efforts were also needed for the Public Housing Information Center system and Tenant Rental Assistance Certification system. The Office of the Chief Information Officer has identified a process for cleaning up existing data and ensuring that the data is at a high quality level.

Housing Assistance Program Delivery

Monitoring and Payment Processing Weaknesses Continue

Under the provisions of the U.S. Housing, Act of 1937, HUD provides housing assistance funds through various grant and subsidy programs to multifamily project owners (both nonprofits and for profit) and housing authorities. These intermediaries, acting for HUD, provide housing assistance to benefit primarily low-income families and individuals (households) that live in public housing, Section 8 and Section 202/811 assisted housing, and Native American housing. In fiscal year 2004, HUD spent about \$23 billion to provide rent and operating subsidies that benefited over 4 million households. Weaknesses continue to exist in HUD's control structure preventing HUD from assuring that these funds are expended for rent subsidies in accordance with the laws and regulations authorizing the grant and subsidy programs.

Since 1996, we reported on weaknesses with the monitoring of housing assistance program delivery and the verification of subsidy payments. In this report, we again focus on the impact these weaknesses have on HUD's ability to (1) ensure intermediaries are correctly calculating housing subsidies and (2) verify tenant income and billings for subsidies. The material weakness discussed below encompasses public housing and tenant-based Section 8 programs administered by PIH along with project-based subsidy programs administered by the Office of Housing.

Material Weakness

Improvements Needed in Oversight and Monitoring of Subsidy Calculations and Intermediaries Program Performance

HUD's internal control structure does not adequately address the significant risk that HUD's intermediaries are not properly carrying out their responsibility to administer assisted housing programs according to HUD requirements. This was due to insufficient on-site monitoring or technical assistance to ensure acceptable levels of performance and compliance were achieved along with the absence of an on-going quality control program that would periodically assess the accuracy of intermediaries rent determinations, tenant income verifications, and billings. We also are reporting on significant control weaknesses in HUD's tenant income verification process and intermediaries' subsidy billings process.

These weaknesses related to tenant income, which is the primary factor affecting eligibility for, and the amount of, housing assistance a family receives, and indirectly, the amount of subsidy HUD pays. Generally, HUD's subsidy payment makes up the difference between 30 percent of a household's adjusted income and the housing unit's actual rent or, under the Section 8 voucher program, a payment standard. The admission of a household to these rental assistance programs and the size of the subsidy the household receives depend directly on its self-reported income. However, significant amounts of excess subsidy payments occur because of intermediaries rent

determinations, and undetected unreported or underreported income. In addition, significant errors were identified in intermediaries' billings and payments processes.

By overpaying rent subsidies, HUD serves fewer families especially those who may be eligible but unable to participate because of limited funding. The impact of payment errors of this magnitude takes on added significance in light of a HUD estimate⁶ that the "worst case housing needs" is around 5.4 million households and is projected to increase at twice the rate of the population growth. This estimate relates to the number of unassisted very-low-income renters who pay more than half of their income for housing or live in severely, substandard housing.

Verification of Subsidy Payments

The estimate of erroneous payments that HUD reports in its financial statements relates to HUD's inability to ensure or verify the accuracy of subsidy payments being determined and paid to assisted households. This year's contracted study of HUD's three major assisted housing programs estimated that the rent determination errors made by the intermediaries resulted in substantial subsidy overpayments and underpayments. The study was based on analyses of a statistical sample of tenant files, tenant interviews, and income verification data for activity that occurred during the last half of fiscal year 2003. This study reports subsidy payment inconsistencies such that HUD incorrectly paid \$1.416 billion in annual housing subsidies of which about \$897 million in subsidies was overpaid on behalf of households paying too little rent, and about \$519 million in subsidies was underpaid on behalf of households paying too much rent based on HUD requirements. The estimate of erroneous payments is reported in note 17 to the financial statements.

The estimate of erroneous payments reported in note 17 this year also includes overpaid subsidies from underreported and unreported income and intermediaries billings errors. For this year's estimate from underreported and unreported income, HUD conducted a new study of misreported income. HUD estimated that housing subsidy overpayments from tenants misreporting their income totaled an additional \$192.2 million in overpayments during calendar year 2003. However, HUD did not provide the information timely or adequately supported with sufficient evidence to substantiate misreported income errors. Our review based on information provided by HUD indicated that the estimate could be as high as \$627 million in overpayments.

In addition, HUD describes an estimate of erroneous payments for its intermediary's subsidy billings errors related to Office of Housing's project-based Section 8 housing program. HUD developed a new estimate for the Section 8 project based program after conducting another quality control review. HUD was

⁶ As stated in U.S. Department of Housing and Urban Development FY 2000–FY 2006 Strategic Plan, September 2000.

unable to contract and conduct its quality control review for the Public and Indian Housing's tenant-based Section 8 and low-income housing subsidy programs in time to be included in this year's report. The quality control results indicate that erroneous payments had resulted from the intermediaries' failure to accurately report or maintain required subsidy determination documentation, along with bookkeeping or procedural errors.

Based on the payments errors that were identified, HUD reported an estimated \$100 million in Office of Housing's program billings errors for fiscal year 2003. However, we were unable to substantiate this estimate and were not provided any information regarding this estimate. We were provided information for an estimate of \$138 million in Office of Housing's program billings errors for fiscal year 2003, which appeared to be a valid estimate. In addition, HUD failed to include its fiscal year 2003 billings error estimate of \$514 million for the tenant-based Section 8 housing program along with its new estimate. In addition, the low-income housing program estimate was excluded from the estimate. HUD did not provide an estimate for its low-income housing subsidy program because it had not previously developed such an estimate. We continue to recommend the low-income housing program be included in future billings studies since the same intermediaries also administer the Section 8 tenant-based program and there may be similar billing errors in the low-income housing program as well. Adding last year's estimate of \$514 million to the \$138 million makes the estimate of erroneous payments total \$652 million for billings errors.

HUD needs to continue initiatives to use available income matching tools to detect unreported tenant income

HUD, housing authorities, and project owners have various legal, technical and administrative obstacles that impede them from ensuring tenants report all income sources during the certification and re-certification process. Since unreported income is difficult to detect, HUD began pursuing statutory authority from Congress to access and use the Department of Health and Human Service's National Directory of New Hires Database to detect unreported income during the certification and re-certification process. This year, Congress authorized legislation for this access. However, the Department of Health and Human Service's interpretation of this authorization restricted HUD's use of the data for testing only, thus restricting HUD's use to determining an estimate for its unreported and underreported income error. HUD is pursuing expansion of the data use with the Department of Health and Human Services, and anticipates using the data to determine tenant's unreported and underreported income during the re-certification process. HUD has continued to encourage housing authorities to verify income and assisted certain housing authorities by establishing agreements with thirty states to allow computer matching of tenant income with State wage data.

More progress needed on the RHIIP initiatives

HUD initiated the Rental Housing Integrity Improvement Project initiatives in fiscal year 2001 in an effort to develop tools and the capability to minimize erroneous rental subsidy payments, which includes the excess rental subsidy caused by unreported and underreported tenant income. Since our last report, HUD has made progress in implementing several of these initiatives that address the problems surrounding housing authorities' rental subsidy determinations, underreported income, and assistance billings. However, HUD has not fully utilized automated tools to (1) detect rent subsidy processing deficiencies, (2) identify and measure erroneous payments, or (3) have housing authorities submit all required data.

Rental Integrity Monitoring reviews show need for stronger measures

The Office of Public and Indian Housing performs rental integrity monitoring reviews to identify incorrectly paid rental subsidy that result from incorrect rental subsidy determinations made by housing authorities. Our analysis of HUD re-reviews of previous conducted rental integrity monitoring reviews showed that housing authorities continued to have problems in determining the correct rental subsidies. At the time of our fieldwork, the four field offices had completed 16 re-reviews of the housing authorities administering 80 percent of Office of Public and Indian Housing funds. The results of these re-reviews showed that 11 housing authorities had failed to improve. The field offices were requiring corrective action plans from the housing authorities to address the problems found. However, the field offices had not taken action against the housing authorities such as sanctions, disallowing and recapturing costs, or referring independent public accounting firms for compliance reviews. In addition, we also found that one field office had not required corrective action on all tenant files when systemic deficiencies were noted, but instead only required the reviewed tenant files with the errors to be corrected.

HUD needs to improve housing authority reporting

HUD uses the tenant data from its Public Housing Information Center system, and the Tenant Rental Assistance Certification System for the income-matching program and program monitoring. To accomplish these two objectives, it is essential that both databases have complete and accurate tenant information. The Public Housing Information Center system information was incomplete as housing authorities reporting requirements were again discretionary this year. In addition, controls over project-based subsidy data maintained in Tenant Rental Assistance Certification System needs improvement. This long-standing weakness with the processing of subsidy payment requests has been hampered by the need for improved information systems to eliminate manually intensive review procedures that HUD has been unable to adequately perform.

Multifamily project monitoring needs to place more emphasis on subsidy determinations

The Office of Housing needs to continue its efforts to verify tenant data and the accuracy of Section 8 subsidies during Management and Occupancy Reviews⁷ as well as increase the number of Management and Occupancy reviews performed on the portfolio administered by HUD staff and traditional contract administrators. Our audit work found that tenants' income and subsidy amounts were not regularly verified to HUD's official data. In addition, only a small portion of multifamily portfolio administered by HUD staff or traditional contract administrators received Management and Occupancy Reviews. The verification of tenant income and Section 8 subsidies is essential in ensuring rental assistance is correctly calculated and that recipients are eligible.

