

Issue Date	March 1, 2000
Case Number	00-FO-177-0003

TO: David Gibbons, Deputy Chief Financial Officer, F

FROM: James A. Heist, Director, Financial Audits Division, GAF

SUBJECT: Report on Efforts to Audit the U.S. Department of Housing and Urban Development's Fiscal Year 1999 Financial Statements

In accordance with the Chief Financial Officers (CFO) Act of 1990, this report presents the results of our attempt to audit HUD's principal financial statements for the fiscal year ended September 30, 1999. We are issuing our report at this date to meet our obligation under the CFO Act to report by March 1, 2000. Our report explains why we were unable to perform sufficient procedures to opine on HUD's financial statements in time to meet this statutory due date or be reasonably close to meeting this date. We are issuing our report without HUD's principal financial statements. HUD is responsible for completing its *Fiscal Year 1999 Accountability Report*, which is to include the financial statements along with this report or an update. Our report includes our findings on HUD's internal controls and compliance with laws and regulations resulting from our attempt to audit HUD's principal financial statements. Had we completed our audit, we might have found additional matters we would have reported. Our report discusses the significance of HUD's financial management and control problems and HUD's actions to correct them. Our report also contains recommendations to assist the Department in its continuing efforts to correct these longstanding problems.

We also identified several matters which, although not reportable conditions, will be communicated in a separate management letter to the Department. We appreciate the courtesies and cooperation extended to the OIG staff and our contractor.

In accordance with HUD Handbook 2000.6 REV-3, within 60 days, please submit to me, for each recommendation listed in the first section of Appendix B that is addressed to the CFO, a status report on: (1) the corrective action taken; (2) the proposed corrective action and target completion dates; or (3) why action is considered unnecessary. For recommendations addressed to the Deputy Secretary, the assistant secretaries or their staffs, please coordinate their response or, at your option, request that they respond directly to me. An additional status report is required on any recommendation without a management decision after 110 days. Also, please furnish us with copies of any correspondence or directives issued in response to our report.

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Abbreviations:

BRP.....	business resumption plan
CM.....	configuration management
CFO.....	Chief Financial Officer
DEC.....	Departmental Enforcement Center
FERA.....	Front-End Risk Assessment
FFMIA.....	Federal Financial Management Improvement Act
FHA.....	Federal Housing Administration
FMC.....	Financial Management Center (Section 8)
FMFIA.....	Federal Managers' Financial Integrity Act
FSI.....	Financial Systems Integration
GAO.....	General Accounting Office
GPRA.....	Government Performance and Results Act
GTR.....	Government Technical Representative
HA.....	housing authority
HAP.....	housing assistance payment
HUD.....	Department of Housing and Urban Development
HUDCAPS.....	HUD's Central Accounting and Program System
IA.....	independent auditor
IBS.....	Integrated Business System
IDIS.....	Integrated Disbursement and Information System
IRS.....	Internal Revenue Service
IT.....	information technology
LOCCS.....	Line of Credit and Control System
MTCS.....	Multifamily Tenant Characteristics System
OIG.....	Office of Inspector General
OMB.....	Office of Management and Budget
PAS.....	Program Accounting System
PHAS.....	Public Housing Assessment System
PHMAP.....	Public Housing Management Assessment Program
PIH.....	Office of Public and Indian Housing
POH.....	Primary Organization Head
REAC.....	Real Estate Assessment Center
REAP.....	Resource Estimation and Allocation Process
REMS.....	Real Estate Management System
SEMAP.....	Section 8 Management Assessment Program
SFFAS.....	Statement of Federal Financial Accounting Standards
SGL.....	Standard General Ledger (of the United States Government)
SHFA.....	State Housing Finance Agency
SS.....	Social Security
SSA.....	Social Security Administration
SSI.....	Supplemental Security Income
TARC.....	Troubled Agency Recovery Center
TRACS.....	Tenant Rental Assistance Certification System

Independent Auditor's Report

To the Secretary,

U.S. Department of Housing and Urban Development

In accordance with the Chief Financial Officers (CFO) Act of 1990, the Department is responsible for preparing a consolidated statement of financial position of the Department of Housing and Urban Development (HUD) as of September 30, 1999 and the related consolidated statements of net cost, changes in net position, budgetary resources and financing for the fiscal year then ended. We are required by the CFO Act, as amended by the Government Management Reform Act of 1994, to audit HUD's principal financial statements and issue our report thereon no later than March 1 after the end of the fiscal year. We are unable to express an opinion on these principal financial statements for the following reasons:

- Material internal control weaknesses with HUD's core financial management system and U.S. Government Standard General Ledger (SGL) adversely affected HUD's ability to prepare auditable financial statements and related disclosures in a timely manner. HUD implemented a new general ledger system in fiscal year 1999 using HUD's Central Accounting and Program System (HUDCAPS), and relied upon an interface with the Program Accounting System (PAS) which served as HUD's general ledger in prior years for HUD's grant, subsidy and loan programs. The general ledger system was migrated from PAS to HUDCAPS during the fiscal year; however the transition was a significant undertaking and is still not complete. The interface filter and the general ledger posting models have resulted in numerous rejected or incorrectly posted transactions that have to be manually researched and corrected. In addition, the migration was done without development of an automated program to help reconcile the general ledger cash accounts to Treasury's figures. As a result, the reconciliation processes to identify discrepancies have fallen behind schedule, and HUD had to make numerous adjustments to the general ledger fund balance with Treasury balances to make them agree with Treasury records. These adjustments were not made via the normal general ledger posting process. Rather, they were made directly to the financial statement report consolidation software called Hyperion Enterprise. The noted problems delayed the closing of the general ledger for fiscal year 1999 until January 24, 2000, and the preparation of the financial statements.
- Due to delays in implementation, the HUDCAPS general ledgers were not available to support the fund balance with Treasury reconciliation process until November 1999. This is a process that should be performed monthly throughout the fiscal year. As a result, the CFO staff relied on the PAS subsidiary ledger balances to reconcile the Department's fund balance with Treasury. Reconciliations did not start taking place until late July 1999 for all but four funds. For the remaining four funds, reconciliations were not performed until after fiscal year end because subsidiary records for those funds were maintained in both HUDCAPS and PAS. As of the date of our report, HUD had not reconciled the differences between HUDCAPS, PAS and Treasury reported balances. We tried to obtain explanations for the differences between the fund balance shown in HUDCAPS versus the Treasury reported balances. These explanations could not be readily provided by the CFO staff preparing the reconciliations because they were still waiting for the necessary information from HUDCAPS to facilitate the reconciliation process.

These deficiencies resulted in significant delays in the financial statement preparation process which included the establishment of critical milestone dates necessary to meet the statutory date of March 1, 2000 for completion of the audit. In fact, critical milestone dates were further behind schedule than the past two fiscal years. Furthermore, a total of 42 adjustments totaling about \$17.6 billion had been processed through the Hyperion

Enterprise financial statement report consolidation program to adjust fiscal year 1998 ending balances. An additional 242 adjustments totaling about \$59.6 billion, were made to adjust fiscal year 1999 activity. All of these adjustments were made outside of HUDCAPS, the Department's official general ledger, and when we ceased our field work, significant unexplained differences remained with the fund balance with Treasury reconciliations. Moreover, adjustments were made to bring HUD's balances into agreement with Treasury records, without the benefit of a proper reconciliation process to ensure that Treasury balances were correct. Despite the pressure from HUD and OMB officials as discussed below, it was not practicable for us to extend our auditing procedures to satisfy ourselves regarding the effect these weaknesses might have on HUD's financial statements, in time to meet the statutory date of March 1, 2000, or be even reasonably close to meeting that date.

Comments on our decision to disclaim an opinion on HUD's financial statements and our evaluation

In a memorandum dated February 29, 2000, the Deputy Secretary objected to our decision to disclaim an opinion on HUD's financial statements. The Deputy Secretary stated that our failure to issue an audit opinion is wrong on the merits, violates professional standards and audit guidelines, and demonstrates bad faith by the OIG. The Deputy Secretary stated that HUD rejects the report. The Deputy Secretary's response is included in its entirety in Appendix D.

HUD has alleged that we did not follow professional standards by not promptly notifying them of our decision to disclaim an opinion in time for them to take action. To support this position, HUD offers a section in *generally accepted auditing standards* relating to "Communication of **Internal Control** (emphasis added) Related Matters Noted in an Audit." We disagree that we violated any standards relating to timely communication. We made it clear throughout the audit process that we intended to issue our report in time to meet the March 1, 2000 statutory due date and that our inability to complete the audit could affect the opinion. We would also point out that the conclusions with respect to HUD's internal control weaknesses, that led to the restriction of our audit scope, were communicated to the Department formally on February 9, 2000. It was only after we informed HUD officials on February 23, 2000 that those same issues were causing us to disclaim an opinion, that HUD initiated the concerted effort described in their response to accelerate the completion of fund balance with Treasury reconciliations. This effort included contractor support to perform a basic accounting function that should have been completed by HUD staff months earlier. We can only conclude that HUD was motivated to take this action primarily because of a desire to obtain an opinion, rather than acting immediately to address the material weakness with HUD's core financial management system that was included in our draft report on internal controls. As noted in the Department's February 18, 2000 response (see Appendix D) to that draft, The Deputy Secretary generally agreed with the draft report's conclusions on the state of HUD's internal controls for fiscal year 1999. To quote from that memorandum:

"The rigor of the independent annual financial statement audit process is valuable in determining the adequacy of HUD's financial management practices, and in identifying areas of needed improvement." The Deputy Secretary went on to state that: "Departmental management generally agrees with the draft

report's conclusions on the state of HUD's internal controls and compliance for the fiscal year (FY) 1999 period of the audit...."

In our judgment, management's failure to promptly act, after we identified and communicated these internal control material weaknesses, reflects poorly on its obligations spelled out in OMB Circular A-123, *Management Accountability and Control*, to continuously monitor and improve the effectiveness of management controls and **use** (emphasis added) the results of OIG reports. Moreover, management (not OIG as the independent auditor) has primary responsibility for monitoring and assessing controls.

In our report on HUD's fiscal year 1998 financial statements¹ dated March 17, 1999, we reported that our ability to conclude that HUD's fiscal year 1998 financial statements were reliable was noteworthy, because that was the first year HUD received an unqualified opinion on its financial statements. However, we also noted that because of continued weaknesses in HUD's internal controls and financial management systems, that accomplishment came only after HUD and its contractors went through extensive ad hoc analyses and special projects to develop account balances and necessary disclosures. Moreover, we cautioned that projections of any evaluation of the internal control 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. We describe in our report the deterioration of the internal controls relating to HUD's core financial management systems that resulted from the implementation of HUDCAPS as the Departmental general ledger.

With respect to HUD's assertion that we did not follow professional standards in disclaiming an opinion, the opposite is true. *Government Auditing Standards* which incorporate *generally accepted auditing standards* require that we obtain "sufficient competent evidential matter" necessary to express an opinion. To the extent that we remain in substantial doubt about any material financial statement assertion we **must** (emphasis added) refrain from forming an opinion until we can obtain "sufficient competent evidential matter" to remove such substantial doubt. The auditing standards explicitly acknowledge that the auditor works within economic limits and to be economically useful, an opinion must be formed within a reasonable length of time and at reasonable cost. Our consideration of timeliness is of added significance given the importance of the March 1 statutory due date. OMB, in various communications to the IG community during the past several months had been stressing the importance of meeting the March 1 due date.

We understand that recently, however, OMB has been urging OIGs to delay reporting beyond the statutory due date, if in a matter of a couple of

¹ "U.S. Department of Housing and Urban Development, Audit of Fiscal Year 1998 Financial Statements" (99-FO-177-0003), issued March 29, 1999

weeks, the respective agencies could improve on their audit opinion status. We are troubled by the decision of OMB to attempt to intercede on behalf of HUD in a matter that is clearly the statutory responsibility of the OIG. Nevertheless, we considered all of these factors and concluded through the exercise of our professional judgment and experience gained through serving for four previous years as HUD's principal auditor, that even if the fund balance with Treasury reconciliation effort proceeded with no unanticipated difficulties, we would still be unable to complete the audit and possibly express an opinion until April 2000, at the earliest. We have repeatedly stressed to HUD officials that we need to perform additional audit procedures over and above the fund balance with Treasury work. That work has been delayed as a direct result of the delays in the financial statement preparation process noted above.

HUD has also alleged that we persisted in refusing to meet with the "Secretary's designated CFO representative." At the time of the initial meeting in question, we did, in fact, attempt to meet with the responsible official in HUD's CFO Office. That official informed us that he was directed not to meet with us and to not accept delivery of the draft disclaimer of opinion. Shortly before our attempt to meet with the responsible official in HUD's CFO Office, an official with HUD's Office of Housing, represented to us that she was interceding on behalf of the CFO's Office. While we never questioned the veracity of that official's representation, at that time, we had not received any direct communication from either the Secretary or the Deputy Secretary to that effect so that we could be clear as to the scope of the representative's authority regarding matters under the purview of HUD's CFO Office. Nevertheless, we attempted to deliver the draft report to the above mentioned Office of Housing official, but she too would not accept delivery of the draft disclaimer of opinion. As to the alleged persistence of the Director, Financial Audits Division's refusal to meet with the "Secretary's designated CFO representative" the next day (February 26, 2000 - a Saturday), the Director fully explained his reasons at the time.

As acknowledged by the Deputy Secretary, OIG staff did meet with the "Secretary's designated CFO representative" on Monday February 28, 2000, but contrary to Deputy Secretary's assertion, not only did we engage in a substantive discussion regarding fund balance with Treasury reconciliations, but also discussed additional audit areas we would need to complete that she was unaware of but had been discussed the previous week with the responsible official in HUD's CFO Office. It was also at this meeting that the "Secretary's designated CFO representative" agreed with our conclusion that we could not express an opinion by March 1, 2000. There was some discussion, however as to the length of time we would need to complete sufficient work to express an opinion. Moreover, we understand our audit responsibility with respect to establishing beginning fiscal year 2000 balances and in that regard have continued to meet with HUD staff and its contractors as additional information becomes available.

Our findings also include:

- Material weaknesses in internal controls in fiscal year 1999 related to the need to:
 - complete improvements to financial systems;
 - ensure that subsidies are based on correct tenant income;
 - improve monitoring of multifamily projects;
 - improve controls over the Federal Housing Administration’s (FHA) budgetary funds and funds control; and
 - enhance FHA’s information technology systems to more effectively support FHA’s business processes.

- Reportable conditions in internal controls in fiscal year 1999 related to the need to:
 - refine performance measures to effectively implement results management;
 - improve controls over project-based subsidy payments;
 - improve monitoring of housing authorities (HA);
 - improve controls over HUD’s computing environment;
 - overhaul personnel security for systems’ access;
 - strengthen access and data integrity controls over HUDCAPS;
 - improve processes for reviewing obligation balances;
 - continue to place more emphasis on early warning and loss prevention for FHA insured mortgages;
 - continue actions to safeguard and quickly resolve FHA’s Secretary-held single family mortgage notes;
 - sufficiently monitor and account for FHA’s single family property inventory;
 - improve FHA’s review process for estimating reserves for the insured portfolio; and
 - enhance the design and operation of controls over FHA’s information systems’ security and application data integrity.

Most of these control weaknesses were reported in prior efforts to audit HUD’s financial statements and represent long-standing problems. In its *Fiscal Year 1998 Accountability Report*, HUD reported that it complied with Sections 2 and 4 of the Federal Managers’ Financial Integrity Act (FMFIA), with the exception of the material weaknesses and nonconformances specifically identified in that report. Section 2 and related guidance require that: (1) an agency’s internal accounting and administrative controls provide reasonable assurance that obligations and costs are in compliance with applicable laws; (2) funds, property and assets are adequately safeguarded; and (3) revenues and expenditures are properly and reliably accounted for and reported. Section 4 requires that accounting systems conform to the accounting principles and standards mandated by the Comptroller General of the United States. For fiscal year 1998 and prior years, we disagreed with the Department’s statement of overall assurance in the Department’s *Accountability Reports*. HUD’s compliance determinations did not fully consider the magnitude of the problems HUD acknowledges in its own FMFIA process. With the Office of Management and Budget’s (OMB) approval as part of an initiative to streamline financial reporting, HUD did not prepare a separate FMFIA report for fiscal year 1999, but will be addressing those reporting requirements in its *Fiscal Year 1999 Accountability Report*. Given the magnitude of the problems that still remain, along with the deterioration of the internal controls relating to HUD’s core financial management systems, we continue to believe that an FMFIA statement of noncompliance would be appropriate for HUD.

Our findings also include the following instances of non-compliance with applicable laws and regulations:

- HUD did not substantially comply with the Federal Financial Management Improvement Act (FFMIA). In this regard, HUD's financial management systems did not substantially comply with (1) Federal Financial Management Systems Requirements, (2) Federal Accounting Standards, or (3) the SGL at the transaction level.
- HUD did not comply with the United States Housing Act of 1937, as amended by the Quality Housing and Work Responsibility Act of 1998. Specifically, HUD is not timely or properly enforcing the act's requirements for the timely expenditure and obligation by HAS of public housing modernization funds. As discussed later, HUD disagrees with our conclusion.

The following contents of this summary letter, as well as the detailed sections of this report that follow, elaborate on: (1) the serious problems with HUD's internal controls and (2) instances where HUD had not complied with applicable laws and regulations. Had we completed our audit, we might have found additional matters we would have reported.

Issues with HUD's Internal 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 has been taking actions to address the weaknesses and in some instances has made progress in correcting them. For the most part, however, progress has been at a slow pace in large part because HUD needs to address issues that fundamentally impact its internal control environment. HUD's most recent effort to address its management deficiencies is *HUD 2020*, announced in July 1997. As discussed below, HUD's ability to address its problems will substantially improve if it is successful in completing efforts to:

- upgrade its financial management systems,
- complete and take full advantage of organizational changes to resolve resource issues,
- address weaknesses with its management control program, and
- improve performance measures for its programs.

The most critical need faced by HUD in improving its control environment is to complete development of adequate systems. 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. The objective of the Financial Systems Integration (FSI) Plan, a part of *HUD 2020*, is to correct Department-wide financial management deficiencies while simultaneously providing the information necessary to carry out the financial and programmatic missions of the Department. A major component of the FSI plan was to implement HUDCAPS, as the core financial system for the Department. As implemented, the HUDCAPS core financial system does not fully comply with federal financial system requirements. In addition, other HUD financial system weaknesses remain uncorrected and financial system integration delays continue. The Department's failure to correct long standing financial system weaknesses in its feeder systems is a

contributing factor to non-compliance with financial system standards at the core financial system level.

In addition to improving its financial management systems, HUD will need to successfully complete and take advantage of organization changes under *HUD 2020* to more effectively manage its staff resources that have declined over the past few years. Many of the weaknesses discussed in this report, particularly those concerning HUD's monitoring of program recipients, are exacerbated by HUD's resource management shortcomings. While we agree that HUD must reform, and agree with some of the corrective measures in the *HUD 2020* plan, critical structural changes need to be fully implemented and effective before HUD's new organization can fully address these weaknesses. In particular, HUD must:

- Complete the transfer of the workload associated with housing assistance contracts to contract administrators.
- Make effective use of Real Estate Assessment Center (REAC) physical and financial assessments to ensure the adequate condition of HUD's housing portfolio.
- Demonstrate that efforts to streamline and outsource activities associated with the management and disposition of HUD-owned single family properties and notes are successful.
- Complete staffing of its newly organized Departmental income verification program and demonstrate effectiveness in reducing overpaid assistance.

Later in this report, we elaborate on the need for improved systems and resource management. In addition, we discuss the need for HUD to continue efforts to improve its management control program and improve performance measures for its programs.

Verification of Subsidy Payments

HUD provides rent and operating subsidies to HAS and multifamily project owners that benefited over 4 million lower-income households through a variety of programs, including public housing and Section 8. HUD's control structure that was in place during fiscal year 1999 did not provide reasonable assurance that these funds were expended by HAS and project owners in compliance with the laws and regulations authorizing these programs. HUD estimates that excess subsidy payments totaled about \$935 million for calendar year 1998. The admission of a household to these rental assistance programs and the size of the subsidy it receives depend directly on its self-reported income. HUD's control structure does not provide reasonable assurance that subsidies paid under these programs are valid and correctly calculated considering tenant incomes and contract rents.

Tenant income is a major factor affecting eligibility for, and the amount of housing assistance a family receives, and indirectly, the amount of subsidy HUD pays. In general, 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. Tenants often do not report income or under-report income from a specific source which, if not detected, causes excessive subsidy payments by HUD.

HUD has developed a nationwide estimate of the amount of excess rental subsidies paid during calendar year 1998. As we describe later in this report, various efforts are planned and underway to build upon this and address the need to institute an ongoing quality assurance program to improve controls over these payments. This includes a large scale income tax data matching project. To ensure that these projects are effective, HUD has taken action to improve the accuracy of and enforce requirements for HAS to timely update information in its tenant databases.

Monitoring Multifamily Projects and Housing Authorities

HUD provides the majority of its grant and subsidy funds to multifamily project owners (both nonprofits and for profit) and HAS. These entities, in turn, provide housing assistance to benefit primarily low income households. Weaknesses exist in HUD's control structure such that HUD cannot be assured that these funds are expended in accordance with the laws and regulations authorizing the grant and subsidy programs.

Legislation authorizing HUD's grant and subsidy programs includes specific criteria concerning tenant eligibility and providing assistance for housing that meets acceptable physical standards. HUD's structure for oversight of recipients does not provide assurance that these funds are expended only on eligible tenants and allowed activities. Moreover, legislation authorizing HUD's programs also establishes minimum performance levels to be achieved. For example, subsidized housing must comply with HUD's housing quality standards.

