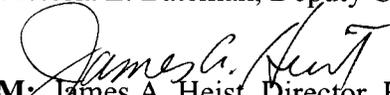




Issue Date	March 1, 2001
Case Number	2001-FO-0003

**TO:** Victoria L. Bateman, Deputy Chief Financial Officer, F

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

**SUBJECT:** Audit of the U.S. Department of Housing and Urban Development (HUD)  
Fiscal Year 2000 Financial Statements

In accordance with the Chief Financial Officers (CFO) Act of 1990, as amended, this report presents the results of our audit of HUD's principal financial statements for the year ended September 30, 2000. Also provided are assessments of HUD's internal controls and compliance with laws and regulations. Our report includes a copy of HUD's principal financial statements. By March 1, 2001, HUD is required to submit the audit report to the Office of Management and Budget (OMB) along with additional required supplementary information, including Management's Discussion and Analysis, Required Supplementary Stewardship Information and information on intra-governmental amounts. Pursuant to the Reports Consolidation Act of 2000 (PL 106-531), HUD is preparing its *Fiscal Year 2000 Performance and Accountability Report*, which will consolidate these and other reports, including HUD's fiscal year 2000 performance report required by the Government Performance and Results Act and a statement prepared by the HUD Inspector General that summarizes what she considers to be the most serious management and performance challenges facing HUD. The *Fiscal Year 2000 Performance and Accountability Report* is to be submitted by HUD to OMB and appropriate committees and subcommittees of the Congress no later than March 29, 2001. We plan to provide an update to our audit report for HUD to include in the *Fiscal Year 2000 Performance and Accountability Report*.

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

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

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**Abbreviations:**

AFS.....	audited financial statements
BOP .....	business and operating plans
CA.....	contact administrator
CFO .....	Chief Financial Officer
CM .....	configuration management
COTS.....	commercial “off-the-shelf”
DEC.....	Departmental Enforcement Center
DMS.....	Data Management System
DSS.....	Decision Support System
FMIA .....	Federal Financial Management Improvement Act
FHA .....	Federal Housing Administration
FISCAM.....	Federal Information Systems Controls Audit Manual
FMC.....	Financial Management Center (Section 8)
FMFIA .....	Federal Managers’ Financial Integrity Act
GAO.....	General Accounting Office
HA.....	housing agency
HAP.....	housing assistance payment
HUD.....	Department of Housing and Urban Development
HUDCAPS.....	HUD’s Central Accounting and Program System
IA.....	independent auditor
IBS.....	Integrated Business System
IDIS .....	Integrated Disbursement and Information System
IRS.....	Internal Revenue Service
IT .....	information technology
JFMIP.....	Joint Financial Management Improvement Program
LOCCS.....	Line of Credit and Control System
MTCS.....	Multifamily Tenant Characteristics System
NAPA.....	National Academy of Public Administration
NIST .....	National Institute of Standards and Technology
OHR.....	Office of Human Resources
OIG.....	Office of Inspector General
OMB .....	Office of Management and Budget
PAS.....	Program Accounting System
PHAS.....	Public Housing Assessment System
PHMAP.....	Public Housing Management Assessment Program
PI.....	physical inspection
PIH.....	Office of Public and Indian Housing
QLP .....	Query Language Processor
REAC .....	Real Estate Assessment Center
REAP .....	Resource Estimation and Allocation Process
REMS .....	Real Estate Management System
SEMAP .....	Section 8 Management Assessment Program
SGL.....	Standard General Ledger (of the United States Government)
SHFA.....	State Housing Finance Agency
SS.....	Social Security
SSI .....	Supplemental Security Income
TARC .....	Troubled Agency Recovery Center
TASS .....	Tenant Assessment SubSystem
TRACS.....	Tenant Rental Assistance Certification System

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# Independent Auditor's Report

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To the Secretary,  
U.S. Department of Housing and Urban Development:

In accordance with the Chief Financial Officers (CFO) Act of 1990, we have audited the accompanying consolidated balance sheet of the Department of Housing and Urban Development (HUD) as of September 30, 2000 and the related consolidated statements of net cost, changes in net position, budgetary resources and financing for the fiscal year then ended. The objective of our audit was to express an opinion on the fair presentation of HUD's fiscal year 2000 principal financial statements. In connection with our audit, we also considered HUD's internal control over financial reporting and tested HUD's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on its principal financial statements.

## Opinion on the Financial Statements

In our opinion, the accompanying principal financial statements present fairly, in all material respects, the financial position of HUD as of September 30, 2000 and the net costs of operations, changes in net position, status of budgetary resources, and reconciliation of net costs to budgetary obligations for the fiscal year then ended, in conformity with generally accepted accounting principles.

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Our audit also disclosed:

- Material weaknesses in internal controls in fiscal year 2000 related to the need to:
  - complete improvements to financial systems;
  - improve oversight and monitoring of housing subsidy determinations;
  - ensure that subsidies are based on correct tenant income; and
  - enhance the Federal Housing Administration's (FHA) information technology systems to more effectively support FHA's business processes.
  
- Reportable conditions in internal controls in fiscal year 2000 related to the need to:
  - refine performance measures to effectively implement results management;
  - improve controls over project-based subsidy payments;
  - strengthen controls over HUD's computing environment;
  - overhaul personnel security for systems' access;
  - address risks with the reliability and security of HUD's critical financial systems;
  - improve processes for reviewing obligation balances;
  - tighten controls over Fund Balance with Treasury reconciliations;
  - enhance the design and operation of controls over FHA's information systems security and application data integrity;
  - continue to place more emphasis on early warning and loss prevention for FHA single family insured mortgages; and
  - sufficiently monitor and account for FHA's single family property inventory.

Most of these control weaknesses were reported in prior efforts to audit HUD's financial statements and represent long-standing problems. In its *Fiscal Year 1999 Accountability Report*, HUD reported that it complied with Section 2 of the Federal Managers' Financial Integrity Act (FMFIA), with the exception of the material weaknesses and nonconformances specifically identified in that report. Section 2 and related guidance require that: (1) an agency's internal accounting and administrative controls provide reasonable assurance that obligations and costs are in compliance with applicable laws; (2) funds, property and assets are adequately safeguarded; and (3) revenues and expenditures are properly and reliably accounted for and reported. HUD was unable to report compliance with Section 4, which requires that accounting systems conform to the accounting principles and standards mandated by the Comptroller General of the United States. For fiscal year 1999 and prior years, we disagreed with the Department's statement of overall assurance in the Department's *Accountability Reports*. HUD's compliance determinations did not fully consider the magnitude of the problems HUD acknowledges in its own FMFIA process. As permitted by the Reports Consolidation Act of 2000 (PL 106-531), HUD did not prepare a separate FMFIA report for fiscal year 2000, but will be addressing those reporting requirements in its *Fiscal Year 2000 Performance and Accountability Report*. Given the magnitude of the problems that still remain, we continue to believe that a FMFIA statement of noncompliance would be appropriate for HUD.

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

- HUD did not substantially comply with the Federal Financial Management Improvement Act (FFMIA). In this regard, HUD's financial management systems did not substantially comply with (1) Federal Financial Management Systems Requirements or (2) the U.S. Standard General Ledger (SGL) at the transaction level.
- HUD did not comply with the United States Housing Act of 1937, as amended by the Quality Housing and Work Responsibility Act of 1998. Specifically, HUD is not timely or properly enforcing the act's requirements for the timely expenditure and obligation by housing agencies (HA) of public housing modernization funds. As discussed later, HUD disagrees with our conclusion and we have referred the matter to the Comptroller General of the United States.
- Certain FHA contract obligations are allocated between FHA's program and liquidating funds based on the nature of the services to be provided. Limits have been set by appropriation law regarding the amount of administrative costs that may be charged to FHA's program accounts. The allocation methodology that FHA has currently applied for certain contracts may require refinement, to better reflect the relationship of the services to specific programs. Such re-allocation of obligations between funds would require additional analysis to determine if the re-allocation would result in a matter of noncompliance with the Anti-Deficiency Act, as of September 30, 2000, relating to FHA's Mutual Mortgage Insurance program account.

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Consolidating Financial Information

We conducted our audit for the purpose of forming an opinion on the consolidated principal financial statements taken as a whole. HUD plans to present a consolidating balance sheet, and consolidating statements of changes in net position, budgetary resources and financing as supplementary information in its *Fiscal Year 2000 Performance and Accountability Report*. The consolidating financial information is to be presented for purposes of additional analysis of the financial statements rather than to present the financial position, changes in net position, status of budgetary resources and reconciliation of net costs to budgetary obligations of HUD's major activities. The consolidating financial information is not a required part of the consolidated principal financial statements. The consolidating financial information has been subjected to

the auditing procedures applied in the consolidated principal financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole.

#### Required Supplementary Information

In its *Fiscal Year 2000 Performance and Accountability Report*, HUD plans to present “Required Supplemental Stewardship Information,” specifically, information on investments in non-federal physical property and human capital. In addition, HUD plans to present a “Management’s Discussion and Analysis” and information on intra-governmental amounts. This information is not a required part of the basic financial statements but is supplementary information required by the Federal Accounting Standards Advisory Board or Office of Management and Budget (OMB) Bulletin 97-01, *Form and Content of Agency Financial Statements*, as amended. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our performance of limited procedures raised doubts that we were unable to resolve regarding whether material modifications should be made to the required supplementary information relating to intra-governmental transactions to conform to guidelines required by OMB Bulletin No. 97-01. HUD requested and received a listing of all intra-governmental transactions from the U.S. Department of Treasury. However, HUD made no attempt to send confirmations to enable the reconciliation of these transactions as required by January 7, 2000 technical amendments to OMB Bulletin 97-01.

The following contents of this summary letter, as well as the detailed sections of this report that follow, elaborate on: (1) the serious problems with HUD’s internal controls and (2) instances where HUD had not complied with applicable laws and regulations.

#### Issues with HUD’s Internal Control Environment

Most of the material weaknesses and reportable conditions discussed in this report relate to issues discussed in prior years’ reports on HUD’s financial statements. HUD has been taking actions to address the weaknesses and in some instances has made progress in correcting them. For the most part, however, progress has been at a slow pace in large part because HUD needs to address issues that fundamentally impact its internal control environment. These issues are Department-wide in scope and must be addressed for HUD to more effectively manage its programs. The General Accounting Office (GAO) recently issued a January 2001 update to their *Performance and Accountability Series: Major Management Challenges and Program Risks* for HUD and, as we have reported for the past several years, concluded that HUD needs to:

- deploy a reliable financial management system that meets its program and financial management needs and complies with federal requirements, and

- continue to develop a process to identify and justify its staff resource requirements.

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

In addition to improving its financial systems, HUD will need to successfully complete and take advantage of organizational changes that have taken place during the past few years and more effectively manage its limited staff resources. Many of the weaknesses discussed in this report, particularly those concerning HUD's oversight of program recipients, are exacerbated by HUD's resource management shortcomings. Accordingly, we consider it critical for the Department to address these shortcomings through the successful completion of ongoing plans.

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

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## Housing Assistance Program Delivery

HUD provides housing assistance funds under various grant and subsidy programs to multifamily project owners (both nonprofits and for profit) and HAS. These intermediaries, in-turn, provide housing assistance to benefit primarily low income households. HUD spent about \$19 billion in fiscal year 2000 to provide rent and operating subsidies that benefited over 4 million households. Weaknesses exist in HUD's control structure such that HUD cannot be assured that these funds are expended in accordance with the laws and regulations authorizing the grant and subsidy programs.

Legislation authorizing HUD's housing assistance programs includes specific criteria concerning tenant eligibility and providing assistance for housing that meets acceptable physical standards. Moreover, legislation authorizing HUD's programs also establishes minimum performance levels to be achieved. For example, subsidized housing must comply with HUD's housing quality standards.

HUD places substantial reliance upon intermediaries to ensure that rent calculations for assisted households are based on HUD requirements. Ultimately, these rent calculations determine the amount of subsidy HUD pays on behalf of the assisted household. Under project-based programs administered by the Office of Housing, this responsibility is carried out by

the individual project owners or agents. Under public housing and tenant-based Section 8 programs, the HAS determine eligibility and rent for eligible households residing in public housing or at approved housing provided by private landlords. In prior reports on HUD's financial statements, we have expressed concerns about the significant risk to HUD that these intermediaries are not properly carrying out this responsibility. HUD's control structure does not adequately address this risk due to insufficient on-site monitoring along with the absence of an on-going quality control program that would periodically assess the accuracy of intermediaries' rent determinations.

A recently completed contracted study of rent determinations under HUD's major housing assistance programs estimates that errors made by project owners and HAS resulted in substantial subsidy overpayments and underpayments. The purpose of the study was to provide national estimates of the extent, severity, costs, and sources of errors occurring in the certification and recertification procedures used by HAS and owners in calculating tenant rents. The study projected that annually, about \$1.9 billion in subsidies was overpaid on behalf of households paying too little rent and about \$0.7 billion in subsidies was underpaid on behalf of households paying too much rent based on HUD requirements.

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## Verification of Subsidy Payments

As discussed above, HUD provides rent and operating subsidies through a variety of programs, including public housing and Section 8. The admission of a household to these rental assistance programs and the size of the subsidy it receives depend directly on its self-reported income. HUD performed computer income matching with its assisted housing universe and estimated that housing subsidy overpayments from tenants misreporting their income totaled \$617 million during calendar year 1999. Tenants often do not report income or under report income which, if not detected, causes HUD to make excessive subsidy payments. Tenant income is a major factor affecting eligibility for, and the amount of, housing assistance a family receives, and indirectly, the amount of subsidy HUD pays. Generally, HUD's subsidy payment makes up the difference between 30 percent of a household's adjusted income and the housing unit's actual rent or, under the Section 8 voucher program, a payment standard

HUD has developed a nationwide estimate of the amount of excess rental subsidies paid during calendar year 1999. As we describe later in this report, various efforts are planned and underway to build upon this and address the need to institute an ongoing quality assurance program to improve controls over these payments. This includes a large scale income tax data matching project. To ensure that these projects are effective, HUD has taken action to improve the accuracy of and enforce requirements for HAS to timely update information in its tenant databases.

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## System and Accounting Issues

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

- controls over the computing environment;
- administration of personnel security operations; and
- reliability and security of critical financial systems.

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

- Specific statutory or grant requirements for outstanding obligations are not being enforced.
- A lack of integration between accounting systems and the need for accurate databases has hampered HUD's ability to evaluate unexpended Section 8 obligations.

Finally, we discuss the need for the CFO to tighten controls over Fund Balance with Treasury reconciliations.

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## Results of the Audit of FHA's Financial Statements

A separate audit was performed of FHA's fiscal year 2000 financial statements by the independent certified public accounting firm of KPMG LLP. Their report on FHA's financial statements, dated February 28, 2001,<sup>1</sup> includes an unqualified opinion on FHA's financial statements, along with discussions of a material weaknesses and three reportable conditions. The FHA material weaknesses is as follows:

- ***FHA's information technology systems must be enhanced to more effectively support FHA's business processes.*** HUD and FHA are conducting day-to-day business with legacy based systems, several of which directly impact FHA's financial activity and necessitate financial transactions to be processed through non-integrated

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<sup>1</sup> KPMG LLP's report on FHA was incorporated in our report entitled, "Federal Housing Administration, Audit of Fiscal Year 2000 Financial Statements" (2001-FO-0002, dated March 1, 2001).

systems, requiring manual analysis and summary entries to be posted to FHA's general ledger. FHA's and HUD's inability to implement modern information technology adversely affects the internal controls related to accounting and reporting financial activities.

KPMG LLP also notes three reportable conditions regarding the need for FHA and HUD to: (1) enhance the design and operation of controls over information systems security and application data integrity, (2) continue to place more emphasis on early warning and loss prevention for single family insured mortgages, and (3) sufficiently monitor and account for its single family property inventory.

KPMG LLP also notes a potential matter of noncompliance with the Anti-Deficiency Act. This relates to certain contract obligations that were allocated between FHA's program and liquidating funds.

We consider the above issues to be a material weaknesses, reportable conditions and material noncompliance at the Departmental level. A more detailed discussion of these issues is not included in our report, but can be found in KPMG LLP's report on FHA's fiscal year 2000 financial statements.

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## Results of the Audit of Ginnie Mae's Financial Statements

A separate audit was performed of the Government National Mortgage Association's (Ginnie Mae) fiscal year 2000 financial statements by KPMG LLP. Their report on Ginnie Mae's financial statements, dated December 29, 2000,<sup>2</sup> includes an unqualified opinion on Ginnie Mae's financial statements. In addition, the audit results indicate that there were no material weaknesses or reportable conditions with Ginnie Mae's internal controls, or material instances of non-compliance with laws and regulations.

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## HUD Has Made Progress in Addressing Management Deficiencies, but Much Remains to be Completed

Most of the issues described in this report represent long-standing weaknesses that will be difficult to resolve. HUD's management deficiencies have received much attention in recent years. For example, in January 1994, GAO designated HUD as a high risk area, the first time such a designation was given to a cabinet level agency. Since that time, HUD has devoted considerable attention and priority to addressing the Department's management deficiencies, and has made some progress. In their January 2001 update, GAO redefined and reduced the number of programs deemed to be high-risk. Specifically, because of the actions taken by HUD in response to GAO's recommendations to improve its management controls over its Community Planning and Development programs, GAO concluded that this program area no longer is at high risk. However, GAO concluded that significant weaknesses still persist in two of HUD's major program areas which remain at high-

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<sup>2</sup> KPMG LLP's report on Ginnie Mae was incorporated in our report entitled, "Government National Mortgage Association, Audit of Fiscal Year 2000 Financial Statements" (01-FO-177-0001, dated February 20, 2001).

risk, single-family mortgage insurance and rental housing assistance. In addition, HUD needs to continue addressing management challenges in two other areas, information and financial management systems and human capital.

With respect to fiscal year 1999, we were unable to conclude that HUD's consolidated financial statements were reliable in all material respects. HUD has successfully addressed issues associated with a major systems conversion effort that caused us to disclaim an opinion on those financial statements. Therefore, our ability to conclude that HUD's fiscal year 2000 financial statements were reliable is noteworthy. However, because of continued weaknesses in HUD's internal controls and financial management systems, HUD continues to rely on extensive ad hoc analyses and special projects to develop account balances and necessary disclosures.

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

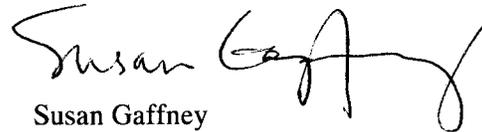
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## Agency Comments and Our Evaluation

On February 2, 2001, we provided a draft of the internal control and compliance sections of our report to the Deputy CFO and appropriate assistant secretaries and other Departmental officials for review and comment, and requested that the CFO coordinate a Department-wide response. The Deputy CFO responded in a memorandum dated February 16, 2001, which is included in its entirety as Appendix D. Remaining sections of the draft report were provided on February 20, 2001. The Department generally agreed with our presentation of findings and recommendations subject to detailed comments included in the memorandum and attachments. The Department's response was considered in preparing the final version of this report. Our detailed evaluation of the response is included in Appendix E.