Our review focused on the use of the individual monitoring tools available to the Office of Housing. The Office of Housing uses HUD staff, Performance Based Contract Administrators and traditional Contract Administrators to oversee multifamily projects. The results of our audit work indicated that tenants' income and subsidy payments were not consistently verified to HUD data during Management and Occupancy Reviews at two of the four Performance Based Contract Administrators visited. In 18 of 35 project files reviewed at one site, tenant income and subsidy amounts contained in tenant files were not verified to the Tenant Rental Assistance Certification System, rent schedules, or Housing Assistance Payment vouchers during Management and Occupancy Reviews. At the other Performance Based Contract Administrator, it was not their policy to verify tenant subsidies in the certification system to the payment voucher during Management and Occupancy Reviews. Therefore, none of the projects reviewed at this Performance Based Contract Administrator contained a verification of the tenant subsidy to the payment voucher. In addition, 17 of the 68 (or 25 percent) project files reviewed at these two Performance Based Contract Administrators lacked sufficient documentation to determine that the reviewer verified the tenant's income or recalculated the section 8 subsidies for accuracy.

At the end of fiscal year 2004, 12,215 projects were assigned to Performance Based Contract Administrators and all received a Management and Occupancy Review. HUD staff and traditional Contract Administrators still administer 10,044 projects. Our review showed HUD's continued implementation of the Performance Based Contract Administrator initiative resulted in an increase in the total number of Management and Occupancy Reviews conducted during fiscal year 2004 compared with the previous year. However, a substantial portion of the multifamily portfolio was still managed by HUD staff and traditional Contract Administrators and only a small portion of this portfolio received Management and Occupancy Reviews. According to data available in the Real Estate

⁷ Occupancy reviews test compliance with occupancy requirements, generally seeking to validate that only tenants meeting eligibility requirements occupy the project, that this is documented by tenant certifications and recertifications maintained by the project owner, and that this information is correctly entered in Tenant Rental Assistance Certification System.

Management System, HUD conducted Management and Occupancy Reviews during fiscal year 2004 for 2079 (or 20 percent) of the 10,044 projects receiving direct oversight by HUD staff or traditional Contract Administrators. Additionally, we found that the selection of properties for a Management and Occupancy Review was based primarily on factors related to the risks associated with deteriorating physical conditions and with the risks associated with loan default. The scheduling of reviews did not include an assessment of factors directly associated with the risk of owner non-compliance with occupancy requirements.

HUD's Actions Planned and Underway to Verify Tenant Income

In fiscal year 2004, HUD again planned to start providing annually its estimates of erroneous payments from rental determination errors, under and unreported income and billings errors as part of its annual total error measurement process under the Rental Housing Integrity Improvement Program. However, for fiscal year 2004 financial statement reporting, HUD only completed estimates for the erroneous payments for Rental Assistance Subsidies Determinations, reported income, and billings errors for the project-based Section 8 program. HUD did not initiate the billings error study for the tenant-based Section 8 and the low income housing subsidy programs early enough in the year to develop an estimate for this year's report.

In fiscal year 2004, the Rental Housing Integrity Improvement Program advisory group continued to meet and implement strategies to address the problems associated with rental subsidy calculations. Starting in fiscal year 2005, HUD plans to conduct the (1) quality control study for rental determinations, (2) misreported income reviews, and (3) intermediaries' billings measurement processes for its three major housing assistance programs as part of an annual comprehensive error measurement process. The measurement process will build upon existing monitoring activities by evaluating the effectiveness of the field-monitoring activities.

This year the Office of Public and Indian Housing continued to implement its rental integrity monitoring program by re-reviewing the 490 housing authorities administering 80 percent of the funds. In addition, HUD still plans to pursue recapture of overpaid rental subsidy identified through these reviews as a disallowed cost. HUD also plans to continue its reviews on a smaller scale with focus on smaller or problem housing authorities.

HUD now plans to use the Department of Health and Human Services new hires data in an income verification system, which would allow all third party intermediaries access to the income verification data. The Office of Housing continues to pursue incentives to improve the Tenant Rental Assistance Certification System data reporting, starting with an 85 percent reporting goal and plans to provide automated web-based interface of the rent calculation software with the database. Funding had been provided for the business process redesign

study on the system's tenant data. This increased capability and information should simplify computer matching and intermediary's billing error measurement.

Multifamily project monitoring is a combined effort on the part of HUD staff and the Performance-Based Contract Administrators. In FY 2004, HUD awarded contracts for Performance Based Contract Administrator services in seven geographic service areas and plans to award contracts in the remaining two areas in early fiscal year 2005. Office of Housing's efforts will continue to focus on higher risk properties. Enforcement actions will continue from referrals because of deficiencies detected through financial assessments and physical inspections. Other efforts supplementing risk management include implementation of the Online Property Integrated Information Suite. The latest version of the tool includes a newly developed Integrated Risk Assessment tool and uses information from physical condition, financial reporting and other data to evaluate the relative risk of each property in the portfolio

OIG's Assessment of HUD's Planned and Completed Actions

Once HUD establishes the capability to annually conduct its total error measurement process, HUD should evaluate the effectiveness of the process, with emphasis on determining what effects completed Rental Housing Integrity Improvement Project tasks have had on reducing erroneous payments and whether additional steps need to be implemented. Our assessment indicates that these initiatives have primarily focused on reducing overpayments and have done little to change the underpaid subsidies, and these underpaid subsidies result in tenants paying more of the rent than they should. HUD should continue to pursue all alternatives identified through the initiatives, such as establishing protocols on disclosing New Hires data to housing authorities and project owners to improve the housing assistance program's effectiveness.

Regarding HUD's rental integrity monitoring initiative, its impact and effectiveness in reducing incorrect rental subsidy determinations could not be fully evaluated this year since most of the re-reviews for the housing authorities were performed after the end of our field work. However, the reviews evaluated during our fieldwork did identify (1) increases in rental determination errors and (2) the need for HUD to conduct additional reviews to include coverage to all housing authorities. HUD also needs to conduct follow-up at the housing authorities identified to have made rental determination errors to ensure corrective action was initiated, and pursue sanctions and other remedial actions against housing authorities that failed to improve.

In addition, HUD has yet to implement a comprehensive evaluation program of rental determination for its Section 8 project-based program. HUD's plans to require housing authorities to use the upfront income verification system are still pending and probably won't be fully implemented because of system delays and access restrictions for non-government administrators. In addition, HUD needs to (1) address deficiencies identified by its billings error study to prevent additional

overpayments to HUD intermediaries and (2) complete the error measurement process for intermediaries' billings by conducting reviews of the intermediaries' billings for the low income housing subsidy program. Once the billings error study is completed, PIH needs to take action to address the problems causing the billings errors.

HUD should also continue to develop the capability to obtain relevant tenant data that would allow the process to be practical and cost effective for rental calculation determinations and billings verification systems. We are also encouraged by the on-going actions to refocus on accountability and HUD plans regarding rental integrity monitoring reviews, quality assurance reviews of billings, the reporting rate and data integrity of the Public Housing Information System, and improvements in the capability of Tenant Rental Assistance Certification System.

We are encouraged by the increased use Performance Based Contract Administrators. We support the plans to increase the frequency of management and occupancy reviews for the assisted portfolio and suggest that similar to the approach to physical inspections, they be performed more frequently for troubled and potentially troubled projects, and that occupancy review work be emphasized.

SYSTEM AND ACCOUNTING ISSUES

In our earlier discussion of concerns with HUD's internal control environment, we stressed the need for HUD to complete on-going efforts to improve its financial systems. Because of the large volume of financial transactions, HUD relies heavily on automated information systems. In prior years, we reported on security weaknesses both in HUD's general processing and specific applications such that HUD could not be reasonably assured that assets are adequately safeguarded against waste, loss, and unauthorized use or misappropriation. Progress in improving these controls has been slow. Presented below is a discussion of the weaknesses noted which relate to the need to improve:

- controls over the computing environment, and
- administration of personnel security operations.

We also discuss the need for HUD to improve its processes for reviewing outstanding obligations and to improve controls for developing estimates of required budget authority for the Section 236 Interest Reduction Program.

Reportable Condition

Controls over HUD's Computing Environment Can be Further Strengthened

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

We evaluated selected information systems general controls of the Department's computer systems, on which HUD's financial systems reside. Our review found information systems controls weaknesses that could negatively affect the integrity, confidentiality, and availability of computerized data. This audit report summarizes the control weakness found during the review⁸.

⁸ Audit Report Number 2005 DP 0001, "Fiscal Year 2004 Review of Information Systems Controls in Support of the Financial Statements Audit," dated October 19, 2004.

Computing Environment

Access to employee data on the vendor name inquiry table in the HUD's Central Accounting and Program System has not been limited. We identified 407 users of the system who had access to records about an individual, including name and identifying number (e.g., Social Security number). We found that 352 of the 407 users (86 percent) did not need to know this information to perform their jobs. Personnel data in this table included employee name, address, and Social Security number, which are used as the vendor code. The Privacy Act of 1974 requires HUD to limit access to sensitive personal identifying information to those employees or contractors that require the access to complete specific job related tasks.

HUD does not have a dedicated backup for the security administrator on the Hitachi mainframe. NIST SP 800-12 states that system administrators need to ensure the continuity of their services.

Network Environment

A number of weaknesses in HUD's network security were found during a vulnerability assessment performed by an OIG contractor. For example, we found (1) critical patches were not applied in a timely manner, (2) computer infrastructure information was inappropriately revealed to the public through discussion forums and e-mails sent by the server, (3) audit trails were not reviewed or maintained for an adequate period of time in the Unix and Windows environments, (4) HUD did not sufficiently protect connections to its network, (5) HUD's intrusion detection system did not detect internal attacks, and (6) vulnerabilities in the configuration of Unix and Windows operating systems and networks.

