



Issue Date November 14, 2006

Audit Case Number 2007-FO-0003

TO: John W. Cox, Chief Financial Officer, F

Randy W. McGinnis

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

SUBJECT: **Additional Details to Supplement Our Report on HUD's Fiscal Years 2006 and 2005 Financial Statements**

HIGHLIGHTS

What We Audited and Why

We are required to annually audit the consolidated financial statements of the U.S. Department of Housing and Urban Development (HUD) in accordance with the Chief Financial Officers Act of 1990, as amended. This report supplements our report on the results of our audit of HUD's principal financial statements for the fiscal years ending September 30, 2006, and September 30, 2005. Also provided are assessments of HUD's internal controls and our findings with respect to HUD's compliance with applicable laws, regulations, and provisions of contracts and grant agreements¹.

Our report on HUD's fiscal years 2006 and 2005 financial statements is included in HUD's Fiscal Year 2006 Performance and Accountability Report. For fiscal

¹Additional details relating to the Federal Housing Administration (FHA), a HUD component, are not included in this report but are included in the accounting firm of Urbach Kahn and Werlin LLP's audit of FHA's financial statements. That report has been published in our report, Audit of Federal Housing Administration Financial Statements for Fiscal Years 2006 and 2005 (2007-FO-0002, dated November 08, 2006)

Additional details relating to the Government National Mortgage Association, (Ginnie Mae), another HUD component, are not included in this report but are included in the accounting firm of Carmichael Brasher Tuvell and Company's audit of Ginnie Mae's financial statements. That report has been published in our report, Audit of Government National Mortgage Association Financial Statements for Fiscal Years 2006 and 2005 (2007-FO-0001, dated November 07, 2006)

year 2006, the Office of Management and Budget (OMB) directed agencies to complete their Performance and Accountability Reports and submit them to the President, OMB and the Congress by November 15, 2006, thereby requiring that we complete our work by that date.

What We Found

In our opinion, HUD's fiscal years 2006 and 2005 financial statements were fairly presented. Our opinion on HUD's fiscal years 2006 and 2005 financial statements was reported in HUD'S Fiscal Year 2006 Performance and Accountability Report. In conjunction with our audit of HUD's fiscal year 2006 financial statements, we reported on six reportable conditions in internal controls related to the need to

- Comply with federal financial management system requirements;
- Continue improvements made in the oversight and monitoring of subsidy calculations and intermediaries program performance;
- Further strengthen controls over HUD's computing environment, including the enhancement of controls at FHA around the User Access Request process and managing the FHA Subsidiary Ledger as a mission critical system;
- Improve personnel security practices for access to the Department's critical financial systems; and
- Improve processes for reviewing obligation balances; and
- Improve FHA's funds controls processes.

Our findings also include the following instances of non-compliance with applicable laws, regulations, and provisions of contracts and grant agreements:

- HUD did not substantially comply with the Federal Financial Management Improvement Act regarding system requirements and applicable accounting standards, and
- FHA and certain of its allotment holders did not have an approved Funds Control Plan.

The audit also identified more than \$558.3 million in excess obligations recorded in HUD's records, which represent funds that HUD could put to better use.

What We Recommend

Most of the issues described in this report represent long-standing weaknesses. We understand that implementing sufficient change to mitigate these matters is a multiyear task due to the complexity of the issues and the impediments to change. In this and in prior years' audits of HUD's financial statements, we have made recommendations to HUD's management to address these issues. Our

recommendations from the current audit, as well as those from prior years' audits that remain open, are listed in appendix B of this report.

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

HUD's Response

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

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Internal Control

Reportable Condition: HUD Financial Management Systems Need to Comply with Federal Financial Management System Requirements

As reported in prior years, the U.S. Department of Housing and Urban Development (HUD) is not in full compliance with Federal financial management requirements. Specifically, it has not completed development of an adequate integrated financial management system. HUD is required to implement a unified set of financial systems and the financial portions of mixed systems encompassing the software, hardware, personnel, processes (manual and automated), procedures, controls, and data necessary to carry out financial management functions, manage financial operations of the agency, and report on the agency's financial status to central agencies, Congress, and the public. As currently configured, HUD financial management systems do not meet the test of being unified. The Federal Financial System Integration Office defines "unified" as meaning that the systems are planned for and managed together, operated in an integrated fashion, and linked electronically to efficiently and effectively provide agency wide financial system support necessary to carry out the agency's mission and support the agency's financial management needs.

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

For many years, HUD's most significant system deficiency involved the Federal Housing Administration (FHA). However, FHA has made progress in correcting weaknesses in its overall compliance with federal financial management system requirements through the implementation of the FHA Subsidiary Ledger. Key milestones were achieved in fiscal years 2004 and 2005, when FHA completed the implementation of its core financial system with the addition of cash management, funds control, and contract modules. FHA improved capabilities, combined with progress reported in prior years, enabled the Office of the Inspector General (OIG) to conclude that the remaining issues related to HUD's information systems controls no longer constituted a material weakness, and this weakness was reclassified as a reportable condition in fiscal year 2005.

The Federal Financial Management Improvement Act of 1996 (FFMIA) requires, among other things, that HUD implement and maintain financial management systems that substantially comply with federal financial management system requirements. These requirements are detailed in the Federal Financial Management System Requirements series issued by the Joint Financial Management Improvement Program/Financial System Integration Office (JFMIP/FISO) and in Circular No. A-127, Financial Management Systems, issued by the Office of Management and Budget (OMB). Circular A-127 defines a single integrated financial

management system as a unified set of financial systems and the financial portions of mixed systems (e.g., acquisition) encompassing the software, hardware, personnel, processes (manual and automated), procedures, controls, and data necessary to carry out financial management functions, manage the financial operations of the agency, and report on the agency's financial status.

As in previous audits of HUD's financial statements, in fiscal year 2006 we identified instances of noncompliance with federal financial management system requirements. These instances of noncompliance have given rise to significant management challenges that have: (1) impaired management's ability to prepare financial statements and other financial information without extensive compensating procedures, (2) resulted in the lack of reliable, comprehensive managerial cost information on its activities and outputs, and (3) limited the availability of information to assist management in effectively managing operations on an ongoing basis.

HUD's ability to prepare financial statements and other financial information requires extensive compensating procedures

As reported in prior years, HUD does not have financial management systems that enable it to generate and report the information needed to both prepare financial statements and manage operations on an ongoing basis accurately and timely. To prepare consolidated departmentwide financial statements, HUD required FHA, the Government National Mortgage Association (Ginnie Mae), and the Office of Federal Housing Enterprise Oversight to submit financial statement information on spreadsheet templates, which were loaded into a software application. In addition, all consolidating notes and supporting schedules had to be manually posted, verified, reconciled, and traced. To overcome these systemic deficiencies with respect to preparation of its annual financial statements, HUD was compelled to rely on extensive compensating procedures that were costly, labor intensive, and not always efficient.

While there have been improvements made in fiscal year 2006 to the financial reporting processes, most notably Ginnie Mae's implementation of a compliant general ledger, the underlying system issues remain. Due to functional limitations of the three applications (HUDCAPS, LOCCS and PAS) performing the core financial system function, HUD is dependent on its data mart and reporting tool to complete the accumulation and summarization of data needed for U.S. Department of the Treasury and OMB reporting.

HUD financial systems do not provide reliable, comprehensive managerial cost information on its activities and outputs

On September 21, 2006 the Government Accountability Office (GAO) reported in GAO-06-1002R Managerial Cost Accounting Practices:

Department of Agriculture and the Department of Housing and Urban Development that HUD financial systems do not have the functionality to provide managerial cost accounting across its programs and activities. This lack of functionality has resulted in the lack of reliable and comprehensive managerial cost information on its activities and outputs. HUD lacks an effective cost accounting system that is capable of tracking and reporting costs of HUD's programs in a timely manner to assist in managing its daily operations. This condition renders HUD unable to produce reliable cost-based performance information.

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

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

HUD has begun to modify its resource management application to enhance its cost and performance reporting for program offices and activities. The application TEAM/REAP was designed for use in budget formulation and execution, strategic planning, organizational and management analyses, and ongoing management of staff resources. The new allocation module will add the capability to tie staff distribution to strategic objectives, the President's Management Agenda, and HUD program offices' management plans. HUD is planning a pilot program of this functionality in fiscal year 2007 in select HUD program areas.