In its memorandum, the Department requested that we revise our conclusions regarding HUD's "core financial system," which is part of our material weakness relating to the need to "complete improvements to financial systems." The Department asserted that the "core" component is substantially compliant. We disagree, and have provided a detailed discussion of our reasons in Appendix E. The Department also asked that we combine two material weaknesses relating to the need to "improve oversight and monitoring of housing subsidy determinations" and "ensure that subsidies are based on correct tenant income." As we explain in Appendix E, while the matters are interrelated, in our judgment, it is appropriate to classify them separately.

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



Susan Gaffney  
Inspector General

February 28, 2001

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## HUD's Internal Control Environment

### HUD Continues to be Impacted by Weaknesses in the Control Environment

Most of the material weaknesses and reportable conditions discussed in this report relate to issues discussed in prior years' reports on HUD's financial statements. HUD has been taking actions to address the weaknesses and in some instances has made progress in correcting them. For the most part, however, progress has been at a slow pace in large part because HUD needs to address issues that fundamentally impact its internal control environment. These issues are Department-wide in scope and must be addressed for HUD to more effectively manage its programs. GAO recently issued a January 2001 update to their *Performance and Accountability Series: Major Management Challenges and Program Risks* and as we have reported for the past several years, concluded that HUD needs to:

- deploy a reliable financial management system that meets its program and financial management needs and complies with federal requirements, and
- continue to develop a process to identify and justify its staff resource requirements.

#### Financial Systems

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

#### Resource Management

In addition to improving its financial systems, HUD will need to successfully complete and take advantage of organization changes that have taken place during the past few years and more effectively manage its limited staff resources. Many of the weaknesses discussed in this report, particularly those concerning HUD's oversight of program recipients, are exacerbated by HUD's resource management shortcomings. Accordingly, we consider it critical for the Department to address these shortcomings through the successful completion of ongoing plans. However, we have not categorized resource management as a separate internal control reportable condition because the effect on HUD's financial statements can be appropriately characterized as a

contributing cause for internal control weaknesses described in other sections of our report.

To operate properly and hold individuals responsible for performance, HUD needs to know that it has the right number of staff with the proper skills. Our office and the National Academy of Public Administration (NAPA) recommended that HUD develop a resource management system to align resources with program needs. In 1997, HUD announced plans to implement a resource estimation process that “would be a disciplined and analytical approach, to identify, justify, and integrate resource requirements and budget allocations.” HUD worked with NAPA to develop a methodology for resource estimation and allocation. NAPA’s methodology was tested and refined in several HUD offices.

As we reported last year, HUD began implementing a new Department-wide resource system, known as the Resource Estimation and Allocation Process (REAP). During fiscal year 2000, however, plans were still not progressing with the urgency one would expect for a priority status project. The implementation experienced inadequate funding with only a portion of the implementing contract funded in fiscal year 2000. In response to our concerns expressed in a September 2000 report<sup>3</sup>, the former Deputy Secretary affirmed the previous administration’s commitment to the REAP project by fully funding the contract. The estimated completion date for REAP is now December 2001.

#### Other control environment issues

In addition to system and resource management issues, in prior years, we reported on other issues that HUD needed to address that we believed impacted its ability to effectively manage its programs. We are able to report some progress. For example, HUD has continued to improve the operation of its management control program. This issue is no longer reported as a reportable condition and remaining issues will be communicated separately. Another reportable condition relating to performance measurement, while still present, has improved in some program areas. Presented below is a discussion of the remaining material weakness and reportable condition relating to the Department’s control environment.

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#### **Material Weakness:** HUD’s Financial Systems are Not Fully Compliant with Federal Financial System Standards

Federal agencies’ financial management systems must comply with OMB Circular A-127, *Financial Management Systems* and the Joint Financial Management Improvement Program’s (JFMIP) financial system requirements. These criteria require agencies to record and classify their transactions in accordance with the SGL. They also require the core financial management system be integrated with other agency systems

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<sup>3</sup> “Progress Assessment - Implementing the Resource Estimation and Allocation Process,” (00-PH-169-0802, dated September 29, 2000).

(financial, program, or a mixture of both) so transactions are entered only once and thereafter can be electronically updated in the core system or via automated interfaces with the supporting financial and management systems.

The components of the integrated financial management system which should be electronically linked include:

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

The Department's financial management system, including its core financial system, do not fully comply with federal financial system requirements. In addition, weaknesses remain in the supporting financial systems and delays in integrating the financial systems continue. Although some improvements were made, management's plans for additional improvements are not clear and have not been supported by adequate analyses. The following financial management system deficiencies, which were reported in last year's report, were present during fiscal year 2000:

- Several interfaces, such as that with the FHA's subsidiary ledger, to the core financial system's general ledger are either not automated or require manual analyses, reprocessing and additional entries.
- Deficient FHA general ledger and subsidiary systems.
- Inability to support adequate funds control for FHA. FHA has developed a short-term solution for funds control, however, this is largely a manual process, with a number of steps which entail hand carrying documents. The systems solution still remains unresolved.
- Inadequate assurance about the propriety of Section 8 rental assistance payments (see report sections beginning with "Controls Over Project-Based Subsidy Payments Need to be Improved").

- Inability to fully support the timely identification of excess funds remaining on expired project-based Section 8 contracts (see report section “HUD Needs to Develop an Accurate Database for Evaluating Section 8 Obligations”).

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

Important interfaces with the core financial system’s general ledger are not automated

For fiscal year 1999, the FHA general ledger account balances were transferred only once to the Department’s general ledger and that was after year-end. JFMIP requires that the core financial system “...provide for automated month-and year-end closing of SGL accounts and rollover of the SGL account balances.” For fiscal year 2000, the Department’s goal was to transfer the FHA accounts on a quarterly basis; however, the prior year adjustments and the two quarters through March 31 were not transferred (uploaded) to the Department’s general ledger until August 8. The third and fourth quarters were not uploaded until 60 and 43 days after the end of the respective quarters. The interface with the FHA system has not improved from last year and still requires the same numerous manual processing steps to transfer the account balances.

During fiscal year 1999, the Department switched the consolidated general ledger from the Program Accounting System (PAS) to HUD’s Central Accounting and Program System (HUDCAPS). Last year, we reported several problems with the automated interface which transferred the PAS transactions to HUDCAPS. The Department has improved the processing and its timeliness of this interface for fiscal year 2000, however, as we identified in a separate audit<sup>4</sup> of HUDCAPS it has not eliminated the need for analyzing and processing rejected transactions and suspense items. Rejected transactions held in the suspense file were not timely reconciled during the year with the original source of the transactions and the processed transactions. This reconciliation is necessary to ensure that all rejected transactions are timely resolved and that all valid transactions have been recorded.

Weaknesses still remain in the core system’s general ledger

OMB Circular A-127 requires that financial reports be derived directly from the general ledger accounts. The SF-224 financial report (showing monthly disbursements and collections) submitted to the U. S. Treasury was not derived directly from the general ledger accounts but was based upon manually entered data on a separate personal computer database system (DBASE III). When the source financial data is separated from the direct general ledger system data, the assurance that the information fairly represents the actual transaction data becomes more difficult.

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<sup>4</sup> “Audit of HUD’s Accounting and Program System,” (2001-DP-0002, dated February 27, 2001).

FHA/Office of Housing's plans for financial system improvements lacked the prerequisite SDM evaluations

As we previously reported, the FHA accounting system needs substantial improvements to be compliant with JFMIP requirements. Its 19 subsidiary systems that feed transactions to its commercial general ledger system lack the capability to process transactions in the SGL format and provide required credit reform data (accounts identified by the cohort year of loan or guarantee commitment and program risk category). Several manual processing steps, including the use of personal computer based software, have to be used to add credit reform data, convert the commercial account balances to government SGL, and transfer the resulting account balances to HUDCAPS. During fiscal year 2000, FHA purchased a JFMIP compliant commercial "off-the-shelf" (COTS) SGL financial system to replace the current system and possibly an interim financial data warehouse. The warehouse will be used to convert the subsidiary system transactions to the SGL and credit reform basis prior to transfer to the FHA COTS system. FHA intends to implement the warehouse and COTS systems during fiscal year 2002. Long range plans on how and which subsidiary systems can be made compliant by either enhancing them, replacing them with the COTS system, or retaining them for use with the warehouse conversion system are not clearly established.

FHA's purchase of the COTS system was to follow the Department's "System Development Methodology" (SDM), which required the completion of a feasibility study, a cost/benefit analysis and a risk analysis prior to the purchase. However, FHA did not adequately complete these studies and, as a result, cannot be assured that the system selected will effectively or efficiently meet its objectives.

The Department's plans for improving its core financial system continue to suffer from strategy changes

For the last two years, we reported that frequent financial system project and strategy changes have resulted in schedule delays and cost overruns. After spending more than \$206 million over 8 years, HUD continues to rely on legacy systems. The financial system improvement plans for the Department are undergoing another change. Instead of completing the original plan of consolidating four general ledger systems into the core financial system, HUDCAPS, the CFO's Office again shifted direction. In August, the Deputy CFO prepared a vision statement for the Department's financial management systems that are to be implemented over three phases. The first phase involves installing a new COTS package as the consolidated general ledger, replacing the HUDCAPS consolidated general ledger. In the second phase, the COTS functionality eliminates the PAS system and directly accepts the FHA balances from the FHA purchased COTS package. In the third phase, the remaining HUDCAPS system functionality (for tenant-based Section 8 rent subsidy payments) and the Line of Credit and Control System (LOCCS) are to be replaced by the COTS system.

It is clear that the vision statement indicates HUDCAPS would be replaced, even though the Department formally decided to use HUDCAPS as its core financial system as recently as January 1998. More than \$55 million

has been invested on development and enhancements through fiscal year 2000. This decision was made without the required supporting HUD's SDM studies. As we recommended in an audit memorandum<sup>5</sup> regarding FHA's COTS purchase, any plan to replace HUDCAPS should be supported by thorough feasibility, cost/benefit and risk studies. The vision statement is also questionable because project-based Section 8 rent subsidy payments, which for this period were scheduled to be included under the HUDCAPS payment and general ledger, were instead placed under the LOCCS/PAS systems. Although PAS is scheduled for elimination prior to HUDCAPS, the CFO believed that the modification required to handle these subsidies, 25 percent of which are to be offset with Section 202 property loan repayments, could be accomplished quicker under the LOCCS/PAS system.

During the reporting period, the CFO discontinued the "Financial System Integration" project as a separate Departmental budget initiative. Sponsorship and development of the executive information system (data warehouse) and departmental grants management system have been transferred to the Office of the Chief Information Officer (CIO). The Department's development efforts of both projects initially failed and current progress toward development is negligible.

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

OMB Bulletin 97-01, *Form and Content of Agency Financial Statements*, requires agencies to report performance measures about the efficiency and effectiveness of their programs. In prior years, we reported that HUD's *Accountability Report* and prior annual reports emphasized financial and non-financial operating results as input or simple output measures and lacked meaningful performance information. We noted progress during fiscal year 2000, principally with the Department's ability to report the results of physical inspections of public and assisted housing projects. We noted continued concerns, however, with the following key program areas, that HUD is continuing to address in some manner:

- CPD designed the Integrated Disbursement and Information System (IDIS) to provide field staff with real-time performance data to assist monitoring efforts and ensure grantee compliance with program requirements. However, IDIS experienced reporting problems and the last grantee was not converted to the system until the end of fiscal year 2000. This fact, along with a regulation which only requires grantees to report performance on an annual basis, has delayed full realization of the purposes for which the system was designed. This resulted in CPD estimating some of its performance

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<sup>5</sup> "Department's September 2000 Purchase of COTS Financial Management System" (00-DP-166-0804, dated September 29, 2000).

information from old data. In addition, IDIS is currently undergoing a significant data cleanup effort. The objective of this effort is to cleanup data that is currently in IDIS and maintain system data at a high quality level. In addition, the Homeless program, which did not derive its data from IDIS, used grant applications to estimate some of their performance data. The Homeless program is requiring that grantees report actual data in future annual progress reports.

- Previously, we reported concerns about HUD's controls over the reliability of performance data as well as the adequacy of component factors to objectively determine HA performance, from the Public Housing Management Assessment Program (PHMAP). PHMAP is being replaced by the Public Housing Assessment System (PHAS). During fiscal year 2000, the Real Estate Assessment Center (REAC) began compiling and reporting the results of physical inspections of public housing agencies using PHAS. However, these scores were only advisory and results were generally not used by field offices or Troubled Agency Recovery Centers (TARC) in their monitoring programs. Official PHAS scores are scheduled to be issued during fiscal year 2001.
- The Departmental Enforcement Center (DEC) began reporting performance information in the fiscal year 1999 Accountability Report. The information included statistics on various enforcement activities completed along with monetary recoveries. We noted that the underlying source systems were in various stages of completion and none were operational. An OIG report<sup>6</sup> recommended the DEC develop a HUD wide tracking system to track enforcement actions. The DEC has made progress in developing a tracking system and has implemented a system that produced initial reports in December 2000. However, the system was not yet capturing information on all enforcement actions. Because the DEC did not have a fully operational tracking system, information to be presented in the *Fiscal Year 2000 Performance and Accountability Report* came from various sources including manual records which are less reliable than a centralized system with good internal controls.

In prior years, we reported our concerns over performance measure data reliability and the Department's plans to remedy the concern with a program requirement to submit quality assurance plans to the CFO for review and approval. We performed a review of the reliability of data presented in HUD's fiscal year 1999 Annual Performance Report and found a number of performance indicators with questionable data quality. Data quality has become the responsibility of the CIO. The CIO required

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<sup>6</sup> "Nationwide Audit, Enforcement Center," (00-NY-177-0001, dated March 28, 2000)

that quality assurance plans for the first four systems be submitted for review by September 30, 2000. Plans for other systems are to be submitted gradually during fiscal year 2001.

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## Housing Assistance Program Delivery

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### Monitoring and Payment Processing Weaknesses Continue

HUD provides housing assistance funds under various grant and subsidy programs to multifamily project owners (both nonprofits and for profit) and HAS. These intermediaries, in-turn, provide housing assistance to benefit primarily low income households. HUD spent about \$19 billion in fiscal year 2000 to provide rent and operating subsidies that benefited over 4 million households. Weaknesses exist in HUD's control structure such that HUD cannot be assured that these funds are expended in accordance with the laws and regulations authorizing the grant and subsidy programs.

The Office of Public and Indian Housing (PIH) provides funding for rent subsidies through its public housing operating subsidies and tenant-based Section 8 rental assistance programs. These programs are administered by HAS who are to provide housing to low income families or make assistance payments to private owners who lease their rental units to assisted families.

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

Legislation authorizing HUD's housing assistance programs includes specific criteria concerning tenant eligibility and providing assistance for housing that meets acceptable physical standards. Moreover, legislation authorizing HUD's programs also establishes minimum performance levels to be achieved. For example, subsidized housing must comply with HUD's housing quality standards.

In prior reports on HUD's financial statements, we reported weaknesses with the monitoring of HAS and multifamily projects. In our current report, we have refocused the discussion to emphasize the impact that these monitoring weaknesses have on HUD's ability to ensure that

housing subsidies are being correctly calculated by HUD's intermediaries based on HUD requirements. The material weakness discussed below encompasses public housing and tenant-based Section 8 programs administered by PIH along with project based subsidy programs administered by the Office of Housing. In addition, we continue to report on a separate reportable condition relating to the project based subsidy payment process.

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**Material Weakness:  
Improvements Needed in  
Oversight and Monitoring of  
Subsidy Determinations**

HUD places substantial reliance upon intermediaries to ensure that rent calculations for assisted households are based on HUD requirements. Ultimately, these rent calculations determine the amount of subsidy HUD pays on behalf of the assisted household. Under project-based programs administered by the Office of Housing, this responsibility is carried out by the individual project owners or agents. Under public housing and tenant based Section 8 programs, the HAS determine eligibility and rent for eligible households residing in public housing or at approved housing provided by private landlords. In prior reports on HUD's financial statements, we have expressed concerns about the significant risk to HUD that these intermediaries are not properly carrying out this responsibility. HUD's control structure does not adequately address this risk due to insufficient on-site monitoring along with the absence of an on-going quality control program that would periodically assess the accuracy of intermediaries' rent determinations. Until recently, the last such study was completed in 1996, based on data collected in 1992.

Subsidy payment errors are substantial

A recently completed contracted study<sup>7</sup> of rent determinations under HUD's major housing assistance programs estimates that errors made by project owners and HAS resulted in substantial subsidy overpayments and underpayments. The purpose of the study was to provide national estimates of the extent, severity, costs, and sources of errors occurring in the certification and recertification procedures used by HAS and owners in calculating tenant rents. Based on analyses of a statistical sample of tenant files, tenant interviews, and income verification data, the study concluded that on a monthly basis:

- 36 percent of all households paid at least \$5 less rent than they should (with an average error of \$105).
- 40 percent of all households paid the correct amount of rent within \$5 (29 percent paid exactly the right amount).

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<sup>7</sup> "Quality Control for Rental Assistance Subsidies Determinations, Interim Final Report," dated November 29, 2000. The study was commissioned by HUD's Office of Policy Development and Research.

- 24 percent of all households paid at least \$5 more rent than they should have (with an average error of \$56).

As pointed out in the study, HUD subsidies for public housing and Section 8 programs equal the allowed expense level or payment standard minus the household's rent, meaning that rent errors have a dollar-for-dollar correspondence with subsidy payment errors. The study projected that annually, about \$1.9 billion in subsidies was overpaid on behalf of households paying too little rent and about \$0.7 billion in subsidies was underpaid on behalf of households paying too much rent based on HUD requirements (see Note 17 to the financial statements).

The impact of payment errors of this magnitude takes on added significance in light of HUD's estimate, as reported recently,<sup>8</sup> that 4.9 million households have "worst case housing needs." This relates to the number of unassisted very-low-income renters who pay more than half of their income for housing or live in severely substandard housing. By overpaying subsidy, HUD is able to serve fewer families who may be eligible but unable to participate because of limited funding. Moreover, in the President's fiscal year 2001 budget, a government wide "Priority Management Objective" was presented to *verify that the right person is getting the right benefit*. To that end, OMB has issued draft guidance to agencies that, if implemented, are to require agencies to estimate the extent of and minimize improper payments.

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Continued Efforts Needed to  
Improve Housing Agency  
Monitoring

HUD provides grants and subsidies to approximately 4,200<sup>9</sup> HAS nationwide. About 3,200 HAS manage public housing units and another 1,000 HAS, with no public housing, manage units under the Section 8 programs. (Many HAS administer both public housing and Section 8 programs). In prior years, we reported that HUD's control structure did not provide reasonable assurance that these funds were expended in compliance with the laws and regulations authorizing these programs. In fiscal year 2000, problems remain which we believe HUD needs to address to provide assurance that HAS provide the correct amount of subsidies for safe, decent, and sanitary housing and protect the federal investment in their properties. Our most significant concern relates to payments made by HUD, through its operating subsidies and Section 8 rental assistance programs, to assist HAS in providing affordable housing that meets HUD's eligibility requirements and housing quality standards to

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<sup>8</sup> "A Report on Worst Case Housing Needs in 1999: New Opportunity Amid Continuing Challenges," dated January 2001.

<sup>9</sup> This number excludes tribally designated housing entities managing housing units under the Native American Housing Assistance and Self Determination Act.