Software Configuration Management

Configuration Management (CM) is the control and documentation of changes made to a system's hardware, software and documentation throughout the development and operational life of the system. HUD uses the automated CM management tools called Endeavor and CoolGen on the IBM compatible Hitachi mainframe and CMPlus on the Unisys mainframe computers. All software changes, including emergency fixes, must go through Endeavor, CoolGen, or CMPlus. The Department does not comply with computer security guidelines issued by NIST and its own internal policies and procedures to ensure that adequate software change controls are in place. For example,

- Configuration management roles and responsibilities are not clearly stated in HUD’s “Configuration Management Policies” and “Configuration Management Procedures” documents;
- HUD has not ensured that personnel are designated as backups to administrators for the Endeavor, CoolGen, and CMPlus configuration management tools; and
- The Configuration Management Plan for the Single Family Premium Collection Subsystem – Upfront needs to be updated as indicated in HUD’s “Configuration Management Best Practices” document. Specifically, the Plan did not: (1) require changes to system requirements and functions to be documented, (2) specify emergency fix libraries, and (3) identify CoolGen as one of the configuration management tools that it uses.

Unisys Operating System

HUD has not implemented sufficient controls over the Unisys 2200 operating system. Below are examples of the deficiencies found.

- Security policies and procedures were not documented.
- Security events such as user activity and audit logs were not maintained, monitored, or reviewed.
- Adequate security training was not provided. We found five out of seven employees did not have the required fundamental Unisys security-related training. In addition, no employees had been trained on the software that administers security on the Unisys platform.
- Adequate controls were not implemented to prevent users excessive privileges to functions that bypass security controls. Twenty-six users may have been inappropriately granted privileges to functions that bypass security controls within the Unisys operating system. We determined that the privileges were excessive for 17 of the 26 users based on their job functions. We were unable to determine whether the privileges were excessive for the remaining nine because HUD could not provide us with their job functions. One example of a function that bypasses security controls is permission for the user to start runs under any user ID identification, including executing the capabilities of a security officer.
- HUD did not enable the system feature designed to clear data from previously assigned storage. Enabling this feature would ensure that residual data from a previous user’s session were not available

to a newly assigned user who may not be authorized to view the data.

Development of Contingency Plans

During fiscal year 2004, it is unlikely that HUD would have been able to recover information technology operations in a timely and orderly manner in the event of a disruption at its “production” computer center operated by Lockheed Martin. We found that the Information Technology Contingency Plan (1) had not been updated since November 2003, (2) did not address changes and risks resulting from recent contractual actions, (3) did not include procedures for the restoration of critical information technology resources and data, (4) did not identify the impact of the loss critical information technology systems and components, (5) did not assess data to determine its sensitivity and criticality, and (6) had not been tested since April 2002. NIST SP 800-34, “Contingency Planning Guide for Information Technology Systems,” indicates that

- The contingency plan must include a strategy to recover and perform system operations at an alternate facility for an extended period.
- A business impact analyses should be completed for each system to establish the sequence of recovery for HUD’s systems.
- The Information Technology Contingency Plan should be reviewed for accuracy and completeness at least annually, as well as upon significant changes to any element of the plan, system, business processes supported by the system, or resources used for recovery procedures, including a new Disaster Recovery Facility or equipment.

HUD’s Actions Planned and Underway to Improve Controls over its Computing Environment

The Assistant Secretary for Administration/Chief Information Officer concurred with all applicable recommendations. One recommendation was agreed to in principle. This was the OIG recommendation that HUD store backup production data at the Electronic Data Systems Disaster Recovery Facility. The Assistant Secretary indicated that it would be cost prohibitive to implement the recommendation at this time. Due to the Lockheed Martin bid protest of the HUD Information Technology Services contract award, HUD cannot invest in the transfer of the backup tapes to disaster recovery facility until after the GAO decision is rendered.

The Deputy Assistant Chief Financial Officer for Systems concurred with our recommendation and agreed to initiate a software change to HUD’s Central

Accounting and Program System to provide a view of the vendor name inquiry table that segregates commercial vendor records from employee records.

OIG's Assessment of HUD's Planned and Completed Actions

The Assistant Secretary for Administration/Chief Information Officer was responsive to our findings and recommendations. We agree that it would be prudent to wait for the GAO decision on the Lockheed Martin bid protest before taking action. A decision from GAO is expected before the end of November 2004. The Deputy Assistant Chief Financial Officer for Systems was responsive to our finding and recommendation.

Reportable Condition

Weak Personnel Security Practices Continue to Pose Risks of Unauthorized Access to the Department's Critical Financial Systems

For several years we have reported that HUD's personnel security over critical and sensitive systems' access has been inadequate. Although HUD has made some progress to address the reported problems, risks of unauthorized access to the Department's critical financial systems remain a major concern. The Department does not have a central repository that would account for all users with above-read (query) access to all HUD general support and application systems. Consequently, HUD has no assurance that all users who have access to HUD's sensitive systems have had the appropriate background investigation. Without adequate personnel security practices, inappropriate individuals may be granted access to HUD's information and resources that could result in destruction or compromise of critical and sensitive data.

We previously reported that the Information Technology Operations Security Branch does not track users with above-read access at the application level. That is, while the Security Branch initially granted read access to the user, the systems administrators for the various applications may subsequently upgrade the user's access. Those with above-read access to sensitive application systems are required to have a background investigation. Without a complete list of users with above-read access, the personnel security officer is unable to perform a full reconciliation of these users to the Security Control and Tracking System database that tracks background investigations for all HUD employees and contractors. In addition, an accurate reconciliation cannot be performed without a user's social security number, which is not always available. We found 75 of approximately 2,800 users who were granted above query access to sensitive application systems may not have had the required background investigation.

HUD Handbook 732.3, "HUD Personnel Security/Suitability" provides that the Office of Chief Information Officer, in conjunction with program security administrators, is responsible for identifying individuals, HUD employees, and contractors who require background investigations based on their access to

sensitive systems. Additionally, the Handbook requires the Office of Chief Information Officer to provide the Office of Human Resources Personnel Security staff with a quarterly list of all individuals who require sensitive access to mission-critical systems within 3 working days following the end of each fiscal quarter. The Office of Human Resources Personnel Security Officer is responsible for reconciling, as needed, the Security Control and Tracking System database with the information technology listing of users who require above query access to mission-critical (sensitive) systems.

This condition occurred because HUD has not fully implemented the HUD Online User Registration System. If fully implemented, the System would contain information about authorized users, including requests for access to automated resources and approvals. HUD has not developed procedures to identify and link user application access data that can be matched with background investigation data in the Security Control and Tracking System.

Without ensuring that all users who have access to HUD's sensitive systems have had the appropriate background investigation, there is increased risk that unsuitable users may intentionally misuse, damage, or destroy HUD's data.

HUD's Actions Planned and Underway to correct Personnel Security Issues

The Assistant Secretary for Administration/Chief Information Officer agreed to implement our recommendations relating to the personnel security.

OIG's Assessment of HUD's Planned and Completed Actions

The Assistant Secretary for Administration/Chief Information Officer was responsive and agreed to implement our recommendations relating to personnel security.

Reportable Condition

HUD Needs to Improve Processes for Reviewing Obligation Balances

HUD needs to improve controls over the monitoring of obligated balances to determine whether they remain needed and legally valid as of the end of the fiscal year. HUD's procedures for identifying and deobligating funds that are no longer needed to meet its obligations are not always effective. This has been a long-standing weakness. Our review of the 2004 year-end obligation balances showed \$708 million in excess funds that could be recaptured. Although HUD has made some progress in implementing procedures and improving its information systems to ensure accurate data are used, further improvements in financial systems and controls are still needed. Major deficiencies include:

- Obligations identified as invalid are not being deobligated in a timely manner.
- Timely reviews of unexpended obligations are not being performed.
- A lack of integration between accounting systems and the need for accurate databases has hampered HUD's ability to evaluate unexpended Section 8 obligations.

Since fiscal year 1998, our audit reports on HUD's financial statements have contained a reportable condition that HUD needs to improve processes for reviewing obligation balances. Because of reporting requirements of the Statement of Budgetary Resources, additional deficiencies noted during this year's review, and the increased emphasis placed on the reported obligation balances by Congress and OMB, we are still assessing these concerns as a reportable condition.

Annually, HUD performs a review of unliquidated obligations to determine whether the obligations should be continued, reduced, or canceled. We evaluated HUD's internal controls for monitoring obligated balances. As in prior reports, we found a number of weaknesses in the process including: (1) offices not deobligating funds that are no longer needed to meet its obligations in a timely manner and (2) underlying financial systems do not support the process for identifying excess budget authority.

HUD is not deobligating funds in a timely manner

Requests for obligation reviews were forwarded by the Chief Financial Officer to the program and administrative offices. The focus of the review was on program obligations that exceeded a \$200,000 balance and administrative obligations that exceeded \$25,000. Excluding the Section 8 programs, which undergo a separate review process by the program offices, the total dollar amount of obligations identified for review totaled \$1.1 billion. Of the \$1.1 billion, \$119.7 million, involving 5,014 transactions, was identified for deobligation. We tested the 174 transactions above the Department's review thresholds to determine whether the associated \$94.7 million balances had been deobligated in HUD's Central Accounting and Program System. We found that, as of September 30, 2004, 58 of the 174 transactions with obligational authority of \$15.1 million had not been deobligated.

HUD needs to place additional emphasis on identifying excess reserves in Section 8 programs

Section 8 budget authority is generally available until expended. As a result, HUD should periodically assess and identify excess program reserves in the Section 8 programs as an offset to future budget requirements. Excess program reserves represent budget authority originally received, which will not be needed to fund the related contracts to their expiration. While HUD had taken some

action to identify and recapture excess budget authority in the Section 8 programs, weaknesses in the review process and inadequate financial systems continue to hamper HUD's efforts. There is a lack of automated interfaces between the Office of Public and Indian Housing and the Office of Housing subsidiary records with the Department's general ledger for the control of program funds. This necessitates that HUD and its contractors make extensive use of ad hoc analyses and special projects to review Section 8 contracts for excess funds. This has hampered HUD's ability to timely identify excess funds remaining on Section 8 contracts.