Under the *HUD 2020* initiative, the REAC has made some progress in providing for assessing the overall physical condition of HUD's housing portfolio, and reports completing 28,835 physical inspections of multifamily and HA properties during fiscal year 1999. However, at fiscal year end, the REAC had not completed financial assessments of multifamily projects due to delays in the rollout of its Financial Assessment Subsystem. Moreover, HUD's assessments of HAS are still advisory, due to the delays in implementing the Public Housing Assessment System (PHAS). In addition, HUD plans to outsource the workload associated with housing assistance contracts have been delayed from the original plan of September 1998 to where HUD now expects to begin transferring these functions in June 2000. HUD field offices are not sufficiently staffed to adequately review project and HA financial statements without REAC's assistance, nor have they been able to perform sufficient on-site monitoring. Until the *HUD 2020* initiatives

have been sufficiently implemented, HUD will continue to be hampered in its ability to effectively monitor multifamily projects and HAS.

System and Accounting Issues

In our earlier discussion of concerns we have 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 controls and in specific application controls 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. Later in our report, we provide a more detailed discussion of the weaknesses noted which relate to the need to improve:

- controls over the computing environment;
- administration of personnel security operations; and
- access and data integrity controls over HUDCAPS, a major HUD payment system.

We also discuss an accounting issue regarding the need for HUD to improve its processes for identifying and deobligating funds that are no longer needed. Major deficiencies include:

- Offices are not always reviewing unliquidated obligations to determine whether the obligations should be continued, reduced, or canceled.
- Procedures for reviewing outstanding obligations do not provide for reviews that fully consider specific statutory or grant requirements.
- HUD's financial systems do not fully support the timely identification of unneeded excess funds remaining on expired project-based Section 8 contracts.

Problems with FHA's Internal Controls Continue

A separate audit was performed of FHA's fiscal year 1999 financial statements by the independent certified public accounting firm of KPMG LLP. Their report on FHA's financial statements, dated February 24, 1999,² includes discussions of material weaknesses and reportable conditions, most of which were also reported in prior audits of FHA's financial statements. The FHA material weaknesses are as follows:

² KPMG LLP's report on FHA was incorporated in our report entitled, "Federal Housing Administration, Audit of Fiscal Year 1999 Financial Statements" (00-FO-131-0002, dated February 29, 2000).

- ***Controls over budgetary funds and funds control must be improved.*** FHA must perform analyses and reconciliations of all of its obligation systems, to ensure that all obligated amounts are properly recorded and that funds control is maintained and implemented in all systems. This process directly relates to ensuring that budgetary status and accounting information is complete, accurate, and available to management for decision-making purposes.
- ***FHA's information technology systems must be enhanced to more effectively support FHA's business processes.*** FHA and HUD are conducting day-to-day business with legacy based systems, several of which directly impact FHA's financial activity and necessitate financial transactions to be processed through non-integrated systems, requiring manual analysis and summary entries to be posted to FHA's general ledger. FHA's and HUD's inability to implement modern information technology adversely affects the internal controls related to accounting and reporting financial activities.

KPMG LLP also notes five reportable conditions regarding the need for FHA and HUD to: (1) continue to place more emphasis on early warning and loss prevention for insured mortgages, (2) continue actions to safeguard and quickly resolve Secretary-held Single Family mortgage notes, (3) sufficiently monitor and account for Single Family property inventory, (4) improve the review process for estimating reserves for the insured portfolio, and (5) enhance the design/operation of controls over information systems security and application data integrity

We consider the above issues to be material weaknesses and reportable conditions at the Departmental level. A more detailed discussion of these issues is not included in our report but can be found in KPMG LLP's report on FHA's fiscal year 1999 financial statements.

HUD 2020 Reforms Need Additional Time to Demonstrate Their Effectiveness

Many of the issues described in this report represent long-standing weaknesses that will be difficult to resolve. HUD's management deficiencies have received much attention in recent years. For example, in January 1994, the General Accounting Office (GAO) designated HUD as a high risk area, the first time such a designation was given to a cabinet level agency. In February 1997, GAO updated their assessment but concluded that HUD's programs will remain at high risk to fraud, waste, abuse and mismanagement until it completes more of its planned corrective actions. In their January 1999 update, GAO concluded that HUD is making significant changes and has made credible progress since 1997 in laying the framework for improving the way the Department is managed. GAO noted that HUD's Secretary and leadership team have given top priority to addressing the Department's management deficiencies through the *HUD 2020* plan and that this top management attention is critical and must be sustained in order to achieve real and lasting change. Given the nature and extent of the challenges facing the Department, both GAO and we acknowledge that it will take time to implement and assess the impact of any related reforms. As of the date

of this report, GAO has not updated their assessment of HUD's high risk status.

In addition to the discussion that follows dealing with HUD's internal control environment, we have provided details on additional non-FHA material weaknesses and reportable conditions, the majority of which were also reported in prior years. For each of these weaknesses, HUD has developed corrective action plans but progress has generally been slow in implementing these plans. For each weakness, we discuss the problem, then discuss the actions HUD has taken or plans to take to correct the weakness. We then provide our assessment of the planned actions and HUD's progress toward actual implementation of the plan.

Additional Agency Comments and Our Evaluation

On February 9, 2000, we provided a draft of the internal control and compliance sections of our report along with a draft of Appendix B to the CFO and appropriate assistant secretaries and other Departmental officials for review and comment, and requested that the CFO coordinate a Department-wide response. Additions to our draft of the internal control and compliance sections of our report were provided on February 17 and 18, 2000. We discussed our conclusion with CFO management on February 23 that it would be necessary to cease audit work and disclaim an opinion on HUD's financial statements. At the request of CFO management, we delayed issuance of a draft of the "Independent Auditor's Report" section until February 25, 2000. On that date we also provided a draft of Appendices A and C, along with additional recommendations to be included in Appendix B. That response, along with additional informal comments we received, were considered in preparing the final version of this report.

Comments on internal controls and compliance and our evaluation

The Deputy Secretary responded to our February 9, 2000 draft in a memorandum dated February 18, 2000, which is included in its entirety as Appendix D. The Deputy Secretary stated that Departmental management generally agreed with the draft report's conclusions on the state of HUD's internal controls and compliance for fiscal year 1999. However, the Deputy Secretary believed that our report did not adequately reflect the progress purportedly made in addressing the long-standing material weaknesses cited on our audit of HUD's fiscal year 1998 financial statements. In addition, the Deputy Secretary presented a numerical comparison of material weaknesses and reportable conditions and asserted that our statement: "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," was misleading.

As noted in our report, key reforms in *HUD 2020* that are directed at HUD's internal control weaknesses were implemented to some extent during fiscal year 1999. Our report acknowledges this progress, most notably with the REAC's physical inspection process. In other areas, however, our results for fiscal year 1999 clearly demonstrate that some reforms had been delayed significantly beyond their originally planned

completion under *HUD 2020* of September 1998. Moreover, HUD experienced difficulties with a key FHA initiative to outsource the management and disposition of HUD-owned single family properties. Therefore, it is too soon to reach a conclusion on the effectiveness of initiatives that have not been fully implemented or demonstrated to be successful. As to the numerical comparison of material weaknesses and reportable conditions, our statement referenced above was not misleading. Rather, the Deputy Secretary's tabulation excluded separate reportable conditions included in the separate audit of FHA's fiscal year 1999 financial statements and combined the two FHA material weaknesses with the material weakness on financial management systems. The tabulation correctly reported that we dropped "Community Planning and Development (grantee) Monitoring" as a reportable condition. The Deputy Secretary provided detailed comments in his response and we have provided our evaluation in Appendix E.

Additional comments on compliance

In responding to our conclusion with respect to HUD's noncompliance with certain provisions of the United States Housing Act of 1937, as amended by the Quality Housing and Work Responsibility Act of 1998, the Department disagreed with our conclusion. Prior to the issuance of our draft report, the Department provided two legal opinions to support their position. Notwithstanding those opinions, we provided our position in a draft of the applicable sections of the report on February 18, 2000. At the Department's request, we provided an additional detailed legal analysis to support our conclusion, after which, the Department provided a third legal opinion. The Department's legal opinions, along with our legal analysis, are provided in their entirety as Appendix F.

The following sections of this report provide additional details on our findings regarding HUD's internal control environment, verification of subsidy payments, monitoring program recipients, system and accounting issues, and noncompliance with laws and regulations.

Susan Gaffney
Inspector General

February 23, 2000

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 has been taking actions to address the weaknesses and in some instances has made progress in correcting them. For the most part, however, progress has been at a slow pace in large part because HUD needs to address issues that fundamentally impact its internal control environment. HUD's most recent effort to address its management deficiencies is *HUD 2020*, announced in July 1997. As discussed below, HUD's ability to address its problems will substantially improve if it is successful in completing efforts to:

- upgrade its financial management systems,
- complete and take full advantage of organizational changes to resolve resource issues,
- improve its management control program, and
- improve performance measures for its programs.

In considering these issues and their impact on HUD's financial statements, we note that the issues are interrelated to some extent. Moreover, to some extent they impact HUD's ability to correct the weaknesses reported in other sections of our report, relating to verification of subsidy payments, monitoring, and systems and accounting issues. With respect to HUD's resource issues, HUD had reported this as a material weakness under FMFIA since fiscal year 1993. In prior reports on HUD's financial statements, we also reported this issue as a material weakness, in part, because of the position taken by management. In assessing management controls for reporting in their *Fiscal Year 1999 Accountability Report*, HUD has asserted that, while there are still actions that need to be taken, sufficient progress has been made to warrant designating this issue as a "management concern."

In considering management's assertion with respect to this issue, we have reassessed the weakness with HUD's resources and the weaknesses with the management control program. In both areas, we are able to report some progress. However, more importantly to our reassessment, their effect on HUD's financial statements can be appropriately characterized as contributing causes for internal control weaknesses described in other sections of our report. Accordingly, we have elected not to separately categorize these two issues as reportable conditions. However, the discussions relating to these areas supplement our discussions of the internal control weaknesses described in other sections of our report. Moreover, we consider it critical for the Department to address them through the successful completion of ongoing plans.

Material Weakness:
HUD's Financial Systems are Not Fully Compliant with Federal Financial Standards

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. The objective of the FSI Plan, a part of *HUD 2020*, is to correct Department-wide financial management deficiencies while simultaneously providing the information necessary to carry out the financial and programmatic missions of the Department.

The components of the integrated financial management system include:

- a core financial system that conforms with the requirements of the Joint Financial Management Improvement Program (JFMIP);
- program systems that support the Department's ability to manage and operate HUD's programs. (program systems must be integrated with the core financial system to record financial events in a timely and accurate manner);
- data warehouses in which data are consolidated and standardized from multiple systems; and
- management information systems with which HUD's financial and programmatic data can be accessed to support management's informational needs.

In 1997, the Department decided to implement HUDCAPS, as the core accounting system for the Department. HUDCAPS is based on an "off-the-shelf" system also known as the Federal Financial System (FFS). We reported then, and continue to believe that the decision was made without a complete and thorough analysis of alternatives. During the early part of 1997, the Department initiated a General Services Administration (GSA) required Letter of Interest process to determine, based on requirements, the best "off-the-shelf" product to use as HUD's core financial system. However, a decision was made without completing the process. The FFS solution was not evaluated in a manner consistent with the evaluation of other proposed solutions and operation capability demonstrations were not performed.

Subsequent to this decision, we communicated to the CFO our concern that (1) user requirements were not adequately considered and may not be met by the FFS solutions; (2) total costs to implement the FFS solution had not been identified, including determining whether known requirements could be met by the system without the purchase of additional software or customer modification of the core system; (3) the FFS solution would require a subsequent conversion effort in order to achieve the preferred modern integrated system, and (4) any effort to further modernize the system may be hindered by GSA procurement requirements.

Despite the risks, HUD proceeded with the implementation of HUDCAPS as the department-wide general ledger, budget execution, and external reporting system. After much effort, schedule delays and cost increases, HUDCAPS was prepared to operate as a department-wide general ledger beginning with fiscal year 1999.

We have determined that as implemented, the HUDCAPS core financial system does not fully comply with federal financial system requirements. In addition, other financial system weaknesses remain uncorrected and financial system integration delays continue. The Department's failure to correct long standing financial system weaknesses in its feeder systems is a contributing factor to non-compliance with financial system standards at the core financial system level. The following financial management system deficiencies, most of which were reported in prior years were present during fiscal year 1999:

- Insufficient information regarding individual multifamily loans, including the inability to financially monitor the insured portfolio. This makes assessing and quantifying credit risk difficult and adversely impacts efficient, ongoing reporting of credit risk to senior management and effective monitoring of multifamily projects.
- Deficient FHA general ledger and subsidiary systems.
- Inadequate assurance about the propriety of Section 8 rental assistance payments.
- Lack of integration between program and accounting systems necessitating duplicate data entry.
- Inability to support adequate funds control for FHA.
- Inability to fully support the timely identification of unneeded excess funds remaining on expired project-based Section 8 contracts.

In addition, the Department's financial systems continue to have security weaknesses in general and specific application controls as reported elsewhere in this report.

Departmental general ledger is not compliant with core financial system requirements

The Department-wide general ledger as currently implemented is not fully compliant with federal financial system requirements. Due to uncorrected weaknesses in FHA's financial management system, FHA's separate general ledger data are not updated in the HUDCAPS general ledger in a timely manner. The process currently in place to ensure the entry of FHA transactions is cumbersome, inefficient, and time consuming.

In fiscal year 1998, the FSI team completed efforts to use HUDCAPS as the department-wide general ledger for fiscal year 1999. To meet this objective, the FSI team prepared HUDCAPS to capture the results of

general ledger transactions from subsidiary ledgers supported outside of HUDCAPS.

The current approach for interfacing FHA financial systems with HUDCAPS requires the performance of a series of cumbersome manual³ conversions of financial data prior to submission to HUDCAPS. First, financial information from feeder systems are converted to a commercial accounting based general ledger. A second manual process crosswalks the commercial accounting based general ledger balances to SGL equivalents. These data are then used to generate standard financial reports and HUDCAPS summary SGL entries. As a result, updated FHA general ledger financial information was transmitted to HUDCAPS only once and after year-end.

JFMIP requires that the core financial system “...provide financial information in a timely and useful fashion to (1) support management’s fiduciary role; (2) support budget formulation and execution functions; (3) support fiscal management of program delivery and program decision making; (4) support internal and external reporting requirements, including, as necessary, the requirements for financial statements prepared in accordance with the form and content prescribed by OMB, reporting requirements prescribed by Treasury, and legal, regulatory and other special management requirements of the agency; and (5) monitor the financial management system.” JFMIP also requires that the core financial system “...provide for automated month-and year-end closing of SGL accounts and rollover of the SGL account balances.”

In addition, OMB Circular A-127, *Financial Management Systems*, requires that “...Integrated Financial Management Systems...shall be designed to provide for effective and efficient interrelationships between software, hardware, personnel, procedures, controls, and data contained within the systems....Wherever appropriate, data needed by the systems to support financial functions shall be entered only once and other parts of the system shall be updated through electronic means consistent with the timing requirements of normal business/transaction cycles.”

The process used to enter FHA SGL transactions into the department-wide general ledger is neither timely nor efficient. As a result, there is no assurance that information on departmental activities can be disseminated in a timely manner to support internal or external users. In addition, the continued reliance upon manual processes to convert FHA financial transactions into a usable format is inefficient and requires duplicate entry of data.

JFMIP Core Financial System requirements state that “easy and timely reconciliations between systems, where interface linkages are appropriate, must be maintained to ensure accuracy of the data.” The

General ledger system interfaces are not fully developed.

³ The “manual” processes include use of personal computer software programs that operate separately from HUD’s official financial systems.

general ledger system was migrated from PAS to HUDCAPS during the fiscal year; however the transition was a significant undertaking and was still not complete as of the date of our report. The interface filter and the general ledger posting models have resulted in numerous rejected or incorrectly posted transactions that have to be manually researched and corrected. In addition, the migration was done without development of an automated program to help reconcile the general ledger cash accounts to Treasury's figures. As a result, the reconciliation processes to identify discrepancies have fallen behind schedule, and HUD had to make numerous adjustments to the general ledger fund balance with Treasury balances to make them agree with Treasury records. These adjustments were made directly through posting to the financial statement report consolidation program called Hyperion Enterprise and bypassed the normal general ledger posting process. The noted problems delayed the closing of the general ledger for fiscal year 1999 until January 24, 2000, and the preparation of the financial statements.

Difficulties with FSI implementation prevented proper reconciliation of fund balance with Treasury accounts

Treasury requires that agencies reconcile their fund balance with Treasury accounts monthly. The reconciling process is an essential internal control to ensure the integrity of U.S. Government financial reporting and provide for reliable measurement of budget results. Due to delays and the magnitude of the FSI implementation, the HUDCAPS general ledgers were not available to support the reconciliation process until November 1999. As a result, the CFO staff relied on the PAS subsidiary ledger balances to verify the Department's fund balance with Treasury. Reconciliations did not start taking place until late July 1999 for all but four funds. For the remaining four funds, reconciliations were not completed until after fiscal year end because subsidiary records for those funds were maintained in both HUDCAPS and PAS. As of the date of our report, HUD has not reconciled the differences between HUDCAPS, PAS and Treasury reported balances. We tried to obtain documented procedures on how HUD completed the cash reconciliation using HUDCAPS, however, none were available. In addition, we tried to obtain explanations for the differences between the fund balance shown in HUDCAPS versus the Treasury reported balances. These explanations could not be readily provided by the CFO staff preparing the reconciliations because they were still waiting for the necessary information from HUDCAPS to facilitate the reconciliation process. Untimely cash reconciliations resulted in questionable accuracy and reliability of amounts reported in the fund balance with Treasury accounts.

The FSI project has not addressed FHA/Office of Housing weaknesses

In addition to difficulties in accomplishing FSI objectives, FHA/Office of Housing system weaknesses persist. As reported in previous years, FHA/Office of Housing financial systems represent a majority of the systems HUD reports as not in conformance with FMFIA.

In its *Fiscal Year 1999 Accountability Report*, HUD plans to report that 13 of the 18 nonconforming systems are the responsibility of FHA/Office of Housing. FHA has developed a proposal to improve FHA financial

management systems. The current proposal calls for a three phase approach in which FHA ultimately is to implement an “off-the-shelf” financial system as its subsidiary accounting system and subsequent enhancement of program systems to support full compliance with Federal financial systems requirements. However, no detailed plans or estimated completion dates have yet been assigned to the proposal.

The FSI project still suffers from frequent project scope, strategy and management changes

Last year we reported that frequent FSI project and strategy changes have resulted in schedule delays and cost overruns. In fiscal year 1997, HUD revised its FSI strategy for the second time. The revised FSI plan called for consolidation of four general ledger systems into the core financial system along with an Enterprise Data Warehouse (later termed the Empowerment Information System). In fiscal year 1998, HUD included data standardization and cleanup as part of the FSI project and in fiscal year 1999, an additional system, the Grants Management System, was added. However, beginning in fiscal year 2000, the FSI Project team no longer had responsibility for the Grants Management System or the Empowerment Information System. The Office of Administration assumed the responsibility for developing these two systems. In addition to these changes, HUD has hired a contractor, in response to an earlier GAO recommendation, to assist the Department in a cost benefit analysis of the FSI project and to redefine the strategy options. These frequent changes have made it difficult for the Department to measure performance and progress, and control costs.

HUD Must Complete and Take Advantage of Organizational Changes to Address Resource Issues

HUD’s administrative resources have decreased over the years, while its workload has increased. We have previously reported that HUD has not developed a comprehensive strategy to manage its resources. Reducing and reallocating resources further weakens controls, particularly when coupled with inadequate financial systems. HUD continues to implement significant organizational changes to overhaul and improve the Department’s operations under the *HUD 2020* plan, announced in June 1997. The plan calls for major staff downsizing, modification of HUD’s field and headquarters organizational framework, consolidation of HUD’s programs and activities, and significant changes in the way HUD conducts its business.

HUD staffing changes have had a major impact on operations

As we reported in our *Semiannual Report to the Congress* for the six months ended September 1999, initially, the *HUD 2020* plan called for nearly all reform changes to be completed by the end of fiscal year 1998. The plan included consolidating several program functions, once performed in numerous field offices, into centers and developing a systematic assessment of HUD housing through the REAC. Under the *HUD 2020* plan, fewer staff would be needed as greater reliance would be placed on contractors, with HUD’s staff responsibility shifting to contract monitoring. *HUD 2020* organizational changes are complete, but the major substance of the reform changes, i.e., business operational changes, is still under development. Because of delays in *HUD 2020* implementation, most of the staffing efficiencies projected to result from *HUD 2020* have not yet been realized.

While concerns remain, *HUD 2020's* success is critical to resolving long standing problems

Many of the weaknesses discussed in this report, particularly those concerning HUD's monitoring of program recipients, are exacerbated by HUD's resource management shortcomings. As we reported in our audit of HUD's fiscal year 1998 financial statements, critical structural changes need to be fully implemented before HUD's new organization can effectively address these weaknesses. In particular, we highlighted four areas. HUD has made some progress, but experienced some difficulties with implementation. Also, as of the end of fiscal year 1999, key initiatives continued to be delayed.