Improved risk evaluation and monitoring of housing authorities needed

house eligible low income households. Our specific concerns, and the efforts to address them, are discussed below.

During fiscal year 2000, HUD continued to implement its performance oriented, risk based strategy for carrying out its HA oversight responsibilities. As we noted in previous years, further improvements in the field offices' monitoring of its HAs need to be made in key monitoring areas such as HA risk assessments, use of independent auditor (IA) reports, implementation and use of available management assessment data—PHAS and the Section 8 Management Assessment Program (SEMAP), and performance of on-site and remote monitoring activities. For fiscal year 2000, field offices were to continue performing risk assessments of all HAs within their jurisdictions by primarily considering HA performance and compliance data, and develop plans to monitor and/or provide technical assistance to those HAs determined to be in the greatest need of attention. As in prior years, the HAs' PHMAP performance certifications, and IAs' compliance reviews were key components of HUD's risk based monitoring strategy for assessing HAs' performance in administering their low income (public housing) programs. Similarly, HUD's risk based monitoring strategy for assessing HAs' Section 8 tenant-based programs continued to rely on information related to HA capacity, program complexity, and the results of past management reviews.

In our testing of four field offices' risk assessments and monitoring of HAs' low income and Section 8 tenant-based programs, we found a number of key monitoring deficiencies still exist that need to be improved to ensure HA monitoring is more effective. For example, even though all four field offices completed formal risk assessments on all HAs who administer a low income program, three of the offices did not always use the results to target high risk HAs for on-site monitoring. Additionally, only two of the four field offices we reviewed used the formal risk assessments they completed for monitoring their Section 8 HA portfolio.

On-site monitoring of HAs is a key component in HUD's monitoring program. HUD performs targeted on-site reviews to evaluate and assist HAs in improving their housing operations. In fiscal year 2000, HUD performed a limited number of on-site reviews. For the four offices we reviewed, field office staff completed 38 low income and 36 Section 8 on-site reviews from those offices' 444 HA portfolio. However, based on the results from the recent report on rental subsidy determinations mentioned earlier, the level of HA monitoring has not been sufficient. Furthermore, additional administrative and legislative delays prevented the PHAS and SEMAP HA assessment programs from being fully implemented. As such, we continue to have concerns regarding the reliability of the performance and compliance data used by HUD's field offices to evaluate HA operations.

Until PHAS, which provides for independent on-site physical inspections of the HAS' low income housing stock, is fully implemented and the inspection results are used by all the field offices to help improve HA operations, its usefulness as an effective monitoring tool for improving HA performance will be limited. Similarly, when implemented, SEMAP should provide the field offices with pertinent data, such as proper selection of applicants, rents, payment standards, and housing quality, that will assist field office staff in making sound decisions in helping to improve HAS with Section 8 tenant based programs.

PIH monitoring systems are not fully utilized

The PIH Information Center<sup>10</sup> (PIC), which replaces PIH's integrated Business System (IBS), supports the management of PIH programs by tracking information critical to PIH business processes. The system is used by HUD staff to track data that can be analyzed to determine and improve HA performance. At the four field offices we tested, current and complete information was not always obtained from the HAS and entered into PIH's IBS/PIC system. We also noted that the PIC was implemented prior to the development of some of its' data management features and the PIC's capabilities were not always available to all the field offices. For instance, PIC currently has a limited capability to track and monitor IA audit findings. HUD plans to incorporate an audit tracking module similar to that of the IBS, but not until the later half of fiscal year 2001, if funding is available. The audit tracking module automates the field offices' ability to track and monitor IA audit findings. The IBS had this capability, plus it was able to track and monitor GAO and OIG audit findings, something the PIC audit tracking module will not do.

With regard to having access to the PIC, one of the field offices did not have access to the PIC because of communication problems, while several reported that they had not received adequate training to utilize PIC's limited capability to track IAs' audit findings. At another field office, data were not being entered into the PIC because of staffing limitations. We also noted that the field offices did not always enter data into the IBS before it was replaced. Since the PIC and the IBS are PIH's primary information systems to remotely monitor HA business processes and performance, their usefulness as an effective monitoring tool is diminished when they can not be used and do not contain complete, consistent, and accurate data.

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<sup>10</sup> The PIH's information center (PIC) replaced most of PIH's IBS data management functions in August 2000. The PIC is an Internet-based data system which uses data entered by HAS as well as the field offices.

Delays in implementing PHAS and SEMAP continue to impede HA monitoring and improved performance

We previously reported that in fiscal year 1998, HUD developed PHAS to provide for a more comprehensive monitoring system of public housing operations. However, during fiscal year 2000, as in fiscal year 1999, HUD did not use PHAS as intended. PHAS was originally scheduled to be implemented for HAS with fiscal years ending on or after September 30, 1999, but HUD delayed implementation three times during fiscal year 2000 to June 30, 2000. During this period, HUD only issued advisory scores. Moreover, as HUD began issuing official PHAS scores in the fourth quarter, Public Law 106-377<sup>11</sup> contained reference to language in the conferee's report<sup>12</sup> that directed HUD to delay the implementation of PHAS. Specifically, HUD was directed to comply fully with the recommendations in a GAO report<sup>13</sup> and clearly demonstrate to the Congress that it could administer PHAS reporting requirements so that HAS could carry out their responsibilities without undue delays. The Act also directed HUD to provide a report to the Committee on Appropriations by March 1, 2001, covering the results of a statistically valid test of PHAS that is independently verified, and describes the steps taken to improve the accuracy and reliability of PHAS. During the interim, HUD was instructed not to take adverse actions against HAS based solely on the PHAS scores.

For fiscal year 2000, the HAS' scores under PHAS were advisory. In addition, HUD field offices received only limited guidance on using the PHAS scores. They were directed to provide technical assistance to HAS, but not directed to take any other actions. During our testing, we found that only two of the four field offices used the PHAS scores for providing technical assistance to HAS, and one of these field offices required its HAS to develop improvement plans for the low scoring PHAS components. On June 6, 2000, HUD amended the final PHAS rule to provide that the PHAS regulation is applicable to HAS with fiscal years ending on or after June 30, 2000, and accordingly, REAC reportedly began issuing the official PHAS scores. However, HUD indicated they were prevented from using these scores to address needed improvements because the conferee's report discussed above instructed them not to.

In fiscal year 2000, REAC reports it performed 27,662 inspections of PIH properties that are administered by 2,535 different HAS. Of the 27,662 inspections, 3,921 resulted in a failing physical score. Furthermore,

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<sup>11</sup> The Conference Report (House Report 106-988) accompanied and described in the fiscal year 2001 VA-HUD Appropriation Act, which was signed by the President on October 27, 2000 and became Public Law 106-377.

<sup>12</sup> The Senate Report 106-410 identifies this requirement which is referenced in Committee on Appropriations' Report 106-988.

<sup>13</sup> The GAO report is GAO/RCED-00-168, titled "HUD Has Strengthened Physical Inspection but Needs to Resolve Concerns About Their Reliability," dated July 25, 2000.

16,562 of the inspections identified one or more life threatening exigent health and safety issues. However, since the scores were still advisory in nature and except as noted above, the field offices and TARC staff generally did not use the results in their monitoring programs. In fact, PIH did not revise its protocol until April 2000 to establish that the TARCS were responsible for the recovery of troubled HAS identified under PHAS, regardless of whether they elected to service the HA themselves or delegated the servicing function to the PIH field office. Additionally, PIH field offices had limited automated means of tracking findings and issues identified from the physical inspections to ensure the deficiencies were corrected. PIH's PIC physical inspection sub-system for tracking deficiencies and the interface with PHAS had not been developed, but PIH does expect to develop this capability by the end of fiscal year 2001. Consequently, under the current environment, the physical inspection process has not had its fully intended impact on improving HA performance.

SEMAP is a management assessment program that HUD developed to measure the performance of approximately 2,600 HAS that administer tenant based Section 8 rental assistance. Under SEMAP, HUD is to measure the performance of HAS that administer the Section 8 program in 14 key areas. If it is determined that a HA is not performing adequately on any of the indicators, SEMAP requires the HA to take appropriate corrective action. As with PHAS, HUD intended to implement SEMAP in the fall of 1998. However, its implementation was stayed until June 20, 2000. Thus, the program had limited impact on monitoring or improving HA's performance in fiscal year 2000.

Reliability and use of Single Audits is limited

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

In our prior years' testing of IAs' audits, we generally found IAs had not performed the audits in accordance with the PIH Compliance Supplement and questioned whether many of the IAs performed sufficient testing to determine if HAS were in full compliance with the program requirements. In fiscal year 2000, REAC completed 142 Quality Audit Reviews at 63 IAs selected based on targeted risk factors. While not statistically valid, the results showed that 19 percent of the IAs did not perform adequate testing in accordance with the OMB compliance supplement as it relates

to HUD programs. In addition, we found all four offices did not fully utilize the IA report results in their monitoring activities.

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***HUD's Actions Planned and Underway to Improve HA Monitoring***

HUD continues to implement reforms that were begun in fiscal year 1997. PIH consolidated financial, funding, and processing activities and separated troubled agency recovery activities from HA oversight and technical assistance functions so field office staffs can concentrate on providing technical assistance and oversight to HAS with declining performance. HUD field offices were consolidated into 27 hubs and 16 program centers. Additionally, two TARC's were established in mid 1998 to support troubled HAS, and the REAC was created to perform HA assessments. The specific structural and operational actions HUD has taken or intends to implement in fiscal year 2001 include:

- During fiscal year 2000, the REAC continued to implement its major assessment systems to produce physical, financial management and PHAS scores for approximately 3,200 HAS. Also, REAC began issuing official PHAS scores for HAS with a fiscal year ending June 30, 2000.
- On June 6, 2000 HUD published technical corrections to the PHAS final rule to change certain provisions of the existing revised final rule (January 11, 2000). The technical corrections reinstated a statutorily required indicator "vacant unit turnaround time," revised language on appealing of PHAS scores and extended advisory scores for HAS with fiscal years ending on or after June 30, 2000.
- On January 16, 2001, HUD issued a notice to its field offices directing them to provide technical assistance to HAS based on low PHAS scores and requires HAS to develop improvement plans to correct weaknesses and deficiencies identified by the low PHAS scores.
- PIH's two TARC's were providing service to an inventory of 45 troubled HAS, and were servicing 23 non-troubled HAS. In addition, TARC personnel assisted Office of Native American Program staff in performing 15 joint monitoring reviews of Tribal Designated Housing Entities. The delay in fully implementing PHAS continues to limit the number of HAS serviced by the TARC's. They were originally established to serve more than 500 troubled HAS. While HUD now asserts that based on current staffing, the two TARC's will be able to service 150 troubled HAS each, as noted elsewhere in this report, HUD lacks a resource estimation process to adequately determine such staffing needs.
- PIH developed a National Risk Assessment Module in PIC that allowed PIH to perform a risk assessment of its HAS on a national level. Late in the fiscal year, the assessment was completed for HAS

with a low income program, and PIH plans to use the results in performing their fiscal year 2001 field monitoring activities.

- On August 17, 2000, HUD issued a notice directing HAS to submit their SEMAP certifications to HUD on-line via the Internet directly to the SEMAP system beginning with HAS with fiscal years ending September 30, 2000, and were to be the first HAS rated under SEMAP. On January 24, 2001, HUD issued guidance to its' field staff on conducting annual SEMAP assessments and are expected to complete the annual assessments by February 23, 2001 for HAS whose fiscal year ended September 30, 2000.

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

While we agree with measures aimed at improving oversight of HAS, the Department's plans to monitor and improve performance in this area are not yet fully developed and continue to experience delays. Until HUD finalizes its implementation plans, we cannot assess HUD's ability to fully implement its oversight strategy. Moreover, HUD's success in addressing the need to objectively assess the quality of the public housing stock is dependent upon field offices receiving and acting on the results of inspections to be performed by the REAC. In addition, the study commissioned by HUD's Office of Policy Development and Research shows that HUD needs to develop additional strategies to improve the quality control for the rental assistance subsidy determinations. Nevertheless, we do believe that some of the initiatives are positive.

We agree with HUD's efforts to use the PHAS scores to provide technical assistance to HAS and to begin requiring improvement plans. This will allow HUD to begin using PHAS to improve the HAS' operations and performance. Also, we agree with HUD's efforts to establish and implement a national risk assessment system to assess the risk associated with the HAS' performance. This gives HUD the ability to uniformly assess its' staffing and funding resource needs to give priority to those HAS that are most at risk. The current process for evaluating HA risk did not uniformly rate the risk associated with the HAS' performance, and allows field offices' to waive on-site monitoring of at risk HAS and to establish the order in which monitoring of HAS will occur. Moreover, the field offices waived the on-site monitoring for reasons other than HAS' improving their performance. Also, the highest risk HAS were not always given priority for on-site monitoring.

In addition, the implementation of SEMAP and the annual assessments will greatly increase the field offices' ability to ensure that HAS are administering section 8 tenant based programs properly and that the subsidy costs are reasonable. Also, the success of SEMAP depends on the HAS submitting their certifications and annual audit report, and timely submission by the HAS will allow SEMAP to become an effective tool for

monitoring the section 8 tenant based program. However, HUD has to ensure that HAS meet the submission requirements.

We continue to have concerns over the Department's current and future use of the two TARCs in improving HA performance. The delays in implementing PHAS continues to limit the number of HAS that are designated as troubled and forwarded to the TARCs for servicing. In fiscal year 2000, only one troubled HA was added to the TARC inventory, while an additional 19 **non-troubled** HAS were added in the same period. Further, we continue to question whether the Final PHAS rule, as implemented by HUD under its *Protocol for HUD Servicing of Troubled Public Housing Authorities* between the TARCs and PIH field offices, will adequately identify a significant number of "at-risk" HAS that will be serviced by the TARCs. The current protocol allows troubled HAS to be serviced by the PIH field offices during recovery efforts rather than by the TARCs.

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Multifamily Project Monitoring  
Needs to Place More Emphasis on  
Oversight of Subsidy Determinations

HUD is responsible for monitoring multifamily projects to assure that subsidies (1) are provided only to projects that provided decent, safe and sanitary housing and (2) have been correctly calculated based on HUD eligibility requirements. To accomplish these two program goals, the Office of Housing uses the reporting from the REAC for physical inspections (PI) and review of audited financial statements (AFS). Office of Housing field staff or contact administrators (CA) have primary responsibility for following up on observations from REAC reporting and conducting management reviews. The Departmental Enforcement Center (DEC) handles projects which are the most troubled based upon referral from the REAC or the Office of Housing. Monitoring of tenant eligibility at projects is accomplished by Office of Housing or CA staff performing management reviews with an added "occupancy review" component<sup>14</sup>. As part of the review, Office of Housing field staff are to oversee the efforts of CAs. Increased reliance is being placed on the use of CAs. These plans have not yet been fully realized, and are discussed in greater detail in the section of the report discussing the operations of the Financial Management Center.

HUD directly or indirectly manages about 31,700 multifamily projects, including about 15,300 that have FHA insured or HUD held mortgages. About 24,700 receive some form of assistance on behalf of eligible tenants residing in those projects. The principal multifamily subsidy programs are:

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<sup>14</sup> Occupancy reviews test compliance with occupancy requirements, generally seeking to validate that only tenants meeting eligibility requirements occupy the project, that this is documented by tenant certifications and recertifications maintained by the project owner, and that this information is correctly entered in TRACS.

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

Audit approach to multifamily programs for both insured and assisted projects

We tested internal controls relating to asset and risk management and delivery of benefits to eligible tenants in multifamily projects. We focused on the use of the individual monitoring tools available to the Office of Housing and the overall communication, integrated risk management and reporting from the field offices to headquarters, as was reflected in the Real Estate Management System (REMS). In conjunction with efforts by our contractor on the FHA audit, KPMG LLP, we conducted interviews at both headquarters and field offices, tested project management files and performed additional procedures at eight locations. Our selection of project files was based on a statistical sample designed by KPMG LLP's statistician and was used for both the FHA and HUD audits. The sample resulted in the selection of 729 project files of which 500 were assisted projects covering the entire range of risk for the multifamily projects. This approach was possible because the Office of Housing could produce a reconciled inventory of multifamily projects through REMS.

Monitoring goals have improved but need to be enhanced and clearly articulated in the field and headquarters BOPs

The Office of Housing plans include steps to move to an integrated risk management system, but at present it is still being developed. For fiscal year 2000, HUD continued to establish goals through the business and operating plans (BOP), utilizing monitoring information from REAC PI results, particularly health and safety issues. While the BOP goals were being met, and include this measure of project monitoring performance, the plans did not use all REAC information and reporting through REMS in assessing risks of individual multifamily projects. BOP reporting after year end started to include results from the REAC reviews of AFS. To a lesser but increasing degree, management/occupancy reviews were conducted and results reported in REMS. Notwithstanding these limitations, and the lack of an overall integrated risk assessment measure, the BOP process did provide more consistency to the goal setting process than was present during fiscal years and 1998 and 1999.

Goals and requirements for monitoring traditionally have been documented as required by Office of Housing handbooks and notices. However, both field program staff and we noticed various instances where authoritative policy and procedures were out of date, incomplete, inconsistent, or absent. This condition was first reported two fiscal years ago, and was acknowledged by the Office of Housing. Although, there has been some improvement, we continue to be concerned about the

pace of policy and procedures development and distribution. As a result, reliance is still being placed on more informal processes. Currently, the Office of Housing plans to develop a strategy to address this concern by September 30, 2001.

Transition to new monitoring tools continued during fiscal year 2000 with PI process improving

Both the REAC produced PI component and review of AFS used in project monitoring improved during fiscal year 2000. Where applicable, the use of these monitoring tools was generally effective except for completion of some follow up efforts, particularly on the riskier portions of the portfolio. Management/occupancy reviews were still the responsibility of HUD field offices due to the CA function not being fully implemented during fiscal year 2000.

During fiscal year 2000 the “baseline” goal of inspecting all properties was completed, giving the Office of Housing an estimate of the overall physical condition for all risk categories of the multifamily insured and assisted portfolio. The results of our sample also showed that the REAC produced scores were generally used by Office of Housing staff with the exception that the most troubled portion of the portfolio, where the follow up process is more extensive, resulted in a lower level of completed follow up actions. It should also be noted that starting January 1, 2001, a new Final Rule on the PI process went into effect. Reinspections will occur on only a portion of the multifamily project inventory with frequency varying according to risk ranking.

While management/occupancy reviews have increased, more are needed to effectively monitor eligibility of assisted households particularly in troubled projects

In prior reports, on HUD’s financial statements, we noted that the field offices performed far fewer management/occupancy reviews of their troubled projects than required by HUD policy. According to the results from our statistical sample, 104 of the assisted projects in our sample were categorized as troubled. We determined when the most recent management review was performed and noted that only 21 percent were reviewed during fiscal year 2000, 30 percent in fiscal year 1999, 9 percent in fiscal year 1998, and 11 percent prior to fiscal year 1998. The remaining 29 percent had no review on file. Management/occupancy reviews are more important for assisted multifamily projects, particularly those that do not submit audited financial statements to the REAC. HUD plans to require CAS to perform annual management/ occupancy reviews of projects they administer. Also, as plans have progressed, the Office of Housing determined that they would oversee any project considered troubled and these are either not transferred to the CAS or can be returned by them if a change in status indicates that the project has become troubled. Consequently, the Office of Housing has additional need to perform management/occupancy reviews for assisted projects.