The Office of Housing has been hampered in its attempts to evaluate unexpended Section 8 project-based budget authority balances. The requirement to evaluate data from two payment methods, managed by two accounting systems has hampered Housing's ability to monitor obligations and execute recaptures uniformly for contracts in both systems. In fiscal year 2004, \$888 million in unliquidated obligation balances were recaptured in the Section 8 project-based program. Our review of the Section 8 project-based contracts in HUD's Central Accounting and Program System and Program Accounting System/Line of Credit and Control System showed 301 and 882 contracts respectively that had expired on or prior to September 30, 2003 with available contract/budget authority. These 1,183 contracts had \$473 million in excess funds potentially available for immediate recapture.

HUD has \$963.2 million in available contract/budget authority to cover the cost of its contracts with housing authorities for the Moderate Rehabilitation housing program. Our review showed that \$217 million of the \$963 million is associated with expired contracts that have no future funding requirements.

During fiscal year 2004, PIH performed an analysis of budget authority for the Section 8 tenant-based program and recaptured approximately \$68 million of unexpended budget authority. This is funding that housing agencies received under contracts with HUD, but did not expend or is not needed to make payments for housing assistance. Our review showed an additional \$3 million associated with expired contracts that have no future funding requirements.

HUD's Actions Planned and Underway to Improve the Process for Reviewing Obligations

Concerning HUD not deobligating funds in a timely manner, HUD plans to deobligate the \$15 million as associated contracts are closed. In the future, HUD plans to emphasize the timely completion of contract closeouts and obligation reviews.

The Office of Multifamily Housing, Financial Management Center, and Office of the CFO are working together to eliminate the requirement to evaluate data from two payment methods, managed by two accounting systems (HUDCAPS and PAS/LOCCS) which has hampered Housing's ability to monitor obligations and

execute recaptures uniformly for contracts in both systems. The effort will be made to convert contracts in HUDCAPS to the PAS/LOCCS payment method in FY 2005.

For the \$693 million in unliquidated obligations for expired Section 8 contracts identified as excess, HUD processed an accounting adjustment to deobligate the funds.

OIG's Assessment of HUD's Planned and Completed Actions

For the Department's program funds, HUD needs to promptly perform contract reviews and recapture the associated excess contract authority and imputed budgeted authority. In addition, HUD needs to address data and systems weaknesses to ensure all contracts are considered in the recapture/shortfall budget process.

With respect to project-based Section 8 contracts, we recommended in our audit of the Department's fiscal year 1999 financial statements that systems be enhanced to facilitate timely close-out and recapture of funds. In addition, we recommend that the closeout and recapture process occur periodically during the fiscal year. Implementation of the recommendations is critical so that excess budget authority can be timely recaptured and considered in formulating requests for new budget authority.

Reportable Condition

HUD Needs to Improve Controls for Developing Estimates of Required Budget Authority for the Section 236 Interest Reduction Program.

The budget authority related to Section 236 Interest Reduction Program is included in the Statement of Budgetary Resources. This program is not considered a major program and is categorized as one of HUD's "other programs" in the various consolidating financial statements. The Section 236 Interest Reduction Program was created around 1965 and new activity was ceased during the mid 1970's. The contracts entered into were typically up to 40 years in duration and over 3,000 contracts remained active. The activities carried out by this program include making interest reduction payments directly to mortgage companies on behalf of multifamily project owners. The obligations were established based upon permanent indefinite appropriation authority and HUD was obligated to fund these contracts for their duration. At the time they enter into the contract, HUD was to record an obligation for the entire amount. Because of the age of the records and the absence of sound financial practices at the time the program was active, HUD has been forced to use the best information available to compute estimated future payments to be made over the life of the loans. These estimates are the basis for HUD's currently recorded obligated balances necessary to fully fund the contracts to their expiration. HUD adjusts the recorded obligations as they proceed through the terms of the

contracts to reflect better estimates of the financial commitment. Factors that can change the budgetary requirements over time include contract terminations, refinancing, and restructuring.

Deficiencies in the Section 236 Interest Reduction Program have been reported by the OIG in prior reports on the financial statements. The Offices of Housing and the Chief Financial Officer have been hampered by historically poor record keeping in their attempt to determine and account for unexpended Section 236 Interest Reduction Program budget authority balances. In response to a recommendation in last year's management letter to the financial statement audit, the Chief Financial Office initiated a review of their data on a portion of the Section 236 projects in April 2004. While sufficient budget authority was already recorded in HUD's books to meet current requirements, based on this review, the Department estimated that the Department's recorded balances would not be sufficient to cover estimated funding requirements over the remaining durations of the contracts. Accordingly, an apportionment was conditionally approved by OMB on September 30, 2004 to provide \$495 million in additional budget authority based on permanent indefinite appropriation. OMB's condition was to require HUD to complete a full contract-by-contract accounting by July 1, 2005 to identify individual under-reported balances as well as over-reported balances.

In light of the apportionment, we expanded our procedures and our review showed there was insufficient documentation to support the amounts recorded on the subsidiary ledgers. In addition, we noted numerous errors in the subsidiary records pertaining to calculations used to estimate projected funding requirements. We found no formal written procedures for computing funding requirements for interest reduction subsidy payments and inadequate procedures to track projects that were terminated, refinanced, or restructured. Because we were unable to complete our audit in time to meet the November 15, 2004 due date required by OMB, we were unable to perform necessary procedures to determine if the estimate for Section 236 budgetary resources was reasonable. We are continuing to work with the Department as they complete the OMB directed review.

HUD's Actions Planned and Underway to Improve Controls over Developing Estimates for Budget Authority for Section 236 Interest Reduction Program

The Department has initiated a contract to review the documentation supporting the 236 contract and budget authority. HUD intends to complete a full contract-by-contract accounting by July 1, 2005 to identify individual under-reported balances as well as over-reported balances in order to meet OMB's request.

OIG's Assessment of HUD's Planned and Completed Actions

HUD's actions to identify and centralize documentation to support the subsidiary records of Section 236 should enable accurate estimates of future budgetary authority. HUD still needs to develop written procedures for estimating

budgetary resources and communicating changes to Section 236 portfolios, including projects that are refinanced, terminated, or restructured.

Compliance with Laws and Regulations

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

During fiscal year 2004, the Department continued to address its financial management deficiencies and took steps to bring the agency's financial management systems into compliance with Federal Financial Management Improvement Act. HUD has continued to obtain independent reviews of its financial management systems to verify compliance with financial system requirements, identify system and procedural weaknesses and develop the corrective actions steps to address identified weaknesses.

The Federal Financial Management Improvement Act requires auditors to report whether the agency's financial management systems substantially comply with the Federal financial management systems requirements, applicable accounting standards, and the SGL at the transaction level. The Act requires agency heads to determine, based on the audit report and other information, whether their financial management systems comply with the Act. If they do not, agencies are required to develop remediation plans and file them with the Office of Management and Budget (OMB).

As part of a multiphase project to be completed by fiscal year 2007, HUD implemented a new FHA automated general ledger in October 2002. This new system automated FHA's posting of transactions to the Standard General Ledger. With the implementation of the FHA Subsidiary System, the Department became substantially compliant with FFMIA Standard General Ledger provision and is moving in the direction of becoming FFMIA compliant with (1) Federal financial management systems requirements and (2) Federal Accounting Standards. We have included the specific nature of noncompliance issues, responsible program offices and recommended remedial actions in Appendix C of this report.

Federal Financial Management System Requirements

In its *Fiscal Year 2004 Accountability Report*, HUD reports that 4 of its 46 financial management systems do not comply with the requirements of the Federal Financial Management Improvement Act and OMB Circular A-127, *Financial Management Systems*. Even though 42 individual systems have been certified as compliant with Federal Financial Management Systems Requirements, collectively and in the aggregate, deficiencies still exist. In addition to deficiencies noted in HUD's Accountability Report, we report as a material weakness that *Financial Management Systems are Not Substantially Compliant with Federal Financial Systems Requirements*. This material weakness addresses how HUD's financial management systems remain substantially noncompliant with Federal financial management requirements, which represent a material weakness in internal controls.

We also continue to report, as a reportable condition that *Controls over HUD's Computing Environment Can be Further Strengthened*. This reportable condition discusses how weaknesses with general system controls over certain applications and weak security management increase risks associated with safeguarding funds, property, and assets from waste, loss, unauthorized use or misappropriation.

Independent A-127 compliance reviews of twelve systems and OIG audit reports have disclosed security over financial information is not provided in accordance with OMB Circular A-130 *Management of Federal Information Resources*, Appendix III and the Federal Information Security Management Act.

Compliance with Federal Accounting Standards

KPMG LLP reported a material weakness regarding HUD/FHA's limited ability to effectively monitor budget execution related to certain funds control processes. Because of the financial and operational ADP issues, FHA is unable to fully integrate, monitor and control its budgetary resources. (Statement of Federal Financial Accounting Standards (SFFAS) Number 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*).

Other Matters

The Office of the HUD Chief Financial Officer is currently investigating a potential Anti Deficiency Act violation associated with the commitment limitation for FHA's General Insurance/Special Risk Fund programs during a continuing resolution for fiscal year 2004. Accordingly, no final legal determination has been made at this time.

APPENDIXES

Appendix A

Objectives, Scope, and Methodology

Management is responsible for:

- preparing the principal financial statements in conformity with generally accepted accounting principles;
- establishing, maintaining and evaluating internal controls and systems to provide reasonable assurance that the broad objectives of Federal Managers' Financial Integrity Act are met; and
- complying with applicable laws and regulations.

In attempting to audit HUD's principal financial statements, we were required by *Government Auditing Standards* to obtain reasonable assurance about whether HUD's principal financial statements are free of material misstatements and presented fairly in accordance with generally accepted accounting principles. We were unable to do so for the reasons listed below that were also described in the our report on HUD's fiscal year 2004 financial statements that was included in HUD's Fiscal Year 2004 Performance and Accountability Report.