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

general ledger, current federal financial management requirements are not met.

HUD has limited availability of information to assist management in effectively managing operations on an ongoing basis

During fiscal year 2006, HUD's financial information systems did not allow it to achieve its financial management goals in an effective and efficient manner in accordance with current federal requirements.

To perform core financial system functions, HUD depends on three applications, a data warehouse, and a report-writing tool. Two of the three applications that perform core financial system functions require significant management oversight and manual reconciliations to ensure accurate and complete information. HUD's use of multiple applications to perform core financial system functions, further complicates financial management and increases the cost and time expended. Extensive effort is required to manage and coordinate the processing of transactions to ensure the completeness and reliability of information.

While the FHA SL project did provide for funds control checks on transactions as they were posted to the general ledger, this check occurred after the decision to guarantee, obligate, or disburse was made. Current federal requirements state that the funds control checks should be performed before issuing a loan guarantee, approving a disbursement, or in some way binding the government to an obligation. Until its business systems are reengineered or replaced, FHA will have to continue to rely on daily or month-end funds control checks for most of its legacy system transactions.

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

Department-wide financial management improvement projects need to be fully implemented to eliminate long-term financial systems deficiencies

As previously noted, FHA's financial management system's environment needed enhancements to more effectively support FHA's insurance, cash management, and budget processes. FHA is in the process of upgrading and integrating its

various insurance and business systems in compliance with HUD's Enterprise Architecture Plan. FHA's Subsidiary Ledger was a critical component of this plan and a number of applications were eliminated or integrated into other applications in connection with its implementation in recent years. FHA's plans to replace four insurance systems and upgrade the system interfaces for six other insurance systems in 2006 were delayed this year due to a change in plans for infrastructure acquisition. FHA secured this infrastructure support late in fiscal year 2006, and initiated procurement of the needed hardware to provide the additional computing capacity. As part of this process, certain financial business processes will be migrated into the FHA Subsidiary Ledger.

In fiscal year 2003, HUD's Office of the Chief Financial Officer launched a project known as the HUD Integrated Financial Management Improvement Project (HIFMIP). HIFMIP's intent is to modernize HUD's financial management systems in accordance with a vision consistent with administration priorities, legislation, OMB directives, modern business practices, customer service, and technology. HIFMIP will encompass all of HUD's financial systems, including those supporting FHA and Ginnie Mae. HUD intended to begin implementation in fiscal year 2006; however, it stated that a change in acquisition strategy was required due to a change in OMB guidance, which delayed the procurement process. HUD anticipates that it will be able to begin the implementation of its core financial system in fiscal year 2007.

Ginnie Mae implemented a new core financial management system in fiscal year 2006 that is compliant with current federal requirements. Ginnie Mae coordinated its activities with HUD to permit a consolidated Departmentwide core financial system in the future.

Reportable Condition: HUD Management Must Continue to Improve Oversight and Monitoring of Subsidy Calculations and Intermediaries' Program Performance

Under the provisions of the U.S. Housing Act of 1937, HUD provides housing assistance funds through various grant and subsidy programs to multifamily project owners (both nonprofit and for profit) and housing authorities. These intermediaries, acting for HUD, provide housing assistance to benefit primarily low-income families and individuals (households) that live in public housing, Section 8 and Section 202/811 assisted housing, and Native American housing. In fiscal year 2006, HUD spent about \$27 billion to provide rent and operating subsidies that benefited more than four million households.

Since 1996, we have reported on weaknesses with the monitoring of housing assistance program delivery and the verification of subsidy payments. We focused on the impact these weaknesses had on HUD's ability to (1) ensure intermediaries are correctly calculating housing subsidies and (2) verify tenant income and billings for subsidies. During the past several years, HUD has made progress in correcting this weakness, which in 2005 resulted in it being reclassified as a

reportable condition. In 2006, HUD continued its progress, including taking steps to establish consolidated reviews to institutionalize the Office of Public and Indian Housing's (PIH) efforts in addressing public housing authorities' (PHA) improper payments and other high-risk elements. HUD's continued commitment to the implementation of a comprehensive program to reduce erroneous payments will be essential to ensuring that HUD's intermediaries are properly carrying out their responsibility to administer assisted housing programs according to HUD requirements.

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

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

HUD is unable to verify subsidy payments

The estimate of erroneous payments that HUD reports in its Performance and Accountability Report relates to HUD's inability to ensure or verify the accuracy of subsidy payments being determined and paid to assisted households. HUD has surpassed goals for reducing the fiscal year 2000 estimated \$2 billion in net annual rental housing assistance overpayments. The baseline estimate of gross annual improper payments was reduced from \$3.2 billion in 2000 to \$1.2 billion in the 2004 study, a 62 percent reduction. In addition, HUD was the first agency to receive a "green" baseline goal score on the President's Management Agenda – Eliminating Improper Payments initiative and has maintained this score.

This year's contracted study of HUD's three major assisted housing programs estimated that the rent determination errors made by the intermediaries resulted in substantial subsidy overpayments and underpayments. The study was based on analyses of a statistical sample of tenant files, tenant interviews, and income verification data for activity that occurred during fiscal year 2005. This study

reports subsidy payment inconsistencies in which HUD incorrectly paid \$925 million in annual housing subsidies, of which about \$584 million was overpaid on behalf of households paying too little rent and about \$341 million was underpaid on behalf of households paying too much rent based on HUD requirements. The estimate of erroneous payments is reported in HUD's Fiscal Year 2006 Performance and Accountability Report.

The estimate of erroneous payments this year also includes overpaid subsidies from underreported and unreported income and intermediaries' billings errors. HUD estimated that housing subsidy overpayments from tenants misreporting their income totaled an additional \$338 million in overpayments during calendar year 2005. During our testing of the initial error estimate results, we found additional cases resulting in valid errors. Therefore, including the subsidy error associated with the income from these cases, the revised estimate is between \$359 million to \$383 million.

Based on the payment errors that were identified related to the Office of Housing's project-based Section 8 housing program, HUD reported an estimated \$85 million in program billings errors for fiscal year 2005. In addition, HUD's Office of Public and Indian Housing (PIH) reported its fiscal year 2004 billings error estimate of \$72 million for the Housing Choice Voucher program.

Additionally, an operating subsidy estimate of \$49 million was included in this year's PIH billings estimate. Therefore, adding the Office of Housing's estimate of \$85 million to this year's PIH estimate of \$72 million for Section 8 and the \$49 million for operating subsidy makes the estimate of erroneous payments total \$206 million for billings errors.

In addition to the RHIP-related estimates, HUD does an annual risk assessment under the Improper Payments Information Act, with statistical sampling and measurement of programs determined to be at possible high risk of improper payments. During fiscal year 2006, HUD had written documentation, including a risk assessment which shows that the Community Development Block Grant (CDBG) was not deemed susceptible to significant improper payments. Therefore, HUD did not prepare an erroneous payment estimate for "Other HUD programs (nonrental assistance)" at risk of improper payments for HUD's Fiscal Year 2006 Performance and Accountability Report. OMB is in the process of evaluating HUD's assessment.

HUD needs to continue initiatives to detect unreported tenant income

HUD, housing authorities, and project owners have various legal, technical and administrative obstacles that impede them from ensuring that tenants report all income sources during the certification and recertification process. In fiscal year 2005, HUD began implementation of the Enterprise Income Verification System. The purpose of the system is to make integrated income data available from one source for PHAs to use to improve income verification during mandatory

reexaminations. The Enterprise Income Verification System is able to provide new hire, wage, unemployment compensation, and Social Security benefit information through a data matching process for households covered by a HUD Form 50058. The Enterprise Income Verification System is available to PHAs nationwide, and all PHAs are encouraged to use and implement the Enterprise Income Verification System in their day-to-day operations.