Communication between the DEC and Office of Housing needs to be improved

As reported last year, according to the Office of Housing, use of management/occupancy reviews was deliberately reduced in light of activities of the REAC and the DEC. For example, when the DEC receives a referral of a troubled project for enforcement action, reviews are to be

suspended while the DEC processes the case. Moreover, reviews that were being performed were not being consistently recorded in REMS as part of a systematic process for assessing risks associated with individual multifamily projects.

In Fiscal Year 2000, in addition to testing projects selected in our statistical sample that were referred to the DEC, we reviewed activity records maintained by the DEC of these projects and compared this with information maintained in REMS. We noted that the information in the DEC records did not always agree with information available to the Office of Housing in REMS making it difficult for the Office of Housing to manage this portion of the portfolio.

Deployment of monitoring tools has progressed and needs to continue

For fiscal year 2000, the Office of Housing generally deployed monitoring tools that were effective to assess the physical condition of HUD multifamily properties. As is reported in KPMG LLP's audit of FHA's fiscal year 2000 financial statements, these efforts, combined with progress in using the AFS, resulted in the elimination of loss mitigation as a reportable condition for the insured multifamily portfolio. However, as is discussed above, portions of the assisted multifamily portfolio do not receive AFS and cannot rely on this monitoring tool. Furthermore, while the number of management/occupancy reviews increased, this effort was still insufficient to provide assurance that rental assistance benefits were determined in accordance with HUD requirements. Also, the fact that the performance based Section 8 CAs were still not functional at the end of fiscal year 2000 continues to be a problem for the field offices. Moreover, data entry and verification problems continued with REMS as we noted in our review of the DEC and REMS records. When monitoring activities are not performed or not performed in a timely manner, HUD lacks assurance that rental subsidies are provided in a manner that meets HUD eligibility requirements.

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

Multifamily plans include a variety of continuing efforts. Principle among these are: continued implementation of the CA initiative; increased enforcement through the DEC of project referrals because of problems detected through REAC's PI and AFS process or when owners fail to file required AFS; implementation of more targeted risk management of reinspections of properties based on baseline risk rankings according to the Final Rule; use of mortgagee inspectors trained in the physical inspection data gathering protocol; increased frequency of management/occupancy reviews for assisted projects; and development of an integrated risk reporting system in REMS to be used in conjunction with the BOP reporting process.

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

Our assessment of planned and completed actions is similar to that expressed last year. However, before repeating some cautions raised in last year's comments we would like to focus on noted improvements.

We were encouraged that the Office of Housing was able to complete the "baseline" inspection of the multifamily portfolio, and could provide us with a reconciled inventory of projects from REMS. We hope the use of the PI monitoring tool continues to be effective following the final rule when it shifts to more risk targeted reviews. We are also encouraged by the increased use of the AFS for the insured portfolio, and evolving enforcement efforts by the DEC for inadequate financial status or non-filing project owners. We support the plans to increase the frequency of management/occupancy reviews for the assisted portfolio and suggest that similar to the approach to physical reinspections, they be performed more frequently for troubled and potentially troubled projects, and that occupancy review work be emphasized. Finally, we recommend the development of an integrated risk reporting system. This will enable the coordinated use of all monitoring tools that can be used throughout the year (as reported in REMS) to provide both field and headquarters staff the necessary reporting to successfully manage risk for insured and assisted projects throughout the year as well as at year end when reported in the audited financial statements, and that REMS data quality continues to be monitored and corrected when necessary.

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

System changes are still evolving with many new initiatives planned for fiscal year 2001. Similarly, compliance and monitoring approaches are changing and should be supported by continual updating of criteria and manuals, training of staff, and capturing the knowledge of staff experiences in discussing approaches by discussion of best practices. These communications should be encouraged and documented.

The Office of Housing is increasingly dependent upon other HUD organizations (e.g. the REAC, DEC and the Section 8 Financial Management Center) and external contractors. The adequacy of what the Office of Housing receives from another HUD organization or external contractor depends on clear needs definitions and adequate resources to achieve full implementation. Moreover, increased use of

external contractors increases the need for monitoring of these functions by the Office of Housing.

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

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

HUD administers various project-based assisted housing programs, most notably, Section 8. Although the payment processes differ, under each program, HUD pays the difference between the contract rent for the units and that portion of the rent the tenant can pay based on their household income. Of the approximately 24,000 assisted multifamily projects, Contact Administrators (CAs), such as State Housing Finance Agencies (SHFA) and HAS, are to eventually oversee about 24,000 assistance contracts with multifamily project owners relating to about 16,000 projects. This is about half of the total multifamily insured and assisted project inventory of 31,780 at fiscal year end. Those projects not subject to oversight by the CAs remain under HUD administration which is split between the of Office of Housing's project managers in the field and the Section 8 Financial Management Center (FMC), an organizational component of PIH. For both CA and HUD administered projects, project owners are responsible for verifying household income reported by the tenants and submitting requests for payments due under the HAP contracts to HUD or the CAs.

Risks associated with the subsidy payment process continue

The plan to use CAs is a major initiative to transfer monitoring and HAP payment processing responsibilities. HUD originally planned to have the CAs in place by September 1998, and in anticipation of this, Office of Housing staff assigned to review HAP payments was cut to ten and transferred to the FMC. As reported last year, the initial group of HAP contracts did not come under CA control until June 2000. From June through September 2000, CAs started to perform a variety of oversight functions, and processing of Section 8 benefit delivery started on October 1, 2000. As mentioned above, the total number of projects to be transferred to the CAs is about half of the total insured and assisted multifamily project inventory. Additionally, certain service functions will remain the responsibility of Office of Housing staff in 18 field locations

know as ‘HUBs.’ Consequently, the workload for these functions will continue to be shared between the HUBs and the FMC. At present, a workload assessment is being conducted to determine how much staff the FMC will need. This assessment is scheduled to be completed in February 2001. Furthermore, the underlying information technology systems are being evaluated and temporarily the processing is handled by the HUDCAPS, PAS, LOCCS and TRACS systems. In the meantime, staffing for the FMC HAP processing function has remained at around 10, and would be significantly understaffed for the planned new functions.

The FMC experienced some difficulties in reviewing merged contracts

In fiscal year 2000, the Office of Housing continued the process of merging multiple assistance contracts for one project into one contract. The Office of Housing plans to continue this transition until all projects are each covered by only one contract. Both the project owners and the FMC have been experiencing some difficulties in processing requests for initial payments under merged contracts. The owners have to account for tenant certifications from two contracts and merge this information in support of a payment request processed by the FMC. The FMC relies on a system test that rejects payments exceeding a specified threshold and looks to underlying certification information to validate the legitimacy of the requested payment. This process is difficult if the project owner makes mistakes.

During fiscal year 2000, changes were not made in LOCCS to adjust the payment threshold to reflect the mergers. As a result, when several contracts were merged into one, the subsequent HAP payment requests for the particular merged contract were significantly higher than the previous average monthly payments for that contract. The merged contracts were identified by LOCCS as requiring a prepayment review. A software update to both the LOCCS and TRACS systems removed the threshold test from LOCCS and built it into TRACS. The FMC was not informed of the update initially, but learned of it in August 2000. This temporarily increased the FMC’s prepayment workload. However, the Office of Housing has since addressed this by issuing a policy to their field offices requiring staff to reset the payment threshold edit check when multiple contracts are merged during renewal.

No sanctions have been taken when noncompliance is identified

The method of voucher selection for post payment reviews and the tracking of review results are not effective as an internal control in ensuring owner compliance with HUD regulations. While the post-payment review has been functioning for more than a year and at least 582 reviews were completed in fiscal year 2000, there are no written policies and procedures in place for this function. As a result, staff were not suspending payments for those contracts which failed to meet the current tenant certification requirement. Suspensions have not occurred because the Office of Housing has not established a policy for such suspensions in its programs. FMC management states that they continue to develop an automated program to compare vouchered units with tenant

data to determine which contracts have insufficient tenant data in TRACS. However, this new process is not operational. When this program is in place, and the Office of Housing's policy is established, plans are to apply a sanction policy uniformly to all non-compliant owners. While consistency in applying sanctions is important, we believe it is also important to apply the sanctions in a timely manner once noncompliance with regulations is identified to deter other owners from failing to provide the required information. FMC management should provide written policies and procedures for post payment reviews in the interim period before the automated post payment review process is operational.

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

Each report on HUD's financial statements since HUD has been subject to audit under the provisions of the CFO Act has identified the lack of effective controls over the project-based subsidy payment process. HUD does not have a process to determine the accuracy of a payment requisition.

Ultimately, HUD plans to transfer monitoring responsibility for approximately 16,000 Section 8 projects to CAS such as SHFAs and HAS. This includes responsibility for making Section 8 payments to project owners. In the interim, the FMC is conducting post payment reviews using staff in Chicago. The review process now focuses on verifying that at least a specified percentage of the tenants on a subsidy voucher have a current certification in TRACS. The staff reviews all vouchers that are generated in one month in a particular state. If contracts are identified that fail this test, the owner is contacted and asked to update the system within 30 days or face possible suspension of future subsidy payments.

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

In fiscal year 2000, most Section 8 HAPs were paid without any HUD review if they pass the system edits. Those that fail these edit checks are subject to a prepayment review by FMC staff. About two percent of the vouchers are reviewed before payment.

While the post payment review process has been successful at instigating voluntary compliance on the part of some of the owners who have been contacted as part of the review, the management information system needs an analysis function to identify the effectiveness of the process. The FMC staff implemented a management system to identify the universe of the vouchers they had reviewed, the results of their reviews, and the status of contracts which were identified for possible suspension of future payments due to noncompliance with contract provisions. The system in place tracks the results of these reviews but does not allow management the additional ability to readily identify the effectiveness of

the post payment review process. The system should allow management to track the contracts that failed the review to ensure that proper follow-up action is taken.

HUD has elected in part to address the Section 8 control weakness through the partial transfer of the functions to CAS. However, for this to be successful, HUD needs to successfully complete the transfer of these functions and adequately monitor the CAS' performance. Moreover, as was noted above, HUD will be left with a significant number of HAP contracts and insured and assisted multifamily projects to administer after the transfer to CAS is completed. HUD needs to finalize plans to improve administration of those contracts, and oversee those multifamily projects including HAP payment processing and Section 8 benefit delivery.

## Verification of Subsidy Payments

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

As discussed in the previous section of this report, HUD provides rent and operating subsidies through a variety of programs, including public housing and Section 8. The admission of a household to these rental assistance programs and the size of the subsidy it receives depend directly on its self-reported income. HUD performed computer income matching with its assisted housing universe and estimated that housing subsidy overpayments from tenants misreporting their income totaled \$617 million during calendar year 1999. Tenants often do not report income or under report income which, if not detected, causes HUD to make excessive subsidy payments. Tenant income is a major factor affecting eligibility for, and the amount of, housing assistance a family receives, and indirectly, the amount of subsidy HUD pays. Generally, HUD's subsidy payment makes up the difference between 30 percent of a household's adjusted income and the housing unit's actual rent or, under the Section 8 voucher program, a payment standard.

Under reporting or understating of income from a specific reported source is easier to detect than unreported income. Program regulations require HAS or project owners to verify through third party written documentation the applicant and tenant income and other factors relating to eligibility and rent determinations. Our concerns with this aspect of HUD's monitoring was discussed in the previous section of this report.

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

With regard to unreported income, various legal, technical and administrative obstacles exist that impede HUD, HAS and project owners from ensuring tenants report all income sources during the certification and recertification process. Consequently, HUD makes excessive subsidy payments and possibly provides assistance to ineligible families while denying housing assistance to eligible families who often are on large waiting lists maintained by many of the HAS. Since unreported income is difficult to detect, HUD has encouraged HAS to computer match with State wage agencies to detect unreported income. HUD reports that a recent PIH survey indicated that a majority of State wage agencies provide data to HAS, and some have electronic systems for this up-front matching.

Since 1996, HUD has sampled its household databases each year to estimate the amount of excess subsidy payments it has made for financial statement disclosure. Also, on a more limited basis, HUD has completed or initiated a number of small scale computer income matching projects at a few select HAS and a large-scale nationwide computer matching project that matched 100 percent of all subsidized households. HUD has made progress on the two small scale sampling matches and the calendar year 1998 large-scale nationwide project. HUD plans to issue reports for the

small scale computer income matching projects in February 2001. Even though HUD has some preliminary results of the calendar year 1998 large scale matching, the final results of the large scale matches are not expected until sometime during fiscal year 2001. HUD's calendar year 1999 large scale match was only in the early stages of gathering data for matching which began in November 2000.

To determine necessary disclosure for HUD's fiscal year 2000 financial statements, HUD performed computer income matching with federal income tax data and other sources to determine the magnitude and effect of under reported and unreported tenant income in calendar year 1999. HUD randomly sampled 1,000 households from its automated tenant databases and matched their reported income with federal tax data in Social Security Administration, Internal Revenue Service (IRS) and other source data bases. HUD compared the computer matching results with source documents. Based on the results of the computer income matching project, HUD statistically projected at the 95 percent confidence level that the amount of excess rental subsidies was \$617 million plus or minus \$101 million during calendar year 1999 (see Note 17 to the financial statements).

HUD has made progress in expanding its income matching program

In March 1999, the Department assigned the responsibility for the income verification function to the REAC. Since assuming this role, the REAC has focused its resources on developing the capability to implement a large-scale nationwide computer matching effort using Federal income tax data and other sources of information. During fiscal year 1999, the REAC developed the Tenant Assessment Subsystem which allows HUD to conduct matching of tenant-reported income maintained in HUD's tenant databases with Federal tax data and other sources. In September 1999, the REAC obtained Federal tax data from the IRS, Social Security Administration, and other sources for calendar year 1998 and performed a computer match of 2.3 million households to identify potential tenant income discrepancies. From the computer match, REAC identified approximately 216,000 households who may have tenant income discrepancies exceeding specified thresholds. Further details and discussion related to the REAC's large-scale project plans for fiscal year 2001 are discussed below under "HUD's Actions Planned and Underway to Verify Tenant Income" and our assessment of those actions.

In fiscal year 2000, REAC continued operations for the large-scale implementation of computer matching and income verification involving social security (SS) and supplemental security income (SSI) information. Currently over 3,000 HAS access the SS and SSI information via a secure Internet facility as a "front-end" way to verify income and annual tenant recertifications. In 1999, project owners began receiving or had access to the SS and SSI information via the Internet (electronic media) and U.S. mail. Also in 1999, administrators of the Office of Housing's rental assistance programs began receiving SS and SSI data via secure Internet

facility, which provides direct delivery of the SS and SSI information to the end users of the data. The SS and SSI computer matching and income verification program has been implemented nationally since 1997 for HAS.

PIH has improved HA reporting into its MTCS tenant database

HUD uses the Multifamily Tenant Characteristics System (MTCS) data for PIH's income matching program, financial planning, budget requests to the Congress, estimates of staff workload, and program monitoring. Also, MTCS data will be used in five of the fourteen indicators in SEMAP that was scheduled to be implemented about December 2000. For HUD's income matching and other program efforts to be effective, it is essential that the MTCS data base have complete and accurate tenant information. Throughout fiscal year 2000, the overall reporting rate of household data into the MTCS steadily improved from 90 percent in December 1999 to more than 94 percent in December 2000. The improved reporting rate, in part, can be attributed to the increased monitoring of the HAS' reporting.

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### ***HUD's Actions Planned and Underway to Verify Tenant Income***

REAC continued to focus its resources on developing the capability to implement a large-scale computer matching and income verification of the information in its tenant databases. REAC completed its first large-scale computer matching of reported calendar year 1998 income from HUD's tenant databases to IRS and SS data files and mailed approximately 212,000 letters to tenants who were identified with potential income discrepancies above established thresholds. These letters identified the tenants' Federal tax data and informed the tenants of their responsibility to disclose the data to program administrators. REAC also notified the program administrators of tenants who were sent discrepancy letters. As of November 30, 2000, REAC reports receiving resolution information on 30,310 of the letters, of which 2,724 were valid discrepancies, 9,757 were not valid discrepancies, 14,026 were resolved as no longer a tenant, and 3,803 unresolved. Although HUD does not encourage any recovery of excess rental assistance identified by the calendar year 1998 computer match, 171 repayment agreements had been made for approximately \$425,000 out of \$1.167 million in excess assistance payments. REAC anticipates it will issue a final report in April 2001, and begin monthly reporting on the resolution of discrepancies reported by HAS and owner/agents until efforts on the cycle are substantially complete.

The REAC has also issued a detailed guide to assist program administrators and tenants in resolving potential tenant calendar year 1998 income discrepancies on August 3, 2000. This guide was made available on the Internet. The program administrators are requested to submit periodic online status reports regarding their resolution of tenant income discrepancies and their recovery of excess rental assistance. The REAC plans to review these reports to determine the success of the large-scale computer income verification in ensuring that subsidies are based on correct tenant income. As an additional quality assurance effort, the

REAC plans to send staff to review program administrators' activities to ensure the integrity of their income discrepancy resolution.

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

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

HUD should continue to evaluate and assess the effectiveness of its ongoing computer matching projects, with particular emphasis on determining what effects the statutory restriction on redisclosing federal income tax data to HAS and project owners has on the program's effectiveness. Also, HUD should continue to explore and evaluate practical and cost effective computer matching techniques and methodologies that will aid in quantifying, on a larger scale, the extent of abuses and the benefits of a permanent computer matching and income verification process. We are also encouraged by the number of on-going actions HUD has taken and continues to pursue to improve the reporting rate and data integrity of the MTCS. As was evidenced by the significant improvement in the reporting rate during fiscal year 2000, these actions appear to be having a positive impact in improving the completeness and data integrity of MTCS.

In our report on HUD's fiscal year 1998 financial statements, we expressed concerns as to whether HUD was ready to immediately embark on a large-scale computer matching income verification effort in fiscal year 1999, especially since key issues relating to developing and testing a suitable methodology, establishing adequate information technology and a human resource infrastructure to support a large-scale matching effort had not been sufficiently developed nor implemented. The results of the calendar year 1998 income match as of November 30, 2000 indicate that the ratio of those resolved as invalid discrepancies to those resolved as valid discrepancies is almost four to one. In addition, almost half of the potential discrepancies went unresolved because the tenant was no longer receiving housing assistance, and there was not a determination of the validity of the discrepancies. The results thus far would indicate the large-scale methodology needs to be further refined.

## System and Accounting Issues

### HUD Needs to Address System and Accounting Weaknesses

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

- controls over the computing environment;
- administration of personnel security operations; and
- reliability and security of critical financial systems.

We also discuss the need for HUD to improve its processes for reviewing outstanding obligations to ensure that unneeded amounts are deobligated in a timely manner. In addition, we discuss the need for the CFO to tighten controls over Fund Balance with Treasury reconciliations.

### **Reportable Condition:** HUD Still Needs to Strengthen the Controls Over Its Computing Environment

HUD's computing environment, the 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 certain 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 selective system controls, and disaster recovery and physical security procedures for both the Hitachi and UNISYS mainframe computers. We also evaluated software change controls, tested security over networks, and observed backup operations in field offices.