- Final consolidated financial statements, reflecting all material proposed adjustments and related disclosures were not presented to us in time to allow us to apply all the procedures necessary to render an opinion in time to meet the OMB required reporting date.
- We were unable to obtain sufficient competent evidential matter in a timely manner to satisfy ourselves that HUD's obligation transactions and balances were supported by appropriate source documents. Department officials were unable to timely retrieve documents supporting significant project-based Section 8 obligations. In addition, we experienced delays in obtaining underlying support for significant balances pertaining to the Section 236, Interest Reduction Program.
- We were unable to obtain sufficient competent evidential matter in a timely manner to satisfy ourselves that estimates included in Note 17 on Rental Housing Subsidy Payment Errors were supported by appropriate source documents. In addition, the Department missed interim milestone dates to complete the supporting studies and enable us to apply the necessary procedures to assess the reasonableness of those estimates.
- Interim milestone dates associated with the accounting firm of KPMG LLP's audit of FHA's financial statements were missed because of (1) the late receipt of the Mutual Mortgage Insurance Fund actuarial study, which is critical to completion of audit work relating to the Single Family Liability for Loan Guarantees and (2) material errors found in the calculation and reporting of the FHA Multifamily Liability for Loan Guarantees and Loan Loss Reserve for its Mark-To-Market loan portfolio. FHA missed interim milestone dates to complete final FHA financial statements (i.e., inclusive of all

adjustments) and this contributed to the Department missing agreed upon milestone dates associated with consolidating FHA's financial statements with the remainder of the Department.

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

We considered HUD's internal control over Required Supplementary Stewardship Information to be reported in HUD's *Fiscal Year 2004 Performance and Accountability Report* by obtaining an understanding of the design of HUD's internal controls, determined whether these internal controls had been placed in operation, assessed control risk, and performed tests of controls as required by OMB Bulletin 01-02, *Audit Requirements for Federal Financial Statements* and not to provide assurance on these internal controls. Accordingly, we do not provide assurance on such controls.

With respect to internal controls related to performance measures to be reported in the "Management's Discussion and Analysis" and HUD's *Fiscal Year 2004 Performance and Accountability Report*, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin 01-02. Our procedures were not designed to provide assurance on internal control over reported performance measures and, accordingly, we do not provide an opinion on such controls. However, as reported in the "HUD's Internal Control Environment" section of this report, we noted certain significant deficiencies in internal control over certain reported performance measures that, in our judgment, could adversely affect HUD's ability to collect, process, record, and summarize those performance measurements in accordance with management's criteria.

To fulfill these responsibilities, we:

- examined, on a test basis, evidence supporting the amounts and disclosures in the consolidated principal financial statements;
- assessed the accounting principles used and the significant estimates made by management;
- evaluated the overall presentation of the consolidated principal financial statements;
- obtained an understanding of internal controls over financial reporting, executing transactions in accordance with budget authority, compliance with laws and regulations, and safeguarding assets;
- tested and evaluated the design and operating effectiveness of relevant internal controls over significant cycles, classes of transactions, and account balances;
- tested HUD's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial

statement amounts and certain other laws and regulations specified in OMB Bulletin 01-02, including the requirements referred to in Federal Managers' Financial Integrity Act;

- considered compliance with the process required by Federal Managers' Financial Integrity Act for evaluating and reporting on internal control and accounting systems; and
- performed other procedures as we considered necessary in the circumstances.

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

Our consideration of the internal controls over financial reporting would not necessarily disclose all matters in the internal controls over financial reporting that might be reportable conditions. We noted certain matters in the internal control structure and its operation that we consider reportable conditions under OMB Bulletin 01-02. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect HUD's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements.

Certain of the reportable conditions were also considered material weaknesses. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Except for the limitations on the scope of our work described in this report, our work was performed in accordance with *Government Auditing Standards* and OMB Bulletin 01-02.

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

Appendix B

Recommendations

To facilitate tracking recommendations in the Audit Resolution and Corrective Action Tracking System, this appendix lists the newly developed recommendations resulting from our report on HUD'S fiscal year 2004 financial statements. Also listed are recommendations from prior years' reports that have not been fully implemented. This appendix does not include recommendations pertaining to FHA issues because they are tracked under separate financial statement audit reports of that entity.

Recommendations from the Current Report

With respect to the material weakness on improvements needed in oversight and monitoring of subsidy calculations and intermediaries program performance, we recommend that the **Chief Financial Officer**:

- 1.a. Assume overall responsibility for the erroneous payments estimate to ensure that the studies to develop the erroneous payments estimate are funded and completed so that the estimate can be developed by the end of the fiscal year.

With regards to the material weakness on improvements needed in oversight and monitoring of subsidy calculations and intermediaries program performance, we recommend that the **Assistant Secretary for Public and Indian Housing**:

- 2.a. Direct the field office to require housing authorities to initiate corrective action for all tenants when the rental integrity reviews identify systemic deficiencies.
- 2.b. Require the field offices to initiate sanctions, disallow and recapture costs or other take action when the rental integrity review indicates housing authorities continue to have significant incorrect rental subsidy determinations.
- 2.c. Require the field offices to conduct periodic rental integrity reviews as part of the monitoring strategy for all housing authorities.
- 2.d. Establish requirements to ensure that housing authorities report accurately and fully all tenant data every reporting period in which rental subsidies are expended.

With regards to the material weakness on improvements needed in oversight and monitoring of subsidy calculations and intermediaries program performance, we recommend that the **Deputy Assistant Secretary for Multifamily Housing**:

- 3.a. Make resources available to develop a realistic method to identify owners/agents who incorrectly determine rental subsidies and require they initiate corrective action for all tenants.

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

- 4.a. Deobligate all excess unexpended funds identified as a result of the fiscal year 2004 audit of financial statements.

With respect to the reportable condition that HUD needs to improve the controls over developing estimates of required budget authority for Section 236 Interest Reduction Program, we recommend that the **Chief Financial Officer** in conjunction with the **Office of Housing**:

- 5.a. Develop written procedures for developing estimates for budgetary resources and communicating changes to Section 236 portfolios, including projects that are refinanced, terminated, or restructured.
- 5.b. Maintain adequate documentation to support the computation of budgetary resources for all active Section 236 Interest Reduction Program contracts.

Unimplemented Recommendations from Prior Years' Reports

Not included in the recommendations listed above are recommendations from prior years' reports on the Department's financial statements that have not been fully implemented based on the status reported in the Audit Resolution and Corrective Action Tracking System. The Department should continue to track these under the prior years' report numbers in accordance with Departmental procedures. Each of these open recommendations and its status is shown below. Where appropriate, we have updated the prior recommendations to reflect changes in emphasis resulting from recent work or management decisions.

OIG Report Number 1999-FO-177-0003 (Fiscal Year 1998 Financial Statements)

With respect to the reportable condition that controls over project-based subsidy payments need to be improved, we recommend that the **Director, Section 8 Financial Management Center** (Note: subsequent to the issuance of our fiscal year 1998 report, responsibility for this recommendation was transferred to the **Office of Housing**):

- 3.a. Verify that project-based Section 8 payments are accurate and allowable by testing source documentation through verification of tenant data. Examples of procedures that do this include confirmations and on-site reviews. (Final action target date is December 30, 2002.)

With respect to the reportable condition that HUD needs to improve processes for reviewing obligation balances, we recommend that the **Assistant Secretary for Housing-Federal Housing Commissioner**:

10.d. Ensure that data used in reviewing unliquidated obligation balances are complete, current, and accurate. (Final action target date is September 30, 2002.)

10.e. Ensure that all contract amounts determined to have excess budget authority are deobligated and recaptured. (Final action target date is September 30, 2002.)

OIG Report Number 2000-FO-177-0003 (Fiscal Year 1999 Financial Statements)

With respect to the material weakness on improvements needed in multifamily project monitoring, and the reportable condition on controls over project based subsidy payments, we recommend that the **Assistant Secretary for Housing-Federal Housing Commissioner**, in consultation with the **Director, Section 8 Financial Management Center**:

3.a. Finalize plans to improve administration of housing assistance payment contracts remaining under HUD responsibility after the transfer to contract administrators is completed. In formulating these plans, HUD should consider the responsibilities being placed on contract administrators and design a comparable oversight strategy, establish organizational responsibilities, and at a minimum, address the following areas:

- management and occupancy reviews,
- rental adjustments,
- opt-out and contract termination,
- housing assistance payment processing including review of monthly vouchers,
- follow-up on health and safety issues and community/resident concerns,
- resolving deficient annual financial statements and physical inspection results, and
- renewing expiring assistance contracts.

(Final action target date is September 30, 2003.)

We recommend that the **Assistant Secretary for Housing-Federal Housing Commissioner**, in consultation with the **Chief Financial Officer**:

9.f. Improve systems and procedures to facilitate timely contract closeout and identification and recapture of excess budget authority on expired project based Section 8 contracts. This process should occur periodically during the fiscal year rather than after fiscal year end. (Final action target date is September 30, 2002.)

OIG Report Number 2001-FO-0003 (Fiscal Year 2000 Financial Statements)

With regards to the material weakness that HUD needs to improve oversight and monitoring of housing subsidy determinations, we recommend that the **Assistant Secretary for Public and Indian Housing**:

1.e. Redirect priorities to fully implement the Public Housing Information Center capabilities for tracking and monitoring housing quality inspection deficiencies and IA audit report recommendations. In addition, hold the field office accountable for obtaining current and complete data from the housing authorities and for maintaining current and complete data in the Public Housing Information Center in a timely manner. (Final action target date is March 31, 2005.)