- ***HUD must complete the transfer of the workload associated with housing assistance contracts to contract administrators.*** We reported last year that the Section 8 Financial Management Center (FMC) was not staffed nor equipped with adequate financial management systems to process payments to project owners. Moreover, renewals of these contracts as they expire were becoming an increasing burden for already reduced Office of Housing field staffs. HUD does not expect to begin transferring contract administration functions for these contracts until June 2000. Moreover, it is anticipated that a significant number of contracts will not be transferred to contract administrators and HUD needs to finalize and implement plans to deal with that workload under its current organizational structure.
- ***HUD must make effective use of REAC physical and financial assessments to ensure the adequate condition of HUD's housing portfolio.*** While structural changes were made during fiscal year 1999, HUD's field offices were still not sufficiently staffed to adequately review project and HA financial statements nor were they able to perform sufficient on-site monitoring without REAC's assistance. The REAC is considered the linchpin of *HUD 2020* because other HUD organizations are so dependent upon its work to better target their monitoring and enforcement resources. During fiscal year 1999, the REAC made substantial progress and has reported completing 28,835 physical inspections of multifamily and HA properties. However, at fiscal year end, the REAC had not completed financial assessments of multifamily projects due to delays in the rollout of its Financial Assessment Subsystem. Moreover, HUD's assessments of HAS are still advisory, due to the delays in implementing PHAS.
- ***HUD must demonstrate that efforts to streamline and outsource activities associated with the management and disposition of HUD-owned single family properties and notes are successful.*** Single family staffing was cut by more than 50 percent under *HUD 2020*, based on the assumption that HUD's inventory of assigned notes would be sold and that contractors would manage the property disposition process. In February 1999, HUD awarded a series of "management and marketing" contracts to manage HUD-owned

properties. Also, HUD awarded a contract in February 1999 to a private sector group to service all single family Secretary-held notes.

As reported by KPMG in their audit of FHA's fiscal year 1999 financial statements, the poor performance of the largest "management and marketing" contractor contributed to the fact that as of September 30, 1999, total single family property inventory reached 49,793 properties, an increase of 10,423 properties compared to the end of fiscal year 1998. Moreover, the number of properties remaining in inventory over one year increased by 64 percent. In addition, delays were encountered in efforts to outsource servicing of the portfolio of single family Secretary-held notes resulting in a further deterioration of the quality of the portfolio during fiscal year 1999.

- ***HUD must complete staffing of its newly organized Departmental income verification program and demonstrate effectiveness in reducing overpaid assistance.*** During fiscal year 1999, REAC assumed responsibility for a permanent income verification program for all HUD rental assistance and public housing programs. Progress has been made on HUD's initial large scale income matching initiative including completing systems enhancements, developing guidance to resolve tenant income discrepancies, and identifying approximately 280,000 households who may have an income discrepancy. HUD expects to begin receiving online status reports by March 2000 from program administrators who are to follow up on the discrepancies. Because the magnitude of the effort, the Department lacks the resources to follow up on the large scale matching results. As a result, its approach to carrying out large scale income matching is heavily dependent on the cooperation of the HAS and owner/agents. The effectiveness of this approach has not been demonstrated.

Contracting attitudes and practices have not changed significantly

We reported in a September 1997 audit⁴ that HUD needs to address its contracting activities. HUD relies heavily on contractors to perform a wide variety of program administration activities. Because HUD's reliance on contractors is expected to increase, particularly in the areas noted above, HUD, in acknowledging weaknesses with its contracting activities, made procurement reform a priority in the *HUD 2020* plan. On September 30, 1999, we issued a follow-up report⁵ on our assessment of the effects of recent HUD reform initiatives on the procurement process. The Department has hired a Chief Procurement Officer, established a Contracts Management Review Board and assigned trained, full time Government Technical Representatives to oversee contracts. Further, HUD recently deployed the HUD Procurement System to link procurement with core accounting systems and provide for tracking contract status from planning through post award contract administration. However, we

⁴ "HUD Contracting" (97-PH-163-0001, dated September 30, 1997)

⁵ "Follow-up Review of HUD Contracting" (99-PH-163-0002, dated September 30, 1999)

concluded that HUD's overall contracting attitudes and practices had not changed significantly.

It is too soon to determine whether HUD will ultimately be successful in carrying out the reforms called for in the *HUD 2020* plan. To improve on HUD's ability to more effectively manage its resources, the Department, in conjunction with the National Academy of Public Administration (NAPA), has developed and pilot tested a resource management methodology. Based on the recommendations in NAPA's October 1999 report, HUD has begun implementing a new Department-wide resource system, known as the Resource Estimation and Allocation Process (REAP) and expects to complete this effort by July 2001. However, we note that three years ago, the Department put forth a similar proposal to develop REAP, but did not follow through. As we have reported previously, the staffing target set forth in the original *HUD 2020* proposal was adopted without first performing a detailed analysis of HUD's mission and projected workload. We are concerned whether the Department will follow through with the current initiative to improve its resource management systems and be able to use those systems to make sound resource allocation decisions in the future.

HUD Needs to Continue Efforts to Improve its Management Control Program

FMFIA and accompanying guidance in OMB Circular A-123, *Management Accountability and Control*, require Federal managers to take systematic and proactive measures to (1) develop and implement appropriate, cost-effective management controls for results-oriented management, (2) assess the adequacy of management controls in federal programs and operations, (3) identify needed improvements, (4) take corresponding corrective actions; and (5) report annually on management controls.

HUD has continued to improve its management control program

The CFO has the responsibility and accountability to manage and oversee the Department's Management Control Program. To carry out the effort, the CFO established an Office of Risk Management which became operational during fiscal year 1998. The program has three major components.

- Incorporate Front End Risk Assessments (FERA) into *HUD 2020* implementation efforts.
- Perform risk management reviews of existing programs and develop a risk evaluation database.
- Conduct special risk management reviews upon request from program managers.

During fiscal year 1998, the CFO's Risk Management Division sponsored management control training for headquarters and field managers and supervisors. During fiscal year 1999, the CFO took steps to prepare for monitoring training to address significant monitoring problems within the Department. However, in June 1999, the Deputy Secretary announced a

“Monitoring and Compliance” initiative for fiscal year 2000 which is designed to move toward the development and implementation of a comprehensive approach to program monitoring and compliance. Rather than have separate training, the CFO is integrating its management control and risk-based monitoring training with the Deputy Secretary’s initiative. This training also includes program-specific training that incorporates the basic principles included in the *Departmental Management Control Program Handbook* (1840.1 Rev-3). The Department began conducting this training the first quarter of fiscal year 2000.

The Department has issued a training edition of the Monitoring Desk Guide. Formal Departmental policy covering CFO and program responsibilities under the new Management Integrity Program (HUD Handbook 1840.1 Rev-3) was completed and issued during fiscal year 1999.

FERAS need to be completed in a more timely manner

During fiscal year 1999, the Department completed five FERAs (four were in process at the end of fiscal year 1998). Prior to the issuance of this report, the Department completed two additional FERAs, one of which was in process during fiscal year 1998. At the end of fiscal year 1999, the Department had twelve additional FERAs in process. The unfinished FERAs included ones related to key components of *HUD 2020* including the Section 8 FMC, and the “Privatization of Single Family Property Disposition.” These particular FERAs had been submitted in draft to the CFO, but remained uncompleted for a significant length of time.

Although the Department has improved on this process, efforts need to continue to ensure that the FERAs are completed in a more timely manner. If planned actions are not identified and carried out as soon as possible, program weaknesses and risk may continue to exist.

HUD has not demonstrated effective efforts for assessing risks in ongoing programs

The Management Integrity Program also depends on Primary Organization Heads (POH) and their responsible managers to routinely perform and document risk of existing programs or activities by performing “Risk Reviews.” The objective for each POH is to allocate monitoring resources to those programs or functions that pose the greatest risk of control weakness and for carrying out their oversight responsibilities. No risk assessments were performed by POHs in fiscal year 1999, however, the CFO’s office initiated 5 reviews in fiscal year 1998 that were not completed in fiscal year 1999. One of these reviews relates, in part, to assessing field responsibilities associated with monitoring multifamily projects, a long-standing material weakness. In September 1998, the CFO notified the Office of Housing of the need to perform a risk review of the Multifamily “HUBS” (field offices). The CFO further confirmed the plans in October 1998. Shortly thereafter, in November 1998, staff from the offices of the CFO and Housing met to discuss the details of the review. However, to date, this risk review has not been completed.

Reportable Condition:
 HUD Needs to Continue to Refine Performance Measures to Effectively Implement Results Management

OMB Bulletin 97-01, *Form and Content of Agency Financial Statements*, requires agencies to report performance measures about the efficiency and effectiveness of their programs. We reported in prior years that there was a lack of performance information included in HUD's *Accountability Report* and prior annual reports which emphasized financial and non-financial operating results as input or simple output measures. In prior years, we noted particular concerns with the following key program areas, that HUD is still addressing in some manner:

- For HUD's rental assistance programs, including Section 8 programs administered by both the Office of Housing and Public and Indian Housing (PIH), HUD's *Accountability Report* describes aggregate dollars expended and number of households assisted. No efficiency or effectiveness measures are provided including any that would address, for example, how well HUD is meeting a key requirement of these programs, that the housing complies with HUD's housing quality standards. A major effort initiated under *HUD 2020* is for the REAC to compile and report the results of physical inspections of public and assisted housing projects. Under PHAS, the REAC is developing advisory scores for HAS, including a physical inspection component. Full implementation of PHAS has been delayed until fiscal year 2000. Baseline data on REAC inspections of multifamily projects are to be completed in fiscal year 2000.
- CPD designed the Integrated Disbursement and Information System (IDIS) to provide field staffs with real-time performance data to assist monitoring efforts and ensure grantee compliance with program requirements. However, IDIS experienced reporting problems during fiscal year 1999. This fact, along with a regulation which only requires grantees to report performance on an annual basis, has delayed full realization of the purposes for which the system was designed. For fiscal year 1999, CPD derived some of its performance information from data that are three to five years old. Other data may be overstated due to double counting of units that receive CPD funding from more than one source, such as a county and state. HUD is developing a new Departmental Grants Management System, in part, to address concerns with IDIS and improve the reliability of grantee performance information.
- The performance information for HAS includes information from the Public Housing Management Assessment Program (PHMAP). In light of concerns about HUD's controls over the reliability of this performance data as well as the adequacy of component factors to objectively determine HA performance, PHMAP is being replaced by PHAS, which was to have been implemented at the end of fiscal year 1999. While scores under PHAS were established during fiscal year 1999, the scores are advisory until PHAS is fully implemented. PHAS scores are to be official for HAS' fiscal years ending March 31, 2000 and thereafter. HUD plans to begin reporting PHAS scores in fiscal

year 2001 after capturing one and one-half years of advisory score data.

For fiscal year 1999, we noted that the Department is to include performance data for organizations created under *HUD 2020* in its *Fiscal Year 1999 Accountability Report*. This includes various information relating to the accomplishments of the Departmental Enforcement Center (DEC), established to centralize the management of HUD's enforcement activities. The accountability report includes statistics on various enforcement activities completed along with monetary recoveries. In assessing the underlying support for this information, however, it was noted by HUD that the underlying source systems were in various stages of completion and none were operational.

HUD issued its fiscal year 1999 annual performance plan under the Government Performance and Results Act (GPRA) in March 1998. The plan contained 96 performance measures or indicators to accomplish seven objectives. The measures or indicators were predominantly process outputs with about 60 percent not identifying the baseline for fiscal year 1999 target performance. The House Report (H.R. 105-610) accompanying HUD's fiscal year 1999 appropriations bill stated, in part, that "...HUD should pay greater attention to the establishment of results-oriented performance measurements rather than maintaining process-oriented performance measurements." To address concerns with the GPRA performance plan, HUD contracted with the National Academy of Public Administration (NAPA). Working with NAPA, HUD revised its performance plan for fiscal year 2000 along with the underlying strategic objectives.

In prior years, we reported on our concerns over performance measure data reliability and the Department's plans to remedy the concern with a program requirement to submit quality assurance plans to the CFO for review and approval. NAPA expressed similar concerns and recommended that HUD develop a strategy or plan that outlines a clear, departmentwide data quality goal and spells out minimally acceptable data quality standards for key elements, such as timeliness, reliability and accuracy.

Verification of Subsidy Payments

Greater Efforts Needed to Verify Subsidy Payments

HUD provides rent and operating subsidies benefiting over 4 million lower-income households through a variety of programs, including public housing and Section 8. HUD's control structure that was in place during fiscal year 1999 did not provide reasonable assurance that these funds were expended by HAS and project owners in compliance with the laws and regulations authorizing these programs. The admission of a household to these rental assistance programs and the size of the subsidy it receives depend directly on its self-reported income. HUD's control structure does not provide reasonable assurance that subsidies paid under these programs are valid and correctly calculated considering tenant incomes and contract rents.

PIH provides funding for rent subsidies through its operating subsidies and tenant based Section 8 rental assistance programs. These programs are administered by HAS who are to provide housing to low income families or make assistance payments to private owners who lease their rental units to assisted families.

The Office of Housing administers a variety of assisted housing programs including parts of the Section 8 program and the Section 202/811 programs. These subsidies are called "project-based" subsidies because they are tied to particular properties, therefore tenants who move from such properties may lose their rental assistance. Unlike public housing and tenant-based Section 8, most of these subsidies are provided through direct contracts with multifamily project owners; there is no HA or local government intermediary. Since there is no intermediary, HUD has more responsibility for ensuring that project owners provide support only to eligible tenants and that they comply with the contract and program laws and regulations. This is a significant responsibility because of the sizable number of project owners HUD must monitor.

Material Weakness: HUD Needs to Do More to Ensure That Subsidies Are Based on Correct Tenant Income

HUD performed computer income matching with its assisted housing universe and estimated that housing subsidy overpayments were \$935 million, an amount we consider to be substantial. Tenant income is a major 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. Tenants often do not report income or under-report income which, if not detected, causes HUD to make excessive subsidy payments.

Under reporting or understating of income from a specific reported source is easier to detect than unreported income. Program regulations require HAS or project owners to verify applicant and tenant income and other factors relating to eligibility and rent through third party written

documentation. In the past, HUD field offices performed in-depth occupancy reviews of HAS and project owners which included file reviews that were specifically designed to ensure income reported by tenants and the amounts of income used to determine eligibility and computation of rent were consistent with the verification sources. The Office of Housing continues to perform some occupancy reviews, but far fewer than required by HUD policy. Our concerns with this aspect of HUD's monitoring is discussed later in the report in the section addressing multifamily project monitoring controls. PIH now essentially relies on audits performed by independent auditors (IA) to determine whether HAS are performing income verifications. Our concerns with HUD's reliance on IAs for monitoring HAS are discussed later in this report in the section addressing HA monitoring controls.

HUD has made limited use of available income matching tools to detect unreported tenant income

With regard to unreported income, various legal, technical and administrative obstacles exist that impede HUD, HAS and project owners from ensuring tenants report all income sources during the certification and recertification process. Consequently, HUD makes excessive subsidy payments and possibly provides assistance to ineligible families while denying access to housing assistance to eligible families who often are on large waiting lists maintained by many of the HAS. Since unreported income is difficult to detect, HUD has encouraged HAS to computer match with State wage agencies to detect unreported income. Unfortunately, most HAS do not have the technical and/or administrative resources to implement this technique.

Since 1996, HUD has sampled its household databases each year to estimate the amount of excess subsidy payments it has made for financial statement disclosure. Also, on a more limited basis, HUD has completed or initiated a number of small scale computer income matching projects at a few select HAS and two larger nationwide sampling projects of 20,000 households. However, the planning of these projects has been sporadic and full implementation and reporting of the results often takes a number of years to complete, thus diminishing the usefulness and effectiveness of the results.

To determine necessary disclosure for HUD's fiscal year 1999 financial statements, HUD performed computer income matching with federal income tax data to determine the magnitude and effect of under reported and unreported tenant income in calendar year 1998. HUD randomly sampled 1,000 households from its automated data bases and matched their reported income with federal tax data in Social Security Administration (SSA) and Internal Revenue Service (IRS) data bases. HUD compared the computer matching results with source documents. Based on the results of the computer income matching project, HUD statistically projected at the 95 percent confidence level that the amount of excess rental subsidies was \$935 million plus or minus \$133 million during calendar year 1998.

HUD has made progress in expanding its income matching program

In March 1999, the Department assigned the responsibility for the income verification function to the REAC. Since assuming this role, the REAC has focused its resources on developing the capability to implement a large-scale computer matching and income verification using Federal income tax information. During fiscal year 1999, the REAC developed the Tenant Assessment Subsystem which will allow HUD to conduct matching of tenant-reported income maintained in HUD's tenant databases with Federal tax data. In September 1999, the REAC obtained Federal tax data from the IRS and SSA for calendar year 1998 and performed a computer match of 2.1 million households to identify potential tenant income discrepancies. From the computer match, the REAC identified approximately 280,000 households who may have tenant income discrepancies exceeding specified thresholds. Further details and discussion related to the REAC's large-scale project plans for fiscal year 2000 are discussed below under "HUD's Actions Planned and Underway to Verify Tenant Income" and our assessment of those actions.

In fiscal year 1999, REAC continued operations for the large-scale implementation of computer matching and income verification involving social security (SS) and supplemental security income (SSI) information. Currently over 2,400 HAS access the SS and SSI information via a secure Internet facility as a "front-end" way to verify income and annual tenant recertifications. Other HAS receive the SS and SSI information via the U.S. mail. The SS and SSI computer matching and income verification program has been implemented nationally since 1997 for HAS.

In 1999 the REAC implemented the SS and SSI verification program for entities that administer rental assistance programs of HUD's Office of Housing. Administrators of the Office of Housing's rental assistance programs currently receive SS and SSI data via electronic media. In September 1999 REAC made the data available to the administrators of the Office of Housing's program via a secure Internet facility in September 1999, which provides direct delivery of the SS and SSI information to the end users of the data.

PIH has improved HA reporting into its MTCS tenant database

HUD uses the Multifamily Tenant Characteristics System (MTCS) data for PIH's income matching program, financial planning, budget requests to the Congress, estimates of staff workload, and program monitoring. Also, MTCS data will be used in seven of the fourteen indicators in the Section 8 Management Assessment Program (SEMAP) that is scheduled to be implemented about April 2000. For HUD's income matching and other program efforts to be effective, it is essential that the MTCS data base have complete and accurate tenant information. Throughout fiscal year 1999, the overall reporting rate of household data into the MTCS steadily improved from 64 percent in December 1998 to more than 90 percent in December 1999. The improved reporting rate, in part, can be attributed to the increased monitoring of the HAS' reporting. Additionally, the reporting software problems experienced in fiscal year 1998 have, for the most part, been resolved allowing HAS to more timely report household data into MTCS.

HUD's Actions Planned and Underway to Verify Tenant Income

As we previously discussed, in calendar year 1999 the REAC focused its resources on developing the capability to implement a large-scale computer matching and income verification of the information in its tenant databases. The REAC had completed the computer matching of HUD reported income for its tenant databases to IRS and SS data files and was in the process of preparing approximately 280,000 letters that are to be sent to tenants who were identified with potential income discrepancies above established thresholds. These letters identify the tenants' Federal tax data and inform the tenants of their responsibility to disclose the data to program administrators. Along with the mailing of tenant letters, REAC is preparing notifications for program administrators to inform them of tenants who were sent discrepancy letters. REAC anticipates it will send the tenant letters and program administrator notifications in March 2000.

The REAC has also prepared a detailed guide to assist program administrators in resolving potential tenant income discrepancies. This guide will be mailed with the discrepancy notifications. The program administrators will be required to submit periodic online status reports regarding their resolution of tenant income discrepancies and their recovery of excess rental assistance. The REAC plans to review these reports to determine the success of the large-scale computer income verification in ensuring that subsidies are based on correct tenant income. As an additional quality assurance effort, the REAC plans to send staff to review program administrators' activities to ensure the integrity of their income discrepancy resolution.

HUD also plans to continue with its efforts to improve the quality and completeness of the MTCS database by continuing to monitor and provide technical assistance to HAS who do not comply with the minimum reporting rate requirements (85 percent), and as appropriate, impose administrative sanctions on HAS that do not comply.

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

HUD should continue to evaluate and assess the effectiveness of its ongoing computer matching projects, with particular emphasis on determining what effects the statutory restriction on redisclosing federal income tax data to HAS and project owners has on the program's effectiveness. Also, HUD should continue to explore and evaluate practical and cost effective computer matching techniques and methodologies that will aid in quantifying, on a larger scale, the extent of abuses and the benefits of a permanent computer matching and income verification process. We are also encouraged by the number of on-going actions HUD has taken and continues to pursue to improve the reporting rate and data integrity of the MTCS. As was evidenced by the significant improvement in the reporting rate during fiscal year 1999, these actions appear to be having a positive impact in improving the completeness and data integrity of MTCS.

In our report on HUD's fiscal year 1998 financial statements, we expressed concerns as to whether the Department was ready to immediately embark on a large-scale computer matching income verification effort in fiscal year 1999, especially since key issues relating to developing and testing a suitable methodology, establishing adequate information technology and a human resource infrastructure to support a large-scale matching effort had not been sufficiently developed nor implemented. Although the REAC has made significant progress, the present large-scale matching methodology has not yet been fully tested, nor has the human resource infrastructure been fully implemented. The project is already more than four months behind its implementation schedule. Additionally, since the current methodology of identifying tenants with potential income discrepancies has not been fully tested, we are concerned that a large number of tenants may receive an income discrepancy letter in error. This could have negative long-term implications on HUD's computer matching program.

Reportable Condition:
**Controls over Project-Based
 Subsidy Payments Need to
 be Improved**

In prior reports on HUD's financial statements, we reported on long-standing weaknesses with the processing of subsidy payment requests under the project-based programs administered by the Office of Housing. Historically, this process has been hampered by the need for improved information systems to eliminate manually intensive review procedures that HUD has been unable to adequately perform. To address this problem, the Office of Housing developed the Tenant Rental Assistance Certification System (TRACS). Owners input tenant information into TRACS and the system calculates the proper Housing Assistance Payment (HAP) for each tenant. Office of Housing field staff can then compare information on the HAP voucher to TRACS. These comparisons, done on a sample basis, were known as post payment reviews because the reviews were performed after the vouchers were paid.