Significant improvements have been made but weaknesses still exist

During fiscal year 2000, HUD made substantial control improvements in the Hitachi computing environment. Previously reported exposures of weak control over two powerful software features, "started task" for initiating system components, and Authorized Program Facility for executing programs in "supervisory" state, have been corrected. However, we continue to note weaknesses with HUD's computing environment as discussed below.

*UNISYS Mainframe*

Critical and sensitive UNISYS data remain vulnerable to unauthorized access

In our reports on HUD's fiscal year 1998 and 1999 financial statements, we reported weak access control over data residing on the UNISYS mainframe. During fiscal year 2000, sensitive Privacy Act data and payment system data remained vulnerable to unauthorized access.

In accordance with Generally Accepted Principles and Practices for Securing Information Technology Systems (Section 3.12), the National Institute of Standards and Technology (NIST) recommends that organizations base access control policy on the principle of least privilege, which states that users should be granted access only to the resources they need to perform their official functions. Last year, we reported that we were able to view sensitive HUD data such as customer names, addresses, social security numbers, and credit information from a number of applications. We were also able to read control language run streams for the payment system (LOCCS) that initiates the electronic transfer of funds to the Treasury Department.

Based on last year's report, the Department initiated an effort to protect sensitive and critical data on the UNISYS. This effort, termed "File Privatization," is essential to ensure that only those with a need would be allowed access. Although HUD has made some progress during the last nine months, critical applications such as LOCCS, PAS, and the Loan Accounting System have not been completed. It is doubtful that the Department would meet the March 31, 2001 deadline for completion of all of the applications. As a result, the privacy of HUD customers could be compromised, and sensitive data placed at risk for potential fraudulent activities.

Aside from not completing the "File Privatization" effort, two access levels for performing system functions in UNISYS were not adequately controlled. There is no audit trail mechanism in place to trace individual use of the HUDSEC privilege. HUDSEC is the most powerful authorization used for performing security and system administration functions. With the HUDSEC privilege, a user has access to all system resources including software and data. Although, usage of HUDSEC is recorded in the system log, its use cannot be associated with individual access so accountability can be established. Without tracking individual use of the HUDSEC privilege, errors, omissions, and unauthorized changes may not be detected. Further, NIST recommends that an organization implement an audit trail mechanism to ensure individual accountability, reconstruction of events, intrusion detection, and problem identification.

The other deficiency deals with controlling SIMAN (Site Management Complex) system administration authorities. This authority allows an individual to grant other users access privileges and setting of passwords. We found four individuals with this access were not removed when they

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terminated employment or changed duties. This level of access must be properly controlled to minimize the risk of unauthorized system administrative activities.

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### *Network Environment*

#### Network vulnerabilities still exist

In addition to reviewing mainframe system controls, we tested selected HUD network controls. Our network control tests were designed to determine if a person could obtain unauthorized access to network resources. Vulnerabilities in one area of the network can be manipulated to obtain greater access in another part. We also examined the backup procedures of Novell servers at selected field sites. Novell servers in the field offices provide the necessary connectivity for field users to access HUD's financial application systems such as HUDCAPS and LOCCS/PAS.

Our work this year indicates that the Department continues to make progress in improving network controls. The most significant improvement is the purchase of a network server analysis software to monitor access controls of Novell servers. The software will help the Department systematically obtain information concerning vulnerabilities that may exist on network servers. However, vulnerabilities that we detected and reported in previous years continue to appear, despite HUD promises to correct these problems.

Novell networks were still frequently set to allow users to log in with unencrypted passwords. Thirteen of 24 servers we tested were set to allow unencrypted password logins. A person using widely available special software could view the user ID and password of a user logging in as it went through the network.

Another previously reported weakness is that Novell operating system files (the bindery) were not protected from unauthorized access. The bindery of 1 of the 24 Novell servers we tested permitted general users full access to these files which would enable them to obtain passwords and system administration privileges. This information would allow a person to login as someone else and use that access to read files, destroy or alter data, and initiate transactions.

We also observed that 14 of the 24 servers had a significant number of users with easily guessed passwords. Easily guessed passwords consist of dictionary words that could be determined with a password cracker or by trial and error. As a result, unauthorized individuals could masquerade as legitimate users to modify or delete files as well initiate transactions.

Field IT directors need additional tape backup equipment and spare servers to ensure continuity of service

With respect to tape backup, we found that most field information technology (IT) directors did not conduct periodic tests of backup tapes as recommended in the NIST publication, *Generally Accepted Principles and Practices for Securing Information Technology Systems* (section 3.9). As a result, there is no assurance that restore operations would be successful during a disruption. The IT directors indicated that their offices lacked spare Novell servers to conduct such a test. In order to conduct the test, an operational server has to be taken down. The current practice is for Headquarters to send a spare server to the field in case of an emergency. This arrangement delays IT directors' ability to quickly restore operations in the event of a server failure.

Another concern is that the IT directors at their respective field offices use a different type of tape backup equipment than the field offices under their control. While an IT office is capable of restoring a tape from field offices under its control, the field offices cannot restore a tape from its IT office. If an IT office experiences a disruption, it must depend on another IT office to resume operations. It would be more efficient for the field offices to restore the tapes of their respective IT offices in the event of a disruption. Further, field IT staff would be more familiar with the operations of their respective IT offices.

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### *Disaster Recovery*

Business resumption plans have not been adequately tested

GAO's Federal Information Systems Controls Audit Manual (FISCAM) suggests the most useful tests involve simulating a disaster situation to test over all service continuity. The tests should determine if the recovery site functions as intended, critical applications and data are properly replicated, and employees have been trained to carry out their roles and responsibilities in a disaster situation.

The business resumption plan for headquarters has not been tested in accordance with GAO guidelines. During fiscal year 2000, HUD conducted two limited tests. A telephone recall test of disaster recovery team members was performed during April and May 2000, and a desk audit of two UNISYS scenarios was performed in August 2000. The test details, results, and lessons learned were documented for each test. However, a full disaster recovery test including database and file restores, the rerouting of telecommunications links, and the switch over of live processing to the Development and Recovery Facility has not been performed since Y2K testing in 1999. In addition, such a test is not scheduled in the three year plan. Without full disaster tests, HUD cannot ascertain whether the business resumption plan would be successful in the event of a disaster.

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### *Software Change Control*

Implementation of configuration management of HUD's application systems suffers from continual delays

GAO's FISCAM indicates controls should be established over the modification of application software programs to ensure only authorized programs and modifications are implemented. This is accomplished by instituting policies, procedures, and techniques that help make sure all programs and program modifications are properly authorized, tested, and approved and that access to and distribution of programs is carefully controlled.

We have been reporting on configuration management (CM) weaknesses since 1996. Progress has been extremely slow. More than 4 years after we reported the weaknesses in this area, HUD's critical and important applications are still not fully implemented under CM. Applications slated for CM implementation have been delayed. For the Hitachi systems, only 36 percent of the applications have been certified. HUDCAPS has been certified, but after the deadline of September 29, 2000. On the UNISYS, more progress has been made with 83 percent of the applications certified under CM. However, both LOCCS and PAS missed the deadline and as yet are not certified. There is virtually no progress on the client/server and Web based applications. None of the 27 LAN-based client-server applications have been certified by the deadline.

The primary cause of delay has been a lack of management direction from responsible HUD IT and program officials. The Department did not provide software support contractors with adequate policies and procedures governing CM standards. Without guidance on matters such as migration strategy, schedule of migration, standards for testing and verification, and access controls, contractors cannot proceed with the implementation. Another problem is the lack of qualified CM administration expertise for each platform. Neither HUD nor the contractor had adequate staff to meet the planned completion dates.

HUDCAPS CM is undermined by unwarranted update access to the production system

Another concern we have regarding CM implementation is access control. Under CM, developers would code a separate development/test computer system then the code would be placed into a separate production computer system. The developers, under normal circumstances should not be allowed update access to the production system. Changes should be made in the development system and then migrated through production control. This is to ensure the integrity of the production software.

We noticed that one profile allowed software developers update access to production program libraries for HUDCAPS, which is under full CM control. Such authorizations undermine the integrity of the entire CM process. Direct update access would allow these developers to bypass all CM controls and enable them to modify or delete any code or data. Although a special request for the developer update access was approved

by the CIO, we disagree with the justification provided and believe the request should have been denied.

Continued delay in CM implementation as well as inadequate access controls in CM expose HUD's critical applications to unnecessary risk of unauthorized, deliberate or unintentional, software modifications, which could result in errors, loss of data , or system failure.

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

On the Unisys Mainframe, the Department is working to complete the file privatization effort. The Department has not addressed the need to monitor the use of the HUDSEC privilege on the UNISYS. After we identified four individuals whose SIMAN administrative authorities were not removed after they changed duties or terminated employment, HUD took immediate action and removed the authorizations.

With respect to the network environment, HUD purchased and distributed the Kane Security Analyst program during fiscal year 2000. Kane Security Analyst is a program that assists the network administrator in improving security by producing assessment reports of the settings of Novell servers. The assessment reports on vulnerabilities such as unprotected operating system files, system administration accounts with default passwords, user accounts with easily guessed passwords and user accounts that have not been in use for long periods of time. HUD is requiring that the Kane Security Analyst be run quarterly for all Novell servers both at Headquarters and the field sites.

With respect to LAN backup and recovery, HUD plans to buy additional backup drives to permit the field offices to restore the tapes of their respective IT offices. HUD also plans to provide each IT office with a server for testing tape backup, and revise the service level agreement with the service contract to require a 24-hour turnaround time for repairing or replacing failed equipment.

Regarding business continuity, we have been advised that although full disaster testing has not been performed since 1999 and is not forecasted in the three year plan, HUD will revise the test schedule to include such tests and allow OIG to observe.

Regarding application software changes, HUD produced a schedule for fully implementing the mission critical applications on the Hitachi, Unisys, and LAN/Client Server platforms under CM. Deadlines were exceeded, progress was slow, and the task was not completed. Although HUD has failed to complete this initiative, we have been advised that new policies and procedures and implementation schedules are being developed to complete this task in a timely manner.

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

The Department made significant control improvements in the Hitachi computing environment. We are hopeful that the Department will assign sufficient priority to the file privatization effort and enhance controls over system administration privileges on the UNISYS.

With respect to the network security, the purchase of the Kane Security Analyst program will help the Department to improve the Novell server security. In addition to a quarterly assessment, the Department should consider using the Kane Security Analyst to perform additional assessments after changes are made to the server, such as adding new applications or creating new user groups. This additional check would provide assurance that the server only gave users the required authorizations. The purchase of the tape backup equipment and additional server for each IT office should help the IT offices to conduct the tests that need to be made, and improve disaster recovery response time.

Regarding disaster recovery, we hope the Department will carry out a more realistic test for the data centers and enhance the physical security of the facilities as well.

With respect to change control, we have repeatedly reported the need to implement a configuration management program for HUD's application systems. The Department has made promises and commitments to address this issue. Although there has been some progress, the schedule continues to slip and much more remains to be done. The Department should assign sufficient priority to ensure that CM is implemented without further delay.

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**Reportable Condition:**  
 Weak Personnel Security  
 Management Continues to  
 Pose Risks of Unauthorized  
 Access the Department's  
 Critical Financial Systems

For the last few years we have reported that HUD's personnel security over critical and sensitive systems' access has been inadequate. HUD has not made sufficient progress to address the reported problems and has not given sufficient priority to personnel security. Without an adequate personnel security program, inappropriate individuals may be granted access to HUD's facilities, information and resources. As a result, these individuals could modify, delete, or destroy critical and sensitive data.

HUD Handbook 2400.24 Rev-2, "Information Security Program," describes the Information Security Program for the Department. This document provides the policies and requirements for implementing security controls over HUD's information systems. It also specifies the responsibilities for security management of HUD's information resources.

A key control over systems access by employee and contractor personnel is the requirement for background screening. The Chief Information Officer (CIO) is responsible for providing policy, guidance, and oversight

for information security. HUD's system owners of critical and sensitive applications such as LOCCS/PAS and HUDCAPS, are responsible for determining the appropriate levels of access for contractors and employees. The level of access required determines the appropriate background screening for system users. The Director of Employee and Labor Relations, Office of Human Resources (OHR) under the Office of Administration is responsible for the day-to-day operations of HUD's personnel security program, which includes the processing, tracking, and reporting of background investigations.

Significant backlog remains

In fiscal year 1999 we reported a potential backlog of as many as 8,200 users having access to HUD's critical systems without the appropriate background investigations. The Department claimed that the backlog was eliminated by March 2000. However, the claim is not valid and a significant backlog still exists. Based on a November 16, 2000 listing of 5793 employees and contractors with access to HUD's critical systems, 2004 (35 percent) have no record of a background investigation.

Improvements needed in OHR's system for reporting the status of background investigations to management

The reporting capability of the personnel Security Control and Tracking System is deficient. This system is used by OHR to track and monitor background investigations. Although all of necessary data are in the system, essential management reports are not available. For example, there is no report summarizing the status of current workload such as the number of completed requests, the number of requests in process and the number that are queued for process. In addition, the system did not provide reports on the number of contractor or federal employees who have access to particular HUD critical systems along with their levels of access.

The CIO has not defined the criteria for identifying critical and sensitive HUD systems

Another serious concern is that the CIO has not fulfilled its responsibility for personnel security. In December 2000, the CIO assumed the responsibility for HUD's information security. However, the CIO did not provide the necessary policy, guidance, and oversight to ensure that users with access to critical and/or sensitive systems have the appropriate levels of access and background investigations.

HUD Handbook 2400.24 requires the security operations within the Office of the CIO to provide guidance to system owners for determining system criticality and sensitivity. Additionally, to address and close the previously reported OIG findings, The Office of Information Technology issued a memorandum to OHR dated October 10, 2000 that indicated the CIO would be providing the definitions and criteria for identifying critical and/or sensitive systems. However, we have no evidence that the CIO has completed this task.

The CIO did not include TASS as a critical system

In August 2000, the Real Estate Assessment Center (REAC) inquired into the status of background investigations on individuals who had access to The Tenant Assessment SubSystem (TASS). This system contains highly

sensitive IRS taxpayer information. OHR, in the absence of guidance, informed REAC that TASS was not identified as a critical system by the CIO and therefore, no background investigation was required. Without CIO policy and guidance for determining the criticality and sensitivity of the data in HUD's systems, neither the systems owners nor OHR can determine the appropriate level of access and background investigations for the system users.

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

OHR acknowledged that the backlog of personnel requiring background investigations has not been eliminated and is working with the CIO to reduce the backlog. With respect to TASS, we were informed by the CIO that the list of critical systems is being updated. On November 30, 2000, the CIO issued new registration procedures for users with access to HUD systems. The procedures are an interim measure until HUD Handbook 2400.24, "Information Security Program," has been formally updated.

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

The Department had made similar promises and commitments to address the personnel security problems identified in previous reports. Although there has been some progress, much more needs to be done. The Department should assign sufficient priority to establish an effective personnel security program by considering it a strategic performance objective.

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**Reportable Condition:  
Reliability and Security of  
HUD's Critical Financial  
Systems Are At Risk**

HUD maintains two major systems to process payments and account for funds of major programs areas and administrative activities. LOCCS/PAS process disbursements of funds to a broad range of grant recipients that include State governments, municipalities, independent companies, non-profit institutions, and individuals. HUDCAPS processes disbursements for both administrative activities and PIH Section 8 programs. The Departmental general ledger also resides in HUDCAPS. During fiscal year 2000, HUD disbursed approximately \$23 billion through LOCCS/PAS and \$11 billion through HUDCAPS.

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

privacy be protected in Federal Government information activities involving personal information

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*Access Control for QLP in LOCCS/PAS*

We estimated that more than 700 HUD and contractor personnel with on-line (demand) access to the Unisys System2 mainframe could have the ability to read and update LOCCS/PAS data using the Query Language Processor (QLP) without authorization. Additionally, HUD has not established an adequate audit trail in the system to detect unauthorized QLP use. Without the controls in place to prevent and detect unauthorized use, HUD is at risk of critical financial data being modified, corrupted, or destroyed.

PAS and LOCCS data are maintained in their respective Unisys mainframe System 2 Data Management System (DMS) databases. LOCCS/PAS databases are defined by a schema, which includes data definition, location, field names, and path of access. Under each schema, there is a subschema for each data access method such as QLP.

Users with both demand access and the security privilege (PB\$CON) can use QLP to read and update PAS and LOCCS data without going through normal transaction processing. To fully control access to the LOCCS/PAS databases, an access and an invoke key must be installed in the schema and subschema, respectively. In addition, the source files of the schema and the subschema containing the keys must be protected from unauthorized access. The invoke key in the subschema would limit the users to read only access. Users must know both the invoke and access keys to update the database.

LOCCS/PAS data are vulnerable to unauthorized changes or intentional destruction

We found that both the PAS and LOCCS databases are not adequately protected with the appropriate access and invoke keys. The LOCCS database is not controlled with an access key and the PAS database lacks an invoke key. In addition, the source files of schema and subschema containing these keys can be read by all demand users. As a result, these users can obtain the access and invoke keys by reading the schema and subschema source files on the development/maintenance machine (Unisys System3), which are identical to those on the production machine (Unisys System2).

We selected a statistical sample of 100 HUD and contractor personnel who had access to the Unisys System2 and found 46 had demand access. Of the 46, 11 (24 percent) also had the specific security privilege (PB\$CON) to read and update the PAS and LOCCS database using QLP. As of September 26, 2000, there were a total of 2984 HUD and contractor personnel who had demand access to this system. We projected that there were over 700 HUD and contractor personnel who could read and update PAS and LOCCS without going through the normal transaction

processing. In addition, the audit trail to track changes to LOCCS/PAS data is inadequate. The system audit trail tracks users who make updates to the data, but does not distinguish changes made using QLP or made during the normal transaction processing. As a result, these users could alter, corrupt or destroy critical financial data without detection.

Policies and procedures need to be established to adequately control the distribution of the invoke and access keys and the use of the QLP to update the PAS and LOCCS data.

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### *Reliability of HUDCAPS*

During fiscal year 2000, we conducted an audit<sup>15</sup> of HUD's Central Accounting and Program System (HUDCAPS). This was initiated based on the results of our attempt to audit the fiscal year 1999 financial statements, which resulted in a disclaimer of opinion. The disclaimer was given, in part, because of HUDCAPS system control weaknesses and Program Accounting System (PAS) to HUDCAPS conversion problems.

As a result of our audit, we found that HUDCAPS, for the most part, was operating as intended. The PAS to HUDCAPS interface is functional and capable of posting the financial transactions accurately and completely to the general ledger. However, we did find significant internal control deficiencies that must be addressed.

HUDCAPS is vulnerable to errors and system failures because of weak maintenance practices

Implementation of CM for HUDCAPS has been continuously delayed. Even though we reported this weaknesses in prior financial statement audits, HUD has not fully implemented CM for HUDCAPS, despite having purchased a CM tool over six years ago. As a result, HUDCAPS remains exposed to errors and system failures from uncontrolled software changes and incorrect version releases. In addition, HUD and contractor personnel performing maintenance functions were granted more access authority than necessary. This weakness exposes HUD to unauthorized changes that could modify, corrupt, or destroy critical data, and disrupt system continuity.

