United States General Accounting Office

GAO

Report to Congressional Requesters

July 1999

MANAGEMENT CHALLENGES

GAO's Responses to HUD's Comments

GAO

Accountability * Integrity * Reliability

GAO/RCED-99-189

GAO

United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-282678

July , 1999

The Honorable Wayne Allard
Chairman, Subcommittee on Housing
and Transportation
Committee on Banking, Housing,
and Urban Affairs
United States Senate

The Honorable John F. Kerry
Ranking Minority Member
Subcommittee on Housing
and Transportation
Committee on Banking, Housing,
and Urban Affairs
United States Senate

As part of the work in producing our January 1999 report Major Management Challenges and Program Risks: Department of Housing and Urban Development (GAO/OCG-99-8), on December 15, 1998, we provided the Department with a statement of facts for its review and comment. In response, in a letter dated December 28, 1998, the Department of Housing and Urban Development's (HUD) Deputy Secretary stated that he was disappointed with the conclusion we reached regarding HUD's risk status (that the integrity and accountability of HUD's programs remain at high risk) and raised several concerns about our statement of facts. Specifically, the Deputy Secretary raised concerns about (1) our designation of HUD's programs as a high-risk area and the criteria we use in designating an area as high-risk and in removing that designation; (2) HUD's belief that we had not fully addressed the impact and significance of reforms that the Department has recently instituted; (3) HUD's belief that our December 18, 1998, report on HUD's information systems was not accurate and complete;[1] and (4) HUD's belief that there were inaccuracies in our statement of facts.

You asked that we provide you with our response to the issues raised by the Deputy Secretary. This report responds specifically to the issues HUD raised. Appendix I includes HUD's letter; and appendix II, our point-by-point evaluation of HUD's comments.

[1]HUD Information Systems: Improved Management Practices Needed to Control Integration Cost and Schedule (GAO/AIMD-99-25, Dec. 18, 1998).

GAO's Designation of HUD's Programs as a High-Risk Area

In summary, our conclusion that HUD's programs are a high-risk area is based on the status of four serious, long-standing Department-wide management deficiencies that, taken together, have placed the integrity and accountability of HUD's programs at high risk since 1994. We and others (i.e., HUD's Inspector General and external auditors) have observed these significant management deficiencies that cut across HUD's program areas, and we have issued numerous reports about them over the past 15 years.[2]

We designated HUD's programs as a high-risk area in 1994 because of (1) internal control weaknesses, such as a lack of necessary data and management processes that were a major factor leading to the HUD scandals of the late 1980s; (2) poorly integrated, ineffective, and generally unreliable information and financial management systems that did not meet the needs of program managers; (3) organizational deficiencies, such as overlapping and ill-defined responsibilities; and (4) an insufficient mix of staff with the proper skills, which hampered the effective monitoring and oversight of HUD's programs.

As pointed out in our January 1999 report on HUD's major management challenges and program risks, our recent work indicates that, while HUD has made credible progress in laying the framework for improving its management, internal control weaknesses and problems with information and financial management systems persist at the Department. Furthermore, recent reforms to address the Department's organizational and staffing problems are in the early stages of implementation, and it is too soon to tell whether or not they will resolve the major deficiencies that we and others have identified. Consequently, as we reported in 1995 and 1997,[3] these deficiencies, taken together, continue to place the integrity and accountability of HUD's programs at high risk.

Our criteria for designating a program or agency high-risk and removing that designation have been discussed with HUD officials on several occasions. In addition, our criteria were included in our 1997 High-Risk Series report and in our written response to HUD's then Acting Deputy Secretary's June 23, 1998, letter on this subject. We have pointed out that our criteria for designating programs or agencies as high-risk areas stem directly from our professional and objective judgment about patterns of

[2]App. III provides a list of major GAO reports on HUD's management, issued from 1984 through April 1999.

[3]High-Risk Series: Department of Housing and Urban Development (GAO/HR-95-11, Feb. 1995) and High-Risk Series: Department of Housing and Urban Development (GAO/HR-97-12, Feb. 1997).

significant management deficiencies uncovered over time in our audits, as well as those of inspectors general and others, that remain largely unresolved. We stated in our response to HUD's June 23, 1999, letter that programs and agencies for which we have removed our high-risk designation are those that have demonstrated results in overcoming management deficiencies. We further stated that it is important to note that while reform initiatives are important, plans for reform are not sufficient in and of themselves. Rather, it is the results of such reform initiatives—demonstrating that management problems have been corrected—that count.