HUD administers various project-based assisted housing programs, most notably, Section 8. Although the payment processes differ, under each program, HUD pays the difference between the contract rent for the units and that portion of the rent the tenant can pay based on their household income. HUD administers about 22,000 assistance contracts with multifamily project owners who are responsible for verifying household income reported by the tenants and submitting requests for payment to HUD due under HAP contracts.

Staffing changes and system weaknesses have increased risks associated with the subsidy payment process

A major initiative under *HUD 2020* is to transfer monitoring responsibilities for Section 8 Housing projects to "contract administrators" such as State Housing Finance Agencies (SHFA) and HAS. In addition to overseeing project owners' activities on HUD's behalf, the contract administrators are to process the HAP payments. HUD planned to have the contract administrators in place by September 1998 and in anticipation of this, Office of Housing staff assigned to review HAP payments was cut to ten and transferred to PIH's Section 8 FMC. According to an agreement between PIH and the Office of Housing, signed April 1, 1998, the voucher processing function was to have up to the previously

approved staffing limit of 25 with the understanding that the staffing level would continue until the execution of the contract administrator contracts. Under current plans, however, the initial group of HAP contracts will not be under contract administrator control until June 2000. In the meantime, staffing for the FMC HAP processing function has remained at around 10, significantly understaffed. Furthermore, planned enhancements to streamline TRACS payment processing capabilities were canceled, adversely affecting the reduced staff's ability to effectively process HAP requests.

During fiscal year 1998, reviews of project-based Section 8 HAP requests were reduced because of *HUD 2020* staff cuts. In the first quarter of fiscal year 1998, HUD began having owners submit payment requests electronically, for processing and payment through the Line of Credit and Control System (LOCCS). In conjunction with implementing electronic processing, LOCCS was enhanced to identify payment requests that exceed a specified percentage of the average monthly payments made during the prior 12 months. Before processing of such payment requests can be completed, the FMC performs a pre-payment review to ensure the requests are valid. Because of the resources needed to resolve these payment requests, the Office of Housing terminated post payment reviews in the first quarter of fiscal year 1998 and LOCCS reconciliations in the second quarter. This occurred before the transfer of the voucher review function from the Office of Housing to the FMC.

Merged contracts have caused delays in making some subsidy payments

In fiscal year 1999, the Office of Housing began the process of merging multiple contracts for one project into one contract. Although the contracts were merged, changes were not made in LOCCS to adjust the average payment threshold to reflect the merger. As a result, when several contracts were merged into one, the subsequent HAP payment requests for the particular merged contract were significantly higher than the previous average monthly payments for that contract. The merged contracts were identified by LOCCS as requiring a prepayment review.

This action has greatly increased the FMC's prepayment workload since May 1999 without a corresponding increase in staffing. In fiscal year 1998, 3,068 prepayment reviews were completed, while in fiscal year 1999 that number more than doubled to 6,948. FMC procedures require that automated payment requests be reviewed within three weeks of receipt of the paper voucher from the owner. Because of the increased number of vouchers requiring review due to the contract mergers, the FMC is not always able to meet this goal. In September 1999, 975 vouchers were identified for the pre-payment review. We found that 106 of those vouchers, totaling \$1.4 million in subsidy requests, were not reviewed within three weeks of receiving the paper voucher. Therefore, project owners were not paid on a timely basis.

Requested payments under the new merged contracts continue to exceed the average payment threshold in the database under the remaining contract number. HUD should make appropriate adjustments to LOCCS payment processing to reflect the combination of contracts at the time

of the contract merger and prevent false errors that the FMC has to review.

HUD's Actions Planned and Underway to Improve the Subsidy Payment Process

Each report on HUD's financial statements since HUD has been subject to audit under the provisions of the CFO Act has identified the lack of effective controls over the project-based subsidy payment process. HUD does not have a process to determine the accuracy of a payment requisition. HUD has abandoned plans to fully implement a TRACS Payment Module because of decisions made as part of *HUD 2020*.

Ultimately, HUD plans to transfer monitoring responsibility for Section 8 projects to contact administrators such as SHFAs and HAS. This includes responsibility for making Section 8 payments to project owners. In the interim, the FMC recently decided to resume post payment reviews in March 1999 using staff in Chicago. The review process now focuses on verifying that at least a specified percentage of the tenants on a subsidy voucher have a current certification in TRACS. The staff review all vouchers that are generated in one month in a particular state. If contracts are identified that fail this test, the owner is contacted and asked to update the system within 30 days or face possible suspension of future subsidy payments.

No sanctions have been taken when noncompliance is identified

While the post-payment review has been functioning for several months and over 500 reviews have been completed, there were no policies and procedures in place for this function. As a result, staff were not suspending payments for those contracts which failed to meet the current tenant certification requirement. Suspensions have not occurred because the Office of Housing has not established a policy for such suspensions in its programs. FMC management states that they are currently developing an automated program to compare vouchered units with tenant data, to determine, for the entire universe, which contracts have insufficient tenant data in TRACS. When this program is in place, and the Office of Housing policy is established, they plan to apply a sanction policy uniformly to all non-compliant owners. While consistency in applying sanctions is important, we believe it is also important to apply the sanctions in a timely manner once noncompliance with regulations is identified to deter other owners from failing to provide the required information

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

Most Section 8 HAPs are being made without any HUD review because the FMC is only able to review about 2 percent of the vouchers before payment. If HUD had continued development of TRACS, including the payment module, and had developed procedures to ensure the accuracy of data in TRACS, there would have been adequate controls over payments. The post payment reviews were a valuable tool when HUD planned to continue TRACS development. TRACS data needed to be

accurate because it was going to be the basis of the HAP. Now the reviews are of limited value. Reconciling owner input TRACS data to the owner prepared HAP voucher only ensures the two sets of owner data agree. The reconciliation does not show the payment is accurate. The only way to determine if a payment is accurate is to test source documentation through confirmations, on-site reviews or other procedures. The HAP vouchers submitted to the FMC are the source documents supporting HAP payments. HUD needs to commit sufficient resources to control the receipt and storage of these documents.

While the post payment review process has been successful at instigating voluntary compliance on the part of some of the owners who have been contacted as part of the review, a management information system should be developed to identify the effectiveness of the process. At the time of our field work, the Chicago FMC staff could not identify the universe of the vouchers they had reviewed, the results of their reviews, or readily identify the status of contracts which were identified for possible suspension of future payments due to noncompliance with contract provisions. Without a system in place to track the results of their review, management can not identify the effectiveness of the post payment review process. In addition, such a system would allow management to track the contracts that failed the review to ensure that proper follow-up action is taken. FMC staff have agreed to implement a system and state that they have not done so in the past because their efforts in the first year have been devoted to other systems.

HUD has elected to address the Section 8 control weakness through the transfer of the functions to contract administrators, rather than fully developing TRACS payment processing functions. HUD has selected the initial group of contract administrators and expects to begin transferring functions to them in June 2000. However, for this to be successful, HUD needs to successfully complete the transfer of these functions and adequately monitor those entities' performance. Moreover, HUD will likely be left with a significant number of HAP contracts to administer after the transfer to contract administrators is completed and needs to finalize plans to improve administration of those contracts including payment processing.

Monitoring Multifamily Projects and Housing Authorities

Monitoring Weaknesses Continue

HUD provides the majority of its grant and subsidy funds to multifamily project owners (both nonprofits and for profit) and HAS. These entities, in-turn, provide housing assistance to benefit primarily low income households. Weaknesses exist in HUD's control structure such that HUD cannot be assured that these funds are expended in accordance with the laws and regulations authorizing the grant and subsidy programs.

Legislation authorizing HUD's grant and subsidy programs includes specific criteria concerning tenant eligibility and providing assistance for housing that meets acceptable physical standards. HUD's structure for oversight of recipients does not provide assurance that these funds are expended only on eligible tenants and allowed activities. Moreover, legislation authorizing HUD's programs also establishes minimum performance levels to be achieved. For example, subsidized housing must comply with HUD's housing quality standards.

Material Weakness: Improvements Needed in Multifamily Project Monitoring

HUD needs to continue efforts to improve the effectiveness of multifamily project monitoring to assure that subsidies are provided only to projects that provided decent, safe and sanitary housing or on behalf of tenants that meet HUD eligibility requirements. Also, HUD's monitoring of project based Section 8 contract administration by SHFAS and HAS has continued to be inadequate. Plans to rely on contract administrators to assume HUD's role in project monitoring have not yet been implemented. HUD provides rental assistance to about 21,000 multifamily projects on behalf of eligible tenants residing in those projects. This assistance includes FHA mortgage insurance and funds provided under several subsidy programs. The principal multifamily subsidy programs are:

- The Section 8 and Section 236 programs which provide subsidies to project owners, who, in turn, provide housing units at reduced rents to low income households.
- The Section 202 and Section 811 programs provide grants to non-profit institutions for the construction of projects providing reduced rent units to the elderly and disabled, respectively. Ongoing rent subsidies are also provided under these programs once the units are occupied.

Most of these subsidies and grants are provided through direct contracts with multifamily project owners; there is no HA or local government intermediary. Accordingly, HUD has more responsibility for ensuring that project owners provide support only to eligible tenants and that they comply with the contract and program laws and regulations. This is a significant responsibility because of the sizable number of projects HUD must monitor.

Monitoring goals which are risk based need to be clearly articulated in the field and headquarters BOPs

For fiscal year 1999 HUD established goals through the Business and Operating Plans (BOP). While the BOP goals were being met, the plans did not adequately establish a risk based approach to managing the multifamily portfolio at the project level. We assessed project monitoring at four field offices, including a review of project files relating to 138 multifamily projects. Most of the projects received rental assistance and were identified by the field offices as troubled or potentially troubled. This identification was independent of the BOP process or any systematic development of risk information using information from the REAC. The capability to develop and use REAC information in assessing risks of individual multifamily projects was still under development during fiscal year 1999. Notwithstanding this limitation, the BOP process did provide more consistency to the goal setting process than was present during the fiscal years 1997 and 1998.

Goals and requirements for monitoring traditionally have been documented as required by Office of Housing Handbooks and Notices. However, both field program staff and we noticed various instances where authoritative criteria were out of date, incomplete, inconsistent, or absent. This condition was first reported last fiscal year and was acknowledged by the Office of Housing. As a result, reliance is still being placed on more informal electronic mail, satellite training, the Internet and guidance disseminated via conference calls.

Transition to monitoring tools developed under HUD 2020 continued during fiscal year 1999

HUD was unable to adequately monitor the financial condition of multifamily projects due to difficulties with REAC's implementing electronic submission of annual financial statements. Through electronic submission and subsequent automated analysis by REAC, project financial scores were to be made available to the field offices during fiscal year 1999. REAC extended the filing deadline to August 1999 and the Office of Housing delayed releasing the data to the field offices until staff could be trained on the use of that data. Distribution of financial results began on September 30, 1999. As a result, the field offices did not have project financial information and corresponding REAC analyses available to them for project monitoring during fiscal year 1999.

The physical inspection component of project monitoring improved during fiscal year 1999. Under the new REAC managed process, physical inspections became increasingly available for use by field office staff throughout the fiscal year. In addition, at two of the four field offices we tested, project managers supplemented the REAC inspections by using the results of inspections performed by mortgagees and field office staff. We determined that those two offices used the physical inspection monitoring process effectively. As reported in our audits of HUD's two previous years' financial statements, the physical inspection process suffered because prior inspection efforts were stopped in favor of implementing the REAC inspection process.

In prior reports on HUD's financial statements, we noted that the field offices performed far fewer management and occupancy reviews of their

troubled and potentially troubled projects than required by HUD policy. For fiscal year 1999, according to the Office of Housing, use of management and occupancy reviews was purposefully reduced in light of activities of the REAC and the DEC. For example, when the DEC receives a referral of a troubled project for enforcement action, reviews are to be suspended while the DEC processes the case. The DEC has provided us with information that as of September 30, 1999, the DEC had received about 483 such referrals and had completed work on 34 percent. However, in two of the four field offices tested, reviews that could have been done were not done because the field staff believed that the reviews were optional. The effort spent by field staff using this monitoring tool was comparable to our observations from prior years. Moreover, reviews that were being performed were not being consistently recorded in the Real Estate Management System (REMS) as part of a systematic process for assessing risks associated with individual multifamily projects.

The policy to reduce the level of management and occupancy reviews for HUD monitored projects is inconsistent with HUD's plans for the projects to be transferred to contract administrators. In this regard, HUD plans to require contract administrators to perform annual management and occupancy reviews of projects they administer.

Better monitoring of "contract administrators" still needed

HUD provides funds to SHFAS and HAS, which in turn enter into rental assistance contracts with multifamily project owners/management agents. In these instances, the SHFAS and HAS assume project monitoring responsibilities similar to HUD, including ensuring that payment requests from project owners are accurate and owners maintain the projects in accordance with applicable laws and regulations. Since HUD funds pass through the SHFAS and HAS to the projects, HUD policy requires the field offices to monitor these "contract administrators." According to HUD policy, at a minimum, a field office should conduct an annual on-site review of contract administrators in its jurisdiction whose performance has been marginally satisfactory or less. All other contract administrators should be reviewed every two years. During the review, HUD should select projects to be reviewed on-site for compliance with laws and regulations.

As with last year's audit, during fiscal year 1999, the field offices we visited did not review any of the contract administrators in their jurisdictions. When HUD does not monitor the projects directly or indirectly, it adversely impacts HUD's ability to assure the propriety of Section 8 disbursements. HUD is still planning to greatly expand the use of contract administrators to administer housing assistance contracts and thereby increase reliance on these intermediaries to carry out project monitoring responsibilities that are currently the responsibility of HUD staff. This effort is scheduled so that the first projects will be turned over to the contract administrators in June 2000.

Various factors contributed to continued problems in monitoring and oversight of multifamily projects

There were various reasons for not monitoring projects, including deployment of *HUD 2020* changes. This included the lack of information from audited financial statements, ongoing delays in implementing the plans to use contract administrators and field office decisions to not do management and occupancy reviews. The lack of monitoring of Section 8 contract administrators continues to be a problem for the field offices. Also, data entry and verification problems continued with REMS and field offices continued to rely on unofficial local systems to assist in overseeing the multifamily projects in their jurisdictions. When monitoring activities are not performed or not performed in a timely manner, HUD lacks assurance that rental subsidies are being paid for decent, safe and sanitary housing or that the subsidized tenants meet the HUD established eligibility requirements. Thus, HUD lacks assurance that assistance payments are being made to properties and on behalf of tenants in a manner that complies with applicable laws and regulations.

HUD's Actions Planned and Underway to Improve Multifamily Project Monitoring

The key initiative aimed at improving HUD's monitoring of multifamily projects is *HUD 2020*. There are several separate administrative and legislative initiatives under this plan including changing organizational structures, systems, and compliance monitoring approaches. Organizational changes include the REAC, the Section 8 FMC, the DEC, and the Office of Multifamily Housing Assistance Restructuring. System changes include continued implementation and modification of REMS, planned development of the Multifamily Accelerated Processing, and Development and Application Processing systems. Changes in compliance and monitoring approaches include the fiscal year 2000 Compliance and Monitoring Initiative, a fiscal year 2000 BOP goal for risk based management of the results of the physical inspections of multifamily projects, the ongoing activities of the Quality and Assurance Division, and the Multifamily Data Quality initiative. Moreover, the Office of Housing reports that, as of January 31, 2000, the REAC had received 15,597 electronic submissions of project financial statements, of which 6,485 were closed by the system as having no compliance conditions.

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

Organizational structure changes have included the issuance of various protocols to define how the new organizations would work with each other and delineate work responsibilities. The protocols as well as operations manuals are evolving. Furthermore, staff has moved within HUD from one organization to another creating the need for additional training. These efforts are in process but are not yet complete. They need to continue until the organizational structure changes have settled.

System changes are still evolving with many new initiatives planned for fiscal year 2000. Similarly, compliance and monitoring approaches are changing should be supported by continued updating criteria and manuals,

training of staff, and capturing the knowledge of staff experiences in discussing approaches by discussion of best practices. These communications should be encouraged and documented.

Implementation of *HUD 2020* has made the Office of Housing increasingly dependent on other HUD organizations (e.g. the REAC, DEC and FMC) and external contractors. The adequacy of what the Office of Housing receives from another HUD organization or external contractor depends on clear needs definitions and adequate resources to achieve full implementation. Moreover, increased use of external contractors increases the need for monitoring of these functions by the Office of Housing.

Reportable Condition:
Continued Efforts Needed to Improve Housing Authority Monitoring

HUD provides grants and subsidies to approximately 3,300 HAS nationwide. In prior years, we reported that HUD's control structure did not provide reasonable assurance that these funds were expended in compliance with the laws and regulations authorizing these programs. In fiscal year 1999, problems remain which we believe HUD needs to address to provide assurance that HAS provide safe, decent, and sanitary housing and protect the federal investment in their properties. Our most significant concern relates to payments made by HUD, through its operating subsidies and Section 8 rental assistance programs, to assist HAS in providing affordable housing that meets HUD's housing quality standards to house eligible low income households. Our specific concerns, and the *HUD 2020* initiatives to address them, are discussed below.

Improved risk evaluation and monitoring of housing authorities needed

During fiscal year 1999, HUD continued to implement its performance oriented, risk based strategy for carrying out its HA oversight responsibilities. Although we generally noted improvement in the field offices' monitoring of its HAS, further improvement needs to be made in key monitoring areas such as HA risk assessment, use of IA reports, full implementation and use of PHAS data, and performance of on-site and remote monitoring activities. Furthermore, additional delays in implementing PHAS in fiscal year 1999 further limited HUD's ability to effectively monitor and improve HA performance because many field offices were reluctant to use the data because it was still being issued on an advisory basis.

In fiscal year 1999, HUD's field offices were to continue performing risk assessments of all HAS within their jurisdictions by primarily considering HA performance and compliance data, and develop plans to monitor and/or provide technical assistance to those HAS determined to be in the greatest need of attention. As was the case in prior years, the HAS' PHMAP performance certifications and IAS' compliance reviews were key components of HUD's risk based monitoring strategy.

In our testing of four field offices' risk assessment and monitoring of HAS, we generally found monitoring activities had improved when compared to our previous years testing. However, a number of key monitoring

deficiencies still exist that need to be improved to ensure the monitoring of HAS is effective. For example, we found in two of the four offices, no formal risk assessment was performed in fiscal year 1999 on its HAS. Additionally, as described below, the PHMAP/PHAS processes were not yet being used effectively to monitor the HAS. We continue to have concerns regarding the reliability of the performance and compliance data used by HUD's field offices to evaluate HA operations. HA performance evaluation factors as currently reported under PHMAP do not effectively address or measure the overall quality of subsidized housing. Until PHAS, which provides for an independent program for on-site inspection of the actual condition of HAS' housing stock, is fully implemented and the inspection results are used by the field offices to help HAS improve operations, its usefulness as an effective monitoring tool for improving HA performance will be limited.

Furthermore, we noted that at all four field offices we tested, current and complete information was not always obtained from the HAS and entered into PIH's Integrated Business System (IBS). Since the IBS is PIH's primary information system to remotely monitor HA business processes and performance, its usefulness as an effective monitoring tool is diminished when it does not contain complete, consistent, and accurate data.

Delays in implementing PHAS continues to impede housing authority monitoring and improve performance

We previously reported that PHMAP is not always a reliable indicator of an HA's performance because HUD's controls did not assure the integrity of the scores and PHMAP performance data did not effectively assess the quality of the public housing stock. In fiscal year 1998, HUD developed PHAS to replace PHMAP to provide for a more comprehensive monitoring system of public housing operations. The PHAS final rule was published on September 1, 1998 and provided that it would be implemented for HAS with fiscal years ending on or after September 30, 1999. However, on October 21, 1999 HUD published a Federal Register notice that further delayed the implementation until after December 1999.

In the interim, for fiscal year 1999, the HAS were scored under the PHMAP process and the REAC continued to issue only advisory scores under PHAS. As we reported in previous years, HUD's controls over the PHMAP process did not assure the integrity of HA scores because limited reviews were performed to confirm HAS' reported PHMAP scores. Furthermore, in a July 14, 1999 internal directive from the assistant secretary to the PIH field offices, the field offices were relieved from conducting confirmatory reviews of standard and high performing HAS, except at their option, because PIH determined the reviews were unwarranted and time consuming. Also, we found that not all the field offices we tested ensure all its HAS implemented appropriate corrective actions to improve performance deficiencies that were identified under PHMAP.

In fiscal year 1999, REAC reports it performed 15,222 inspections at 13,559 PIH properties that are administered by 3,162 different HAS. Of

the 15,222 inspections, 3,038 resulted in a failing physical score. Furthermore, 4,228 of the inspections identified one or more life threatening exigent health and safety issue. However, since the scores were still advisory in nature, the field office and Troubled Agency Recovery Center (TARC) staff were generally reluctant to use the results in their monitoring program. In fact, PIH did not release any guidance on the field offices' use of the PHAS scores until late August 1999 in anticipation that PHAS scores would be issued after September 30, 1999. Additionally, in an audit related memorandum dated September 30, 1999⁶, we expressed concern that HUD had no means of tracking findings and issues identified from the inspections to ensure the deficiencies are corrected. Consequently, under the current environment, the physical inspection process has not had its fully intended impact on improving HA performance.

Reliability and use of Single Audits is limited

Given HUD's reduced monitoring resources and its increased focus on HA performance (as opposed to compliance issues), HUD needs to be able to place reliance on the audits of HAS conducted by IAS pursuant to the Single Audit Act. In accordance with the standards under which these audits are conducted, the IAS are required to review and test HA compliance with laws and regulations that are material to the HA's financial statements. To improve the usefulness of audit reports submitted pursuant to the Single Audit Act, HUD management issued a comprehensive compliance supplement for use by the IAS in performing audits of HAS. However, there are a number of issues that impede HUD's ability to place appropriate reliance on the IA reports.