Another deficient maintenance practice is a lack of tested formal procedures for the restoration process in the event of a system processing disruption. Currently, there are no administrative procedures and trained staff to support the recovery process. Further, there are no documented procedures to keep the backup processing current with the application requirements. Without tested formal procedures, there is no assurance the recovery process would work during a system disruption.

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<sup>15</sup> "Audit of HUD's Accounting and Program System," (2001-DP-0002, dated February 27, 2001).

Data quality controls for HUDCAPS are weak

We also had a concern regarding the lack of procedures to timely resolve system and user problems. Some of the problems had been unresolved for over six months. Without an effective problem resolution process, uncorrected errors could corrupt HUDCAPS data and/or prevent users from effectively performing their duties.

Another area where weaknesses exist is in data quality control. HUD did not perform reconciliations between the data from the Decision Support System (DSS) with the data in the HUDCAPS production tables to ensure accuracy and completeness. The HUDCAPS DSS is a database that obtains and stores key financial information from various HUDCAPS tables in an easily retrievable format for management reporting and decision making as well as providing the data for generating the financial statements. Without periodic reconciliation, there is no assurance that the DSS is reliable.

The second deficiency reported is on the need to control the use of the UTTCOR utility. UTTCOR is a powerful system utility that can be used to resolve data discrepancies by directly altering data in the HUDCAPS financial tables. During the fiscal year 1999 testing, we discovered that access to this powerful system utility had been granted to over 20 contractor and HUD personnel. In addition, audit trails on UTTCOR were not adequately maintained. HUD did improve controls over UTTCOR by reducing the access to a few key individuals and established a centrally controlled library for all change requests and approvals. However, contractor programmers were still storing input files for UTTCOR use in their private libraries of software programs on the system. Files stored in private libraries can be deleted or altered by the owner without detection. As a result, unauthorized use of UTTCOR can occur. This vulnerability can be eliminated by simply requiring that all input files for UTTCOR utility be stored in centrally controlled production libraries on the system.

The third deficiency is that the rejected transactions in the HUDCAPS Document Suspense File (SUSF) were not timely resolved and the posting model for the PAS to HUDCAPS interface was not timely updated. Without timely resolution of rejected transactions and updates of posting models, incomplete or invalid transaction processing could occur. As a result, HUDCAPS financial data may not be current or accurate.

A fourth deficiency is that HUDCAPS has not been updated to reflect legislated changes. The dollar amounts for at least two funds in HUDCAPS were misapplied because the funds' balances should have been merged with another fund pursuant to the fiscal year 2000 HUD Appropriations Act. Also, the transactions for the 0148 fund and three no-year funds have not been correctly posted to the general ledger. As a result, HUD program managers could not rely on HUDCAPS for fund control purposes.

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***Control Over the Vendor Table in HUDCAPS***

In addition to the audit of HUDCAPS, we followed up on the previously reported excessive number of users with access controls to the Vendor (VEND) table.

The Vendor (VEND) table in HUDCAPS contains critical data for making payments to contractors, employees and business partners. This table also contains sensitive employee and vendor, personal data such as Social Security Number and bank account numbers. An "MTI" transaction log is maintained in the system to monitor user data modification for key HUDCAPS tables including VEND.

Users with update access to the vendor table continue to be excessive

In fiscal year 1999, we reported that 57 percent of the users who had update access to the HUDCAPS VEND table did not utilize it during the fiscal year. We recommended that the CFO evaluate and remove from access those users who no longer need it. In response to our recommendation, the CFO's office deleted 105 users with update access to the VEND table who had not used the system in a six month period.

During the follow-up work on our report on the fiscal year 1999 financial statements, we found that access to the vendor table continues to be excessive. Our analysis of the MTI log for fiscal year 2000 indicated that there are 372 users with update authority, which allows these individuals to enter and change data in the VEND table. Of these 372 individuals, 194 (52 percent) did not use their access at all during fiscal year 2000. The number of individuals with update access to VEND could be reduced much more. Because of the ability of these users to make changes to payment and vendor data, user access to the VEND table should be restricted to those who actually need it.

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

With respect to the QLP control weakness, the CFO and CIO are working on a solution to address this deficiency. They agreed to implement the access key in the LOCCS DMS schema and estimated that implementing this control would require minimal programming time and cost. They have not yet addressed installing the invoke key for PAS and fully protecting the LOCCS/PAS source files containing schema and subschema.

With respect to the internal control deficiencies in system maintenance, data quality, and cash reconciliation of HUDCAPS, the CFO has responded to the recommendations we made in our draft audit. The CFO agreed to take action on some of the recommendations but disagreed with others.

With respect to HUDCAPS access controls, we reported last year that an excessive number of users had access to the vendor tables. The CFO

indicated that it has taken action to reduce update access to the vendor tables. The CFO is currently relying on the various program offices, as part of the annual system user recertification process, for recertifying user access privileges in HUDCAPS.

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

With respect to the QLP access deficiencies, we just recently briefed the CFO on our finding. The CFO is developing a plan of action to address our concerns.

With respect to reported HUDCAPS system deficiencies, we are evaluating Department's response to the draft report and plan to issue a final report in February 2001.

We commend the CFO for reducing the number users with update access to the Vend Table. However, more needs to be done. While the annual recertification process is an effective control, it is not sufficient. The CFO should also periodically review the MTI logs to identify and revoke the update access privilege to those individuals who are not using it.

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

HUD needs to improve controls over the monitoring of obligated balances to determine whether they are still needed and legally valid as of the end of the fiscal year. HUD's procedures for identifying and deobligating funds that are no longer needed to meet its obligations are not always effective. Although HUD has made some progress in implementing procedures and improving its information systems to ensure accurate data are used, further improvements are still needed. Major deficiencies include:

- Specific statutory or grant requirements for outstanding obligations are not being enforced.
- A lack of integration between accounting systems and the need for accurate databases has hampered HUD's ability to evaluate unexpended Section 8 obligations.

Annually, HUD performs a review of unliquidated obligations to determine whether the obligations should be continued, reduced, or canceled. We evaluated HUD's internal controls for monitoring obligated balances. We found a number of weaknesses in the process including (1) reviews were not considering specific statutory or other requirements relating to particular programs and (2) underlying financial systems do not support the process for identifying excess budget authority for the Section 8 programs because of data inconsistencies and inaccurate data. The first deficiency was previously identified in our report on HUD's fiscal year 1999 financial statements and the second issue was identified in our two previous reports on HUD's financial statements.

We found a need for increased oversight and emphasis on the obligation review process. We found deficiencies in the controls over HOPE VI funds and public housing modernization funds and the need for correcting and verifying data underlying the Section 8 obligations.

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

PIH was not enforcing performance requirements under the revitalization grant agreements for HOPE VI grants. The HOPE VI grant agreements contain language which established that the grantee must submit to HUD, within a 90 to 120 day time-frame from the effective date of the grant agreement, a revitalization plan acceptable to HUD. The grant agreements also contain language which established a two year time-frame for the commencement of construction activities. In addition, the grant agreement provides remedies HUD may pursue when grantees fail to meet required time-frames. These remedies range from issuing warning letters to ultimately withdrawing funds. The Quality Housing and Work Responsibility Act of 1998 provides that if a grantee under the HOPE VI program does not proceed within a reasonable time-frame, in the determination of the Secretary, the Secretary shall withdraw the grant amounts under this section that have not been obligated by the HA.

We tested the 84 HOPE VI awards made from fiscal year 1996 through fiscal year 1999 and found that 45 of the 84 grants had revitalization plans that had not been approved. These 45 awards had \$1.0 billion in funds unobligated by the HAs and the revitalization plans were from 3 months to 44 months late. Analysis of the files for the 45 grants showed no default letters had been issued placing the HA on notice that they were in violation of the grant agreement.

In addition, our tests relating to the 84 HOPE VI grants showed that 20 of the HAs had not executed a general contractor's contract or initiated construction work within the required 24 months from the date of execution of the grant agreement. Analysis of the files for the 20 grants showed that no default letters had been issued placing the HA on notice that they were in violation of the grant agreement.

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

In the "Compliance with Laws and Regulations" section of this report, we report that HUD is not in compliance with the United States Housing Act of 1937, as amended by the Quality Housing and Work Responsibility Act of 1998. In this regard, HUD is not enforcing the requirements for the expenditure and obligation by HAs of public housing modernization funds. In the annual review of HUD's outstanding obligations, these provisions were not considered in identifying obligated amounts that may no longer be valid. Moreover, HUD was not taking sufficient action to ensure that other enforcement actions relating to the timely use of modernization funds were carried out in a timely manner.

HUD has made progress in identifying excess reserves in the Section 8 programs

Section 8 budget authority is generally available until expended. As a result, HUD should periodically assess and identify excess program reserves in the Section 8 programs as an offset to future budget requirements. Excess program reserves represent budget authority originally received which will not be needed to fund the related contracts to their expiration. In 1997, HUD initiated action to identify and recapture excess budget authority in its Section 8 contracts. Prior to this, HUD had been unaware of the extent of excess budget authority available to offset needs for new budget authority for the Section 8 programs.

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

The Office of Housing has been hampered in its attempts to evaluate unexpended Section 8 project-based budget authority balances. Data inconsistencies between HUDCAPS and TRACS have resulted in the need for field office verification of data, necessitated separate budget reviews of data in TRACS and HUDCAPS, and impaired HUD's ability to evaluate unliquidated balances. In August and September 2000, \$1.1 billion in unliquidated obligation balances were recaptured in the Section 8 project-based program on expired contracts. However, the related analyses of potential budget shortfalls and excesses for the 27,637 contracts contained in the TRACS database showed only 17,805 contracts (64 percent) were included in the analysis and 9,832 contracts (36 percent) were excluded. Review of the excluded contracts showed the 9,832 contracts were excluded for a number of reasons including invalid "burn rates" and disbursement dates, inactive contracts, and expired contracts. The available budget authority associated with these contracts totaled at least \$1.3 billion. In addition, 2,302 of the contracts had expired prior to September 30, 1999. These 2,302 contracts had \$19.7 million in excess funds available for immediate recapture.

Also, we compared the fiscal year 1999 budget analysis with the fiscal year 2000 budget analysis for TRACS contracts and found that 249 contracts, omitted from the fiscal year 1999 analysis because additional research and data correction were required, were also omitted from the fiscal year 2000 analysis. No research had been performed to correct the data inaccuracies. These 249 contracts have available budget authority of \$77 million. Since HUD's procedures allow up to one year after contract expiration to complete the close-out process and recapture any remaining funds, the \$1.3 billion would not materially affect the fair presentation of HUD's financial statements. However, HUD needs to address data and systems weaknesses to facilitate completion and ensure all contracts are considered in the recapture/shortfall budget process.

PIH has improved its process for identifying excess unexpended budget authority for Section 8 funds, but further improvements are still required in the underlying information systems to ensure accurate data can be obtained on these balances. In August 2000, PIH performed an analysis of budget authority of all years related to the Section 8 tenant-based program and estimated that approximately \$1 billion of excess

unexpended budget authority was available for deobligation and recapture. This is funding that HAS received under contracts with HUD but did not expend or is not needed to make housing assistance payments. We evaluated the accuracy of the Section 8 tenant-based estimate of available budget authority and projection of requirements and found HAS were excluded from the analysis because of discrepancies in the data systems. HUD excluded 111 HAS from the recapture database because of discrepancies in the data involving: (a) the Available Budget Authority Table (ABAT) and the Year-End Settlement Statements (YEST) and (b) contracts which are in their last effective year (first open year). These 111 HAS had available budget authority totaling \$18 million. In addition, PIH performed an analysis of available budget authority on expired contracts for the Section 8 Moderate Rehabilitation program and estimated that \$246 million of excess unexpended budget authority was available for recapture. HUD excluded from the analysis HAS with \$43 million in available budget authority because of discrepancies with contracts in their last effective year (first open year).

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

HUD implemented an automated tracking system for the HOPE VI grant program in fiscal year 1999. The tracking system produces quarterly progress reports which provides milestone, budget, and project information to the program managers. This database provides timely information to enable program managers to monitor and enforce contract compliance. HUD needs to use this system to monitor grantee performance to ensure that milestones are met within a reasonable time. HUD should evaluate the reasons for delays in executing a revitalization plan and general contractors' contracts and take actions to either extend the time-frame or provide notice of default of the grant agreement to enforce compliance.

To address the budget process concerns identified with the Section 8 project-based contracts, the Office of Housing initiated an in-house project to automate and combine the contracts in HUDCAPS and TRACS into a single database to streamline the process for recapturing funds on Section 8 project-based contracts. HUD plans to make additional improvements to its information system to permit automated program review and to lessen the reliance on field office input and data verification.

To address the data integrity issues in HUDCAPS for the Section 8 programs they administer, PIH has initiated actions to correct system problems involving the ABAT/YEST discrepancies and the first open year exclusions. The planned system enhancements are scheduled to be completed by June 2001 and implemented prior to the next recapture analysis.

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

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

HUD's proposed actions to improve the Section 8 accounting systems and the continued emphasis on improving the integrity of the accounting information should facilitate the recapture and budgeting for Section 8 funds.

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**Reportable Condition:**  
The CFO Needs to Tighten Controls over Fund Balance with Treasury Reconciliations

Treasury requires that agencies reconcile their fund balance with Treasury accounts monthly. The reconciliation process is an essential internal control to ensure the integrity of U.S. Government financial reporting and provide for reliable measurement of budget results. Due to the implementation of a new general ledger system in fiscal year 1999, the general ledger was unavailable to support the reconciliation process until November 1999. This condition was one of the factors that resulted in our inability to opine on HUD's fiscal year 1999 financial statements. In order to correct the fund balance with Treasury reconciliation problems, the Department hired a contractor to assist in reconciling all fund balance accounts as of September 1999 and through fiscal year 2000. Corrective actions were underway during fiscal year 2000 to improve reporting and reconciling of Treasury fund balances; however, weaknesses still exist that impair the completeness and reliability of the reconciliations. Specifically, we have concerns with:

- completion of the SF-224, Statement of Transactions;
- clearance of the TFS-6652, Statement of Differences; and
- completion of the cash reconciliations.

Procedures for processing the SF-224, Statement of Transactions need to be updated

The SF-224, Statement of Transactions, is the central accounting document used to report monthly accounting activity to Treasury. The SF-224 provides Treasury with information on agency deposits and disbursements. Treasury relies on the totals from the SF-224 to identify differences between Federal agencies' records and Treasury control totals reported by financial institutions.

During fiscal year 1999, the CFO reorganized and new staff were assigned to perform the monthly SF-224 processing function. At the time of the transfer, the new staff received little to no training in the manually intensive SF-224 process. When we requested the SF-224 procedures, the Department could only locate procedures dating back to the mid 1980's. A year later, the Department still lacks the proper documented procedures to assist the staff in completing the monthly statements. In

approximately 35 percent of the transactions we tested, we found items that were not timely posted to the general ledger, and noted the need for corrections to SF-224s because of errors in posting items to the wrong appropriations. Further, we were told by a supervisor of instances where staff were reporting items on the SF-224 without the proper documentation to avoid having the item(s) appear on the Statement of Differences that HUD receives from Treasury.

The information on the SF-224 should be based upon actual supporting documentation, which in turn would support the general ledger entries. However, we found the support documentation behind the SF-224 was not marked in any way to show responsible staff, dates, or where the items were posted on the SF-224 or the general ledger. By not having the proper documented procedures in place, we believe the Department has increased its risk of misstating its cash balance and is circumventing a major internal control over that balance. We believe that the majority of these “errors” could be eliminated if the staff had proper procedures and guidance to follow. The Department has informed us that it intends to update the procedures after they complete the transition to an automated SF-224 process.

Items on the TFS-6652, Statement of Differences, were not cleared in a timely manner

Treasury produces the Statement of Differences to identify differences between deposit and disbursement data. Treasury identifies these differences by comparing the SF-224 data reported by the Department to data reported by financial institutions. Our testing revealed that differences are not cleared in a timely manner, with some items taking over 16 months to correct. These prior month differences need to be resolved. In addition, we noted that the majority of the differences were caused by staff input error on the SF-224.

Monthly reconciliations with Treasury were heavily dependent upon contractor support

As previously stated, the Department hired a contractor to provide accounting support services to the OCFO. The contractor was also to prepare formats and procedures to reconcile fund balance with Treasury accounts and train staff on the reconciliation procedures. We reviewed the “draft” reconciliation procedures developed by the contractor, and generally found them to be adequate, however, they had not been finalized.

Relying heavily on the assistance of the contractor, in August 2000, the Department completed the first fiscal year 2000 cash reconciliations covering the first two quarters of the fiscal year. The next cash reconciliation was completed for the third quarter with monthly cash reconciliations completed thereafter. The contractor acted as an intermediary between the CFO’s systems staff and the CFO’s accounting staff in order to obtain the proper reports to assist in the reconciliation process. The contractor also assisted the CFO accounting staff with the actual reconciliations. The CFO staff were responsible for determining the corrective action that would be needed to clear the variances

between the Department and Treasury. Although we acknowledge the CFO's efforts to obtain the assistance it needed to correct its reconciliation issues, we are concerned that once the contractor leaves, the Department will not have the capacity to fulfill its monthly reporting obligations. For example, the CFO staff were not fully trained on how to use the new cash reconciliation procedures until February 2001, nearly five months into the next fiscal year. In addition, while reviewing the cash reconciliations, we noted several errors. While these reconciliations were reviewed by a supervisor, the errors noted were easily recognizable and should have been caught during the second level review.

In addition, the Department has had difficulty identifying and resolving differences between its accounting records and cash transactions reported by Treasury for several years. There are many underlying reasons for the Department's difficulties, many of which have been explained above. However, in order to avoid explaining a difference between the amount reported in its general ledger and the amount reported by Treasury, the Department adjusts its general ledger to equal the balance reported by Treasury.

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***HUD's Actions Planned and Underway to Strengthen Fund Balance with Treasury Reconciliations***

As stated above, the Department, with contractor support, has improved the frequency of reconciliations and drafted fund balance with Treasury procedures. In addition, the contractor is in the process of providing cash reconciliation training to the CFO staff.

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

While we agree the Department has shown improvement in completing its monthly cash reconciliations, there is still more that should be done. In fact, as of mid February 2001, the Department had not completed the first quarter cash reconciliations for fiscal year 2001. The Department plans to complete only one cash reconciliation for the first quarter of the fiscal year. Reconciliations should be completed monthly to conform with Treasury requirements.

## Compliance with Laws and Regulations

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

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 FFMIA. If they do not, agencies are required to develop remediation plans and file them with OMB.

During fiscal year 2000, the Department addressed concerns which resulted in a disclaimer of audit opinion for the Department's Fiscal Year 1999 financial statements. In addition, the Department has taken steps to implement a strategy that will address the deficiencies identified with the Department's financial systems weaknesses. As a result of efforts taken by the Department, we are no longer reporting FFMIA noncompliance with applicable accounting standards.

While the Department has made steps to become FFMIA compliant, overall HUD still is not in substantial compliance with FFMIA because HUD's financial management systems did not substantially comply with (1) federal financial management systems requirements, or (2) the SGL at the transaction level. We have included the specific nature of the noncompliance, responsible program offices and recommended remedial actions in Appendix C of this report.