We have also pointed out to HUD officials our consistent application of our criteria for high-risk designations. Specifically, we reached our conclusion about HUD and all of our determinations of which government operations are considered to be high-risk in our January 1999 Performance and Accountability Series reports[4] using the same methodology and criteria, which were the same as those used for our February 1997 High-Risk Series reports.

HUD's Reforms

We disagree with the Deputy Secretary's statements that the impact and significance of reforms that HUD has recently instituted were not fully addressed in our statement of facts. In the statement of facts we provided to HUD and in our January 1999 report on HUD's major management challenges and program risks that followed, we described the major actions the Department has taken and the achievements it has realized since it launched its 2020 Management Reform Plan in June 1997. In addition, we discussed HUD's goals under the plan for the areas where we identified management deficiencies: internal controls, systems, organization, and staffing. We also stated that HUD's reforms should help to address internal control weaknesses facing the agency and described HUD's establishment and implementation of risk assessments for programs that were established or substantially revised; the Department's development and deployment of certain information and financial management systems; and the establishment and operation of various HUD offices, including the Department's specialized and nationwide centers that consolidate processes and functions within and across program areas. Beyond the statement of facts provided to HUD, in our final report on HUD's management challenges and program risks, our "Overview" included a summary of HUD's achievements since its 2020 plan was announced and

[4]Major Management Challenges and Program Risks: A Governmentwide Perspective (GAO/OCG-99-1, Jan. 1999).

our conclusion that HUD has made credible progress in laying the framework for improving its management.

In other recent reports and testimonies, we have recognized HUD's continued emphasis on, and progress toward, addressing its long-standing management deficiencies. HUD's Secretary and leadership team have given top priority to addressing the Department's management deficiencies. This attention by top management is critical and must be sustained in order to achieve real and lasting change. Importantly, given the nature and extent of the challenges facing the Department, it will take time to implement and assess the impact of any related reforms.

GAO's Report on HUD's Information Systems

Many of the Deputy Secretary's comments on our statement of facts related to a draft of our December 18, 1998, report on HUD's information systems. The final report contained our responses to those comments as well as clarifications we made to the report as a result of HUD's comments. For example, the Deputy Secretary stated that the draft of our December 1998 report was not accurate about the amount to be spent to develop financial systems and that a more accurate estimate for the effort is $250 million. In our December 1998 report and statement of facts, we had stated the Department expects to spend about $239 million for development costs plus $132 million for maintenance costs. We also reported that HUD had not yet finalized the plans, costs, and a schedule to complete its current financial systems integration strategy, so systems costs continue to be uncertain. Accordingly, HUD's estimates have fluctuated considerably, as reflected in various documents received from the Chief Financial Officer and his staff. We reported, for example, that cost estimates have changed from the $540 million reported by HUD in June 1998; to the $255 million cited in the Department's November 12, 1998, comments on our draft report on information systems; to the $239 million that HUD reported a week later. However, we found that the $255 million and the $239 million estimates did not include at least $132 million associated with maintaining the systems. As pointed out in our December 1998 report, HUD's continuing uncertainty as to what the total cost estimate is for its financial systems integration demonstrates the Department's need to develop and use well-defined cost-estimating processes to prepare reliable cost estimates.

The Accuracy of Our Statement of Facts

We also disagree with the Deputy Secretary's statements that there were inaccuracies in our statement of facts. Many of the statements identified as

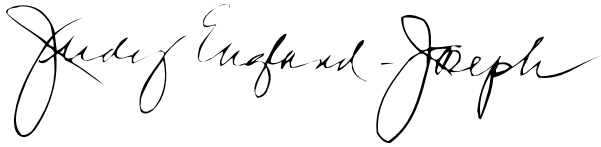
inaccurate related to statements that clearly described HUD's past problems, and not current problems as construed by the Deputy Secretary. For example, HUD asserted that the statement, "Managers were not actively assessing risks in their programs as required under the management control program," was totally false. The statement HUD quoted was in a paragraph in our statement of facts that began "In February 1997 we reported. . . ." This paragraph summarized the information we had reported in our 1997 High-Risk Series report regarding internal controls. Our January 1999 report on HUD's major management challenges and program risks reiterated the phrase "we reported in 1997" to make it clearer that this statement referred to past problems at HUD.