In our prior years testing of IAS' audits, we generally found IAS had not performed the audits in accordance with the PIH Compliance Supplement and questioned whether many of the IAS performed sufficient testing to determine if HAS were in full compliance with the program requirements. In fiscal year 1999, the REAC implemented an audit quality assurance plan and completed 65 Quality Audit Reviews (QAR) at 29 IAS. The results showed that 17 percent of the IAS did not perform adequate testing in accordance with the PIH compliance supplement. Additionally, we found that three of the four field offices we tested did not ensure all the HAS that were required to prepare and submit IA reports did so in a timely manner nor did they take appropriate follow-up actions to obtain the missing reports. Also, for two of the four field offices, we questioned whether the IA report results were effectively used in performing annual risk assessments. Thus, we continue to have concerns about the usefulness of the IA reports as an effective monitoring tool by the field offices.

⁶ "Implementation of the Real Estate Assessment Center's Physical Inspection Assessments" (99-BO-199-0802, dated September 30, 1999)

HUD's Actions Planned and Underway to Improve HA Monitoring

HUD continues to implement *HUD 2020* reforms that were begun in fiscal year 1997. Under *HUD 2020*, the new PIH structure consolidated financial, funding, and processing activities and separate troubled agency recovery activities from HA oversight and technical assistance functions so field office staffs can concentrate on providing technical assistance and oversight to HAS with declining performance. HUD field offices were consolidated into 27 hubs and 16 program centers. Additionally, two TARCs were established in mid 1998 to support troubled HAS, and the REAC was created to perform HA assessments. The specific structural and operational actions HUD has taken or intends to implement in fiscal year 2000 include:

- During fiscal year 1999, the REAC developed and implemented its major assessment systems to produce physical, financial and PHAS advisory scores for approximately 2,800 HAS. In fiscal year 2000, REAC plans to issue more than 3,100 advisory scores. Additionally, REAC inspected more than 13,000 PIH properties at about 3,100 different HAS. The inspection results indicated that approximately 3,000 inspections received a failing score and life threatening exigent health and safety issues were identified in approximately 4,200 inspections.
- On January 11, 2000 HUD published a revised PHAS final rule to amend certain provisions of the existing final rule (September 1, 1998). The revised rule provided additional information and revised and established certain procedures for HUD's assessment of HAS' physical and financial condition, management operations, and resident services and satisfaction. Specifically, the proposed rule introduced new "substandard" performance designations in addition to "troubled" designations established under the Quality Housing and Work Responsibility Act.
- PIH's two TARCs provided service to an average inventory of 52 designated HAS, mostly small and moderate sized, and began servicing 4 non-troubled HAS. The delay in fully implementing PHAS continues to limit the number of HAS serviced by the TARCs. They were established to serve more than 500 troubled HAS.
- The REAC plans to significantly increase the number of QARS it completes on IA audits of its HAS in fiscal year 2000. The REAC plans to complete 300 QARS and 30 limited scope engagements (includes multifamily and HA reviews) in fiscal year 2000.
- PIH Field Operations is developing a National Risk Assessment Module that will allow PIH to perform a risk assessment of its HAS on a national level. It is anticipated the module will be completed in September 2000.

- On July 26, 1999 the rule was amended to base ratings for the first seven SEMAP indicators, and for the deconcentration bonus indicator, on the HAS' SEMAP certifications rather than on the IAS' annual audit reports. HUD expects the first SEMAP ratings will occur in about April 2000.

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

While we agree with *HUD 2020* measures aimed at improving oversight of HAS, the Department's plans to monitor and improve performance in this area are not yet fully developed and continue to experience delays. Until HUD finalizes its implementation plans, we cannot assess HUD's ability to fully implement its oversight strategy. Moreover, HUD's success in addressing the need to objectively assess the quality of the public housing stock is dependent upon field offices receiving and acting on the results of inspections to be performed by the REAC. Nevertheless, we do believe that some of the *HUD 2020* proposals are positive.

Specifically, we agree with HUD's efforts to establish and implement a standard inspection protocol to assess the physical condition and quality of public housing. The current process for evaluating HA performance does not consider the quality and livability of its housing stock. We also agree with HUD's decision to develop PHAS to replace the existing PHMAP to provide for a more complete assessment of HA operations. The current PHMAP process relies too much on the HAS' self assessments of their performance.

Although we generally agree with HUD's decision to establish two TARCS to service troubled HAS, we have concerns over whether the proposed PHAS Rule, as implemented by HUD, will adequately identify a significant number of "at-risk" HAS that will be serviced by the TARCS for the purpose of improving HA performance. Furthermore, we are concerned over the emphasis placed on improving the assessment score (PHMAP or PHAS) itself. The assessment scores are only an indication of an issue and improving the score may not necessarily resolve the problems that caused the HA to be troubled.

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System and Accounting Issues

HUD Needs to Address System and Accounting Weaknesses

In our earlier discussion of concerns we have 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;
- administration of personnel security operations; and
- access and data integrity controls over HUDCAPS, a major HUD payment system.

We also discuss the need for HUD to improve its processes for reviewing outstanding obligations to ensure that unneeded amounts are deobligated in a timely manner.

Reportable Condition: HUD Needs to Improve Controls Over Its Computing Environment

HUD's automated information systems are critical in supporting 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.

Significant improvements have been made but weaknesses still exist

We evaluated selected system controls for both the Hitachi and UNISYS mainframe computers. We also tested security over networks, evaluated portions of HUD's disaster recovery process, software change controls, and contingency planning. In fiscal year 1999, HUD has made some improvements in computer security and contingency planning. In addition we noted that, thus far, HUD experienced only minor impact from the Year 2000 millennium rollover. However, we continue to note weaknesses with HUD's computing environment as discussed below.

Hitachi Environment

A significant improvement was made through the implementation of "Fail Mode" on the access control security software, CA-Top Secret, for the Hitachi mainframe. "Fail Mode" is the vendor recommended option for a full production mainframe system such as the one supporting HUDCAPS.

Top Secret operates at the highest level of security in “Fail Mode” because it controls all access requests.

Two powerful system features were not fully controlled

“Started Tasks” are essential automated procedures for initiating components of system software. We found two weaknesses in the controls for “Started Tasks.” As a result of our audit of HUD’s fiscal year 1998 financial statements, the bypass security option for “Started Tasks” was replaced with a high privileged profile for the default entry. A “Started Task” using the default profile has read, update, delete, and create access to every data set on the system. Although a procedure was established to monitor and review the use of this default entry on a weekly basis, it was not done for seven “Started Tasks” that used the default entry on a recurring basis. The ADP Security Office did not follow up with a review of the audit trail records to ensure that the use of the default entries were legitimate and presented no vulnerabilities.

The other weakness in this area was that sixty other “Started Tasks” had profiles with excessive access privileges. There were sixty “Started Tasks” that were assigned profiles with global access authorities. These authorities allow read, update, delete, and create access to every data set on the production Hitachi mainframe. Not all of these sixty “Started Tasks” require such authorities. For example, “Started Tasks” that support the “DB2” database subsystems do not need access to operating system parameters. Since HUDCAPS depends on system software initiated by “Started Tasks,” these weaknesses expose critical financial data to possible damage, loss, and errors.

We also evaluated the administration of the Authorized Program Facility (APF). This is a mechanism to protect the operating system and the integrity of the overall processing environment. An authorized program can execute in “supervisory” mode. This would allow the program to assume total control over the computer system and has the capability to read and modify system control tables, bypass data access controls, circumvent system logs, and perform other activities critical to the integrity and security of the processing environment. System guidelines recommend that all of the authorized software programs residing in APF libraries be accurately identified in the APF entry list. During our evaluation of APF administration at the data center, we found two out of 134 APF authorizations did not apply proper maintenance. There was an entry in the APF list for a non-existent library and a library with an incorrect volume specification. Both of these conditions would allow knowledgeable individuals to place unauthorized programs into the APF. This exposure could result in loss, errors, and damage to HUD’s critical financial software and data.

UNISYS Environment

Access controls over sensitive data remain weak

Access controls over data residing on the UNISYS mainframe need to be improved. We found that sensitive Privacy Act data and payment system data were not adequately protected from unauthorized access. This

weakness was also reported in our audit of HUD's fiscal year 1998 financial statements.

The National Institute of Standards and Technology (NIST) recommends that organizations base access control policy on the principle of least privilege, which states that users should be granted access only to the resources they need to perform their official functions. We were able to view sensitive HUD data such as customer names, addresses, social security numbers, and credit information from a number of applications. We were also able to read control language run streams for the payment system (LOCCS) that initiate the electronic transfer of funds to the Treasury Department. We were able to read these sensitive data because sufficient protective controls had not been placed on the files. We estimate that up to 3,010 users have similar access to view sensitive HUD data, and may also be able to modify data, depending on their existing level of access and programming knowledge. As a result, the privacy of HUD customers is being compromised, and the sensitive data placed at risk for potential fraudulent activities.

With respect to security management for the UNISYS, NIST recommends that an organization implement an audit trail mechanism to ensure individual accountability, reconstruction of events, intrusion detection, and problem identification. We found the process by which suspicious system activity is reviewed and followed up on needs to be improved. Although the ADP Security Office performs some reviews of the UNISYS audit logs, they do not have a documented policy for following up on security related incidents. For example, we noted several unsuccessful system logon attempts late at night and early in the morning. Although these attempts may be attributed to authorized business, the ADP Security Office did not follow up on them. As a result, system attacks or loss of data may go unnoticed and continue to occur if a documented process is not established and adhered to on a regular basis.

Network Environment

Network controls have improved but vulnerabilities still exist

We tested selected controls in the network environment in addition to reviewing mainframe system controls. Our network control tests were designed to determine if a person could obtain unauthorized access to network resources. Vulnerabilities in one area of the network can be manipulated to obtain greater access in another part.

Our tests indicate that there has been some improvement in the access controls over HUD's networks. The most critical problem we determined that has been corrected is the existence of default user IDs and passwords, such as "guest" and "administrator." These default IDs and passwords have been turned off or have been changed to make them harder to guess. However, some vulnerabilities that we detected and reported in previous years have not been removed, despite HUD promises to do so. Novell networks were still frequently set to allow users to log in with unencrypted passwords. A person using special software could view the user ID and password of a user logging in as it went through the

network. Another weakness we noted is the lack of control over Novell operating system files. Access to these files allows a person to copy system files to hacking programs, which are designed to identify user IDs and passwords. This information would allow a person to login as someone else and use that access to read files and even initiate transactions.

We also noted some weaknesses that could allow an outsider to obtain access over HUD computing resources. Most of these weaknesses relate to Windows NT or Unix servers and personal computers that operate on HUD's network. An example of this type of weakness is file transfer protocol signal handling, which gives users root access. Unauthorized outsiders could use "root access" to access HUD system and/or data files which could then be manipulated, copied, and even destroyed with little or no audit trail.

We detected vulnerabilities by using two automated tools for network security evaluation. Given the size and complexity of HUD's network, an automated network monitoring package would enable detection and correction of security exposures.

Disaster Recovery

Plans for disaster recovery have not been adequately tested

Business Resumption Plans (BRPs) for headquarters and field operations have not been timely and adequately tested to address and support all different aspects of disaster recovery. Peak and non peak hour testing, disaster simulation and testing of field operations have not been conducted. OMB Circular A-130 provides a basis for testing requirements. Also, disaster recovery standards and best practices have been promoted by leading experts in the field. In 1996, the Federal Systems Integration and Management Center, an independent consultant, conducted a study of HUD's service continuity. The report recommended that testing should take place during peak and non-peak hours because disasters do not give sufficient time for preparation and can occur at any time. Also, these tests do not have to be of a disruptive nature and can be performed as a non-operational "paper test." We have reported on the lack of testing before. Without adequate testing, HUD cannot ascertain whether the BRPs will be effective for disaster recovery.

We also noted that at the three field offices we visited, Fort Worth, Denver and New York, the information technology (IT) staff indicated that they lacked knowledge of the BRPs developed by program areas in the event of system failures. IT staff should be involved in developing the BRPs in order to provide needed technical support to the program areas in the event of a disaster.

Software Change Control

Implementation of application change control software continues to be a low priority

We continue to report weaknesses in configuration management (CM) for the Hitachi and UNISYS mainframe applications as well as those on the servers. There is no consistent method of controlling changes to applications system software. Tracking of software changes is limited to piecemeal, manual procedures where documentation of approval and movement of changes between development stages varies, depending upon the stage of development and who is making the changes. This creates an unnecessary risk to the software integrity of HUD's application systems.

Although we have continually reported this significant weakness since 1996, there is a lack of progress in CM implementation. A work plan for all platforms promised to be completed in 1999, has not yet been completed. Only 12 of the 37 critical applications were identified as being under CM. We are also concerned that planned implementation consists only of schedules with no specific tasks and dependencies identified. Some even lack estimated completion dates, training plans, and testing strategy. As a result, there is no way to measure progress or establish accountability in this critical area. In fiscal year 1999, HUD's critical applications continued to be exposed to unnecessary risk of unauthorized, unintentional, or malicious software modifications resulting in errors, loss of data, or system failure.

Year 2000 (Y2K) Computer Problem

So far, HUD experienced only minor year 2000 problems

So far, HUD has experienced minimal disruptions from the millennium rollover. No major system failures have occurred. Since 1996, the Department has invested considerable effort in fixing the Y2K date problem. It appears that this high priority approach has resulted in lowering the risk of Y2K failures. In addition, the Y2K effort produced useful business contingency plans that prescribed detailed procedures for workarounds in the event of system failures.

HUD's Actions Planned and Underway to Improve Controls Over Its Computing Environment

On the Hitachi mainframe, HUD successfully placed the Top Secret global control parameter in "Fail Mode" during fiscal year 1999. Under "Fail Mode," Top Secret provides the highest security level. Also, there are procedures in place at HUD's data center to control the use of powerful system resources for the Hitachi mainframe. Data center management has indicated that the weaknesses in the "Started Task" and APF system features will be corrected. The issue of excessive access privileges has been under review for several months and is being addressed with the long range security plan. Regarding the UNISYS mainframe, the Department has developed a plan to address the access control weakness reported in our audit of HUD's fiscal year 1998 financial statements. Final actions will not be completed until September, 2000.

With respect to the LAN environment, IT had planned during fiscal year 2000 to evaluate and acquire network monitoring tools. This planned action was in response to the weak controls reported in our audit of HUD's fiscal year 1998 financial statements. However, IT recently indicated that because of limited funding, it would not be possible to invest in network monitoring tools.

We have been advised that IT staff in the field offices are involved in revising the BRPs to reflect the concerns and interests of the field as well as to ensure more effective coordination with the program offices and centers. This effort will provide the needed technical support to the program areas in the event of a disaster. Regarding disaster recovery testing, incremental testing of the BRP was done on a biannual basis until 1998, when the effort to correct the Y2K date problem was given priority use of the disaster recovery facility. There are no plans to conduct peak and non peak hour testing, disaster simulation and testing of IT field operations.

Regarding application software changes, HUD planned to place thirty-seven critical mainframe and client server applications under selected CM tools. At the time of our field work, 12 critical mainframe applications were reported as placed under the control of CM tools and only one critical application was implemented during fiscal year 1999. No critical client server or personal computer based applications have been completed under CM. Also, HUD had promised to complete a final workplan for all computing platforms by September 1999, in response to our previous recommendation. However, this plan has not been completed.

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

We commend the Department for implementing Top Secret in Fail Mode. This is a significant accomplishment because the Hitachi computing resources are now protected at the highest level of access security. We are also hopeful that the Department will follow through with planned security enhancements to fully protect Privacy Act and sensitive payment data from unauthorized access on the UNISYS mainframe.

We are concerned that the Department cannot invest in a network monitoring tool because of funding limitations. A monitoring tool is essential to detect and correct vulnerabilities, and prevent unauthorized attempts to compromise HUD's network. HUD's ability to conduct business with its contractors and clients would be seriously impaired without the services of its network. The Department should make the implementation of network monitoring software one of its top priorities.

We remain concerned with the Department's lack of progress in using an automated tool to control the software changes for the critical applications on all computing platforms. Although promises of corrective action have been planned, little was accomplished in fiscal year 1999. HUD must complete the promised comprehensive workplan specifying the

tasks, milestones, and assigned responsibilities so progress can be measured and accountabilities established.

Reportable Condition:
**Personnel Security Over
 Systems Access Continues
 to be Inadequate**

Significant internal control weaknesses exist in HUD's management of its personnel security function. We found that the Office of Human Resources (OHR) has not established an adequate personnel security system for ensuring requested background checks are accurate and complete, and are processed in a timely manner. Specifically, we found that OHR has not:

- coordinated the list of background applications submitted with other HUD offices (i.e., IT and the various program offices/system owners) to ensure all required system users are submitting applications, or
- established an adequate system and process to track and manage background investigations.

HUD has not made a sufficient commitment to adequately address these issues which have been reported previously. The Office of Administration's fiscal year 1999 Business and Operating Plan did not identify personnel security as a priority performance goal for OHR. As a result, there may be as many as 8,200 current users who were given access to HUD's critical systems without the appropriate background investigations being performed. This condition puts HUD at substantial risk that inappropriate individuals may have gained access to its facilities, information, and resources.

A key control over systems access by employee and contractor staff is the requirement for personnel (background) screening. HUD's application system owners for sensitive application programs, such as LOCCS and HUDCAPS, are responsible for requesting the appropriate screening for system users. OHR is responsible for processing and tracking the background screening status of applicable employees and contractor staff. System owners are responsible for decisions regarding the security of application systems. System owners, along with the Government Technical Representatives (GTR), are responsible for determining the access level of HUD and/or contractor staff. The Office of Procurement and Contracts (OPC) and the GTRs are responsible for ensuring that contracts contain the necessary background screening requirements. The Chief Information Officer is responsible for providing policy guidance on information security. Finally, the Information Security Staff within IT is responsible for implementing the information security policy and providing guidance and oversight of the Department's security operations in conformance with existing laws and regulations.

Lack of a coordinated effort by HUD has resulted in a significant backlog of background investigations

HUD Handbook 2400.24 states that OHR is to ensure timely submission of background information forms, that these forms are to be reviewed for completeness, and that periodic reports of employee resources activity are to be forwarded to IT and the respective system owners.

Additionally, OHR personnel are to provide IT a report at least bimonthly of all newly hired or separated employees. Also, the handbook states that OHR should obtain background investigation forms for both employee and contractor personnel from system owners and GTRs and provide notification to them when the requested background investigations are completed.

We found that a potential backlog of as many as 8,200 background checks exists because of a lack of coordination in the identification and processing of background checks between IT, OHR, and HUD critical system owners and GTRs. We conducted a limited review of users with access to one of HUD's primary mainframe computer systems. Our review was based on separate user data provided by OHR and IT. We found that the IT user data showed that at least 234 users had access to this system for over 4 years, 128 users for over 3 years, 71 users for over 2 years, and 121 users for over 1 year, for a total of 554 users, all without a corresponding record of background investigation in OHR's database. As a result, HUD is vulnerable to unauthorized or inappropriate users who may have access rights to HUD's critical sensitive facilities, information and resources. For example, we note a recently publicized incident where a property management company was awarded a multimillion dollar HUD contract. That company had access to a critical HUD system and the top company official was later revealed to be a convicted felon with a history of bankruptcies. Although the contractor was removed because of non performance, this instance provides an actual exposure from weak personnel security controls.

We have reported this condition previously but little has been done to address this issue. We had recommended that OHR, the program office system owners, and OIT coordinate the names of all current users who access any of HUD's critical sensitive systems to determine the accuracy, completeness and suitability of the user population. OHR's Director of Labor and Employee Relations Division stated that the current backlog of investigations, due to a peak workload without the commensurate staff in place, will be eliminated by March 31, 2000 through the coordinated efforts to secure the necessary funding, a contract for temporary services, and support from IT. However, the achievement of this target date is questionable unless management commits the necessary resources and identifies personnel security as a priority task within the Office of Administration's BOP.

OHR lacks an adequate system and process for tracking and managing background investigation workload

We found that no established written procedures exist in OHR for processing background investigation applications as prescribed in HUD Handbook 2400.24 and OMB Circular A-130, Appendix III. Currently, OHR may be using as many as four different systems and methodologies for logging and tracking background investigations. Their personal computer based systems are not complete and we found instances of records containing errors. For example, we found five cases where duplicate entries were made for the same individuals by transposing numbers in their social security numbers. In our report on our audit of HUD's fiscal year 1998 financial statements, we stated that one of the

causes of having outdated and inaccurate data was the lack of established controls for updating and maintaining the background investigation database. In our current field work, we have seen no progress in implementing the necessary controls or officially deciding on a primary automated system for processing background investigation applications. Given the potential for a substantial number of background checks to be received in OHR, the current system of manual recording data seems ineffective, and at best, inefficient.

HUD's Actions Planned and Underway to Correct Personnel Security Weaknesses

Over the last three years, HUD promised to take corrective actions to address reported personnel security weaknesses. Specifically, HUD was to identify all individuals performing sensitive and/or critical system functions that needed to receive background investigations. Also, the Department was to initiate action to maintain an accurate and up to date database of background investigations. The Office of Administration indicated a high priority commitment has been made to address the personnel security issues. Increased attention and resources are being devoted to personnel security and increased coordination and collaboration has been enhanced between OHR, IT, GTRS, and system owners. Funding has been obtained and a contractor has been engaged to process the backlogged case files to meet the March 31, 2000 target date. Additionally, OHR personnel security staff regularly attend monthly meetings of the security administrators where personnel security is a top agenda item. Also, since January 28, 2000, at the direction of management, OHR has been using the Personnel Security Control and Tracking (SCATS) to track and monitor the investigation workload. Further, the database of background investigations has recently been updated and its reliability will be tested in the near future.