#### Federal Financial Management Systems Requirements

In its *Fiscal Year 2000 Accountability Report*, HUD reports that 11 of its 67 financial management systems do not materially conform with the requirements of FFMIA and OMB Circular A-127, *Financial Management Systems*. The number of reported non-conforming systems was reduced from the 18 reported in the *Fiscal Year 1999 Accountability Report* because 5 systems were discontinued or reclassified as nonfinancial systems and the Department corrected deficiencies in 3 non-conforming systems. HUD also added one system that was previously assessed as conforming to its list of non-conforming systems.

In addition to deficiencies noted in HUD's Accountability Report, we report as a material weakness that *HUD's Financial Systems are Not Compliant with Federal Financial Standards*. This material weakness addresses how HUD's general ledger is not compliant with core financial systems requirements as they relate to interfaces with the core financial system's general ledger, weaknesses that remain in the core system's general ledger and issues related to the short and long term plans to make 19 subsidiary systems that feed transactions to its commercial general ledger system SGL compliant.

Reviews of prior reports and A-130 reviews have disclosed that security over financial information is not provided in accordance with Circular A-130 *Management of Federal Information Resources*, Appendix III. We report as a Reportable Condition that Reliability and Security of HUD's Critical Financial Systems are at Risk. This reportable condition discusses access controls for two major systems that process payments and accounts for funds of major program areas and administrative activities.

Compliance with the SGL at the transaction level

HUDCAPS is the Department's official standard general ledger system. FHA provides consolidated summary level data to HUDCAPS. FHA has 19 subsidiary systems that feed transactions to its commercial general ledger system. These 19 systems lack the capability to process transactions in the SGL format. To provide consolidated summary level data from FHA to HUDCAPS, FHA uses several manual processing steps, including the use of personal computer based software to convert the commercial accounts to government SGL, and transfer the account balances to HUDCAPS. JFMIP requires that the core financial system "...provide for automated month- and year-end closing of SGL accounts and rollover of the SGL account balances". As discussed in our financial systems material weakness, the interface with the FHA system still requires numerous manual processing steps to transfer account balances which result in untimely postings.

Compliance determinations should be expanded to focus on the complete core accounting and feeder system process

For fiscal year 1999, we reported that the Department did not take the problems causing the material weaknesses into consideration when assessing and reclassifying five of its legacy systems to conforming with federal financial management systems requirements. These systems were reclassified as a result of HUD putting into place processes to post FHA SGL balances to HUDCAPS, however, the processes put in place did not result in timely or efficient postings.

For fiscal year 2000, HUD contracted for A-127 reviews of nine systems which included the five systems noted in our fiscal year 1999 report. The scope of the A-127 reviews was limited to reviewing the system's compliance as a separate and distinct part of the greater HUD financial management structure. The methodology applied to conduct the assessments did not address systems weaknesses identified in prior audit reports and did not address whether or not systems are in conformance with FFMIA.

The assessments did not take into consideration A-127 factors for Agency-wide financial information classification structure, integrated financial management systems<sup>16</sup>, application of the U.S. Government Standard General Ledger, Federal Accounting Standards, Financial

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<sup>16</sup> Two of the nine systems were assessed for this factor. One of the two is a feeder system which is part of the Department's strategy to improve its financial management systems.

Reporting, and Budget Reporting. Based on the scope of the reviews and compliance factors assessed, each is listed as conforming with FFMIA.

Seven of the nine systems reviewed are feeder systems which are part of the Department's strategy to implement a new subsidiary ledger to address financial system weaknesses. Only one of seven feeder systems was assessed for the Integrated Financial Management System compliance element. We find this limited scope contrary to the Department's long range plan to improve financial performance. In the plan, the Department states that it will replace 19 fragmented systems and the existing manual process to convert financial transaction to SGL with a JFMIP compliant COTS package to maintain the FHA subsidiary ledger. Given the relationship to the long range plan and existing systems deficiencies, the scope of reviews should be expanded to evaluate the complete core accounting system and related feeder process and develop remediation plans accordingly.

Compliance with submission of remediation plan to OMB

Section 803 (c) (3) of FFMIA requires that when the agency head agrees with the auditor's findings of noncompliance, a remediation plan shall be developed, in consultation with OMB, that describes the resources and milestones for achieving compliance. HUD submitted its fiscal year 2002 submission of information pertaining to planning, budget, and acquisition of capital assets to OMB on December 15, 2000. The plan to correct material system weaknesses has a target completion date of December 31, 2005. As a result, the Department will not be in compliance by April 2001, the statutorily determined deadline, and will need to obtain OMB's approval for additional time to comply with FFMIA.

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

HUD is not in compliance with the United States Housing Act of 1937, as amended by the Quality Housing and Work Responsibility Act of 1998 (the Act). HUD is not timely or properly enforcing the requirements for the expenditure and obligation by HAS of public housing modernization funds. This is an unresolved issue from our report on HUD's fiscal year 1999 financial statements and was forwarded to the Comptroller General of the United States in August 2000 for a legal opinion and resolution.

PIH did not enforce the expenditure provisions of the Act for modernization funds

Our analysis of HUD records relating to expenditure of fiscal year 1996 and prior years public housing modernization funds showed \$193 million in unexpended funds as of September 30, 2000. The Act provides that public housing modernization assistance received under The Act shall be spent not later than four years after the date on which funds become available for obligation. The Act provides that the Secretary shall enforce the requirement for expenditure of funds through default remedies up to and including the withdrawal of funds. For fiscal year 1999, we reported the same deficiency relating to HAS having \$337 million in unexpended fiscal year 1995 and prior fiscal year funds. HUD believed the provision of the Act, as it relates to expenditures, do not apply to funds made available prior to enactment of the Act. However, it is our opinion the provisions do apply because the Act specifically merged the previously awarded

PIH did not enforce the obligation provisions of the Act for modernization funds and failed to take timely enforcement actions

assistance into the present “Capital Fund” thereby subjecting the previously awarded funds to the enforcement provisions of the Act.

Our review of records relating to public housing modernization funds showed that HAS had \$142 million in unobligated fiscal year 1998 and prior fiscal year modernization funds as of September 30, 2000. HUD’s policy with respect to these unobligated funds is not in compliance with the Act.

The Act provides with respect to the public housing modernization funds, that such funds shall be fully obligated by the HAS no later than 24 months after the date the funds become available to the agency for obligation. The Act provides that an HA shall not be awarded assistance for any month during the fiscal year in which the HA has funds unobligated in violation of the Act. Additionally, during any fiscal year in which the agency is in violation, the Secretary shall withhold all assistance that would otherwise be provided to the HA. If the HA cures its failure to comply during the year, it shall be provided with the share attributable to the months remaining in the year.

HUD did not feel that the sanction and recapture provisions of the Act applied to fiscal year 1997 and prior fiscal year funds. HUD provided policy regarding these funds in the December 22, 1999 Federal Register Notice. The notice provided that if these unobligated fiscal year 1997 and prior fiscal year funds are not fully obligated by March 30, 2000, an additional final sanction of the loss of all unobligated fiscal year 1997 and prior fiscal year public housing modernization funds, through notification of annual contributions contract default and recapture of outstanding unobligated funds, shall be implemented. In addition, HUD stated that no fiscal year 2000 funds for modernization activities would be issued to an HA that had unobligated fiscal year 1997 and prior fiscal year modernization funds until all such unobligated funds were obligated. However, the sanction and recapture of fiscal year 1997 and prior year’s funds were not in accordance with provisions of the Act. Furthermore, HUD believed the December 22, 1999 Federal Register Notice was a legal and reasonable exercise of PIH’s authority to prescribe remedies for the unobligated fiscal year 1997 and prior funds.

We agreed that HUD may impose any number of additional remedies for the unobligated funds, however it is our opinion that at a minimum, HUD must impose the Congress’ mandated remedy according to the Congress’ prescribed time-frame. Moreover, review of subsequent actions taken by HUD with respect to enforcing the remedies provided by the Federal Register Notice showed that HUD did not even enforce the sanctions it had proposed. Our analysis as of September 30, 2000 showed that 49 HAS still had \$5.5 million in fiscal year 1997 or prior year funds unobligated. Instead of following its stated policy, HUD issued \$83 million in fiscal year 2000 funds to these 49 HAS.

**PRINCIPAL  
FINANCIAL  
STATEMENTS**

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## Objectives, Scope and Methodology

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Management is responsible for:

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

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

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

We considered HUD's internal control over Required Supplementary Stewardship Information to be reported in HUD's *Fiscal Year 2000 Performance and Accountability Report* by obtaining an understanding of the design of HUD's internal controls, determined whether these internal controls had been placed in operation, assessed control risk, and performed tests of controls as required by OMB Bulletin 01-02, *Audit Requirements for Federal Financial Statements* and not to provide assurance on these internal controls. Accordingly, we do not provide assurance on such controls.

With respect to internal controls related to performance measures to be reported in the "Management's Discussion and Analysis" and HUD's *Fiscal Year 2000 Performance and Accountability Report*, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin 01-02. Our procedures were not designed to provide assurance on internal control over reported performance measures and, accordingly, we do not provide an opinion on such controls. However, as reported in the "HUD's Internal Control Environment" section of this report, we noted certain significant deficiencies in internal control over certain reported performance measures that, in our judgment, could adversely affect HUD's ability to collect, process, record, and summarize those performance measurements in accordance with management's criteria.

To fulfill these responsibilities, we:

- examined, on a test basis, evidence supporting the amounts and disclosures in the consolidated principal financial statements;

- assessed the accounting principles used and the significant estimates made by management;
- evaluated the overall presentation of the consolidated principal financial statements;
- obtained an understanding of internal controls over financial reporting, executing transactions in accordance with budget authority, compliance with laws and regulations, and safeguarding assets;
- tested and evaluated the design and operating effectiveness of relevant internal controls over significant cycles, classes of transactions, and account balances;
- tested HUD's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin 01-02, including the requirements referred to in FFMIA ;
- considered compliance with the process required by FMFIA for evaluating and reporting on internal control and accounting systems; and
- performed other procedures as we considered necessary in the circumstances.

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

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

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

Our work was performed in accordance with *Government Auditing Standards* and OMB Bulletin 01-02.

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

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## Recommendations

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To facilitate tracking recommendations in the Departmental Automated Audits Management System, this appendix lists the newly developed recommendations resulting from our report on HUD's fiscal year 2000 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.

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### Recommendations from the Current Report

With respect to the material weakness on improvements needed in oversight and monitoring of subsidy calculations, we recommend that the **Deputy Secretary**:

- 1.a. Develop appropriate plans to implement the President's fiscal year 2001 Priority Management Objective (PMO) - *Verify that the right person get the right benefit*, and (when implemented) OMB's guidance on Improving Federal Benefit Payment Integrity. Specifically, the PMO and guidance instructs agencies with major Federal benefit programs where the risk of improper payments is greater than minimal to periodically assess and report their performance and progress. This will likely require the agency to prepare an estimate of the amount of improper subsidy payments on a periodic basis.
- 1.b. Develop a plan with milestones to implement the four recommendations (on page ES-viii) in the Office of Policy Development and Research's contracted Interim Final Report, *Quality Control for Rental Assistance Subsidies Determinations*, dated November 29, 2000.

We recommend that the **Assistant Secretary for Public and Indian Housing**:

- 1.c. Develop guidance that directs that the field offices to select and give priority for on-site monitoring to the at risk HAS in order to maximize resources to abate the number of those that are at risk. In addition, on-site monitoring waivers of the at risk HAS should be justified on the basis of the progress that the at risk and HAS made in eliminating the problems that caused them to become at risk.
- 1.d. Develop guidance that allows field offices to uniformly identify the at risk HAS through the risk assessment process in PIH's risk based monitoring strategy.
- 1.e. Redirect priorities to fully implement the PIC 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 HAS and for maintaining current and complete data in PIH's IBS and PIC in a timely manner.

We recommend that the **Deputy Assistant Secretary for Multifamily Housing** in consultation with the **Director of the Departmental Enforcement Center** (DEC):

- 1.f. Until such time that the DEC can complete implementation of information systems that can be accessible by multifamily project management staff, either through REMS or directly, take measures

to assure that the information that is currently recorded in REMS by the Office of Housing or DEC staff is accurate and consistent with actions taken by the DEC and multifamily field offices.

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

- 1.g. Continue plans to upgrade the reporting in REMS to provide for a dynamically updated computer ranking combining all the major monitoring tools available to the Office of Housing, as applicable, to the project being ranked. Specifically, we suggest the following upgrades to REMS, and in its use:
  - Establish fields for each major monitoring tool indicating the proper date for the “next to be conducted” scoring or evaluation according to the protocol and populated this field by computer dating based on the last time the monitoring tool was used and rank reported.
  - Establish a field that combines the ranking from all current monitoring tools used as applicable and conducted resulting in an overall ranking by the computer. This does not replace the existing judgment based ranking, but would be used to produce reporting when these rankings varied.
  - Periodically review (no less than quarterly), the overall risk ranking for each field office “HUB” and any justifications for variance between the computer and judgment rankings as necessary.

With respect to the reportable condition that controls over project-based subsidy payments need to be improved, we recommend that the **Director of the Section 8 Financial Management Center**:

- 2.a. Provide written policies and procedures for post payment reviews in the interim period before the automated post payment review process is operational.
  - Appropriate voucher selection methods, i.e. random sampling, and results tracking mechanisms, should be established.
  - Appropriate interaction with the Office of Housing should be taken to establish sanction policies and authority for suspension of payments to owners who do not comply with HUD regulations.

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

- 3.a. Install an audit trail mechanism to track and monitor individual use of the HUDSEC user ID so accountability can be established.
- 3.b. Ensure administrative access authorities of users are removed when they transfer duties or terminate employment.
- 3.c. Assign sufficient priority to the File Privatization initiative to complete so the effort can be completed without delay.
- 3.d. Ensure that software developers and testers do not have update access to production financial systems.

We recommend that the **Chief Information Officer** along with the **Assistant Secretary for Administration**:

- 3.e. Establish policies and procedures to ensure that the Kane Security Analyst tool is run at least every quarter and when modifications are made to the Novell servers such as new programs or user groups.
- 3.f. Based on the Kane reports, ensure users who are identified as having easily guessed passwords modify their passwords according to Departmental guidance.
- 3.g. Based on Kane reports, ensure Novell servers disallow unencrypted passwords.
- 3.h. Obtain and distribute the tape backup equipment that will allow field offices to restore backups made by their respective IT office.
- 3.i. Establish procedures to ensure that tape backups are tested and documented.

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

- 3.j. Perform at least one full disaster mode test on a yearly basis to determine if the recovery site will function as intended, critical applications can be properly replicated, and key personnel are able to carry out their duties and responsibilities in a disaster situation. A full disaster mode test should include selecting a reasonable sample of critical applications to be tested, restoring the databases and files for the applications, rerouting telecommunications links, and switching over live processing to the recovery site.
- 3.k. Complete Department wide policies and procedures governing standards for implementing and managing CM on both the mainframe and client server platforms.
- 3.l. Obtain highly qualified CM administrators to aid in implementing HUD's mission critical applications under CM control according to the agency wide policies and procedures, and subsequently manage the applications thereafter.
- 3.m. Establish new implementation schedules with realistic dates and assign sufficient priority to prevent further delays.

With respect to the reportable condition that weak personnel security management continues to pose risks of unauthorized access to the Department's critical financial systems, we recommend that the **Chief Information Officer**:

- 4.a. Provide policy and guidance to the program offices (system owners) and the Office of Administration for determining system criticality and sensitivity, and the appropriate levels of access and background investigations for system users.
- 4.b. Ensure that the critical and/or sensitive system list is maintained and updated timely and regularly provided to the Director of Employee and Labor Relations, Office of Human Resources.

We recommend that the **Assistant Secretary for Administration**:

- 4.c. Enhance the reporting capability of the SCATS system so that essential management reports are available. Management reports should include summary and detailed information on the number of

completed requests, the number of requests in process, the number awaiting process, and the access levels of federal and contractor users with access to HUD's critical and/or sensitive systems.

With respect to the reportable condition that the reliability and security of HUD's critical financial systems are at risk, we recommend that the **Chief Financial Officer**:

- 5.a. Establish the access key(s) in the LOCCS schema and the invoke key in the PAS subschema.
- 5.b. Limit the access to the schema and subschema source files for both PAS and LOCCS, and the security privilege (PB\$CON) to those users with a justified need for the access.
- 5.c. Adopt policies and procedures to control the distribution of the QLP invoke and access keys for updating PAS and LOCCS data.
- 5.d. Establish an audit trail that can be used to detect unauthorized use of QLP for database updates.
- 5.e. Review the MTI log quarterly to determine which users have not accessed the VEND table in six months and remove their access.

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

- 6.a. Take actions to address the data integrity problems in HUDCAPS for Section 8 Tenant-based Housing Authorities to ensure accurate data are used in the process for identifying excess unexpended budget authority.

With respect to the reportable condition that the CFO needs to tighten controls over Fund Balance with Treasury reconciliations, we recommend that the **Chief Financial Officer**:

- 7.a. Ensure that all staff are properly trained in their particular function, whether it be in the completion of the monthly reporting documents, clearance of differences or the cash reconciliation so the reporting is completed timely and in an accurate manner.
- 7.b. Draft an updated version of the Statement of Transactions, SF-224 procedures. If the automated formatted SF-224 is delayed, a draft for the manual procedures should also be completed. The procedures should provide that adjustments are not to be made to the general ledger or to the SF-224, Statement of Transactions without the proper supporting documentation.

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## Unimplemented Recommendations from Prior Years' Reports

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

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

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

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

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

- 3.a. Establish effective administration of HAP payments by (1) fully implementing Section 8 performance-based contracts, and (2) developing a process and controls to assure the accuracy and timeliness of payments not administered by performance-based contractor administrators. (Final action target date is December 31, 2001.)

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

The issues that led to the following recommendations have not changed; however, HUD has created the REAC and the Departmental Enforcement Center which will have responsibility over responding to the recommendations and addressing the issue. Therefore, we have revised the recommendation. With respect to the material weakness on improvements needed in multifamily project monitoring, we recommend that the **Director of the Real Estate Assessment Center (REAC)**:

- 4.d. Develop procedures to (1) monitor Section 8 third party contractors not under Section 8 performance – based contracts and contracts that will continue to be administered by HUD staff; and (2) ensure field offices follow-up on compliance and performance issues resulting from REAC’s analysis of financial statements..  
(Final action target date is March 31, 2001.)

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

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

- 2.a. Assess the readiness of HUD to meet Statement of Federal Financial Accounting Standards No. 4, Managerial Cost Accounting Concepts and Standards, in Fiscal Year 1997 and to recommend a coordinated plan of action for HUD’s major operating components that accomplish the Government Performance and Results Act and Statement of Federal Financial Accounting Standards objectives. (Final action target date is May 26, 2001.)