We recommend that the **Deputy Assistant Secretary for Multifamily Housing**:

1.g. Continue plans to upgrade the reporting in Real Estate Management System to provide for a dynamically updated computer ranking combining all the major monitoring tools available to the Office of Housing, as applicable, to the project being ranked. Specifically, we suggest the following upgrades, and uses:

- Establish fields for each major monitoring tool indicating the proper date for the “next to be conducted” scoring or evaluation according to the protocol and populated this field by computer dating based on the last time the monitoring tool was used and rank reported.
- Establish a field that combines the ranking from all current monitoring tools used as applicable and conducted resulting in an overall ranking by the computer. This does not replace the existing judgment based ranking, but would be used to produce reporting when these rankings varied.
- Periodically review (no less than quarterly), the overall risk ranking for each HUB and any justifications for variance between the computer and judgment rankings as necessary. (Final action target date is September 30, 2003.)
-

OIG Report Number 2001-FO-0003 (Fiscal Year 2000 Financial Statements)

With regards to the material weakness that HUD needs to improve oversight and monitoring of housing subsidy determinations, we recommend that the **Assistant Secretary for Public and Indian Housing**:

1.e. Redirect priorities to fully implement the Public Housing Information Center capabilities for tracking and monitoring housing quality inspection deficiencies and IA audit report recommendations. In addition, hold the field office accountable for obtaining current and complete data from the housing authorities and for maintaining current and complete data in the Public Housing Information Center in a timely manner. (Final action target date is March 31, 2005.)

We recommend that the **Deputy Assistant Secretary for Multifamily Housing**:

1.g. Continue plans to upgrade the reporting in Real Estate Management System to provide for a dynamically updated computer ranking combining all the major monitoring tools available to the Office of Housing, as applicable, to the project being ranked. Specifically, we suggest the following upgrades and uses:

- Establish fields for each major monitoring tool indicating the proper date for the “next to be conducted” scoring or evaluation according to the protocol and populated this field by computer dating based on the last time the monitoring tool was used and rank reported.
- Establish a field that combines the ranking from all current monitoring tools used as applicable and conducted resulting in an overall ranking by the computer. This does not replace the existing judgment based ranking, but would be used to produce reporting when these rankings varied.
- Periodically review (no less than quarterly), the overall risk ranking for each HUB and any justifications for variance between the computer and judgment rankings as necessary. (Final action target date is September 30, 2003.)

OIG Report Number 2002-FO-0003 (Fiscal Year 2001 Financial Statements)

With respect to the material weakness that HUD’s financial management systems are not substantially compliant with Federal financial system requirements, we recommend that the **Chief Financial Officer**:

1.e. Initiate and complete independent and unbiased feasibility and cost-benefit studies for the “Departmental General Ledger” project, and ensure that any system solution considered be consistent with the Department’s Enterprise Architecture Plan being developed. (Final action target date is July 31, 2004.)

We recommend that the **Deputy Assistant Secretary for Multifamily Housing**:

2.e. Develop a plan with milestones that would increase, for that portion of the Section 8 portfolio that remains HUD’s responsibility, the number of on-site management reviews conducted annually and would ensure owners of assisted multifamily projects comply with HUD’s occupancy requirements. (Final action target date is September 30, 2003.)

With respect to the reportable condition that controls over project-based subsidy payments need to be improved, we recommend that the **Deputy Assistant Secretary for Multifamily Housing**:

2.f. Make resources available to develop a realistic method to identify tenants/owners who erroneously report income. (Final action target date is September 30, 2003.)

With respect to the reportable condition that HUD still needs to strengthen the controls over its computing environment in regards to physical security, we recommend that the **Chief Information Officer**:

4.i. Conduct a risk analysis to determine whether the protective measures for the data center and the backup facility identified in the July 2000 HUD' Critical Infrastructure Protection Plan are warranted. The risk analysis should also consider whether a card key entry control system need to be installed to control exits in backup facility. The protective measures include barriers around the building, magnetometer and x-ray scanner for screening incoming personnel, screening of mail and delivery packages before being brought into the center, and blast-resistant coating on street level windows. (Final action target is January 30, 2004.)

OIG Report Number 2003-FO-0004 (Fiscal Year 2002 Financial Statements)

With respect to the material weakness on improvements needed in oversight and monitoring of subsidy determinations, we recommend that the **Chief Financial Officer** in coordination with the appropriate **program offices**:

1.a. Conduct a review of the public housing subsidies and intermediaries' billings to determine whether the subsidies were recorded, billed and collected in accordance with HUD policies and regulations. The review should establish the amount of erroneous payments resulting from intermediaries' billings to HUD for the public housing program, and service as a baseline for implementing corrective action to reduce or eliminate the erroneous payments resulting from intermediary's billings. (Final action target date is November 15, 2004.)

With respect to the reportable condition that controls over project-based subsidy payments need to be improved, we recommend that the **Deputy Assistant Secretary for Multifamily Housing**:

3.a. Make resources available to develop a realistic method to identify tenants/owners who erroneously report income in Tenant Rental Assistance Certification System. (Final action target date is December 31, 2003.)
3.b. Implement a policy and procedure for suspending payments on contracts where non-compliance with tenant reporting requirements has been determined by the Multifamily HUD Office or the Financial Management Center. (Final action target date is September 30, 2003.)

With respect to the reportable condition that HUD needs to strengthen the controls over its computing environment in regards to the Hitachi environment, we recommend that the **Chief Information Officer**:

4.b. Provide adequate technical training to the HUD ADP Security group so that the Department is able to monitor contractors' activities. (Final action target date is April 28, 2004.)

In regards to CM implementation, we recommend the **Chief Information Officer**:

- 6.b. Perform reconciliation between all of the modules contained within the production environments and the modules under the control of PVCS for all client/server applications using the component-level release approach. (Final action target date is February 28, 2005.)
- 6.c. Establish a process to remove obsolete modules from the production environment and to separate obsolete modules within PVCS to prevent them from being used in the future. (Final action target date is February 28, 2005.)

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

- 10.b. Strengthen procedures to annually or more frequently review Section 8 programs for unexpended funds that can be recaptured and used to offset future budget requirements. (Final action target date is September 3, 2004.)
- 10.c. Strengthen accounting procedures for the Section 236 IRP program to (1) record prepayments and remove inactive contracts in a timely manner, and (2) compute estimated subsidy payments using proper amortization factors. (Final action target date is April 8, 2004.)
- 10.d. Strengthen the accounting for the Section 236 Interest Reduction Program by developing an integrated automated system. (Final action target date is September 30, 2004.)

OIG Report Number 2004-FO-0003 (Fiscal Year 2003 Financial Statements)

With respect to the material weakness on improvements needed in oversight and monitoring of subsidy calculations and intermediaries program performance, we recommend that the **Assistant Secretary for Public and Indian Housing**:

- 1.a. Initiate corrective action to address the underlying causes for the erroneous payment resulting from billing errors, such as the intermediaries' failure to accurately report or maintain required documentation of subsidy determinations, and bookkeeping and procedural errors. (Final action target date is June 30, 2005.)

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

- 2.a. Deobligate all excess unexpended funds identified as a result of the fiscal year 2003 audit of financial statements. (Final action target date is September 30, 2004.)
- 2.c. Consider expired contract authority from Section 8 project-based contracts maintained in HUDCAPS when formulating budget requests. (Final action target date is October 4, 2004.)

With respect to the reportable condition that controls over project-based subsidy payments need to be improved, we recommend that the Deputy Assistant Secretary for Multifamily Housing in coordination with Financial Management Center Director:

- 3.a. Initiate corrective action to address the underlying causes for the erroneous payment resulting from billing errors, such as the intermediaries' failure to accurately report or maintain required subsidy determination documentation, and bookkeeping and procedural errors. (Final action target date is September 30, 2005.)
- 3b. Establish controls over the HUD administered project-based Section 8 payment process at FMC to comply with Title VII of the GAO Policy and Procedures Manual for Guidance of Federal Agencies. (Final action target date is September 30, 2005.)
- 3.c. Establish criteria to enforce the accuracy of the data submitted through TRACS. (Final action target date is September 30, 2005.)

Appendix C

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

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

Federal Financial Management Systems Requirements

1. HUD's annual assurance statement issued pursuant to Section 4 of the Financial Manager's Integrity Act will report four non-conforming systems⁹.

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

<u>Responsible Office</u>	<u>Number of Systems</u>	<u>Non-Conforming Systems</u>
Office of Housing	20	3
Chief Financial Officer	15	1
Office of Administration	3	0
Office of Public and Indian Housing	2	0
Government National Mortgage Association	3	0
Office of Community Planning and Development	3	0
	<u>46</u>	<u>4</u>

⁹ The four nonconforming systems are: A21-Loan Accounting system, A80N-Single Family Mortgage Notes Serving, A80S-SF Acquired Asset Management, and F47 Multifamily Insurance.

The following section outlines the Department's plan to correct noncompliance with OMB Circular A-127.