OHR and IT also claimed to have reduced the potential backlog of system users who may require background investigations from 8,200 to a current backlog of 1,338 employees and contractors. The current list eliminated duplicative counts from the original list and only includes those users that have above "read access."

Our draft report recommended that the Deputy Secretary provide the Office of Administration with the necessary authority to ensure Department-wide compliance with established Federal and HUD personnel security policies and procedures regarding access to critical information systems. In response to the draft report, the Deputy Secretary requested that this recommendation be removed as the Office of Administration has the necessary authority to ensure Department-wide compliance. Currently, IT, through its ADP Security Branch, has responsibility for development and implementation of IT Enterprise-wide operational security standards and procedures. They work closely with the Office of Human Resources staff responsible for the personnel security function to ensure needed background investigations are performed. Also, the ADP Security Branch will, quarterly/or as requested,

provide listings identifying those individuals who should undergo a background investigation, based on the desired access to a mission critical application system. Therefore, no additional authority is necessary for these elements to carryout this responsibility.

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

The Department had made similar promises and commitments to address the personnel security problems identified in previous reports. HUD did not respond to our draft recommendation that the Office of Administration place personnel security as a priority task in their BOP. Although HUD has indicated that this effort will be given the highest priority, we are concerned that without placing this as a priority task in the BOP, there will be no method to ensure accountability and that personnel security problems will be addressed and corrected in a timely manner.

As for the use of SCATS to track and monitor the investigative workload, there appears to be some confusion as to the tracking system that should be used by OHR. During our field work, we were informed that the OHR staff was using the Security Entry and Tracking System as the primary system for entering and tracking background investigative data. The selection of one tracking system is crucial to avoid duplication and ensure the integrity of the personnel security data. In regard to the testing of the database for reliability, we will monitor the actions taken and request that a target date be provided as to when the test will be completed and that a copy of the results be provided to us.

The reduction of the potential backlog of users who may require background investigations from 8,200 to 1,338 is still a significant backlog that requires immediate attention. Also, notwithstanding that users with only "read access" poses less risk than users with greater access, Security Handbook 2400.24 requires these individuals to have at least a more limited "National Agency Check and Inquiry," and, therefore, should be included in the OHR's tracking system. Additionally, until effective reconciliation and monitoring procedures are established, HUD remains at substantial risk of unauthorized individuals gaining access to sensitive facilities, systems and resources.

We do not agree that the Office of Administration currently has sufficient authority to ensure Department-wide compliance with personnel security procedures and standards. Although IT and OHR are organizationally placed within the Office of Administration, there are other program offices that are not under the Office of Administration's control who are critical partners in ensuring the integrity of the personnel security process. The Office of Administration must also rely on actions of the program offices (system owners), GTRs, and OPC as part of the personnel security process. System owners are primarily responsible for decisions regarding the security of application systems. System owners, along with the GTR, are responsible for determining the access level of HUD and/or contractor staff. OPC and the GTRs are responsible for ensuring that contracts

contain the necessary background screening requirements. However, the Office of Administration has no organizational authority over these offices to ensure that their duties and responsibilities are met. Therefore, this recommendation will remain until we receive written assurance that the Office of Administration will have the authority to enforce the personnel security standards and procedures across all organizational lines of authority.

Reportable Condition:
Access and Data Integrity
Controls over HUDCAPS
Need to be Strengthened

In fiscal year 1999, HUD implemented a Departmental general ledger in HUDCAPS as part of its system integration effort. HUDCAPS also processes disbursements for both administration activities and for PIH Section 8. During fiscal year 1999, HUD disbursed approximately \$10 billion through HUDCAPS.

OMB Circular A-127, *Financial Management Systems*, states that integrated financial management systems shall have consistent internal controls over data entry, transaction processing and approval, and reporting. Controls should also provide for an appropriate segregation of duties. OMB Circular A-130, *Management of Federal Information Resources*, provides that the agency is responsible to protect government information commensurate with the risk and magnitude of harm that could result from the loss, misuse, or unauthorized access to or modification of such information. The Circular also requires that the individual's right to privacy be protected in Federal Government information activities involving personal information

Vendor Tables

The Vendor (VEND) table in HUDCAPS contains critical data for making payments to contractors, employees and business partners. This table also contains sensitive employee personnel and banking data such as Social Security Number, bank account numbers, etc. The Vendor Activation (VACT) table is used to approve and activate changes made to the VEND table. An "MTI" transaction log is maintained in the system to monitor user data modifications for key HUDCAPS tables including VEND and VACT. Because of the ability to initiate and/or approve vendor transactions as well as access to employee personal data, these tables must be controlled to ensure access is limited to the minimum number of personnel.

Excessive number of users have access to vendor tables

The number of HUDCAPS users with access to these two tables is excessive. This condition was also noted in previous years' reports on HUD's financial statements. There are 511 contractor and HUD employees with either read or data entry access to the VEND table. Additionally, 34 individuals have either read only or approval and activation authority access to the VACT table.

Our analysis of the "MTI" transaction log shows a need to limit the number of individuals who have read and data entry access to the VEND table. Of the 511 people with access to the VEND table, 83 have read

only access and 428 individuals can enter and change data. Of these 428 individuals, 242 (57 percent) did not use their access at all during fiscal year 1999. The need for these 242 individuals to have access is questionable.

We also noted that of 186 individuals who modified the VEND table, 96 (52 percent) made 10 or fewer changes during the year. In addition, 65 percent of the data modifications to VEND were made by staff at the Financial Accounting Center (FAC) in Ft. Worth. The number of users with VEND access could be reduced further by limiting the need for changing VEND data outside of the FAC.

With respect to controls over the VACT table, we identified 24 individuals with read only access. Because VACT table can be used to view data in the VEND table, these 24 individuals can also view sensitive personnel data. Since read only access does not allow approval and activation of any changes, there is no apparent reason for these individuals to have VACT access. We also noted that there is an excessive number of individuals with approval and activation authority to the VACT table. Of the ten individuals with this authority to the VACT table, four were located in Headquarters and six at the FAC. Since 80 percent of the changes made during fiscal year 1999 were made by the Financial Accounting Center, VACT access should be limited to the FAC.

Proper segregation of duties has not been maintained over the access to vendor tables

We found the following instances of where individuals had access to both the VEND and VACT tables contrary to proper segregation of duties:

- Eleven users were granted access to both the VEND and VACT tables during fiscal year 1999 of which 9 approved and activated their own changes to the VEND table using the VACT table. This was brought to the attention of management in the previous years' report and action was taken in March 1999 to segregate the access to the tables. However, this segregation of duty weakness still exists since two of the eleven users still had access to both tables beyond March 1999.
- One user's security profile was modified two times within two days allowing this user alternating access to the VEND and VACT tables.
- One of the four security administrators modified his security profile which gave him access to both the VEND and VACT tables.

We also noted that two of the three CFO system administrators made changes to the VEND table even though the CFO's office had agreed to take action to prevent this type of access based on a previous recommendation. We were informed that the system administrators were given this access because there was occasional need to establish vendors to facilitate data conversion/system integration objectives. However, we believe that an "occasional need" does not justify circumvention of segregation of duty controls. Further, our analysis of the "MTI" log indicates that a significant number of VEND table changes made by the two system administrators were related to personnel data

and not data conversion. For example, 55 and 34 percent, respectively, of the VEND table changes made by the two system administrators were modifications of personnel data.

We found no policies and procedures for controlling how access to VEND and VACT tables should be granted and modified. This vulnerability places HUD at risk that unauthorized payments could be made and errors and omissions could occur undetected.

Required annual user recertifications have not been performed

The annual user recertification required by the HUDCAPS System Security Plan has not been performed since December 1997. This plan requires that security administrators review the security profiles and update them as necessary. Also, program offices are to recertify their HUDCAPS users to ensure that they are granted proper and authorized access privileges. Additionally, the plan requires that for those situations where it is not feasible to provide adequate separation of duties, compensating controls be developed. However, because these requirements have not been performed in over two years, there is no assurance that access to sensitive and critical HUDCAPS tables has been restricted to authorized personnel.

UTTCORE Utility

The National Institute of Standards and Technology, “Generally Accepted Principles and Practices for Securing Information Technology Systems” states that controls should be placed on system software commensurate with risk. The document further provides that these controls should include policies regarding the use of powerful system utilities, and procedures be developed to ensure only authorized personnel perform system maintenance. HUD uses a powerful system utility called UTTCORE to resolve data discrepancies by directly altering the data in the HUDCAPS financial tables. Because of this ability to directly change data, its use must be strictly controlled to prevent unauthorized access and/or unintentional errors from occurring.

User access to the UTTCORE utility is excessive

We noted an excessive number of users with access to the UTTCORE program. There are 23 individuals who have authority to use the UTTCORE utility. This list included users from four different contractor and HUD program offices. We questioned the need for the high number of users and the database administrator agreed that not all the users on the list require access to UTTCORE in order to perform their jobs. Allowing uncontrolled use of the UTTCORE utility exposes HUD’s financial data to damage and fraudulent activities.

Audit trails are not adequately maintained

Another problem we noted is the lack of audit trails. Although some UTTCORE processing documentation exists, it is not complete. In some instances, we were unable to locate corresponding problem initiation records, change approval documents, and system output reflecting changes made to the tables. This condition occurred because there were no formal policies or procedures to control the use of this utility or for reporting and documenting problems. Also, change requests were being

approved by various program offices as opposed by the system owner, the CFO. Further, the input parameters and output files were being maintained in numerous private libraries instead of a centralized system library. A central library is necessary to provide a standardized audit trail and ensure proper file maintenance during staff turnover. As a result, errors and omissions made to the financial records could occur and remain undetected.

PAS to HUDCAPS Interface

For fiscal year 1999, the official HUD general ledger, which previously resided in the Program Accounting System (PAS) application was changed to reside in HUDCAPS. This change was part of HUD's efforts to consolidate its accounting functions under a single system. However, since many financial transactions are still entered into the PAS system, a daily interface was required to post the PAS financial transactions to the HUDCAPS general ledger.

PAS to HUDCAPS interface is prone to errors

We found that financial data exchanged between PAS and HUDCAPS are not being completely reconciled and documented in a systematic and timely manner. As a result, there is a risk that errors are not being resolved in a timely manner to ensure the financial data are accurate and complete.

The CFO's office has developed a software program that performs a reconciliation of key elements of each transaction and generates a report of data errors between the two systems. These data errors are to be subsequently researched and resolved. We were informed that, although the reconciliation software is run daily, the review and resolution of the data errors are usually performed only about once a month. Also, daily error files are not being maintained since the most recently generated file overwrites the previous one. Further, the data errors identified and corrective actions taken are not documented. Consequently, the financial data would be susceptible to errors and omissions.

HUD's Actions Planned and Underway to Correct Access and Data Integrity Control Weaknesses

With respect to HUDCAPS access controls, we reported last year that an excessive number of users had access to the vendor tables. The CFO agreed to use the results from analyses of access logs to determine whether the number of users with vendor table access could be reduced. We have provided the CFO's office with an analysis of the "MTI" log and other user access lists. In addition, the CFO is willing to conduct a recertification of users and to update the HUDCAPS System Security Plan to include more detailed procedures for controlling access to the vendor tables.

With respect to the use of UTTCORE, and the interface between PAS and HUDCAPS, the CFO is evaluating our concerns.

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

Based on our analysis, we are hopeful that the CFO will significantly reduce the number of users with access to HUDCAPS vendor tables. In addition, it is essential to maintain proper segregation duties and conduct user recertifications to reduce the risk of unauthorized payments, errors and omissions.

With respect to UTTCORE, the CFO must control the use of this powerful utility. Uncontrolled use of the UTTCORE utility exposes HUD's financial data to damage and fraudulent activities.

Regarding the PAS to HUDCAPS interface, the CFO must timely perform the reconciliation and document the results. These controls are needed to ensure that the financial data are accurate and complete.

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. Although HUD has made some progress in implementing procedures and improving its information systems to ensure accurate data are used, further improvements are still needed. Major deficiencies include:

- Offices are not always reviewing unliquidated obligations to determine whether the obligations should be continued, reduced, or canceled.
- Procedures for reviewing outstanding obligations do not provide for reviews that fully consider specific statutory or grant requirements.
- HUD's financial systems do not fully support the timely identification of unneeded excess funds remaining on expired project-based Section 8 contracts.

HUD was not completing obligation reviews or fully considering program requirements

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. We found a number of weaknesses in the process including (1) some offices not completing the reviews and (2) reviews not considering specific statutory or other requirements relating to particular programs. The first deficiency was previously identified in our audit of HUD's fiscal year 1998 Financial Statements. These deficiencies result from a lack of oversight and emphasis placed on validating outstanding balances.

Requests for obligation reviews were forwarded by the CFO to the program and administrative offices. The CFO provided listings of all obligations with no disbursement activity for six months which were open as of June 30, 1999 requesting that the status of obligations be reviewed

for validity (i.e. whether they continue to be needed) and that the listings be annotated as appropriate. Excluding the Section 8 programs which were reviewed separately by the program offices, the total dollar amount of obligations identified for review totaled \$7.8 billion. Of the \$7.8 billion, \$238 million was identified for deobligation after the close of the fiscal year for accounting purposes and financial statement adjustment.

The obligation listings evidenced that some program offices did not annotate the obligations as valid or invalid. For example, the obligation listings forwarded to PIH for HOPE VI grants totaling \$503 million in obligations were not annotated.

In addition to the weaknesses found in completing the obligation reviews, we found a need for increased oversight and emphasis on the obligation review process. We found deficiencies in the controls over HOPE VI funds and public housing modernization funds and the need for improved guidance to review the obligations.

HOPE VI funds were not being timely used according to grant agreements

PIH was not enforcing performance requirements under the Revitalization Grant Agreements for HOPE VI grants. The HOPE VI fiscal year 1996 grant agreements contain language which established a two year-time frame, beginning on the date of HUD's written approval of the Revitalization Plan, within which the general contractor's contract must be executed and commencement of activities must be accomplished. In addition, the grant agreement provides remedies HUD may pursue when grantees fail to meet required time-frames. These remedies range from issuing warning letters to ultimately withdrawing funds. The Quality Housing and Work Responsibility Act of 1998 provides that if a grantee under the HOPE VI program does not proceed within a reasonable time-frame, in the determination of the Secretary, the Secretary shall withdraw the grant amounts under this section that have not been obligated by the public housing agency.

Our tests relating to 19 HOPE VI grants totaling \$391 million awarded using fiscal year 1996 appropriations showed that 7 of the 19 public housing agencies had not executed a general contractor's contract and had \$151 million in funds that remained unobligated by the public housing agencies. Analysis of the files for the seven grants showed that only one default letter had been issued placing the housing agency on notice that they were in violation of the grant agreement. In addition, no extension letters had been issued excusing the lateness of the contracts. For the other 12 housing agencies, general contractors contracts were due for 10 of the HAS, but we were unable to determine the status from information in PIH's files. However, we noted that default letters had been issued to two of these ten grantees.

PIH did not assess the continued status of modernization funds to assure compliance with statutory requirements

In the "Compliance with Laws and Regulations" section of this report, we report that HUD is not in compliance with the United States Housing Act of 1937, as amended by the Quality Housing and Work Responsibility Act of 1998. In this regard, HUD is not enforcing the requirements for the expenditure and obligation by HAS of public housing modernization

funds. In the annual review of HUD's outstanding obligations, these provisions were not considered in identifying obligated amounts that may no longer be valid. Moreover, HUD was not taking sufficient action to ensure that other enforcement actions relating to the timely use of modernization funds were carried out in a timely manner.

HUD has made progress in identifying excess reserves in the 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. In 1997, HUD initiated action to identify and recapture excess budget authority in its Section 8 contracts. Prior to this HUD had been unaware of the extent of excess budget authority available to offset needs for new budget authority for the Section 8 programs.

HUD needs to develop an accurate database for evaluating Section 8 project-based obligations

The Office of Housing has been hampered in its attempts to evaluate unexpended Section 8 project-based budget authority balances. Data inconsistencies between PAS and TRACS have resulted in the need for field office verification of data and has impaired HUD's ability to evaluate unliquidated balances in a timely manner. In addition, an assessment of excess balances on contracts transferred in fiscal year 1999 to the Section 8 FMC had to be completed using hardcopy information because the information was not available electronically. In December 1999, \$1.675 billion in unliquidated obligation balances were recaptured in the Section 8 project-based program on expired contracts. However, the related analysis of potential budget shortfall and excesses excluded 391 expired contracts with \$408 million in reserve budget authority because of insufficient data to perform the analysis. Our analysis of the 391 contracts showed that only 9 of the contracts had expired prior to September 30, 1998. Since HUD's procedures allow up to one year after contract expiration to complete the closeout process and recapture any remaining funds, the \$408 million would not materially affect the fair presentation of HUD's financial statements. However, HUD needs to address data and systems weaknesses to facilitate completion of the recapture process in a more timely manner.

PIH has made progress in identifying excess unexpended budget authority

PIH has continued to improve its process for identifying excess unexpended budget authority on Section 8 Tenant-Based contracts and the underlying information systems to ensure accurate data can be obtained on these balances. In July 1999, PIH performed an analysis of budget authority for all years related to the Section 8 tenant-based program and estimated that approximately \$1.4 billion of excess unexpended budget authority was available for deobligation and recapture. This is funding that housing agencies received under contracts with HUD but did not expend or is not needed to make housing assistance payments.

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

HUD implemented an automated tracking system for the HOPE VI grant program. This tracking system produces quarterly progress reports which provides milestone, budget, and project information to the program managers. This database should provide timely information to enable program managers to monitor and enforce contract compliance. As a result of our inquiries, PIH has taken action to draft warning letters for seven of the housing agencies in violation of the grant agreements. HUD needs to ensure that grantee performance proceeds within a reasonable time. HUD should evaluate the reason for delays in executing General Contractor's contracts and take actions to either extend the two-year time frame or provide notice of default of the Grant Agreement to enforce contract compliance.

To address the budget process concerns identified with the Section 8 Project-based contracts, the Office of Housing will continue two efforts to clean up the data and streamline the process for recapturing funds on Section 8 project-based contracts. HUD plans to make additional improvements to its information system to permit automated program review and to lessen the reliance on field office input and data verification. In addition, HUD proposes to automate the budgeting and recapture process for Project-based contracts contained in HUDCAPS.

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

If implemented, PIH's plans to utilize the quarterly tracking system to monitor and enforce public housing agencies' compliance with HOPE VI grant agreements should enable HUD to carry out the performance requirements under the grant agreements for HOPE VI grants.

As discussed previously, HUD's obligation reviews focused on review of obligations having no disbursement activity for six months. To address the issues such as those we raised with the HOPE VI and public housing modernization grants, HUD should amend its procedures for the annual review of obligations to require program areas to identify statutory or other requirements that may impact particular programs. Program offices should be instructed to review all outstanding obligations subject to particular programmatic provisions and recommend appropriate action to deobligate funds or take other actions as appropriate.

HUD's proposed actions for strengthening the internal controls for reviewing unliquidated obligations should increase the timeliness of the obligation reviews. Also, HUD has made considerable progress in implementing a process to recapture excess budget authority. During 1999, HUD recaptured over \$3 billion in excess budget authority available on Section 8 contracts. We are encouraged by the number of initiatives underway to verify the accuracy of the databases and efforts to streamline the recapture process. However, for the project-based programs, HUD needs to improve its systems and procedures to facilitate

recaptures periodically rather than after the end of the fiscal year. If completed, these actions should help improve the data integrity and result in the timely recapture of all excess budget authority on Section 8 project-based contracts.

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Compliance with Laws and Regulations

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

Federal Financial Management Systems Requirements

FFMIA 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.

We have determined that HUD is not in substantial compliance with FFMIA because HUD's financial management systems did not substantially comply with (1) Federal Financial Management Systems Requirements, (2) Federal Accounting Standards, or (3) the SGL at the transaction level. We have included the specific nature of the noncompliance, responsible program offices and recommended remedial actions in Appendix C of this report.

In its *Fiscal Year 1999 Accountability Report*, HUD reports that 18 of its 73 financial management systems do not materially conform with the requirements of FFMIA and OMB Circular A-127, *Financial Management Systems*. The number of reported non-conforming systems was reduced by 10⁷ from the 28⁸ reported in the *Fiscal Year 1998 Accountability Report*.

In addition to deficiencies noted in HUD's Accountability Report, we report as a material weakness that *HUD's Financial Systems are Not Compliant with Federal Financial Standards*. This material weakness addresses how HUD's general ledger is not compliant with core financial systems requirements. The Department did not take the problems causing the material weaknesses into consideration when assessing and reclassifying seven of its legacy systems to conforming with federal financial management systems requirements. These systems were reclassified as a result of HUD putting into place processes to post FHA SGL balances to HUDCAPS. However, the processes in place to ensure the entry of FHA transactions are cumbersome, inefficient, and time consuming. In addition, during fiscal year 1999, FHA applied these processes only to post beginning and ending balances and not monthly during the fiscal year. HUD plans to complete an independent verification and validation of these seven systems in fiscal year 2000.

Reviews of prior reports have disclosed that security over financial information is not provided in accordance with Circular A-130 *Management of Federal Information Resources*, Appendix III. As

⁷ This reduction was based on the Department reclassifying three systems from conforming to non-conforming and discontinuing seven systems previously reported as non-conforming.

⁸ This number of nonconforming systems does not include five systems for which corrective actions were not completed during fiscal year 1998. These five systems were also certified as conforming in fiscal year 1999.

discussed below, the issue of security is further noted in assessments of two systems, however, based on audit reports from other sources, security should be addressed beyond those two systems.