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

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

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

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

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

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

- 3.a. Verify that project-based Section 8 payments are accurate and allowable by testing source documentation through verification of tenant data. Examples of procedures that do this include confirmations and on-site reviews. (Final action target date is September 30, 2001.)
- 4.d. We recommend that the **Deputy Assistant Secretary for Multifamily Housing**, with input as needed from the CFO, the REAC, the Office of Multifamily Housing Restructuring, and the Enforcement Center, establish the capacity to issue and maintain current criteria by establishing:
- a team to update and issue through, official Departmental channels, the required revisions to all criteria (Handbooks, Directives, guidance and policy statements) for multifamily projects, which are clear, adequate and effectively distributed; and
  - a permanent capacity or division within the Office of Housing to revise criteria as needed.
- (Final action target date is September 30, 2001.)

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

- 7.d. Continue efforts to minimize access control weaknesses with UNISYS demand mode processing by proceeding with the UNISYS security enhancement plans. (Final action target date is September 30, 2000.)
- 7.j. Ensure that configuration management on the Hitachi, UNISYS, client/server and personal computer based platforms is a priority.
- Schedule and implement Hitachi critical applications under Endeavor.

- Select and procure configuration management software, and schedule and implement the software for critical UNISYS applications.
- Continue with the procurement, scheduling and implementation of client/server and personal computer based platform applications.

(Final action target date is September 29, 2000.)

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

- 8.d. Periodically reconcile its database of background check statuses using listings provided by the Office of Information Security and access listings provided by the Program Security Administrators. (Final action target date is April 30, 2000.)

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

- 10.d. Ensure that data used in reviewing unliquidated obligation balances are complete, current, and accurate. (Final action target date is September 30, 2000.)
- 10.e. Ensure that all contract amounts determined to have excess budget authority are deobligated and recaptured. (Final action target date is September 30, 2000.)

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**OIG Report Number 00-FO-177-0003 (Fiscal Year 1999 Financial Statements)**

With respect to the material weakness that HUD's financial systems are not compliant with federal financial standards, we recommend that the **Deputy Secretary:**

- 1.a. Direct CFO and FHA to work together to develop a general ledger interface with the FHA accounting system which will provide for automated monthly transfers of financial information. (Final action target date is September 30, 2000.)

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

- 1.c. Develop an automated template to assist in reconciling all general ledger cash accounts to Treasury records. (Final action target date is February 28, 2001.)
- 1.d. Complete fund balance with Treasury reconciliations in a timely manner and identify and correct all systematic problems. (Final action target date is February 28, 2001.)
- 1.e. Finalize the draft procedures to be used to complete the fund balance with Treasury account reconciliation between HUDCAPS and Treasury balances. (Final action target date is February 28, 2001.)
- 1.f. Restrict adjustments to the Hyperion reporting program to financial statement reclassifications and post all transaction adjustments to the general ledger. (Final action target date is February 28, 2001.)

- 1.g. Delay conversion of additional funds to HUDCAPS (except for Section 8) until fund balance with Treasury reconciliations can be completed in a timely manner, and related system problems are identified and corrected. (Final action target date is November 30, 2000.)

We recommend that the **Deputy Secretary**:

- 1.h. Clearly define the objective and project scope of the Financial Systems Integration project and ensure compliance. (Final action target date is September 30, 2000.)

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

- 2.a. Track and determine bottlenecks for completing and implementing risk reviews. (Final action target date is May 15, 2001.)
- 2.b. Report to the Deputy Secretary issues that are not resolved. (Final action target date is May 15, 2001.)
- 2.c. Establish due dates for responses to CFO reviews and hold program offices accountable. (Final action target date is May 15, 2001.)

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

- 3.a. Finalize plans to improve administration of HAP contracts remaining under HUD responsibility after the transfer to contract administrators is completed. In formulating these plans, HUD should consider the responsibilities being placed on contract administrators and design a comparable oversight strategy, establish organizational responsibilities, and at a minimum, address the following areas:
  - management and occupancy reviews,
  - rental adjustments,
  - opt-out and contract termination,
  - HAP payment processing including review of monthly vouchers,
  - follow-up on health and safety issues and community/resident concerns,
  - resolving deficient annual financial statements and physical inspection results, and
  - renewing expiring assistance contracts.

(Final action target date is March 31, 2001.)

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

- 4.c. Adhere to the schedule of planned actions for protecting sensitive and critical HUD data on the UNISYS from unauthorized access. (Final action target date is March 31, 2001.)

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

- 5.b. Establish and document a process to ensure that only authorized individuals with the appropriate position sensitivity level of clearance be granted continued access to HUD critical systems. (Final action target date is September 30, 2000.)
- 5.c. Develop and implement a system to process and track requests for background investigations. (Final action target date is September 30, 2000.)

With respect to the reportable condition that HUD needs to improve its processes for reviewing obligation balances, the following two recommendations have been reopened because corrective actions have not been taken and deficiencies still exist. We recommend that the **Assistant Secretary for Public and Indian Housing**:

- 9.a. Evaluate the reasons for delay by the public housing agencies with unobligated balances of HOPE VI funds awarded during fiscal year 1997 and prior years and take actions to either waive the regulations and extend the termination date of the grant or terminate the grant as to all further activities and initiate close-out procedures and recapture unobligated funds.
- 9.b. Ensure that the Office of Public Housing Investments utilizes their quarterly tracking system to monitor and enforce public housing agencies' compliance with HOPE VI grant agreements.

The following recommendations remain open because corrective actions have not been fully implemented and deficiencies still exist. We recommend that the **Assistant Secretary for Public and Indian Housing**:

- 9.c. Enforce the requirement of the United States Housing Act of 1937, as amended by the Quality Housing and Work Responsibility Act of 1998 for the expenditure of public housing modernization funds through default remedies up to and including the withdrawal of funds. (Final action target date is December 31, 2000.)
- 9.d. Issue clarifying guidance that is in accordance with the United States Housing Act of 1937, as amended by the Quality Housing and Work Responsibility Act's provisions regarding the obligation, by HAS, of modernization funds. (Final action target date is December 31, 2000.)

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

- 9.f. Improve systems and procedures to facilitate timely contract close-out and identification and recapture of excess budget authority on expired project based Section 8 contracts. This process should occur periodically during the fiscal year rather than after fiscal year end. (Final action target date is January 1, 2001.)

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

This Appendix provides details required under FFMIA reporting requirements. To meet those requirements, we performed tests of compliance using the implementation guidance for FFMIA issued by OMB. The results of our tests disclosed HUD's systems did not substantially comply with the foregoing requirements. The details for our basis of reporting substantial noncompliance, responsible parties, primary causes and the 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 FMFIA is to report 11 non-conforming systems. HUD reduced the number of non-conforming systems from 18 to 11 as a result of 5 systems being discontinued or reclassified as nonfinancial systems and making corrective actions to 3 systems. HUD also added one system to its list of non-conforming systems. 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:

Responsible Office

Number of Systems

Non-Conforming Systems

Office of Housing	25	8
Chief Financial Officer	17	2
Office of Administration	4	0
Office of Public and Indian Housing	3	1
Office of Fair Housing and Equal Opportunity	0	0
Government National Mortgage Association	8	0
Office of Community Planning and Development	9	0
Office of the Chief Procurement Officer	0	0
Real Estate Assessment Center	<u>1</u>	<u>0</u>
	<u>67</u>	<u>11</u>

The following section outlines the Department’s plan to correct specific A-127 system non-conformances.

**Office of Housing**

<b><u>System</u></b>	<b><u>Outstanding Noncompliance Issue @ 09/30/00</u></b>	<b><u>Plan @9/30/00</u></b>	<b><u>Target date to Complete all Phases</u></b>	<b><u>Resources</u></b>
A56 - Mortgage Insurance General Accounting	<ul style="list-style-type: none"> <li>• Classification Structure</li> <li>• Integrated Financial Management System</li> <li>• Accounting Standards</li> <li>• Financial Reporting</li> <li>• Budget Reporting</li> <li>• Functional Requirements</li> <li>• Clear Documentation</li> <li>• Internal Controls</li> <li>• Training/User Support</li> <li>• Maintenance</li> </ul>	Implement new subsidiary ledger system interfaced with one or more operational feeder systems  Implement all 19 operational feeder systems	03/31/02  12/31/05 <i>Orig.: 9/99</i>	FY 99 \$1,289,000 FY 00 \$4,421,000 FY 01 \$8,096,000 FY 02 \$6,337,000 FY 03 \$3,385,000 FY 04 \$1,463,000 FY 05 \$1,236,000
A80N - Single Family Mortgage Notes Servicing (Feeder)	<ul style="list-style-type: none"> <li>• Functional requirements</li> <li>• Training/User Support</li> </ul>	Produce a set of written system requirements  Produce a set of instructions specific to how HUD uses the software to perform case specific functions.	09/30/01  09/30/01 <i>Orig.: 9/99</i>	\$50,000
A80S - Single Family Acquired Asset Management (Feeder)	<ul style="list-style-type: none"> <li>• Internal Controls</li> <li>• Functional Requirements</li> <li>• Clear Documentation</li> </ul>	Implement SAMS Release 4.5	05/01/01 <i>Orig.: 9/99</i>	\$5,000

<u>System</u>	<u>Outstanding Noncompliance Issue @ 09/30/00</u>	<u>Plan @9/30/00</u>	<u>Target date to Complete all Phases</u>	<u>Resources</u>
F47 - Multifamily Insurance (Feeder)	<ul style="list-style-type: none"> <li>• Functional requirements</li> <li>• Clear documentation</li> <li>• Training/user support</li> </ul>	Update Functional Requirements document, User's Guide and Training Guide  This system is also scheduled to move into the new general ledger system that is planned for implementation.	09/30/01  12/31/05 <i>Orig.: 9/99</i>	\$150,000
F05 - Section 8 Management Information System	<ul style="list-style-type: none"> <li>• Classification structure</li> <li>• Integrated Financial Management System</li> <li>• Application of standard general ledger</li> <li>• Accounting Standards</li> <li>• Financial Reporting</li> <li>• Budget Reporting</li> <li>• Functional Requirements</li> <li>• Internal Controls</li> <li>• Training/User Support</li> <li>• Maintenance</li> </ul>	Incorporate the remaining F05 functionality into F24A Development Application Processing (DAP) and F87 Tenant Rental Assistance Certification System (TRACS), then terminate the F05 Section 8 Management Information System	11/30/01  <i>Orig.: 3<sup>rd</sup> quarter FY 99</i>	\$120,000 in development funds
F75 - Multifamily Insurance and Claims System (Feeder)	<ul style="list-style-type: none"> <li>• Functional Requirements</li> <li>• Clear Documentation</li> <li>• Training/User support</li> </ul>	Complete Functional requirements document  Complete Users Guide  Complete training guide and provide user support  System will be converted to another platform, at which time new compliant Functional Requirements, User's Guide and training will be implemented	09/30/01  <i>09/30/01</i>  <i>09/30/01</i>  <i>09/30/01</i> <i>Orig.: 9/99</i>	\$280,200
F87 - Tenant Rental Assistance Certification System	<ul style="list-style-type: none"> <li>• Application of standard general ledger</li> <li>• Accounting standards</li> </ul>	Assess results of GAO review of the Financial Management Center  Conduct a full A-127 review  Prepare a remediation plan based on outcome of A-127 review  Include in FY 2002 budget those tasks required to correct any deficiencies identified  Plan and schedule necessary tasks to bring TRACS into compliance  Complete planned A-127 related tasks	02/28/01  04/30/01  05/31/01  06/01/01  06/30/01  09/30/02 <i>Orig.: 9/99</i>	To be determined based on review results
R25 - FHA Contract Tracking System	<ul style="list-style-type: none"> <li>• Functional Requirements</li> <li>• Clear Documentation</li> <li>• Training/User Support</li> <li>• Maintenance</li> </ul>	Incorporate functionality into the Cash, Control, Accounting, Reporting System (CCARS) and terminate the system	12/31/00  <i>Orig.: 9/99</i>	\$202,224

**Office of the Chief Financial Officer**

<u>System</u>	<u>Outstanding Noncompliance Issue @ 09/30/00</u>	<u>Plan @9/30/00</u>	<u>Target date to Complete all Phases</u>	<u>Resources</u>
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A21 - Loan Accounting System	<ul style="list-style-type: none"> <li>• Integrated Financial Management System</li> </ul>	Develop a statement of work to re-engineer/re-platform LAS  Implement a replacement system	1 <sup>st</sup> quarter FY 2001  Dependent on availability of resources  <i>Orig.: 9/00</i>	Not determined
A65A - Section 235 Automated Validation and Editing	<ul style="list-style-type: none"> <li>• Classification Structure</li> <li>• Integrated Financial Management</li> </ul>	Converted general ledger for 0148 to HUDCAPS  24 documents processed per year, not considered cost effective to create electronic interface	9/00  <i>Orig.: 9/99</i>	N/A

**Office of Public and Indian Housing**

<b><u>System</u></b>	<b><u>Outstanding Noncompliance Issue @ 09/30/00</u></b>	<b><u>Plan @09/30/00</u></b>	<b><u>Target date to Complete all Phases</u></b>	<b><u>Resources</u></b>
N07- Regional Operating Budget and Obligations Tracking (ROBOTS)	<ul style="list-style-type: none"> <li>• Integrated financial management system</li> <li>• Functional requirements</li> </ul>	<ul style="list-style-type: none"> <li>• Implement PIH Information Center (PIC) system as the integrated solution for the PIH Operation Fund.</li> </ul>	09/30/01  <i>Orig.: 7/99</i>	\$800,000

2. In addition to individual systems not conforming with A-127, the Department’s current systems have interface shortfalls and are housed on aging legacy systems which result in the Department processing financial transactions through non-integrated systems and necessitating significant manual analyses. The Department has addressed those weaknesses, in it’s “Financial Management Vision”, however, actions to correct weaknesses are not planned for completion until the end of calendar year 2005. The focus of the Financial Management Vision is to install a COTS package as a consolidated general ledger in the following phases:

- a. Replace subsidiary general ledgers for Ginnie Mae, administrative accounts, and small program accounts.
- b. Implement COTS package as subsidiary ledger for FHA and accounts in PAS.
- c. Implement COTS package as subsidiary ledger for FMC Section 8 and remaining disbursements.

The COTS implementation includes plans to replace 19 legacy feeder systems. These 19 systems are associated with the overall weakness and the conversion will require validation of the existing feeder system extracts and determination of the appropriate SGL accounting treatment and data format. We have listed these systems for which the Office of Housing is the responsible office.

**System Code    Systems Code/Name****Reported by HUD as conforming with A-127:**

A80R	Single Family Premium Collection Subsystem-Upfront
A43	Single Family Mortgage Insurance System
F71A	Title I Generic Debt Management System
F46	Multifamily Property Management System
A80G	Multifamily Mortgage Auction System
F24	Multifamily Application Fees and Premiums Spreadsheet
F49	Multifamily Accounting, Reporting, and Servicing System
FHACTS	FHA Contract Tracking System
A43C	Single Family Insurance Claims System <sup>17</sup>
A80B	Single Family Premium Collection Subsystem-Periodic <sup>1</sup>
F12	Single Family Home Equity Conversion Mortgage System <sup>1</sup>
A80D	Single Family Distributive Shares And Refund Subsystem <sup>1</sup>
F71	Title I Notes Servicing Debt Management Collection System <sup>1</sup>
F72	Title I Insurance Premiums and Claim System <sup>1</sup>
F31	CCARS/Cash Control Accounting and Reporting System <sup>1</sup>

**Reported by HUD as nonconforming with A-127:**

A80N	Single Family Mortgage Notes Servicing System
A80S	Single Family Acquired Asset Management System
F47	Multifamily Insurance System
F75A	Multifamily Insurance Claims System

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<sup>17</sup> Fiscal Year 2000 A-127 reviews were based on individual system functionality and did not include an assessment of systems' interfaces.

3. Our audit disclosed reportable conditions regarding the security over financial information. Although reportable conditions, we are including security issues as a basis for noncompliance with FFMIA because of the collective effect of the issue and noncompliance with Circular A-130, Appendix 3. The responsible office, nature of the problem and primary causes are summarized below.<sup>18</sup>

**Responsible Office****Nature of the Problem****Office of the CFO**

We estimate that more than 700 HUD and contractor personnel could have the ability to read and update LOCCS/PAS data using the QLP without authorization.

The primary cause for this occurrence is the need to periodically review access privileges because HUD has not established an adequate audit trail in the system to detect unauthorized QLP use.

**Office of Housing**

REMS and MFIS which are key FHA Multifamily applications, lack sufficient segregation of duties between key operational functions, such as data entry and transaction approval.

SAMS contractors have the ability to access sensitive security reports that show login information for other contractors.

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

The primary cause for these occurrences are that HUD has not provided adequate protection over sensitive programs and files. HUD has not enhanced the level of segregation of duties for key data processing functions, limiting contractor access to sensitive application security reports, and ensuring that security risk assessments are performed by key applications.

**Office of Housing**

FHA's SAMS lacks database controls to ensure that data integrity is maintained when the application encounters processing problems.

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

**Chief Information Officer**

Inappropriate individuals may be granted access to HUD's facilities, information and resources.

The primary cause is that HUD has not given sufficient priority to personnel security.

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<sup>18</sup> The issues are discussed in greater detail in the sections of this report relating to the reportable conditions "HUD Still Needs to Strengthen the Controls Over Its Computing Environment," "Weak Personnel Security Management Continues to Pose Risks of Unauthorized Access to the Department's Critical Financial Systems", and "Reliability and Security of HUD's Critical Financial Systems are at Risk". Also, KPMG LLP's separate report on their audit of FHA's fiscal year 2000 financial statements includes a reportable condition relating to "FHA/HUD must Enhance the Design/Operation of Controls Over Information Systems Security and Application Data Integrity."

**Responsible Office****Nature of the Problem****Chief Information Officer**

Sensitive Privacy Act data and payment system data are vulnerable to unauthorized access.

The primary cause is that HUD has not completed efforts to implement "File Privatization" in critical applications such as LOCCS, PAS, and Loan Accounting System.

**Chief Information Officer**

Errors, omissions, and unauthorized changes could be undetected in UNISYS applications.

The primary cause is the Department does not track individual use of its HUDSEC privilege. HUDSEC is the most powerful authorization used for performing security and system administration functions.

**Chief Information Officer**

The risk of unauthorized system administrative activities exists.

The primary cause is the Department does not control its Site Management Complex (SIMAN) system administration authorities.

**Chief Information Officer**

HUD critical applications risk unauthorized, deliberate or unintentional, software modifications, which could result in errors, loss of data, or system failure

The primary cause is the lack of adequate policies and procedures governing CM standards.

Specific recommendations to correct security weaknesses are listed in Appendix B of this report and KPMG LLP's separate report on their audit of FHA's fiscal year 2000 financial statements.

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

HUDCAPS is the Department's official standard general ledger system. FHA provides consolidated summary level data to HUDCAPS. FHA has 19 subsidiary systems that feed transactions to its commercial general ledger system. These 19 systems lack the capability to process transaction in the SGL format. To provide consolidated summary level data from FHA to HUDCAPS, FHA uses several manual processing steps, including the use of personal computer based software to convert the commercial accounts to government SGL, and transfer the account balances to HUDCAPS. JFMIP requires that the core financial system "...provide for automated month-and year-end closing of SGL accounts and rollover of the SGL account balances". As discussed in our financial systems material weakness, the interface with the FHA system still requires numerous manual processing steps to transfer account balances which result in untimely postings.