During fiscal year 2006, the Enterprise Income Verification System became the single source system for income verification and was extended to cover the multifamily housing program. In multifamily housing, HUD's intermediaries previously used the Tenant Assessment Subsystem (TASS) to obtain Social Security benefit information. On September 29, TASS went offline, and its functionality is now mirrored in the Enterprise Income Verification System for Multifamily Housing users. In the second quarter of fiscal year 2007, HUD expects to obtain approval for multifamily housing owners and management agents to use the Department of Health and Human Services (HHS) National Directory of New Hires (NDNH) data through the Enterprise Income Verification System. This will provide them access to new hire, wage, and unemployment insurance benefit data and assist in reducing errors in subsidy payments.

HUD needs to continue progress on RHIIP initiatives

HUD initiated the RHIIP initiatives in fiscal year 2001 in an effort to develop tools and the capability to minimize erroneous rental subsidy payments, which includes the excess rental subsidy caused by unreported and underreported tenant income. Since our last report, HUD has made progress in implementing several of these initiatives that address the problems surrounding housing authorities' rental subsidy determinations, underreported income, and assistance billings. However, HUD still needs to ensure that it fully utilizes automated tools to detect rent subsidy processing deficiencies and identify and measure erroneous payments.

In the past, PIH performed rental integrity monitoring reviews to identify incorrectly paid rental subsidies that result from incorrect rental subsidy determinations made by housing authorities. During fiscal year 2006, HUD implemented an initiative to perform consolidated reviews in order to reinforce the PIH's effort in addressing PHA improper payments and other high-risk elements. These reviews have also been implemented to ensure the continuation of the PIH's comprehensive monitoring and oversight of PHAs. The consolidated reviews (Tier I and II) consist of the following components: Rental Integrity Monitoring (RIM); Upfront Income Verification (UIV); Section Eight Management Assessment Program (SEMAP); and Management Assessment Subsystem (MASS) of the Public Housing Assessment System (PHAS). The RIM component of the consolidated review consist of the requirements to conduct RIM reviews of Tier I and II PHAs, with an emphasis on corrective action plan (CAP) development and implementation.

According to Fiscal Year 2006 Management Plan's directive, HUD was to conduct occupancy and certification reviews of 100 Tier I PHAs (approximately 20 percent of the 490 PHAs that receive 80 percent of HUD funding) and an additional 175 reviews for Tier II PHAs (approximately a 5 percent sample of non-tier I PHAs) based on field office risk assessment. Documentation provided during our review showed that 98 Tier I reviews and 195 Tier II reviews were performed during fiscal year 2006. Because of the consolidated reviews, 21 CAPs were implemented and 10 of these reviews have already been closed out. At the end of our fiscal year 2005 fieldwork, we noted that 34 CAPs were still open from the 2003-2004 RIM re-reviews. During our fiscal year 2006 review, we determined that 16 of these CAPs are still open because the PHA was either in receivership or in troubled status. HUD must continue to assure that CAPs are implemented and closed out, thereby assuring that the systemic errors identified during the reviews were corrected.

Last year, we reported that the Public Housing Information Center system (now known as the Inventory Management System) information was incomplete and/or inaccurate because housing authority reporting requirements were discretionary. This had been a long-standing deficiency, which has resulted in intensive manual review procedures. The Department relies heavily on the data received from PHAs in order to administer, monitor and report on the management of PHAs and the Housing Choices Voucher programs. Therefore, PHAs have been mandated to submit 100 percent of family records to HUD's Public Housing Information Center system (Inventory Management System) Form 50058 Module. PHAs must submit accurate records with no fatal edits for HUD to consider the records successfully submitted. In addition, PHAs must have a minimum 95 percent reporting rate at the time of their annual Form HUD 50058 reporting rate assessment or be subject to sanctions. During our field review at four field offices, we noted 77 PHAs that were not meeting the minimum 95 percent reporting rate. Since HUD uses the tenant data from its Public Housing Information Center system (Inventory Management System) for the income-matching program and program monitoring, it is essential that the database have complete and accurate tenant information. Therefore, until a more efficient and effective means of verifying the accuracy of the data is developed, HUD must continue to emphasize the importance of accurate reporting and proactively enforce sanctions against those PHAs that do not follow the requirement.

HUD has made substantial progress in taking steps to reduce erroneous payments. However, they must continue regular on-site and remote monitoring of the PHAs and use the results from the monitoring efforts to focus on corrective actions when needed.

We are encouraged by the on-going actions to focus on improving controls regarding income verification as well as HUD's plans regarding CAPs, consolidated reviews, and the continual income and rent training for HUD, owners, management agents, and PHA staff.

Reportable Condition: Controls over HUD's Computing Environment Can Be Further Strengthened

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

We evaluated selected information systems general controls of the Department's computer systems on which HUD's financial systems reside. Our review found information systems control weaknesses that could negatively affect the integrity, confidentiality, and availability of computerized data. Presented below is a summary of the control weaknesses found during the review.

Entity wide Security Program

HUD has made strides toward implementing a compliant entity wide security program as required by the Federal Information Security Management Act of 2002 (FISMA).

However, additional progress is needed. Specifically, we found that:

- Although HUD certified and accredited its general support systems in early fiscal year 2006, known security vulnerabilities still exist. HUD accepted the risk associated with the general support systems by allowing known vulnerabilities to remain open under the condition that maintaining the certification was based on progress made toward closing the vulnerabilities. However, many of the security vulnerabilities remain open with no date for resolution.
- HUD completed certifications and accreditations for all of its major applications in fiscal year 2005. However, the quality of the major applications security document varied by application and when the testing was performed. In our fiscal year 2006 application reviews, we found vulnerabilities classified as delayed with no resolution date provided. For example, FHA's major applications have 895 open information security vulnerabilities of which 767 (86 percent) are in a delayed status.
- HUD program officials and system owners have not fully met their responsibilities as specified in section 3544(a) of FISMA. In addition, HUD has not fully implemented an agency-wide information system security program as required. Examples of fiscal year 2006 improvements needed for HUD systems, including financial management systems, are (1) accurately identifying major and non-major systems, (2) properly categorizing security impact levels for

information systems, (3) updating security documents, and (4) testing technical controls for systems with high-impact risk levels. Details can be found in a previously issued OIG memorandum.² We also plan to issue a separate detailed audit report on HUD's entity-wide security program.

HUD Procurement System

In fiscal year 2006, we audited the HUD Procurement System (HPS) and HUD Small Purchase System (SPS) to assess their compliance with federal financial management requirements and the FISMA. These two systems are part of the Department's integrated financial management system and, during fiscal year 2006, processed 6,760 transactions totaling \$1.1 billion.

We found neither system contained sufficient financial data to effectively manage and monitor procurement transactions. Adequate controls have not been established to ensure that: (1) all parties to an acquisition transaction are identified; (2) users do not exceed their procurement authority; and (3) only users with procurement authority are authorizing the obligation of funds within the system interface with HUDCAPS. Additionally, the Office of the Chief Procurement Officer is bypassing certain built-in separation of duties controls within the HPS. Application and system administrator personnel are inappropriately performing security administration functions.

Finally, HUD's Office of the Chief Procurement Officer has not designed or implemented information security controls or ensured that its information security responsibilities were fulfilled as required by FISMA and HUD's information technology security policies and procedures. We plan to issue a separate audit report on HUD's procurement systems, which will include additional details.

IBM Mainframe z/OS Operating System

HUD has not implemented sufficient controls over the IBM mainframe z/OS operating system. For example,

- Physical and logical access security controls over the IBM mainframe operating system z/OS computer consoles at the HUD contractor-maintained data center could be strengthened. For instance, authorized or unauthorized commands issued from the computer consoles cannot be traced back to a particular individual. In addition, a person with physical access to the computer consoles can enter commands without a logon user ID and password. Finally, although there is one camera outside the computer room, there is no surveillance camera inside the computer room to monitor the activities. As a result, there is no record of who issued commands entered on the computer consoles.

² Audit Memorandum No. 2006- DP-0803, OIG Response to Questions from the Office of Management and Budget under Federal Information System Management Act of 2002, dated September 29, 2006.