Federal Accounting Standards

A material weakness was reported by KPMG LLP regarding FHA's budgetary and accounting processes that affected HUD's ability to prepare auditable financial statements. This resulted in the need to:

- implement 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*); and
- 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*).

Furthermore, earlier in this report, we discuss the material weakness that *HUD's Financial Systems are Not Compliant with Federal Financial Standards*. This material weakness addresses how HUD's general ledger is not compliant with core financial systems requirements. This weakness also adversely affects HUD's ability to prepare auditable financial statements and related disclosures in a timely and efficient manner.

Compliance with the SGL at the transaction level

Beginning in fiscal year 1999, HUDCAPS is the Department's official standard general ledger system. FHA provided consolidated summary level data to HUDCAPS for fiscal year 1999 beginning and ending balances. FHA analyzed its general ledger and prepared a documented crosswalk to the SGL to prepare both the financial statements and the reports on budget execution. FHA also implemented the budgetary-related SGL accounts in its general ledger, however, as reported by KPMG, LLP, the subsidiary systems that contain the transaction detail activity could not provide reports which were properly reconciled to the general ledger. In addition, detailed reports supporting the aggregate amounts recorded in the general ledger and reports on budget execution were not maintained. OMB Circular A-127 requires that transaction detail be available to support the SGL account entries.

As noted above, we have reported as a material weakness that *HUD's Financial Systems are Not Compliant with Federal Financial Standards*. This material weakness addresses how HUD's general ledger is not compliant with core financial systems requirements, including SGL requirements.

Compliance determinations should undergo review and verification

To determine if financial management systems comply with FFMIA requirements, the Department focused its OMB Circular A-127 compliance analysis of the financial management systems inventory in four areas: (1) non-conforming systems, (2) new systems implemented during fiscal year

1999 (3) systems that underwent significant changes in functionality and (4) program office requests to change system classifications. To accomplish this, the Department contracted out assessments for nine systems which resulted in six of the systems being reclassified to nonfinancial, one conforming system being reclassified to nonconforming and two systems continuing to be assessed as conforming.

We noted the following concerns that were not challenged or addressed:

- The Department reclassified REMS from a mixed financial system to a nonfinancial system on the primary basis that the system is a repository of financial-related data and processes do not trace to the core accounting system. However, REMS is used for financial reporting and decision making activities. HUD has also described REMS as the official source of data on Multifamily Housing's portfolio of insured and assisted properties.
- The contractor evaluation of the Single Family Premium Collections System Up-Front states that the system does not substantially comply with the requirements of OMB Circular A-127 with the exception of SGL compliance at the transaction level. However, the system was reclassified as compliant based on the Office of Housing's assertion that processes have been improved so that the SGL requirement is now being met and as a result the system is SGL compliant. No other detail reviews were conducted to substantiate the assertion of compliance.

For systems that did not undergo contract reviews, the CFO requested system owners to review their systems and their compliance with Federal financial standards. The reviews required system owners to focus on changes in systems inventory and non-conforming systems and changes in compliance status of financial management systems. For the systems that were reclassified from nonconforming to conforming we noted the following conditions that were not challenged or questioned:

- We have noted that security has been overlooked in compliance reviews. HUD has identified only two systems that do not conform with OMB Circular A-130 *Management of Federal Information Resources*, Appendix III. Other findings have identified application access controls, application data integrity, and overall entity-wide security issues which impact HUD's financial management systems. KPMG, LLP, reported that the Single Family Asset Management System lacks a key database control. That system is classified as nonconforming, however, the Department's assessment concluded that the system complies with OMB Circular A-130.
- Other security weaknesses include HUD's inability to provide adequate protection over sensitive programs and files on the UNISYS mainframe system and to issue HUD's Information Security Program Handbook. These issues should be considered in the assessments of other systems

The CFO primarily relies on program office certification of systems. As a result of the CFO's office not requiring indepth reviews of systems prior to reclassifying from nonconforming to conforming, systems were improperly classified as conforming and deficiencies were not being identified. This contributed to continued financial management weaknesses by not enabling deficiencies to be corrected through the remediation plan required by FFMIA.

The Department intends to use a financial management review guide beginning in fiscal year 2000. The review guide provides substantially more in-depth assessment criteria than was requested from the program offices in the past.

Compliance with submission of remediation plan to OMB

Section 803 (c) (3) of FFMIA requires that when the agency head agrees with the auditor's findings of noncompliance, a remediation plan shall be developed, in consultation with OMB, that describes the resources and milestones for achieving compliance. HUD submitted its fiscal year 2001 submission of information pertaining to planning, budget, and acquisition of capital assets to OMB on September 13, 1999. Remediation plans for 10 of the 18 reported nonconforming systems did not include resource information. In addition, all noncompliance issues were not addressed in the plans for some nonconforming systems. We have also noted that remediation plans for systems need to be updated to address financial systems integration and FHA funds control issues.

HUD Did Not Comply with the United States Housing Act of 1937

HUD is not in compliance with the United States Housing Act of 1937, as amended by the Quality Housing and Work Responsibility Act of 1998 (The Act). HUD is not timely or properly enforcing The Act's requirements for the timely expenditure and obligation by HAS of public housing modernization funds. HUD management, based on Office of the General Counsel legal opinions, disputes our findings. The Department's legal opinions, along with our legal analysis, are provided in their entirety as Appendix F. Our specific concerns relate to two issues and are discussed below.

PIH did not enforce provisions of The Act relating to the timely expenditure of modernization funds

Our analysis of HUD records relating to the expenditure of fiscal year 1995 and prior years' public housing modernization funds showed \$337 million in unexpended funds as of September 30, 1999. The Act provides that public housing modernization assistance received under The Act shall be spent not later than four years after the date on which funds become available for obligation. The Act provides that the Secretary shall enforce the requirement for expenditure of funds through default remedies up to and including the withdrawal of funds. HUD does not believe the remedial provision applies to fiscal year 1995 and prior funds and has not taken any actions to enforce the provisions. HUD OGC asserts that the relevant enforcement provisions of The Act do not apply to funds made available prior to enactment of The Act. However, it is our opinion that the provisions do apply because The Act specifically merged the previously awarded assistance into the present "Capital

Fund,” thereby subjecting the previously awarded funds to the enforcement provisions of The Act.

PIH did not act timely nor apply proper remedies to enforce The Act’s provisions regarding timely obligation of modernization funds

Our analysis of HUD records relating to public housing modernization funds showed that \$148 million in fiscal year 1997 and prior years’ modernization funds were unobligated by the HAS as of September 30, 1999. HUD’s policy with respect to these unobligated funds is not in compliance with The Act. The Act expressly provides, with respect to the obligation by HAS of fiscal year 1997 and prior years’ public housing modernization funds, that such funds shall be fully obligated by the HAS not later than September 30, 1999. HUD set forth its policy regarding these funds in a December 22, 1999 Federal Register Notice. The notice provided that if these unobligated fiscal year 1997 and prior years’ funds are not fully obligated by March 30, 2000, an additional final sanction of the loss of all unobligated fiscal year 1997 and prior public housing modernization funds, through notification of annual contributions contract default and recapture of outstanding unobligated funds, shall be implemented. However, the sanction and recapture of fiscal year 1997 and prior year’s funds are not in accordance with provisions of The Act.

The Act provides that an HA shall not be awarded assistance for any month during the fiscal year in which the HA has funds unobligated in violation of The Act. Additionally, during any fiscal year in which the HA is in violation, the Secretary shall withhold all assistance that would otherwise be provided to the HA. If the HA cures its failure to comply during the year, it shall be provided with the share attributable to the months remaining in the year. HUD does not feel that the sanction and recapture provisions of The Act apply to fiscal year 1997 and prior years’ funds. Furthermore, HUD believes the December 22, 1999 Federal Register Notice was a legal and reasonable exercise of PIH’s authority to prescribe remedies for the unobligated fiscal year 1997 and prior years’ funds. We agree that HUD may impose any number of additional performance remedies, however it is our opinion that at a minimum, HUD must impose the Congress’ mandated remedy according to the Congress’ prescribed timeframe.

Other Matters Under Investigation

Investigations are being conducted by HUD OIG with respect to certain activities in connection with sales of HUD-held mortgage notes. These investigations could reveal other violations of laws and regulations. However, the ultimate outcome of such investigations is unknown.

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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 FMFIA are met; and
- complying with applicable laws and regulations.

In attempting to audit HUD's consolidated 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 described in the Independent Auditor's Report.

In planning our audit of HUD's consolidated principal financial statements, we considered internal controls over financial reporting by obtaining an understanding 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 1999 Accountability Report* by obtaining an understanding 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 98-08, *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 HUD's *Fiscal Year 1999 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 98-08. Our procedures were not designed to provide assurance on internal control over reported performance measures and, accordingly, we do not provide an opinion on such controls.

To fulfill these responsibilities, to the extent we were able, given the limitations on the scope of our work described in this report, 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;
- planned to evaluate 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 98-08, including the requirements referred to in FFMIA;
- considered compliance with the process required by FMFIA 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 FMFIA. We limited our internal control testing to those controls that are material in relation to the consolidated 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 to be reportable conditions under OMB Bulletin 98-08. 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 to be 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 98-08, as amended.

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

Recommendations

To facilitate tracking recommendations in the Departmental Automated Audits Management System, this appendix lists the newly developed recommendations resulting from our report on efforts to audit HUD's fiscal year 1999 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 that HUD's financial systems are not compliant with federal financial standards, we recommend that the **Deputy Secretary**:

- 1.a. Direct CFO and FHA to work together to develop a general ledger interface with the FHA accounting system which will provide for automated monthly transfers of financial information.

We recommend that the **Chief Financial Officer**:

- 1.b. Modify the PAS to HUDCAPS interface to eliminate system rejections.
- 1.c. Develop an automated template to assist in reconciling all general ledger cash accounts to Treasury records.
- 1.d. Complete fund balance with Treasury reconciliations in a timely manner and identify and correct all systematic problems.
- 1.e. Develop and document the procedures to be used to complete the fund balance with Treasury account reconciliation between HUDCAPS and Treasury balances.
- 1.f. Restrict adjustments to the Hyperion reporting program to financial statement reclassifications and post all transaction adjustments to the general ledger.
- 1.g. Delay conversion of additional funds to HUDCAPS (except for Section 8) until fund balance with Treasury reconciliations can be completed in a timely manner, and related system problems are identified and corrected.

We recommend that the **Deputy Secretary**:

- 1.h. Clearly define the objective and project scope of FSI and ensure compliance.

With respect to the management control program issues, we recommend that the **Chief Financial Officer**:

- 2.a. Track and determine bottlenecks for completing and implementing risk reviews.
- 2.b. Report to the Deputy Secretary issues that are not resolved.
- 2.c. Establish due dates for responses to CFO reviews and hold program offices accountable.

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 HAP 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,
 - HAP 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.

With respect to the reportable condition that HUD needs to improve controls over its computing environment, we recommend that the **Assistant Secretary for Administration**:

- 4.a. Ensure periodic reviews are performed on the use of powerful system features on the Hitachi mainframe to minimize exposures to unauthorized activities. These features include "Started Task" and Authorized Program Facility.
- 4.b. Review and reduce the number of the 60 "Started Task" profiles assigned global access authority.
- 4.c. Adhere to the schedule of planned actions for protecting sensitive and critical HUD data on the UNISYS from unauthorized access.
- 4.d. Adopt a policy for following up on security related incidents for the UNISYS mainframe.
- 4.e. Assign the purchase of a network monitoring tool as a high priority IT investment and develop a plan, with specific milestones, for the purchase and implementation of this tool.
- 4.f. Develop a test plan, with specific milestones, for disaster recovery (or Business Resumption Planning) of IT infrastructure. The test plan should specify methodology and timeframes for unscheduled testing, peak and non-peak hour testing, disaster simulation, and field IT operations.
- 4.g. Coordinate with program offices to include field IT staff in the development of BRPs for field offices.
- 4.h. Complete the promised project plan for Configuration Management implementation on all computing platforms. This project plan should include: (1) defined tasks with dependencies, (2) the level of effort required, (3) testing and training plans, (4) estimated and completed dates of each task, and (5) assigned responsibilities of organizations and individuals.

With respect to the reportable condition that personnel security over systems access continues to be inadequate, we recommend that the **Deputy Secretary**:

- 5.a. Provide the Office of Administration with the necessary authority to ensure Departmentwide compliance with established Federal and HUD personnel security policies and procedures regarding access to critical information systems.

We recommend that the **Assistant Secretary for Administration** identify personnel security as a priority task in the Office of Administration's Business Operating Plan. This task should include the following:

- 5.b. Establish and document a process to ensure that only authorized individuals with the appropriate position sensitivity level of clearance be granted continued access to HUD critical systems.
- 5.c. Develop and implement a system to process and track requests for background investigations.

With respect to access controls over VEND and VACT tables, we recommend that the **Chief Financial Officer**:

- 6.a. Evaluate those personnel who have access to VEND and VACT tables and remove from access those personnel who no longer need it.
- 6.b. Centralize and limit the authority over and the use of the VACT table to the Financial Accounting Center, Ft. Worth.
- 6.c. Establish policies and procedures for controlling modifications to HUDCAPS security profiles to ensure an adequate segregation of duties. These policies and procedures should also include the requirement that periodic reviews of the "MTI" log of the security table changes be made by someone other than the Security or System Administrators.
- 6.d. Ensure that annual user recertifications and security profile reviews are performed.

With respect to the use of UTTCORE, we recommend that the **Chief Financial Officer**:

- 7.a. Restrict the use of the UTTCORE utility to authorized personnel only.
- 7.b. Ensure that an adequate audit trail is maintained for the processing of the UTTCORE utility by establishing:
 - Formal policies and procedures to control the processing of this utility
 - A central control over all change requests and approvals.
 - A central library for input parameters and output files.

With respect to the interface between HUDCAPS and PAS, we recommend that the **Chief Financial Officer**:

- 8.a. Develop procedures for more frequent and systematic research of the exception reports created by the reconciliation software.

With respect to the reportable condition that HUD needs to improve its processes for reviewing obligation balances, we recommend that the **Assistant Secretary for Public and Indian Housing**:

- 9.a. Evaluate the reasons for delay by the public housing agencies with unobligated balances of HOPE VI funds awarded during fiscal year 1996 and prior year and take actions to either waive the regulations and extend the termination date of the grant or terminate the grant as to all further activities and initiate close-out procedures and recapture unobligated funds.

- 9.b. Ensure that the Office of Public Housing Investments utilizes their quarterly tracking system to monitor and enforce public housing agencies' compliance with HOPE VI grant agreements.
- 9.c. Enforce the requirement of the United States Housing Act of 1937, as amended by the Quality Housing and Work Responsibility Act of 1998 for the expenditure of public housing modernization funds through default remedies up to and including the withdrawal of funds.
- 9.d. Issue clarifying guidance that is in accordance with the United States Housing Act of 1937, as amended by the Quality Housing and Work Responsibility Act's provisions regarding the obligation, by HAS, of modernization funds.

We recommend that the **Chief Financial Officer**:

- 9.e. Amend the procedures for the annual review of obligations to require program offices to identify program specific statutory requirements, such as those in the Quality Housing and Work Responsibility Act, or other requirements relating to the use of funds such as provisions in grant agreements.

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.

With respect to the noncompliance issue relating to FFMIA, and the required remediation plan, we recommend that the **Chief Financial Officer**:

- 10.a. Revise the remediation plan to address the need to:
 - Update FHA's separate general ledger data in the HUDCAPS general ledger in a timely manner and eliminate current cumbersome, inefficient, and time consuming processes.
 - Correct deficiencies in the PAS to HUDCAPS interface and general ledger posting models to minimize rejected or incorrectly posted transactions that have to be manually researched and corrected.
 - Incorporate the separate plan being developed to implement funds control in all FHA systems to ensure that future reports on budget execution are accurate. The issues to be addressed in this plan are discussed in more detail in KPMG LLP's report on FHA's fiscal year 1999 financial statements.

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 Departmental Automated Audits Management 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 current status is shown below. Where appropriate, we have updated the prior recommendations to reflect changes in emphasis resulting from more recent work or management decisions.

OIG Report Number 92-TS-179-0011 (Fiscal Year 1991 Financial Statements)

With respect to the resource management issues formerly classified as a material weakness, the following three recommendations have been reopened because corrective actions have not been fully implemented. The Department has committed to working with NAPA to implement a Department-wide resource management system and expects to be completed by July 2001. Responsibility has been reassigned from the Assistant Secretary for Administration to the Deputy Secretary. We recommend that the **Deputy Secretary**:

- 2.a. Establish a more systematic approach to determining staffing requirements.
- 2.b. Hold field offices and headquarters accountable for work accomplishments in line with available resources and established standards.
- 2.c. Ensure that once greater efficiencies are implemented, staffing standards are realigned to be consistent with the revised workload.

With respect to the material weaknesses in the areas of Grants, Subsidies and Direct Loans Program Issues, we recommend that HUD (primary responsibility - **Office of Housing**):

- 3.a. Pending CFS/TRACS implementation, standardize the existing manual HAP payment review process and develop a reporting mechanism in the regional offices and headquarters such that the success of pursuing and collecting overpayments can be properly managed. (Final action target date is September 30, 1994.)

OIG Report Number 96-FO-177-0003 (Fiscal Year 1995 Financial Statements)

With respect to the need to prepare HUD's principal financial statements, as they relate to the mortgage insurance programs of FHA, in accordance with SFFAS Number 2, we recommend that the **Chief Financial Officer**, in consultation with the Assistant Secretary for Housing-Federal Housing Commissioner:

- 1.a. Develop and implement a plan to prepare the FHA data needed to meet SFFAS Number 2 requirements for inclusion in HUD's Fiscal Year 1996 principal financial statements, in a timely manner to enable that data to be subjected to auditing procedures. (Final action target date is June 30, 1999.)

The issues that led to the following recommendations have not changed; however, HUD has created the REAC and the Departmental Enforcement Center which will have responsibility over responding to the recommendations and addressing the issue. Consequently, within this context, we repeat the recommendation in unrevised form as it first appeared in our fiscal year 1995 report followed by the latest draft management decision suggested by the Office of Housing on how these recommendations should be addressed. In our fiscal year 1995 report, with respect to the material weakness on improvements needed in multifamily project monitoring, we recommend that the **Assistant Secretary for Housing-Federal Housing Commissioner**:

- 4.a. For the annual financial statement review contract, assure that the contractor delivers the report review packages to the respective field offices according to the delivery schedule specified in the contract terms. (Final action target date is October 1, 1997.)
- 4.c. Award a contract for specialized asset management services to selected properties, enabling the field offices to select the property and the necessary services for contractor assistance, based on risk to HUD and type and number of identified deficiencies. (Final action target date is April 30, 1997.)

4.d. For the working group that sets goals for the Housing Management Plan, consider adding goals pertaining to:

- SHFA monitoring, with targets that represent adherence to the policy in HUD handbooks as to the frequency and timing of such reviews.
- The timely analysis of annual financial statements by the field offices, with a target based on the timeliness of the analysis after the receipt of the statements.

(Final action target date is October 31, 1997.)

Revised management decisions have been suggested by the Office of Housing as follows:

4.a. The REAC will be responsible for the tracking, receipt, review and analysis of annual financial statements. The REAC will begin the collection and analysis of the annual financial statements for the period ended December 31, 1998. Annual financial statements will be submitted electronically, reviewed and analyzed by REAC's Financial Analysis Subsystem and results linked electronically for immediate access by Multifamily Housing offices and the Enforcement Center through REMS. (Estimated completion date December 31, 1999.)

4.c. The REAC and Enforcement Center will contract for asset management services (e.g., inspections, project due diligence, legal services support) needed to carry out the responsibilities of their organizations. (Completed action of awarding contracts has already occurred.)

4.d. The REAC will assess and identify troubled projects which will include SHFA projects with mortgage insurance. All HUD-insured projects with subsidy will be analyzed through the REAC assessment. (Estimated completion date September 30, 2000.)

OIG Report Number 97-FO-177-0003 (Fiscal Year 1996 Financial Statements)

With respect to the reportable condition that HUD needs to continue efforts to develop improved performance measures, we recommend that the **Chief Financial Officer**:

- 2.a. Assess the readiness of HUD to meet SFFAS No. 4, Managerial Cost Accounting Concepts and Standards, in Fiscal Year 1997 and to recommend a coordinated plan of action for HUD's major operating components that accomplish the GPRA and SFFAS objectives. (Final action target date is September 30, 1998.)

With respect to the reportable condition that HUD needs to be more proactive in implementing its management control program, we recommend that the **Deputy Secretary**:

- 3.a. Establish practices for and hold program managers accountable for systematically identifying systemic weakness in their ongoing programs, initiating risk abatement strategies, identifying corrective actions and completing those actions in a timely fashion. Program managers should periodically report on their program risk assessment results and planning throughout the year. (Final action target date is March 31, 1998.)

With respect to the reportable condition that HUD needs to continue efforts to improve housing authority monitoring, we recommend that the **Assistant Secretary for Public and Indian Housing**:

- 6.b. Develop procedures for incorporating the results of the independent housing quality assessments into PIH's risk based monitoring strategy. (Final action target date is October 31, 1998, as recorded in the

Departmental Automated Audits Management System. HUD expects to complete its national risk assessment program and complete action on this recommendation by September 30, 2000)

With respect to the reportable condition that the personnel security program needs strengthening, we recommend that the **Assistant Secretary for Administration**:

- 9.c. Initiate action to ensure the Personnel Security Tracking System contains complete data and is updated in a timely manner. (Final action target date is August 1, 1998.)