Lastly, in taking the Deputy Secretary's concerns into account, we added information he provided to update our final report on HUD's management challenges and program risks, including the completion of inspections for over 4,200 multifamily properties by HUD's real estate assessment center; the referral of 200 cases involving multifamily properties to the enforcement center; the increase in debarments of multifamily housing landlords; and the progress made by HUD in implementing reforms, as reported by HUD's consultants. We also added further details on the number of financial management systems or components of these systems developed or deployed by HUD under its systems integration efforts and the number of HUD managers that have completed risk management training. Where appropriate, we incorporated other clarifications to our final report on the basis of the Deputy Secretary's comments.

We are sending copies of this report to the appropriate Senate and House committees; the Honorable Andrew Cuomo, Secretary of Housing and Urban Development; and the Honorable Jacob Lew, Director, Office Management and Budget. We will make copies available to others upon request.

If you or your staff have any questions, please call me at (202) 512-7631. Other GAO contacts for and key contributors to this report are listed in appendix IV.

Sincerely yours,



Judy A. England-Joseph
Director, Housing and Community
Development Issues

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Abbreviations

CFO	Chief Financial Officer
DOD	Department of Defense
FHA	Federal Housing Administration
FMFIA	Federal Managers Financial Integrity Act
FSI	financial systems integration
GAO	General Accounting Office
HUD	Department of Housing and Urban Development
HUDCAPS	HUD's core accounting system
IG	Inspector General
I-TIPS	Information Technology Investment Portfolio System
JFMIP	Joint Financial Management Improvement Project
OIG	Office of the Inspector General
OMB	Office of Management and Budget
REAC	real estate assessment center
SFFAS	Statement of Federal Financial Accounting Standards

The Department of Housing and Urban Development's Comments on the Major Challenges and Program Risks Identified in GAO'S Statement of Facts

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

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

DEC 28 1998

The Honorable David Walker
Comptroller General

Mr. James Hinchman
Principal Assistant Comptroller General

U.S. General Accounting Office
Washington, DC 20548

Dear Messrs. Walker and Hinchman:

The purpose of this letter is to formally respond to the draft report "Government at Risk Series - Department of Housing and Urban Development." Secretary Cuomo wrote to both of you because of the depth and breadth of our concerns about the GAO draft. These concerns merit the attention of the highest officials in the GAO.

We are very disappointed that the General Accounting Office (GAO) did not reach a more accurate conclusion regarding the Department's "risk" status and the impact and significance of the major reforms that HUD has instituted during the past few years. Instead, though the report does mention some accomplishments and improvements in passing, it strongly and clearly implies that some as yet undefined measure of success has not been achieved, and leaves it ambiguous as to whether operations at HUD remain "high risk."

HUD's comment 1.

Comprehensive reorganization, major system developments and deployment, carefully crafted staffing reforms, and the hallmark achievement of HUD's first ever audited financial statements are all glossed over by GAO as minor advances and are presented as interesting interim movements toward some unknown mark on an undefined measuring stick. While HUD has changed significantly in the past few years, GAO continues to view the Agency as it was in the late 1980's and early 1990's, disregarding the scope and impact of the 2020 reforms. It appears that GAO is waiting for operational perfection to be achieved before HUD will be permitted to shed its high risk label. Put in the plainest language possible, GAO continues to see HUD as it was five to ten years ago and not as it is today.

In the February, 1997 High Risk Report (GAO/HR-97-12), four long-standing, department-wide management problems were identified: internal controls, information and financial management systems, organizational structure, and staff skill mix and allocation. In his January 22, 1998, Senate confirmation hearings, Secretary Cuomo stated that "HUD's mission cannot be carried out in the future unless HUD's own house is in good order, and there must be effective management and financial accountability." These words still hold true today, and yet, GAO's report fails to recognize the sea change of managerial improvement and accountability that HUD has undergone since February 1997.