- The most powerful administrative authority was improperly assigned to HUD and contractor personnel who did not have the need for such privileges. One of the privileges with this authority is the ability to dynamically change the system security parameters.
 - A powerful top secret administrator account, with a link to the master control ID and access to all IBM mainframe resources, was assigned to a HUD employee who had left the Department more than a year ago and was not deactivated until after our inquiry.
 - The communication between the vendor supporting the IBM mainframe, HUD information technology management, and program offices can be improved to facilitate informing program offices about IBM operation service disruptions in a timely manner. A major disruption on the IBM mainframe occurred on July 6, 2006, resulting in stoppage of all batch jobs. However, HUD information technology management and program offices were not notified in a timely manner. In addition, the recovery process was not thoroughly coordinated with the responsible program offices, which could have resulted in damaging applications including bad application performance, data corruption, and inconsistent data, all of which could lead to the disruption of HUD business functions.
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Software Configuration Management

We reviewed HUD's configuration management³ controls to determine whether they were in place and used for all changes. Our review found that the following areas need improvement: (1) duties for the administration of HUD's configuration management tools are not properly segregated, (2) the configuration management function is not adequately supported, and (3) the configuration management procedure's documentation does not clearly specify the roles and responsibilities for personnel supporting the configuration management function.

We also found weaknesses in the administration of the configuration management tool used for HPS. Specifically, (1) release procedures used are not being performed correctly, (2) administrators on the Unix operating system have inappropriate privileges for HPS, and (3) the configuration management plan has not been officially approved and includes obsolete and incomplete information.

³ Configuration management is the control and documentation of changes made to a system's hardware, software and documentation throughout the development and operational life of the system.

Contingency Planning and Preparedness

HUD has made progress in implementing contingency planning and preparedness controls and previous OIG recommendations. However, risks to HUD's critical financial systems remain a major concern. Specifically,

- HUD's information technology contingency planning process does not fully comply with National Institute of Standards and Technology Special Publication 800-34. HUD did not complete all the business impact analyses for all major applications, including financial management applications. The risk assessments for major applications, including financial management applications, need to be updated. Moreover, the requirements identified by the business impact analyses and risk assessments were not incorporated in the development of the completed contingency plans and disaster recovery plans.
- Although HUD has alternate data recovery facilities that have the capability to restore its mission-critical and major applications, there is no assurance that critical and major applications can be restored within the recovery time objectives of 24 hours for mission-critical applications and 48 to 72 hours for major applications.
- HUD's disaster recovery plans and information technology contingency plans are not updated to reflect current conditions and system enhancements.

Details can be found in a separate OIG audit report.⁴

Physical Security

Our review found that physical security controls for HUD facilities and disaster recovery sites are generally in place at the network operations center and the data center, both maintained by two different contractors. However, several areas of concern require management attention. Specifically, (1) documentation for the network operations center is not current, (2) access controls at both computer facilities need to be tightened, and (3) the contractor did not conduct required annual shelter-in-place⁵ drills at the data center.

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

⁴ Audit Report No. 2006-DP-0005, Review of HUD's Information Technology Contingency Planning and Preparedness, dated August 31, 2006.

⁵ The goal of sheltering in place during hazardous materials accidents is to minimize the exposure of the threatened public to the dangerous chemical(s). Sheltering in place uses a structure and its indoor atmosphere to temporarily separate people from a hazardous outdoor atmosphere.

For several years, we have reported that HUD's personnel security practices over access to critical and sensitive systems have been inadequate. Various deficiencies in HUD's information technology personnel security program were found and recommendations were proposed to correct the problems noted. However, the risk of unauthorized access to HUD's financial systems remains a critical issue. We followed up on previously reported information technology personnel security weaknesses and deficiencies and found that deficiencies still exist. Specifically,

- In prior years, OIG recommended that HUD develop an action plan to fully implement the HUD Online User Registration System to ensure that all user data are tracked and require system administrators to register users and their access level into this database. The Office of the Chief Information Officer provided OIG with an action plan, and the recommendation was closed. However, the system has not been fully implemented. Instead, HUD has decided to replace it with another system targeted for implementation by December 31, 2006. Until a system is fully implemented and the database populated, HUD cannot efficiently and centrally track and register all users at the appropriate access level.
- HUD has not developed adequate interim procedures to fully identify and match information on users with access to HUD applications with the database that contains background investigation data for all employees and contractors. HUD has addressed information technology personnel security procedures in the HUD Information Technology Security Procedures, Version 1.1, but has not provided specific instructions to facilitate the reconciliation process. This reconciliation process would identify users with potentially unauthorized or inappropriate access levels to HUD's systems (e.g. users granted above-read access without the appropriate background check). However, because no central system can identify all users and access levels, an inclusive reconciliation cannot be effectively performed.
- Quarterly reconciliations to identify users with above-read (query) access to HUD mission-critical and sensitive systems but without appropriate background checks were not routinely conducted. The last two reconciliations were performed in December 2005 and August 2006. The Personnel Security Officer was unable to perform regular quarterly reconciliations because the contractor's automatic data processing (ADP) security supporting staff did not provide the list of users with above-read access in a compatible data format.
- Some contractors were granted system administrative privileges to sensitive systems without record of having had a proper background investigation.

Without adequate information technology security controls, individuals may be granted inappropriate access to HUD's information and resources that could result in destruction or compromise of critical and sensitive data.

Reportable Condition: HUD Needs to Improve Processes for Reviewing Obligation Balances

HUD needs to improve controls over the monitoring of obligation balances to determine whether they remain needed and legally valid as of the end of the fiscal year. HUD's procedures for identifying and deobligating funds that are no longer needed to meet its obligations are not always effective. This has been a long-standing weakness. Our review of the 2006 year-end obligation balances showed \$558.3 million in excess funds that could be recaptured. Although HUD has made some progress in implementing procedures and improving its information systems to ensure that accurate data are used, further improvements in financial systems and controls are still needed. Major deficiencies include:

- Timely reviews of unexpended obligations are not being performed, and
- A lack of integration between accounting systems and the need for accurate databases has hampered HUD's ability to evaluate unexpended Section 8, Rental Assistance Payment, Rent Supplement, and Interest Reduction Program obligations.

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

Annually, HUD performs a review of unliquidated obligations to determine whether the obligations should be continued, reduced, or canceled. We evaluated HUD's internal controls for monitoring obligated balances.

Section 8 Programs

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

The Office of Housing has been hampered in its attempts to evaluate unexpended Section 8 project-based budget authority balances. The requirement to evaluate data from two payment methods, managed by two accounting systems, has hampered the Office of Housing's ability to monitor obligations and execute recaptures uniformly for contracts in both systems. In fiscal year 2006, the Office of Housing showed improvements in its analysis of outstanding obligation balances. This fiscal year, the Office of Housing recaptured approximately \$801 million in unliquidated obligation balances in the Section 8 project-based program. Our review of the Section 8 project-based contracts showed an additional 40 contracts that had expired on or before September 30, 2005 or were inactive with available contract/budget authority. These 40 contracts had \$21.6 million in excess funds potentially available for immediate recapture. Office of Housing staff stated that \$19.1 million of the \$21.6 million was in process pending correction of accounting system errors.

However, the Office of Housing still needs to recoup Section 8 funds due to HUD from Performance Based Contract Administrators (PBCAs). Our review of HUD disbursements to PBCAs showed approximately \$18 million in overpayments of Section 8 funds. PBCAs assist the Office of Housing in managing its portfolio of properties, including the disbursement of subsidies to property owners who participate in the Section 8 program. Beginning in fiscal year 2000, PBCAs received regularly scheduled payments throughout the year for each managed property based on the property's annual budget. At year-end, a settlement statement was to be prepared to reconcile budgeted amounts with actual expenditures. However, settlement statements were not prepared by the PBCAs for fiscal year 2000 because the Office of Housing did not issue the necessary guidance.

In April 2001, the Office of Housing replaced the budget-based process for disbursing Section 8 funds with a process based on actual expenditures. However, approximately \$18 million due HUD from the budget-based process was never returned to HUD from the PBCAs. We previously reported this issue in our audit of the fiscal year 2003 financial statements. As part of our audit follow-up on previous audits and closed recommendations, we found that the Office of Housing still needs to establish year-end settlement procedures to facilitate the remittance of these excess Section 8 funds retained by PBCAs.