Office of Housing

<u>System</u>	<u>Outstanding Noncompliance Issue @ 09/30/04</u>	<u>Plan @9/30/04</u>	<u>Target date to Complete all Phases</u>	<u>Resources</u>
A80N Single Family Mortgage Notes Servicing A80S Acquired Asset Management System F47 Multifamily Insurance System	<ul style="list-style-type: none"> • Classification structure • Integrated FMS • Application of SGL • Federal Accounting Standards • Financial Reporting • Budget Reporting • Functional 	Short term: Implement a new FHA general ledger to automate FHA headquarters' funds control processes, financial statement reporting, and updates to the departmental general ledger	10/2002 (C)	FY00 and prior - \$2,381,000 FY01-\$5,250,000 FY02-\$8,800,000 FY03-\$8,600,000 FY04-\$7,322,000 FY05-\$8,579,000 FY06-\$14,388,000
		Mid Term: Automate funds control processes for FHA field offices Implement a new FHA payment and collection software to improve FHA's accounting operations	12/2004(C) 4/2004(C)	
		Midterm Intermediate: <ul style="list-style-type: none"> • Upgrade PeopleSoft to current web-based version, from 7.5 to 8.4 <ul style="list-style-type: none"> ○ Implement version 8.4 for FY2004 ○ Convert FY2003 data to new format and close out 7.5 system databases • Implement General Ledger Improvements • Incorporate Credit Subside Control processing <ul style="list-style-type: none"> ○ Implement initial functionality ○ Convert FY 2003 data to new format • Incorporate Funds Control Database processing • Incorporate Cash Management function • Re-engineer Single Family Acquired Asset Management System (A80S, SAMS) 	10/2003(C) 03/2004(C) 01/2004(C) 10/2003(C) 03/2004(C) 03/2004(C) 03/2004(C) 04/2005	
		Long Term: Integrate or replace FHA insurance systems with the FHA subsidiary ledger software to improve accounting and insurance operations Long-Term Intermediate Milestones <ul style="list-style-type: none"> • Replace Distributive Shares and Refunds System (A80D) • Replace Multifamily Insurance System (F47) • Improve Integration with Single Family Claims System (A43C) • Improve Integration with Multifamily Claims (F75) • Replace Single Family Premiums Collection System-Periodic (A80B) • Replace Single Family Premiums 	09/2007 04/2005 04/2005 04/2005 04/2005 03/2006 03/2006	

<u>System</u>	<u>Outstanding Noncompliance Issue @ 09/30/04</u>	<u>Plan @9/30/04</u>	<u>Target date to Complete all Phases</u>	<u>Resources</u>
		Collection System-Upfront (A80R) <ul style="list-style-type: none"> • Turn over operational responsibility to user areas • Interface with Single Family Mortgage Notes Servicing –A80N 	12/2006 09/2007	

Office of the Chief Financial Officer

<u>System</u>	<u>Outstanding Noncompliance Issue @ 09/30/04</u>	<u>Plan @9/30/04</u>	<u>Target date to Complete all Phases</u>	<u>Resources</u>
A21 - Loan Accounting System	<ul style="list-style-type: none"> • Integrated Financial Management System 	Initiate Stage Begin Procurement Effort for SDM, Define stage Award Contract Develop Functional Requirements Complete Functional Requirements COTS procurement solicitation Implement a replacement system for LAS	Complete Complete Complete Complete Complete 10/30/2005	\$225,779

2. Our audit disclosed reportable conditions regarding the security over financial information. Similar conditions have also been noted in HUD's A127 reviews and other OIG audit reports. We are including security issues as a basis for noncompliance with FFMIA because of the collective effect of the issue and noncompliance with Circular A-130, Appendix 3 and the Government Information Security Reform Act (GISRA). The responsible office, nature of the problem and primary causes are summarized below.¹⁰

<u>Responsible Office</u>	<u>Nature of the Problem</u>
Office of Administration/Chief Information Officer	HUD's information system security program has not included the minimum set of controls established by OMB Circular Number A-130, Appendix III nor has it included all the requirements for an information security program specified in section 3544(b) of the Federal Information Security Management Act. HUD has not met the requirements for (periodically assessing and managing risks, (2) developing policies and procedures that are based on assessments of risk and that cost-effectively reduce information security risks to an acceptable level, and (3) clearly assigning security responsibilities

These conditions occurred because HUD does not have an organizational structure that facilitates implementation of security requirements in FISMA, OMB Circular A-130, and NIST publications. For example, HUD has not designated a Senior Agency Information Security Officer position, reporting directly to the Chief Information Officer, empowered with the authority and resources needed to establish a comprehensive information system security program. Without an effective information system security program, HUD is not adequately managing and mitigating the risks (1) of the loss of confidentiality, availability, and integrity of data and (2) that it would be unable to resume business operations and recover essential data after a disruption in computer operations.

Office of Administration/Chief Information Officer	HUD does not comply with computer security guidelines issued by NIST (National Institute of Standards and Technology) and its own internal policies and procedures in the areas of (1) software change controls, (2) designation of personnel as backup to computer administrators, and (3) access to personnel data.
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These conditions occurred because written policies and procedures are neither reviewed nor updated regularly.

¹⁰ The issues are discussed in greater detail in a separate report issued by the Information Systems Audit Division entitled "Fiscal Year 2004 Review of Information Systems Controls in Support of the Financial Statement Audit". In addition, KPMG LLP's separate report on their audit of FHA's fiscal year 2004 financial statements includes a reportable condition relating to "FHA/HUD Can More Effectively Manage Controls Over the FHA ADP Systems Portfolio".

Responsible Office

Nature of the Problem

Office of Administration/Chief Information Officer

HUD's networked environment is vulnerable in that (1) critical patches are not applied in a timely manner, (2) computer infrastructure information is inappropriately revealed to the public through discussion forums and e-mails sent by the server, (3) audit trails are not reviewed or maintained for an adequate period of time in the Unix and Windows environments, (4) protection of HUD's network connection needs improvement, (5) HUD's intrusion detection system did not detect internal attacks, and (6) there are many vulnerabilities in the Unix and Windows systems and machines and in network devices.

These conditions exist because (1) HUD does not clearly identify individuals' roles and responsible, (2) information is inappropriately revealed to the public, (3) responsibilities and procedures are not clearly established and communicated, and (4) HUD has not installed intrusion detection system software on all HUD personal computers and servers.

Office of Administration/Chief Information Officer

HUD has not implemented sufficient controls over the Unisys 2200 operating system. It has not (1) documented security policies and procedures; (2) maintained, monitored, or reviewed security events such as user activity and audit logs; (3) provided adequate security training; (4) implemented adequate controls that would not allow users to have excessive privileges to functions that bypass security controls; and (5) enabled the Residue Clear system feature.

These conditions occurred because security policies and procedures were not developed due to limited staff and resources and because management did not consider it a priority.

Office of Administration/Chief Information Officer

There is inadequate assurance that HUD would be able to recover information technology operations in a timely and orderly manner in the event of a disruption.

This occurred because an Interim Disaster Recovery Plan does not represent an Information Technology Contingency Plan.

Office of Administration/Chief Information Officer

The Department does not have a central repository that would account for all users with above-read (query) access to all HUD general support and application systems.

This condition occurred because HUD has not fully implemented the HUD Online User Registration System.

Office of Housing and CIO

Certain information security controls need improvement to provide HUD/FHA with a more secure ADP systems environment.

The primary cause for this is because FHA systems have not been consistently incorporated into HUD's security certification and accreditation program.

Office of Housing and CIO

The level of systems portfolio management could be improved for FHA systems used to process key FHA financial data

The primary cause for this is that the FHA Subsidiary Ledger project is not yet complete and intends to perform a Single Family and Multifamily business process re-engineering effort that will ensure ADP

Responsible Office **Nature of the Problem**

systems supporting key FHA financial and business processes are adequately supported and included in HUD OCIO's enterprise architecture and ADP systems portfolio.

Office of Housing and CIO Several FHA systems, including the Institution Master File and the Lender Approval Subsystem, lacked system documentation supporting current operations.

HUD/FHA personnel are knowledgeable about the HUD/FHA systems; however, many are eligible for retirement in the near future.

Specific recommendations to correct security weaknesses are listed in the OIG Information Systems Division's "*Fiscal Year 2004 Review of Information Systems Controls in Support of the Financial Statements Audit*" and KPMG LLP's report on their audit of FHA's fiscal years 2004 and 2003 financial statements.

Federal Accounting Standards

KPMG LLP reported in a material weakness that HUD/FHA continues to conduct many day-to-day business operations with legacy-based systems, limiting FHA's ability to effectively monitor budget execution related to certain funds control processes. FHA is currently implementing a long-term plan to improve its financial systems processing environment, however, full implementation is expected by fiscal year 2007. Specific accounting standards affected are:

:

- Budgetary controls to prevent misreporting of budget execution information relating to FHA appropriations (Statement of Federal Financial Accounting Standards (SFFAS) Number 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*).
- Review and reconcile obligations in order to provide complete financial information (SFFAS Number 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*).

Specific recommendations to correct the weaknesses are listed in KPMG LLP's report on their audit of FHA's fiscal years 2004 and 2003 financial statements.

Appendix D

SCHEDULE OF QUESTIONED COSTS AND FUNDS PUT TO BETTER USE

Recommendation Number	Ineligible 1/	Unsupported 2/	Unreasonable or Unnecessary 3/	Funds Put to Better Use 4/
4a				708,000,000

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law, contract or Federal, State or local polices or regulations.

2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity where we cannot determine eligibility at the time of audit. Unsupported costs require a future decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of Departmental policies and procedures.

3/ Unnecessary/Unreasonable costs are those costs not generally recognized as ordinary, prudent, relevant, and or necessary within established practices. Unreasonable costs exceed the costs that would be incurred by a prudent person in conducting a competitive business.

4/ Funds Put to Better Use are quantifiable savings that are anticipated to occur if an OIG recommendation is implemented resulting in reduced expenditures in subsequent period for the activities in question. Specifically, this includes costs not incurred, de-obligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings.

AGENCY COMMENTS



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

CHIEF FINANCIAL OFFICER

November 8, 2004

MEMORANDUM FOR: Randy McGinnis, Financial Audits Division, GAF
FROM: Carin M. Barth, Chief Financial Officer, F *Carin M. Barth*
SUBJECT: Management Comments on Draft Report on HUD's
Fiscal Year 2004 Financial Statements – Internal Control
and Compliance Sections

Thank you for the opportunity to comment on the subject draft report's internal control and compliance sections, as requested in your memorandum of November 1, 2004. We recognize that this is an incomplete working draft, as your audit team continues to work with the Department in an effort to meet the President's Management Agenda goal for an accelerated completion and issuance of HUD's audited FY 2004 consolidated financial statements and Performance and Accountability Report (PAR) by November 15, 2004. Our below comments pertain to the two material weakness issues and four of the six reportable condition issues referenced in draft report. Our comments do not address the draft report's reference to the two prior year reportable conditions in FHA, as those issues will be separately addressed in the pending completion of the FHA audit. Our below comments provide our position on the preliminary conclusions reached on completed portions of the audit, as well as our position on other carry-over issues from FY 2003 still under review. A listing of suggested technical and editorial changes and other comments on the draft report is being sent to you under separate cover.