OIG Report Number 98-FO-177-0004 (Fiscal Year 1997 Financial Statements)

With respect to the material weakness that HUD needs to do more to ensure that subsidies are based on the correct tenant income, we recommend that the **Deputy Secretary or the appropriate responsible official**:

- 2.a. In conjunction with development of the *HUD 2020* plan, determine the staffing requirements and organizational placement of activities necessary to carry out an ongoing income matching program. (Final action target date is March 31, 1999.)

With respect to the noncompliance issue relating to FFMIA, we recommend that the **Chief Financial Officer**:

- 5.b. In developing the remediation plan described in recommendation 6.a., ensure that all assessments for systems determined to be in compliance with OMB Circular A-127 are adequately documented and develop corrective actions for systems determined to be non-conforming. (Final action target date is September 30, 1998.)

OIG Report Number 99-FO-177-0003 (Fiscal Year 1998 Financial Statements)

With respect to the material weakness that HUD needs to complete improvements to its financial management systems, we recommend that the **Chief Financial Officer**:

- 1.a. Develop an FSI strategic plan that clearly articulates the planned approach for accomplishing the FSI vision. (Final action target date is January 3, 2000.)
- 1.b. Establish a moratorium on changes to the FSI project scope and strategy. (Final action target date is January 3, 2000.)

With respect to the material weakness regarding excess subsidy payments, we recommend that the Chief Financial Officer, in consultation with the Assistant Secretaries for Public and Indian Housing and Housing, and the Director, Real Estate Assessment Center:

- 2.a. Ensure all outstanding income verification projects (both Phase I and Phase II) are completed and results reported in fiscal year 1999. (Final action target date is June 30, 2000.)
- 2.b. Continue activities to develop a practical and cost effective technique and methodology for large scale computer income verification matching. In the interim, develop and implement a work plan for smaller scale computer income verification matching. (Final action target date September 29, 2000.)

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 June 30, 2000.)

In preparation for the transfer of functions to contract administrators, we recommend that the **Deputy Assistant Secretary for Multifamily Housing**, with input from PIH, REAC, and the CFO's staff:

- 3.c. Analyze the impact on control risk of outsourcing oversight to contract administrators and make appropriate adjustments to the statement of work relating to the contract actions. (Final action target date is December 31, 1999.)

With respect to the material weakness that improvements are needed in multifamily project monitoring, we recommend that the **Deputy Assistant Secretary for Multifamily Housing**:

- 4.a. Increase efforts to conduct management reviews during fiscal year 1999 which would prioritize review of known troubled and potentially troubled projects, and projects being considered for subsidy renewal. At a minimum, the reviews should address or follow up on:

- all health and safety issues being identified by the REAC physical inspection teams,
- other known or existing concerns (e.g. poor financial history or physical condition) that can be addressed via a management review that were delayed because of the creation of the REAC and the Enforcement Center, and
- occupancy responsibilities.

(Final action target date is March 31, 2000.)

- 4.b. Develop a comprehensive strategic plan and corresponding monitoring goal for fiscal year 2000 that will consider:

- requiring the REAC to deliver scores on audited financial statements and provide for property managers use, copies of audited financial statements until such time as the information being used by the REAC for data entry is attested to by an independent auditor;
- submitting to the REAC all remaining multifamily projects that have not yet received a physical inspection under the new REAC-developed protocols;
- completing data verification efforts in REMS utilizing the results from the efforts of the multifamily field offices, the REAC, the Enforcement Center, and the Quality Assurance Center;
- determining in the plan when information will be available for project managers' use in monitoring multifamily projects and design realistic goals which can be tracked on a monthly basis; and
- developing a strategic goal of monitoring contract administrator performance which can be tracked.

(Final action target date is March 31, 2000.)

- 4.c. For fiscal year 1999, develop, at a minimum, mitigating controls that are not limited to, but can include:

- obtaining, reviewing and following up during management reviews any critical findings in the 1998 annual financial statements of any project where monitoring is conducted by SHFAS and HAS, or any other communication from SHFAS and HAS communicated to local HUD field offices;
- establishing in the field offices the capability to do monitoring of contract administrators; and
- determining what controls and tasks should be in the planned contract administrator contracts that will be effective October 1, 1999.

(Final action target date is March 31, 2000.)

- 4.d. Further, we recommend that the **Deputy Assistant Secretary for Multifamily Housing**, with input as needed from the CFO, the REAC, the Office of Multifamily Housing Restructuring, and the Enforcement Center, establish the capacity to issue and maintain current criteria by establishing:
- a team to update and issue through, official Departmental channels, the required revisions to all criteria (Handbooks, Directives, guidance and policy statements) for multifamily projects, which are clear, adequate and effectively distributed; and
 - a permanent capacity or division within the Office of Housing to revise criteria as needed.

(Final action target date is September 30, 2000.)

With respect to the reportable condition that HUD needs to improve housing authority monitoring, we recommend that the **Assistant Secretary for Public and Indian Housing** :

- 5.a. Provide field office staff with revised guidelines and/or procedures on how to access, interpret and utilize HA information the REAC will be accumulating and disseminating on its annual HA assessments under PHAS. (Final action target date is March 31, 2000 as recorded in the Departmental Automated Audits Management System. PIH advises that it expects to complete action on this recommendation by June 30, 2000.)

With respect to the reportable condition that HUD needs to improve system security and other controls, we recommend that the **Assistant Secretary for Administration**:

- 7.d. Continue efforts to minimize access control weaknesses with UNISYS demand mode processing by proceeding with the UNISYS security enhancement plans. (Final action target date is September 30, 2000.)
- 7.g. Obtain a network management package that alerts staff to conditions that are questionable or unacceptable. We provided information about the weak user passwords to responsible staff. The users should be notified of their weak passwords and reminded of the importance of strong passwords. (Final action target date is September 29, 2000.)
- 7.j. Ensure that configuration management on the Hitachi, UNISYS, client/server and personal computer based platforms is a priority.
- Schedule and implement Hitachi critical applications under Endeavor.
 - Select and procure configuration management software, and schedule and implement the software for critical UNISYS applications.
 - Continue with the procurement, scheduling and implementation of client/server and personal computer based platform applications.

(Final action target date is April 16, 2000.)

With respect to the reportable condition that personnel security for systems' access requires overhaul, we recommend that the Director, Office of Human Resources:

- 8.d. Periodically reconcile its database of background check statuses using listings provided by the Office of Information Security and access listings provided by the Program Security Administrators. (Final action target date is March 31, 2000.)

With respect to the reportable condition that additional efforts are needed to strengthen access controls over HUD's payment systems, we recommend that the Chief Financial Officer:

- 9.a. Reduce the number of HUDCAPS security profiles that allow view or data entry access to the VEND tables. (Final action target date is March 30, 2000.)
- 9.b. Request that a programming change be made to segregate the LOCCS "data entry" rights between bank table entry and regular voucher (non-bank table) entry. (Final action target date is August 31, 1999.)
- 9.d. Enforce the quarterly recertification requirements for HUDCAPS users, including the supervisor requirement to identify compensating controls for sole employee transaction executions. (Final action target date is August 31, 1999.)
- 9.g. Request that the PAS security administrator send out periodic PAS user certification listings. (Final action target date is August 31, 1999.)
- 9.h. Request that the Ft. Worth Accounting Office determine the feasibility of restricting its employees with either LOCCS or PAS access. (Final action target date is December 31, 1999.)

With respect to the reportable condition that HUD needs to improve processes for reviewing obligation balances, we recommend that the Chief Financial Officer:

- 10.a. Revise the procedures used in the annual review of unliquidated obligation balances to ensure the reviews are initiated and completed in a timely manner. (Final action target date is December 31, 1999.)
- 10.c. Revise the procedures used in the annual review of unliquidated obligation balances to ensure all obligations identified as no longer needed are recaptured for purposes of adjusting the financial statement balances. (Final action target date is December 31, 1999.)

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, 2000.)
- 10.e. Ensure that all contract amounts determined to have excess budget authority are deobligated and recaptured. (Final action target date is September 30, 2000.)

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

This Appendix provides details required under FFMIA reporting requirements. To meet those requirements, we performed tests of compliance using the implementation guidance for FFMIA issued by OMB. 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 Departments 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 FMFIA is to report 18 non-conforming systems. HUD credits the reduced number of non-conforming systems to retiring non-conforming legacy systems and implementing processes to correct systems' deficiencies with the requirement to capture SGL accounting information at the transaction level. While the Department has retired non-conforming legacy systems as noted in its draft Accountability Report, the Department reclassified seven of the non-conforming systems to conforming based on actions taken to enable the Department to provide summary data in SGL format to HUD's general ledger. However, the systems do not comply with all federal financial management systems requirements, federal accounting standards and compliance with the SGL at the transaction level. The OIG has noted material weaknesses that *HUD's Financial Systems are Not Fully Compliant with Federal Financial Standards* that affected HUD's ability to prepare auditable financial statements. In addition, KPMG LLP has reported material weaknesses regarding FHA's funds control, budgetary and accounting processes. 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	27	13 ⁹
Chief Financial Officer	20	2 ¹⁰
Office of Administration	4	1
Office of Public and Indian Housing	2	2
Office of Fair Housing and Equal Opportunity	0	0
Government National Mortgage Association	8	0
Office of Community Planning and Development	10	0
Office of the Chief Procurement Officer	1	0
Real Estate Assessment Center	<u>1</u>	<u>0</u>
	<u>73</u>	<u>18</u>

⁹ In addition to the systems reported as nonconforming, the Office of Housing has 7 systems that were identified as conforming without performing a proper assessment or fully considering the material weaknesses noted in this report and KPMG, LLP's audit of FHA's fiscal year 1999 financial statements.

¹⁰ The list of CFO nonconforming systems does not include HUDCAPS, which we concluded was not compliant with core financial system requirements including SGL requirements.

The primary reason for the existence of non-conforming systems is that plans to correct systems weaknesses have not been fully developed. HUD, for the most part, plans to replace non-conforming systems with new systems or incorporate the functions of nonconforming systems into conforming systems. The following sections outline the Department's plan to correct specific system non-conformances.

Office of Housing

<u>System</u>	<u>Outstanding Noncompliance Issue @ 10/1/98</u>	<u>Status/Plan @9/30/99</u>	<u>Target date to Complete all Phases</u>	<u>Resources</u>
A31 - Single Family Premium Collection System	<ul style="list-style-type: none"> • Classification structure • Integrated Financial Management System • Application of SGL • Accounting Standards • Financial Reporting • Budget Reporting • Functional Requirements • Internal Controls 	System replaced by A80B (Single Family Premium Collection System - Periodic <i>except</i> for pre-1962 Section 530 cases. System will remain nonconforming until these cases are matured by the end of fiscal year 2002.	9/99	N/A
A43 - Single Family Insurance System	<ul style="list-style-type: none"> • Application of standard general ledger • Clear documentation 	To address SGL noncompliance implemented processes to post to financial data warehouse and post to HUDCAPS Complete User Guide	12/99 <i>Orig: 9/99</i>	\$35,000
A56 - Mortgage Insurance General Accounting	<ul style="list-style-type: none"> • Classification Structure • Integrated Financial Management System • Application of the standard general ledger • Accounting Standards • Financial Reporting • Budget Reporting • Functional Requirements • Clear Documentation • Internal Controls • Training/User Support • Maintenance 	To address SGL noncompliance implemented processes to post to financial data warehouse and post to HUDCAPS No plan for remaining issues	None determined <i>Orig: 9/99</i>	Not determined
A80G - Multifamily Mortgage Auction System	<ul style="list-style-type: none"> • Application of the standard general ledger • Functional requirements • Training/User Support 	To address SGL noncompliance implemented processes to post to financial data warehouse and post to HUDCAPS Develop new system to support new mortgage auctions	None determined <i>Orig: 9/99</i>	Not determined
A80N - Single Family Mortgage Notes Servicing	<ul style="list-style-type: none"> • Application of standard general ledger • Functional requirements • Training/User Support 	To address SGL noncompliance implemented processes to post to financial data warehouse and post to HUDCAPS Other issues not addressed	None determined <i>Orig: 9/99</i>	Not determined
A80S - Single Family Acquired Asset Management	<ul style="list-style-type: none"> • Applications of standard general ledger • Functional Requirements • Clear Documentation 	To address SGL noncompliance implemented processes to post to financial data warehouse and post to HUDCAPS Other issues not addressed	None determined <i>Orig: 9/99</i>	Not determined
D64A - Single Family Housing Enterprise Data Warehouse	<ul style="list-style-type: none"> • Security requirements 	Completed security review and reviewing findings and recommendations Conduct review to determine whether system is subject to A-127	10/31/99 FY 2000	FY 99: \$25,000

<u>System</u>	<u>Outstanding Noncompliance Issue @ 10/1/98</u>	<u>Status/Plan @9/30/99</u>	<u>Target date to Complete all Phases</u>	<u>Resources</u>
F05 - Section 8 Management Information System	<ul style="list-style-type: none"> • Classification structure • Integrated Financial Management System • Application of standard general ledger • Accounting Standards • Financial Reporting • Budget Reporting • Functional Requirements • Internal Controls • Training/User Support • Maintenance 	<p>Suspended plans to terminate system since F05 generates a quarterly report for Census Bureau.</p> <p>No plans to address nonconforming issues</p>	<p>FY 2001</p> <p><i>Orig: 3rd quarter FY 99</i></p>	<p>\$5,000 to archive data and terminate system</p>

F07 - Computerized Underwriting Processing System	<ul style="list-style-type: none"> • Classification structure • Integrated Financial Management System • Application of standard general ledger • Accounting Standards • Financial Reporting • Budget Reporting • Functional Requirements • Internal Controls • Training/User Support • Maintenance 	<p>Discontinue system and replace with F24</p>	<p>FY 2001</p> <p><i>Orig: 3rd quarter FY 99</i></p>	<p>\$60,000 for operations through 3rd quarter FY 1999</p>
F47 - Multifamily Insurance	<ul style="list-style-type: none"> • Application of standard general ledger • Functional requirements • Clear documentation • Training/user support 	<p>To address SGL noncompliance implemented processes to post to financial data warehouse and post to HUDCAPS</p> <p>Other issues not addressed</p>	<p>None determined</p> <p><i>Orig: 9/99</i></p>	<p>Not determined</p>
F75 - Multifamily Insurance and Claims System	<ul style="list-style-type: none"> • Application of standard general ledger • Functional Requirements • Clear Documentation • Training/User support 	<p>To address SGL noncompliance implemented processes to post to financial data warehouse and post to HUDCAPS</p> <p>Other issues not addressed</p>	<p>None determined</p> <p><i>Orig: 9/99</i></p>	<p>Not determined</p>
F87 - Tenant Rental Assistance Certification System	<ul style="list-style-type: none"> • Application of standard general ledger • Accounting standards 	<p>Transferred FMC Housing Annual Certification Contracts to HUDCAPS as of September 30, 1999.</p> <p>Recommended for further review to determine compliance</p>	<p>None determined</p> <p><i>Orig: 9/99</i></p>	<p>Not determined</p>
R25 - FHA Contract Tracking System	<ul style="list-style-type: none"> • Application of standard general ledger • Functional Requirements • Clear Documentation • Training/User Support • Maintenance 	<p>To address SGL noncompliance implemented processes to post to financial data warehouse and post to HUDCAPS</p> <p>Other issues not addressed</p>	<p>None determined</p> <p><i>Orig: 9/99</i></p>	<p>Not determined</p>

Office of the Chief Financial Officer

<u>System</u>	<u>Outstanding Noncompliance Issue @ 10/1/98</u>	<u>Status/Plan @9/30/99</u>	<u>Target date to Complete all Phases</u>	<u>Resources</u>
ATLAS - Advanced Technology Ledger Accounting System	<ul style="list-style-type: none"> • Classification Structure • Integrated Financial Management System 	<p>Replace remaining ATLAS functions with PC applications</p>	<p>9/00</p> <p><i>Orig: 9/99</i></p>	<p>Not determined</p>

A65A - Section 235 Automated Validation and Editing	<ul style="list-style-type: none"> • Classification Structure • Integrated Financial Management 	Analyze feasibility of integrating A65A with A75 HUDCAPS	9/00 <i>Orig: 9/99</i>	FY 99: \$31,148 FY 00: Less than \$20,000 Conversion costs dependent on implementation solution
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Office of Administration

<u>System</u>	<u>Outstanding Noncompliance Issue @ 10/1/98</u>	<u>Status/Plan @9/30/99</u>	<u>Target date to Complete all Phases</u>	<u>Resources</u>
A63- Furniture and Equipment Management Information System	<ul style="list-style-type: none"> • Classification Structure • Integrated Financial Management System • Accounting Standards • Financial Reporting • Functional Requirements • Security Requirements • Internal Controls • Training/User support • Maintenance 	Discontinue system by 10/31/99 and replace with Facilities Integrated Resources Management System	FY 2000 <i>Orig: 9/99</i>	\$700,000 for FY 1999

Office of Public and Indian Housing

<u>System</u>	<u>Outstanding Noncompliance Issue @ 10/1/98</u>	<u>Status/Plan @9/30/99</u>	<u>Target date to Complete all Phases</u>	<u>Resources</u>
F86 - Multifamily Tenant Characteristics System (MTCS)	<ul style="list-style-type: none"> • Financial Reporting 	PIH reports that weaknesses have been resolved, however, details on efforts to resolve weaknesses have not been provided to CFO System scheduled for replacement	6/00	\$5 million requested for enhancements
N07- Regional Operating Budget and Obligations Tracking (ROBOTS)	<ul style="list-style-type: none"> • Integrated financial management system • Functional requirements 	<ul style="list-style-type: none"> • Implement HUDCAPS as the subsidiary ledger for the PIH Operating Fund programs • Develop an interface to capture the eligibility calculation in ROBOTS for transmission to HUDCAPS as an obligation amount and • Propose interface solution to eliminate dual entry of the obligation amount in two systems • Determine whether to modify ROBOTS or pursue other systems alternatives based on decision pertaining to new Performance Funding System 	4/00 <i>Orig: 7/99</i>	FY 99: \$340,000 for ROBOTS/ HUDCAPS interface FY 00: \$242,000

2. Our field work disclosed reportable conditions regarding the security over financial information. Although reportable conditions, 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. The responsible office, nature of the problem and primary causes are summarized below.¹¹

Responsible Office **Nature of the Problem**

Office of the CFO Excessive access privileges to vendor tables and a sensitive system utility expose critical financial data in HUDCAPS to possible damage, loss, errors and possible unauthorized payments.

The primary cause for this occurrence is the need to periodically review access privileges.

Office of Housing While testing controls, our auditors, KPMG LLP, were able to access programs and files containing sensitive information about FHA customers and sensitive system activities.

REMS, an FHA Multifamily database used for financial reporting and decision making activities, lacks key security controls such as forced password changes and segregation of duties between field office Security Administrators and data entry personnel.

The FHA Connection, an extremely sensitive Internet-based interface that allows lending institution employees to access mission critical FHA systems, lacks key security elements required by OMB Circular A-130.

The primary cause for these occurrences are that HUD has not provided adequate protection over sensitive programs and files.

Office of Housing FHA's SAMS risks data corruption when system postings are aborted

The primary cause for this occurrence is that key database controls have not been implemented

Office of Housing REMS data may not be complete and accurate.

The primary cause for this occurrence is that periodic reconciliations are not performed between REMS and source data.

Offices of Information Technology and Chief Information Officer Two powerful system utilities on the Hitachi mainframe, "Started Tasks" and the Authorized Program Facility, were not fully controlled.
Up to 3,095 users may be able to modify data on the UNISYS mainframe, depending on their existing level of access and programming knowledge.
Network controls have improved but vulnerabilities still exist.

The primary cause is that HUD has not implemented sufficient protective controls.

HUD system users may not be aware of current security practices and controls.

The primary cause is HUD's Information Security Program Handbook has not been formally issued since

¹¹ The issues are discussed in greater detail in the sections of this report relating to the reportable conditions, "HUD needs to improve controls over its computing environment" and "Access and data integrity controls over HUDCAPS need to be strengthened" and KPMG LLP's separate report on their audit of FHA's fiscal year 1999 financial statements.

Responsible Office Nature of the Problem

September 1994.

Specific recommendations to correct security weaknesses are listed in Appendix B of this report and KPMG LLP's separate report on their audit of FHA's fiscal year 1999 financial statements.

Federal Accounting Standards

A material weakness was reported by KPMG LLP in FHA's budgetary and Federal basis accounting that affected HUD's ability to prepare auditable financial statements. This resulted in a need to:

- implement budgetary controls to prevent misreporting of budget execution information relating to FHA appropriations (SFFAS Number 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*); and
- 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*).

Furthermore, earlier in this report, we discuss the material weakness that *HUD's Financial Systems are Not Fully Compliant with Federal Financial Standards*. This material weakness addresses how HUD's general ledger is not compliant with core financial systems requirements. This weakness also adversely affects HUD's ability to prepare auditable financial statements and related disclosures in a timely and efficient manner.

**U.S. Government Standard General Ledger
at the Transaction Level**

Beginning in fiscal year 1999, HUDCAPS is the Department's official standard general ledger system. FHA provided consolidated summary level data to HUDCAPS for fiscal year 1999 beginning and ending balances. FHA analyzed its general ledger and prepared a documented crosswalk to the SGL to prepare both the financial statements and the reports on budget execution. FHA also implemented the budgetary-related SGL accounts in its general ledger, however, as reported by KPMG, LLP, the subsidiary systems that contain the transaction detail activity could not provide reports which were properly reconciled to the general ledger. In addition, detailed reports supporting the aggregate amounts recorded in the general ledger and reports on budget execution were not maintained. OMB Circular A-127 requires that transaction detail be available to support the SGL account entries.

As noted above, we have reported as a material weakness that *HUD's Financial Systems are Not Fully Compliant with Federal Financial Standards*. This material weakness addresses how HUD's general ledger is not compliant with core financial systems requirements, including SGL requirements.