In August 2006, the Office of Public and Indian Housing performed a recapture of expired contracts in the Moderate Rehabilitation housing program totaling \$171 million. However, our review showed that excess funds on Moderate Rehabilitation contracts were not always being recaptured and considered in the budget process. The Office of Public and Indian Housing did not consider expired budget authority from Moderate Rehabilitation contracts when formulating its budget request for contract renewals. Through the annual budget process, the Office of Public and Indian Housing fully funds contract renewals for Section 8 Moderate Rehabilitation contracts. In addition, we found that any

excess budget authority from the prior expired contracts was rolled forward to these contract renewals.

We identified 100 contracts in which HUD retained excess budget authority of \$125.5 million from expired contracts in addition to receiving full funding for the contract renewals. HUD officials stated that they did not have a system in place to estimate recoveries from expired contract/budget authority with this group of contracts. HUD stated that it would consider revising their recapture methodology for fiscal year 2007. In addition, we identified an additional \$11.8 million available for immediate recapture from expired contracts.

During fiscal year 2006, the Office of Public and Indian Housing performed an analysis of budget authority for the Section 8 tenant-based program and recaptured approximately \$223.8 million of unexpended budget authority. These funds were generated primarily by recapturing the remaining fiscal year 2004 and prior funds.

Administrative/Other Program Obligations

Requests for obligation reviews were forwarded by the Chief Financial Officer to the program and administrative offices. The focus of the review was on program obligations that exceeded a \$281,000 balance and administrative obligations that exceeded \$26,000. Excluding the Section 8 and Section 235/236 programs, which undergo a separate review process by the program offices, the total dollar amount of obligations identified for review totaled \$759.1 million. Of the \$759.1 million, HUD identified 4,422 transactions totaling \$71.7 million for potential deobligation. We tested the 4,422 obligations above the Department's review thresholds to determine whether the associated \$71.7 million balances had been deobligated in HUD's Central Accounting and Program Accounting System. We found that, as of September 30, 2006, 60 of the 4,422 transactions with obligation authority of \$7.9 million had not been deobligated. The Department initiated the process of closing these contracts and the associated funding should be recaptured in fiscal year 2007.

Rent Supplement and Rental Assistance Payments

HUD is not recapturing excess undisbursed contract authority from the Rent Supplement and Rental Assistance Payments programs in a timely manner. HUD needs to take the necessary steps to review and deobligate, when appropriate, prior year undisbursed amounts.

The Rent Supplement and Rental Assistance Payments programs were created around 1965 and 1974 respectively. The Rent Supplement program and Rental Assistance Payments operate much like the current project-based Section 8 rental assistance program. Rental assistance is paid directly to multi-family housing owners on behalf of eligible tenants

HUD's subsidiary ledgers show, for each fiscal year, the amount authorized for disbursement and the amount that was disbursed under each project account. Funds remain in these accounts until they are paid out or deobligated by the accounting department. If the funds are not paid out or deobligated, the funds remain on the books, overstating the required contract authority.

Our review showed that HUD developed and implemented procedures in fiscal year 2006 to periodically review the programs and contract authority requirements. However, HUD still needs to emphasize and complete its reviews. We performed a review of the multifamily projects unliquidated obligations accounts under the Rent Supplement and Rental Assistance programs and found \$118.5 million in undisbursed contract authority from prior fiscal years on 103 multifamily projects that should be recaptured. These projects had been terminated, converted to Section 8, or opted out of the programs, but their associated funds had not been recaptured.

For the \$118.5 million in excess undisbursed contract authority identified by OIG in the Rent Supplement and Rental Assistance Payment programs, HUD processed adjustments to deobligate \$118.5 million.

Section 236 Interest Reduction Program

The budget authority related to the Section 236 Interest Reduction Program is included in the Statement of Budgetary Resources. This program is not considered a major program and is categorized as one of HUD's "other programs" in the various consolidating financial statements. The Section 236 Interest Reduction Program was created under the National Housing Act as amended in 1968, and new activity was ceased during the mid-1970's. The contracts entered into were typically up to 40 years in duration and more than 3,100 contracts remain active. The activities carried out by this program include making interest reduction payments directly to mortgage companies on behalf of multifamily project owners. The obligations were established based upon permanent indefinite appropriation authority and HUD was obligated to fund these contracts for their duration. At the time it entered into the contract, HUD was to record an obligation for the entire amount. Because of the age of the records and the absence of sound financial practices at the time the program was active, HUD has been forced to use the best information available to compute estimated future payments to be made over the life of the loans. These estimates are the basis for HUD's currently recorded obligated balances necessary to fully fund the contracts to their expiration. HUD adjusts the recorded obligations as it proceeds through the terms of the contracts to reflect better estimates of the financial commitment. Factors that can change the budgetary requirements over time include contract terminations, refinancing, and restructuring.

Deficiencies in the Section 236 Interest Reduction Program have been reported by OIG in prior reports on the financial statements. The Offices of Housing and the Chief Financial Officer have been hampered by historically poor record keeping in their attempt to determine and account for unexpended Section 236 Interest

Reduction Program budget authority balances. In response to fiscal year 2004's OIG report and OMB concerns, the Department initiated a contract-by-contract review in August 2005 to identify individual underreported balances as well as over reported balances to support the Section 236 contract and budget authority

This year's OIG's review of the Interest Reduction Program noted improvements in HUD's processes for reviewing obligations. HUD developed and implemented procedures for periodically reconciling its obligation account. Since the new procedure was implemented in May 2006, HUD has completed contract reconciliations with four major service providers. This action resulted in HUD identifying potential recaptures of \$204 million from 169 contracts that were either terminated or prepaid. However, our review disclosed that further reviews are needed and HUD's reconciliation of contracts with other service providers has not yet been completed.

We identified 65 inactive Interest Reduction Program contracts with more than \$242.5 million in contract and budget authority that could be deobligated. These 65 contracts had been prepaid and terminated from the program. HUD agreed and processed adjustments to deobligate \$242.5 million. In addition, we identified five contracts with overestimated requirements of \$12.5 million. HUD plans to deobligate the \$12.5 million associated with the five contracts in fiscal year 2007.

In addition, in response to our prior year recommendation, HUD completed a contract-by-contract review of 51 projects with contract terms that HUD previously assumed were 50 years. Based on this review, HUD updated and revised the contract terms for all of the 51 projects from 50 years to an average 41 years. This action resulted in HUD deobligating \$12 million in fiscal year 2005 and \$106 million in fiscal year 2006 for the 51 projects reviewed.

HUD still needs to complete reviewing contracts and periodically reconcile balances with its contract servicers to ensure that future contract authority needed for the Section 236 Interest Reduction Program can be more accurately estimated and reported.

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

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

Compliance with Laws and Regulations

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

During fiscal year 2006, the Department continued to address its financial management deficiencies and took steps to bring the agency's financial management systems into compliance with Federal Financial Management Improvement Act (FFMIA). HUD has continued to obtain independent reviews of its financial management systems to verify compliance with financial system requirements, identify system and procedural weaknesses and develop the corrective actions steps to address identified weaknesses.

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. FFMIA requires agency heads to determine, based on the audit report and other information, whether their financial management systems comply with the FFMIA. If they do not, agencies are required to develop remediation plans and file them with the OMB.

Federal Financial Management System Requirements

In its *Fiscal Year 2006 Accountability Report*, HUD reports that 2 of its 41 financial management systems do not comply with the requirements of the FFMIA and OMB Circular A-127, *Financial Management Systems*. Even though 39 individual systems have been certified as compliant with federal financial management systems requirements, collectively and in the aggregate, deficiencies still exist. We report as a reportable condition that *HUD Financial Management Systems Need to Comply with Federal Financial Management Systems Requirements*. This reportable condition addresses how HUD's financial management systems remain substantially noncompliant with federal financial management requirements.

We also continue to report as reportable conditions that (1) *Controls over HUD's Computing Environment Can Be Further Strengthened* and (2) *Weak Personnel Security Practices Continue to Pose Risks of Unauthorized Access to the Department's Critical Financial Systems*. These reportable conditions discuss how weaknesses with general controls and certain application controls, and weak security management increase risks associated with safeguarding funds, property, and assets from waste, loss, unauthorized use or misappropriation.