The Department generally agrees with the substance of the two reportable conditions on: 1) controls over HUD's computing environment; and 2) personnel security practices for access to the Department's critical financial systems. However, we request reconsideration of the level of detail to be reported on the nature of vulnerabilities in these areas. With respect to the other two material weakness and two reportable condition issues, we request consideration of the following comments as you complete your audit and final report:

Financial Management Systems Compliance

We disagree with the draft report's interpretation and application of federal financial management systems requirements, and find that the report lacks a compelling case that the perceived financial management systems compliance deficiencies put the Department at undue risk of material misstatements in its financial statements. As currently written, the draft implies that HUD cannot be compliant until it has a single, fully automated financial management system, inclusive of the FHA, GNMA and OIHEO components. To the contrary, OMB Circular No. A-127 allows for manual processes as part of both an acceptable "financial system" and an acceptable "single integrated financial management system," as follows:

- o A-127's definition of a "financial system" states that "...A financial system encompasses automated and manual processes, procedures, controls, data, hardware, software, and support personnel dedicated to the operation and maintenance of systems functions..." (underlining added for emphasis)
- o A-127 also states that: "The term "single integrated financial management system" means a unified set of financial systems and the financial portions of mixed systems encompassing the software, hardware, personnel, processes (manual and automated), procedures, controls and data necessary to carry out financial management functions, manage financial operations of the agency and report on the agency's financial status to central agencies, Congress and the public." (underlining added for emphasis)

We again request that OIG consider that GNMA, FHA and OFEO are separate legal entities with their own requirements for separate audited financial statements, and that there is no significant unmet business or management need by not having them under a single, automated financial management system with HUD's grant, subsidy and loan program activity. Furthermore, we believe that the process for consolidating the financial statements for the Department, inclusive of GNMA, FHA and OFEO, is acceptable and not a material risk to the Department, as implied in the draft report. While HUD is proceeding with the HUD Integrated Financial Management Improvement Project (HIFMIP) to provide a modern, better integrated financial management systems environment for the Department, we do not view completion of HIFMIP as necessary for HUD to be substantially compliant.

OMB's "Revised Implementation Guidance for the Federal Financial Management Improvement Act" (FFMIA) states that: "In determining whether an agency's financial management systems substantially comply with FFMIA, management and auditors need to consider whether a system's performance prevents the agency from meeting the specific requirements of FFMIA..." The OMB guidance states that FFMIA was intended to assure that agency systems "generate reliable, timely and consistent information necessary for Federal managers' responsibilities." The guidance further states that: "Agencies that can:

- Prepare financial statements and other required financial and budget reports using information generated by the financial management system(s);
- Provide reliable and timely financial information for managing current operations;
- Account for their assets reliably, so that they can be properly protected from loss, misappropriation, or destruction; and
- Do all of the above in a way that is consistent with Federal accounting standards and the Standard General Ledger are substantially compliant with FFMIA."

With the exception of the FHA financial systems deficiencies that are being remediated through the FHA Subsidiary Ledger Project, HUD's position is that its core financial management system is substantially compliant with FFMLA in that the above requirements are being fulfilled. Pending independent verification of the improvements made under the FHA Subsidiary Ledger Project in FY 2004, HUD may be positioned to report compliance with FFMLA next year.

Oversight of Rental Housing

We continue to agree that the Department's management control improvements over its rental housing assistance programs have not yet progressed to the point where they reduce to an acceptable level the risk of material levels of erroneous payments due to tenant underreporting of income or program administrator errors in income and rent determinations and subsidy billings to HUD. We agree with your combining of the previous reportable condition on controls over project-based subsidy payments as part of this issue. However, we find the draft report write-up on this material weakness issue does not fully and accurately reflect the nature and status of HUD's completed and planned corrective actions, nor the significant results in reducing estimated erroneous payments to date. At the time the draft report was issued, the updated erroneous payment measurement information was not yet available for the tenant income reporting and multifamily housing billing components. Please consider the following points as you complete your reporting on this issue:

- o This issue needs to be put in the context of the FY 2000 baseline estimate of \$3.281 billion of gross erroneous payments due to errors in program administration and tenant reporting of income, and the 51 percent reduction disclosed in the recent updated estimate of \$1.606 billion in gross erroneous payments based on FY 2003 activity. Both error components were substantially reduced, and underpayments were reduced along with overpayments. Furthermore, the FY 2003 baseline estimate on multifamily housing billing error was \$138 million, or 1.8 percent of the \$7.737 billion in program expenditures in FY 2003. Corrective actions taken by HUD and its housing industry partners and stakeholders are demonstrating a positive effect in reducing program risk and error in the rental assistance programs.
- o Regarding monitoring by the Office of Multifamily Housing, the draft report credits Housing with conducting Management and Occupancy (M&O) reviews at all 12,215 Section 8 projects covered by Performance Based contract Administrators (PBCAs) in FY 2004, but the lead paragraph inappropriately depicts that "only a small portion" of the portfolio administered by HUD staff or traditional contract administrators (CAs) received M&O reviews. Later in the report it is acknowledged that 2,079 or 20 percent of the 10,044 projects administered by HUD or traditional CAs in FY 2004 had M&O reviews. This is not a small amount, and coverage will be increased as more of these projects will receive annual M&O reviews when they are covered by PBCAs in FY 2005. Based on the positive error measurement results for FY 2003, the increased level of monitoring in FY 2004 should produce even greater reductions in error.

- o The Office of Public and Indian Housing's (PIH) Rental Integrity Monitoring (RIM) review effort covered 490 PHAs that administer 80 percent of PIH funding. The effort provided technical assistance to PHAs with significant systemic weaknesses, and follow-up reviews to assess program improvements and the need for possible enforcement actions or sanctions. It is not accurate to say that field offices have not taken any measures against PHAs as a result of RIM. According to the latest (9/30/04) report, field offices have implemented the following actions against PHAs: 4 sanctions, 16 SEMAP adjustments, 1 disallowed cost and 12 CPA referrals for PHAs. Many other actions are reported in the pending category. Please note many of the re-reviews occurred in the last quarter of fiscal year 2004 and therefore no action can take place until after the due process in Notice 2003-34 is affected. RIM re-review actions are addressed through HUD's FY 2005 management plan.
- o PIH successfully developed and implemented the Upfront Income Verification (UIV) system in FY 2004 to share state wage data with PHAs for the purpose of correctly determining income, rent and subsidy levels to avoid erroneous payments. Contrary to erroneous statements in the draft report, HUD also received new statutory authority to conduct computer matching with the HHS National Directory of New Hires database, and is working with HHS to implement that authority on a phased basis. Implementation is scheduled to occur for PHAs in June 2005, and in FY 2006 for multifamily housing administrators. HUD has already used HHS data for error measurement purposes.
- o PIH is exceeding the Form HUD-50058 reporting goals. The reporting rate as of June 30, 2004 was 88 percent for households in the public housing program and 99 percent for households in the voucher programs (Housing Choice Voucher, Certificate, and Moderate Rehabilitation programs). HUD regulations (24 CFR 908.101) require PHAs to report the Form HUD-50058 electronically to HUD. The goal is being raised to 100 percent for FY 2006.

Controls Over Performance Measures

Audit work on this prior year reportable condition had not yet been completed as of the date of the draft report, pending the auditors' receipt of the draft Management Discussion and Analysis (MD&A) for the FY 2004 PAR. The draft MD&A was provided to OIG on November 3, 2004. We had previously provided the audit team with evidence of the significant progress made under HUD's Data Quality Improvement Program, as well as documentation in support of an audit sample of FY 2004 performance indicators. The PAR provides information on the data sources for each of HUD's annual performance indicators. While HUD will continue efforts to improve the quality of its performance data, it is management's view that this issue does not warrant recognition as a reportable condition in the Department's financial statement audit.

Processes for Reviewing Obligation Balances

As of the date of the draft report, work in this area was still on-going and awaiting additional information and review on pending *Notice of Finding and Recommendation* issues recently brought to management's attention. Considering the audit issues raised to date, and last year's reportable condition, we disagree with the draft report's conclusion that "Excess funds are not being

considered in the budget formulation process,” and with possible recommendations to unilaterally change the Department’s current policies, established methods, and timing associated with the recapture of excess balances associated with HUD programs. To the contrary, we find that the draft report fails to properly consider HUD’s overall budget formulation process, including annual statutory “rescission” targets that current recapture policies enable the Department to meet. We believe that the Department has established the fiscally responsible policies and procedures necessary to deal with the current budget realities and the external pressures associated with the “excess funds” issue. I have scheduled a meeting to discuss and resolve the audit issues in this area early next week.

As noted in your incoming request for comments, work on the audit continues and further changes to the report may be necessary. Given the preliminary nature of the current draft, we would welcome the opportunity to comment on a final draft early next week.

The directed acceleration of the preparation and audit of HUD’s FY 2004 financial statements is a significant challenge for the Department and its auditors. I want to thank HUD financial managers and staff, as well as the Inspector General’s auditors, for all their extraordinary efforts in bringing this annual cycle to what we hope will be the anticipated successful conclusion. If you have any questions on our comments, please feel free to contact me on 708-1946, or James Martin of my staff at 708-0614, extension 3706.

Appendix F

OIG EVALUATION OF AGENCY COMMENTS

Due to time constraints, we did not formally respond to each of the Department's comments on our draft report. However, we did consider their response along with informal comments in finalizing our report.