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

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

Other Matters

HUD's Office of the Chief Financial Officer is responsible for investigating and reporting on violation of the Anti-deficiency Act. As of the conclusion of this audit, the Chief Financial Officer has made preliminary determinations that five cases that occurred during the period 2002 through 2006 are Anti-deficiency Act violations that warrant reporting to the President, Congress, and GAO, pending completion of the investigations. The preliminary determinations also indicate that none of the five cases requires a deficiency appropriation or were thought to be willful violations.

APPENDIXES

Appendix A

Objectives, Scope, and Methodology

Management is responsible for

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

In auditing HUD's principal financial statements, we were required by *Government Auditing Standards* to obtain reasonable assurance about whether HUD's principal financial statements are free of material misstatements and presented fairly in accordance with generally accepted accounting principles. We believe that our audit provides a reasonable basis for our opinion.

In planning our audit of HUD's principal financial statements, we considered internal controls over financial reporting by obtaining an understanding of the design of HUD's internal controls, determined whether these internal controls had been placed in operation, assessed control risk, and performed tests of controls to determine our auditing procedures for the purpose of expressing our opinion on the principal financial statements 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 2006 Performance and Accountability Report* by obtaining an understanding of the design of HUD's internal controls, determined whether these internal controls had been placed in operation, assessed control risk, and performed tests of controls as required by OMB Bulletin 06-03, *Audit Requirements for Federal Financial Statements* and not to provide assurance on these internal controls. Accordingly, we do not provide assurance on such controls.

With respect to internal controls related to performance measures to be reported in the Management's Discussion and Analysis and HUD's *Fiscal Year 2006 Performance and Accountability Report*, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin 06-03. Our procedures were not designed to provide assurance on internal control over reported performance measures and, accordingly, we do not provide an opinion on such controls.

To fulfill these responsibilities, we

- Examined, on a test basis, evidence supporting the amounts and disclosures in the consolidated principal financial statements;
- Assessed the accounting principles used and the significant estimates made by management;
- Evaluated the overall presentation of the consolidated principal financial statements;
- Obtained an understanding of internal controls over financial reporting, executing transactions in accordance with budget authority, compliance with laws and regulations, and safeguarding assets;
- Tested and evaluated the design and operating effectiveness of relevant internal controls over significant cycles, classes of transactions, and account balances;
- Tested HUD's compliance with certain provisions of laws and regulations, 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 06-03, including the requirements referred to in the Federal Managers' Financial Integrity Act;
- Considered compliance with the process required by the Federal Managers' Financial Integrity Act for evaluating and reporting on internal control and accounting systems; and
- Performed other procedures we considered necessary in the circumstances.

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

Our consideration of the internal controls over financial reporting would not necessarily disclose all matters in the internal controls over financial reporting that might be reportable conditions. We noted certain matters in the internal control structure and its operation that we consider reportable conditions under OMB Bulletin 06-03. 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.

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.

Our work was performed in accordance with generally accepted *Government Auditing Standards* and OMB Bulletin 06-03.

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

Appendix B

Recommendations

To facilitate tracking recommendations in the Audit Resolution and Corrective Action Tracking System, this appendix lists the newly developed recommendations resulting from our report on HUD'S fiscal year 2006 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 reportable condition that HUD needs to improve the process for reviewing obligation balances, we recommend that the Chief Financial Officer in coordination with the appropriate program offices:

- 1.a. Deobligate all excess unexpended funds identified as a result of the fiscal year 2006 audit of financial statements.
- 1.b. Ensure Section 8 fund overpayments to PBCA's are properly accounted for and returned to HUD and record the total estimated overpayment and interest amounts as an adjustment to program receivables and to miscellaneous receipts, respectively, on the Financial Statements.
- 1.c. Continue the research of Section 236 Interest Reduction Contracts and the reconciliation of contracts with other service providers.
- 1.d. Consider expired budget authority from Section 8 Moderate Rehabilitation contracts when formulating budget requests.

Unimplemented Recommendations from Prior Years' Reports

Not included in the recommendations listed above are recommendations from prior years' reports on the Department's financial statements that have not been fully implemented based on the status reported in the Audit Resolution and Corrective Action Tracking System. The Department should continue to track these under the prior years' report numbers in accordance with departmental procedures. Each of these open recommendations and its status is shown

below. Where appropriate, we have updated the prior recommendations to reflect changes in emphasis resulting from recent work or management decisions.

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

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

- 1.e. Redirect priorities to fully implement the Public Housing Information Center capabilities for tracking and monitoring housing quality inspection deficiencies and IA audit report recommendations. In addition, hold the field office accountable for obtaining current and complete data from the housing authorities and for maintaining current and complete data in the Public Housing Information Center in a timely manner. (Final action target date is December 31, 2006.)

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

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

- 2.f. Make resources available to develop a realistic method to identify tenants/owners who erroneously report income. (Final action target date is November 15, 2006.)

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

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

- 3.a. Initiate corrective action to address the underlying causes for the erroneous payment resulting from billing errors, such as the intermediaries' failure to accurately report or maintain required subsidy determination documentation, and bookkeeping and procedural errors. (Final action target date is October 15, 2007.)
- 3b. Establish controls over the HUD-administered project-based Section 8 payment process at FMC to comply with Title VII of the GAO Policy and Procedures Manual for Guidance of Federal Agencies. (Final action target date is October 15, 2007.)
- 3.c. Establish criteria to enforce the accuracy of the data submitted through TRACS. (Final action target date is November 15, 2006.)

Appendix C

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

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

Federal Financial Management Systems Requirements

1. HUD's annual assurance statement issued pursuant to Section 4 of the Financial Manager's Integrity Act, will report two non-conforming systems⁶.

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	19	0
Office of Chief Financial Officer	14	0
Office of Administration	2	0
Office of Chief Procurement Officer	2	2
Office of Community Planning and Development	2	0
Office of Public and Indian Housing	1	0
Government National Mortgage Association	1	0
	<u>41</u>	<u>2</u>

⁶ The two-nonconforming systems are: A35-HUD Procurement System and P035-Small Purchase System.

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

Office of the Chief Procurement Officer

A35 HUD Procurement Systems (HPS)

P035 Small Purchase System (SPS)

Noncompliance Issue(s)	Tasks/Steps (including Milestones)	Target Dates	Completion Dates
1. HUD's Procurement Systems Do Not Have Adequate Controls for Monitoring the Procurement Process	<p>Intermediate Resolution Plan</p> <p>1A Review transactions of the four contracting officers identified as exceeding their contract authority and take actions as appropriate.</p> <ul style="list-style-type: none"> • Identify and research the transactions in question to determine if the obligations were appropriate or not. • Take appropriate action to resolve issue <p>1B Implement procedural controls to ensure that contracting officers do not exceed their procurement authority. The OCPO will:</p> <ul style="list-style-type: none"> • Develop procurement authority control procedures. • Include validation of contracting officer authority as part of each Procurement Management Review. 	<p>12/1/2006</p> <p>3/31/2007</p> <p>3/31/2007</p> <p>Ongoing</p>	
	<p>1C Remove the ability to obligate funds through the HUD Centralized Accounting and Program System (HUDCAPS) interfaces from all users who have not been specifically granted procurement authority.</p> <p>1D Implement controls to ensure that only users with procurement authority can obligate funds through the HUDCAPS interfaces.</p>	<p>6/30/2007</p> <p>6/30/2007</p>	

	<p>1E Establish procedures to ensure the contracting officers are identified for each electronic record.</p> <ul style="list-style-type: none"> • Develop procedures for electronic records, which are recorded in HPS, to ensure that a Contracting Officer is identified for each record. • Develop quarterly reports to verify that the above procedure is being followed. <p>Implementing system changes will be held pending completion of the cost benefit analysis. OCPO will determine whether to focus resources on fixing the existing system, or replacing the systems.</p>	<p>4/30/2007</p> <p>7/01/2007</p>	
2. HUD Procurement Systems' Separation of Duties Controls Were Bypassed	<p>2A The OCPO will formally appoint separate individuals to act as security administrator and system administrator for each OCPO system and that the individuals will not be performing conflicting duties.</p> <p>2B OCPO management will determine if multiple system profiles are actually a valid requirement on an individual basis in HPS. The goal is to eliminate unnecessary and redundant profiles in HPS and that the individuals will not be performing conflicting duties.</p> <ul style="list-style-type: none"> • Identify users with multiple HPS profiles • Meet with Program Areas • Deactivate unnecessary/redundant profiles 	<p>1/31/2007</p> <p>5/31/2007</p> <p>1/15/2007</p> <p>4/15/2007</p> <p>5/31/2007</p>	
	<p>2B & 2C The OCPO will develop and implement formal procedures for granting access by using the concept of least privilege to OCPO systems, as well as annual user access reviews.</p> <ul style="list-style-type: none"> • Revise system access request forms • Revise process in which user requests system access • Revise procedure in which system access is granted • Develop formal procedure to enforce annual user access review 	<p>4/30/2007</p> <p>1/31/2007</p> <p>2/28/2007</p> <p>3/31/2007</p> <p>4/30/2007</p>	

	<p>2D OCPO management recommends implementing the following tasks to alleviate the routing issue. OCPO will determine if multiple SPS system profiles are actually a valid requirement on an individual basis. The goal is to eliminate all unnecessary and redundant profiles in SPS.</p> <ul style="list-style-type: none"> • Identify users with multiple HPS profiles • Meet with respective procurement areas to define issue and discuss recommended resolution. • Restructure Issuing Office hierarchy to alleviate the necessity of multiple profiles for a given user. <p>Implementing system changes will be held pending completion of the cost benefit analysis. OCPO will determine whether to focus resources on fixing the existing system, or replacing the systems.</p>	<p>6/30/2007</p> <p>2/15/2007</p> <p>5/15/2007</p> <p>6/30/2007</p>	
<p>3. HUD's Procurement Systems Do Not Contain Sufficient Financial Data to Allow It to Effectively Manage and Monitor Procurement Transactions</p>	<p>3A Perform a cost benefit analysis to replace the OCPO systems.</p> <p>3B Implement functionality to ensure that there is sufficient information within HUD's procurement systems to support the primary acquisition functions of fund certification, obligation, deobligation, payment, and closeout. <i>(See long term resolution plan below)</i></p> <p>Implementing system changes will be held pending completion of the cost benefit analysis. OCPO will determine whether to focus resources on fixing the existing system, or replacing the systems.</p>	<p>2/28/2007</p>	
<p>4. The Office of the Chief Procurement Officer Did Not Design or Implement Required Information Security Controls</p>	<p>4A OCPO management will ensure that training or other resources are obtained to develop or perform required managerial, operational, and technical security controls.</p> <ol style="list-style-type: none"> 1. Update Risk Assessments 2. Update Security Plans 3. Update Contingency Plans and tests; 4. Monitoring processes, which include applicable Federal Information Processing Standards (FIPS) Publication 200 managerial, operational, and technical information security controls; and <p>Evaluations of the managerial, operational, and technical security controls.</p>	<p>12/31/2008</p>	

	<p>4B OCPO management will ensure it develops mitigation strategies for the known open information security vulnerabilities.</p> <ul style="list-style-type: none"> • Review vulnerabilities • Develop mitigation strategy <p>4C OCPO management will designate a manager to perform “continuous monitoring” of the office’s information systems security and federal certification and accreditation process</p>	<p>7/31/2007</p> <p>4/30/2008</p> <p>7/31/2008</p> <p>1/15/2007</p>	
	<p>4D OCPO will reevaluate the HUD Procurement System and Small Purchase System application systems’ security categorization in light of Office of Management and Budget guidance on personal identifiable information.</p> <p>4E OCPO will develop a business impact analysis for the procurement systems and revise the contingency plan based on the BIA.</p> <ul style="list-style-type: none"> • Develop business impact analyses • Revise contingency plans • Incorporate BIA into contingency plans <p>Implementing system changes will be held pending completion of the cost benefit analysis. OCPO will determine whether to focus resources on fixing the existing system, or replacing the systems.</p>	<p>4/30/2007</p> <p>9/30/2007</p> <p>4/30/2007</p> <p>7/31/2007</p> <p>9/30/2007</p>	
	<p>LONG-TERM Resolution Plan</p> <p>3B Based on the availability of funds, replace OCPO systems with COTS software to ensure found issues with Internal and Security controls are addressed.</p> <p>MILESTONES – NOT LATER THAN</p> <ul style="list-style-type: none"> • Develop Independent Government Estimate • Conduct Market Research • Source Selection • Implement system 	<p>11/30/2009</p> <p>5/31/2008</p> <p>8/31/2008</p> <p>5/31/2009</p> <p>11/30/2009</p>	

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

<u>Responsible Office</u>	<u>Nature of the Problem</u>
Office of Chief Information Officer	<p>HUD's entity wide security program weaknesses still exist, specifically:</p> <p>Although HUD certified and accredited its general support systems in early fiscal year 2006, many of the security vulnerabilities remain open with no date for resolution.</p> <p>HUD completed certifications and accreditations for all of its major applications in fiscal year 2005. However, the quality of the major applications security document varied by application and when the testing was performed.</p> <p>HUD program officials and system owners have not fully met their responsibilities as specified in section 2544(a) of the Federal Information Security Management Act. In addition, HUD has not fully implemented an agency-wide information system security program as required.</p>

These conditions occurred because HUD accepted the risk associated with the general support systems by allowing known vulnerabilities to remain open under the condition that maintaining the certification was based on progress made toward closing the vulnerabilities. In addition, HUD's management does not consistently enforce policies and procedures.

Office of Chief Procurement Officer	<p>HUD Procurement System (HPS) and HUD Small Purchase System (SPS) do not contained sufficient financial data to effectively manage and monitor procurement transactions. Adequate controls have not been established to ensure that: (1) all parties to an acquisition transaction are identified; (2) users do not exceed their procurement authority; and (3) only users with procurement authority can obligate funds within the system interface with HUD's Central Accounting and Program System (HUDCAPS). Additionally, the Office of the Chief Procurement Officer (OCPO) is bypassing certain built-in separation of duties controls within the HUD Procurement System.</p>
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These conditions occurred because HUD's OCPO has not designed or implemented information security controls or ensured that their information security responsibilities were fulfilled as required by FISMA and HUD's information technology security policies and procedures.

Office of Chief Information Officer	<p>HUD has not implemented sufficient controls over the IBM mainframe z/OS operating system, for example:</p> <p>Physical and logical access security controls over the IBM mainframe operating system z/OS computer consoles at the HUD contractor maintained</p>
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Responsible Office

Nature of the Problem

data center have not been fully implemented.

The most powerful administrative authority was improperly assigned to HUD and contractor personnel who did not have the need for such privileges.

A powerful Top Secret Administrator account with the link to the master control ID and access to all IBM mainframe resources, was assigned to a HUD employee who had left the Department more than a year ago.

IBM operation service disruptions information was not communicated to the program offices in a timely manner.

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

Responsible Office

Nature of the Problem

Office of Chief Information Officer

HUD's configuration management control weaknesses still exist, specifically:

Duties for the administration of HUD's configuration management tools are not properly segregated.

The configuration management function is not adequately supported.

The configuration management procedure's documentation does not clearly specify the roles and responsibilities for personnel supporting the configuration management function.

The weaknesses in the administration of the configuration management tool used for the HPS are as follows: (1) release procedures used are not being performed correctly, (2) administrators on the Unix operating system have inappropriate privileges for the HPS, and (3) the configuration management plan has not been officially approved and included obsolete and incomplete information.

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

Office of Chief Information Officer

Contingency planning and preparedness control weaknesses still exist, specifically:

HUD's information technology contingency planning process does not fully comply with National Institute of Standards and technology Special Publication 800-34.

HUD has no assurance that critical and major applications can be restored within the recovery time objectives of 24 hours for mission critical applications and 48 to 72 hours for major applications

HUD's disaster recovery plans and information technology contingency plans are not updated to reflect current conditions and system enhancements.

These conditions exist because HUD did not complete all the business impact analyses for all major applications, including financial management applications. The risk assessments for major applications, including financial management applications, need to be updated. Moreover, the requirements identified by the business impact analyses and risk assessments were not incorporated in the development of the completed contingency plans and disaster recover plans.

Office of Chief Information Officer

Physical security weaknesses at both the network operations center and the data center still exist, specifically, (1) documentation for the network operations center is out of date, (2) access controls at both computer facilities need to be tightened, and (3) the contractor did not conduct required annual shelter-in-place drills at the data center.

These conditions occurred because both the network operations center and the data center are maintained by two different contractors.

Responsible Office

Nature of the Problem

**Office of Chief
Information Officer**

Personnel security weaknesses still exist, specifically:

HUD has not fully implemented the HUD Online User Registration system or its replacement.

HUD has not developed adequate interim procedures to fully identify and match information on users with access to HUD applications with the database that contains background investigation data for all employees and contractors.

HUD does not routinely conduct quarterly reconciliations to identify users with above read (query) access to HUD mission critical and sensitive systems, who did not have appropriate background checks.

HUD granted some contractors system administrative privileges to sensitive system without proper background investigations.

These conditions occurred because HUD is still in the process of replacing the HUD Online User Registration system with another system targeted for implementation by December 31, 2006. HUD has not provided specific instructions to facilitate the reconciliation process. The Personnel Security Officer was unable to perform regular quarterly reconciliations because the contractor's ADP Security supporting staff did not provide the list of users with above-read access in a compatible data format.

**Office of Housing and
CIO**

FHA was unable to locate all the User Access Request (UAR) forms for both the contractor and HUD employees.

This condition occurred because most of the missing system access request forms were approved prior to the change to the current HUD Information Technology Services (HITS) contractor.

**Office of Housing and
CIO**

FHA Subsidiary Ledger (FHASL) is not managed as a mission critical system at the HITS data center.

This condition occurred because FHASL was not designated a critical system when the contract was awarded. Accordingly, it is not included in the disaster recovery backup plans for mission critical systems covered by the data center contract. FHASL has since been designated a critical system in HUD's Inventory of Automated Systems.

Appendix D

SCHEDULE OF QUESTIONED COSTS AND FUNDS PUT TO BETTER USE

Recommendation Number	Ineligible 1/	Unsupported 2/	Unreasonable or Unnecessary 3/	Funds Put to Better Use 4/
1.a.				\$118.5M
				\$7.9
				21.6M
				\$11.8M
				\$255.0M
1.b.				\$18.0M
1.d.				\$125.5M

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law, contract or federal, state or local polices or regulations.
- 2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity where we cannot determine eligibility at the time of audit. Unsupported costs require a future decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.
- 3/ Unnecessary/Unreasonable costs are those costs not generally recognized as ordinary, prudent, relevant, and or necessary within established practices. Unreasonable costs exceed the costs that would be incurred by a prudent person in conducting a competitive business.
- 4/ Funds Put to Better Use are quantifiable savings that are anticipated to occur if an OIG recommendation is implemented resulting in reduced expenditures in subsequent period for the activities in question. Specifically, this includes costs not incurred, de-obligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings.

Appendix E

Agency Comments



CHIEF FINANCIAL OFFICER

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

November 3, 2006

MEMORANDUM FOR: Randy McGinnis, Director, Financial Audits Division, GAF

FROM: John W. Cox, Chief Financial Officer, F *JWC*

SUBJECT: Management Comments on Draft Report on HUD's
Fiscal Year 2006 Financial Statements – Internal Control
and Compliance Sections

Thank you for the opportunity to comment on the subject draft report's internal control and compliance sections, as requested in your memorandum of October 31, 2006. We are pleased to see the recognition of HUD's continuing progress in strengthening internal controls and financial systems, to address prior year audit issues. For the first time since the Office of Inspector General began conducting financial statement audits under the Chief Financial Officers Act of 1990, the Department has no auditor-reported material weakness issues. We generally agree with the nature of the draft report's findings and recommended corrective actions, with the exception of the content of the draft section on "Compliance with Laws and Regulations" and the proposed presentation of reportable conditions from the FHA financial statement audit. Our request for your reconsideration of those issues is discussed in the Attachment to this memorandum. Additional comments on technical corrections or considerations have been provided to you under separate cover.

As noted in your incoming request for comments, work on the audit continues and further changes to the draft report may be necessary. We request an opportunity to comment on any additional or significantly revised finding issues developed during the remainder of the audit, before your final report is issued.

The President's directed acceleration of the preparation, audit and issuance of Federal agency financial statements within 45 days after the end of the fiscal year remains a significant challenge for the Department and its independent auditors. We anticipate meeting that goal this year and I want to thank you and your audit team for the collaborative manner in which you worked with HUD management and staff towards bringing this annual audit cycle to a successful conclusion. Working together, we continue to improve HUD's financial management operating environment as a foundation for the important mission of the Department. If you have any questions on our comments, please feel free to contact me or Jim Martin, Deputy CFO, on (202) 708-1946.

Attachment

Compliance with Laws and Regulations

The “Compliance with Laws and Regulations” section of the draft report discusses HUD’s compliance in two areas: 1) compliance with the Federal Financial Management Improvement Act (FFMIA) and OMB’s corresponding implementation guidance; and 2) compliance with a provision of HUD’s FY 2003 Appropriations Act (Public Law 108-7) and HUD’s corresponding internal policies and procedures for funds control. We request reconsideration and deletion of both issues from this section, considering the following:

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

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

While we agree our current financial systems configuration could be better integrated to achieve efficiencies and eliminate the need for some compensating controls, the above-required objectives are met with a low risk of a material misstatement of financial information for management decision making and reporting. Therefore, management will continue to report substantial compliance with FFMIA, as we did for the first time in FY 2005. Nevertheless, the objectives of the on-going HUD Integrated Financial Management Improvement Project are to provide a better integrated and more efficient core financial system that will address some of the internal control concerns the draft report raises in the discussion of several of the reportable condition issues.

Compliance with HUD’s Funds Control Plan Requirements – With respect to compliance with the cited provisions of HUD’s FY 2003 Appropriations Act, HUD has provided for an adequate system of accounting for its appropriated and other budgetary resources. Even if HUD were to fail to adhere to its internal policy to document its funds control processes, we do not believe the lack of current documentation alone would warrant reporting in this section of the audit report. While the reportable conditions separately raised by the OIG’s auditors on funds control issues do identify opportunities to improve and strengthen HUD’s funds control processes, the nature of the issues identified do not warrant reporting the current processes as non-compliant with laws or regulations.

In addition to questions on the merits of this issue as a significant compliance matter, we had questions on the scope and actual nature of this issue, as presented in the draft report. The compliance section of the draft report only cites the lack of an updated Funds Control Plan for the Housing Choice Voucher Program, but the "Highlights" section on page number 2 of the draft report also references the lack of an approved Funds Control Plan for FHA as part of this proposed compliance issue. With respect to the Housing Choice Voucher Program, we ask that the auditors revisit that Funds Control Plan because we believe it substantively reflects the current funding process, which is pretty straightforward. With respect to FHA, HUD's CFO provided FHA approval to operate under interim funds control processes, during a major systems modernization effort, on the condition that FHA update and submit funds control plans once the FHA Subsidiary Ledger Project implementation was completed. The new funds control processes have been flowcharted and FHA is in process of completing Funds Control Plans for the new processes under the new system. More relevant is the fact that FHA has an adequate system of funds control that has been accepted by OIG's financial auditors as the basis for eliminating a prior material weakness issue on FHA's funds control and budget execution. In addition, these controls were reviewed and accepted through an independent attestation in support of FHA's assurance statement on internal controls over financial reporting. Under the circumstances, neither program area has an actual funds control deficiency that warrants reporting as non-compliance with laws and regulations.

Consolidation of Reportable Conditions from the FHA Financial Audit

The subject draft report references three reportable conditions from the separate audit of the Federal Housing Administration's (FHA) financial statements in a listing of eight reportable conditions in the "Highlights" section. While we generally agree with those three FHA finding issues, each of those issues is already a subset of an existing reportable condition from the OIG's consolidated financial statement audit work. We therefore request that the three referenced FHA reportable conditions be removed from this listing and appropriately incorporated in the discussion of the corresponding existing reportable conditions from the consolidated audit, to eliminate duplication.

Appendix F

OIG EVALUATION OF AGENCY COMMENTS

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