It has been well documented by GAO and others that HUD's problems did not occur overnight and that the short-term fixes attempted in the past did not produce lasting results. Under HUD's 2020 Management Reform Plan, the Department implemented a bold initiative to fundamentally re-design the manner in which HUD delivers its programs. These necessary actions were well planned and did not represent change for the sake of change, but were designed, in large part, to directly address the four long-standing management deficiencies within a new paradigm for HUD.

HUD's comment 2.

The profound significance of HUD's major achievements and accomplishments is missing in the report, as well as a corresponding description of reduced risk at the agency. The Department has developed and implemented a detailed plan for reform - - a plan that has reduced the risk of waste, fraud, and abuse. Yet, the tenor of the draft report leaves the reader to conclude that, since there are not absolute measurable results in all areas, little that is positive has happened at HUD during the past two years.

HUD's comment 3.

On June 23, 1998, in a letter to Mr. Hinchman when he was Acting Comptroller, HUD requested that "GAO present established and objective criteria that have been and will be used to determine what programs in an agency constitute high risk, and, what makes an entire federal agency high risk." Although GAO responded to the June 23rd letter, GAO still did not provide the specific criteria to be met in order for HUD to be removed from the "high risk" designation. In that same response, GAO provided a list of "reports and testimonies over the past 14 years… pointing to patterns of significant management deficiencies at HUD." Unfortunately, neither that letter nor the current draft report acknowledge the fact that comprehensive management solutions and actions have been applied to these problems, steps that merit HUD's removal from the "high risk" list.

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HUD's comment 4.

This issue was further amplified in a December 22 meeting that we convened with senior GAO and HUD staff to discuss this draft report, and despite point blank questions, GAO was unable to articulate what constitutes "high risk" at HUD and for all agencies; in fact, GAO acknowledged that no such government-wide "high risk" test existed. This is unacceptable to us and should be to you, as well. It is critical, before you finalize and publish this report, that the GAO send HUD the specific criteria used to determine whether an Agency is high risk, the data showing how other agencies stood when the GAO applied that objective, standardized " high risk" test, and the analysis used by GAO in this report of the data versus the "high risk" criteria. Absent these criteria, it is very difficult for HUD to respond to this draft report, and it would be misleading for GAO to maintain such an undefined and indefensible label for HUD.

~~As you are aware, GAO designated the entire Department~~ as a "high-risk" area in 1994 because of four long-standing, department-wide management problems. HUD has been the only federal cabinet-level agency so characterized by GAO. Despite comments from your staff, the (incomplete) draft report is, in fact, silent regarding this label, and consequently, it is important that GAO state in the clear affirmative, if this is the case, that HUD is no longer a high-risk agency. If GAO maintains that HUD is still "high risk," we note the following concerns:

HUD's comment 5.

- **NO HIGH RISK CRITERIA; NO HIGH RISK TEST APPLIED CONSISTENTLY OR TO ALL AGENCIES.** GAO came to HUD six months or more ago to conduct a biennial review of the Department's programs. At that time, the agency asked for the set of objective, standardized criteria that had been applied in the past, and would be applied comprehensively and consistently to all federal agencies in this review, to determine if they merited the high risk label. We have still not received a document setting out these criteria. Worse still, senior GAO staff have indicated to me and other senior HUD officials, on repeated occasions, that no such list exists and that no high risk test was being applied to all federal agencies. Most recently, we were given two additional explanations for this troubling situation. First, that there were no criteria but the label of high risk was applied based on the "professional judgment" of GAO staff. Second, that because HUD has four agency-wide

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long-standing problems, it was and would remain a high risk agency. When asked if this high-risk "test" of four or more agency-wide problems had been applied to all or for that matter any other federal agency, the answer, supported by all senior GAO staff present, was no, it had not been applied anywhere else.

HUD's comment 6.

- **A SHIFTING STANDARD FOR DETERMINING IF HUD IS HIGH RISK.** As the review began, rather than providing the agency with the high risk criteria, senior GAO staff indicated that they would be fair and reasonable in their review - not holding the agency to an impossible standard of perfection but rather applying a standard for removing HUD from the high risk list if "reasonable progress" was achieved in implementing our 2020 reforms. At other times, and again most recently, staff has said the standard would be "results", a demonstration that HUD's problems have been fixed completely and that there was substantial, long-term results that bore out the success and sustainability of the reforms. Which standard is it? The difference is significant. One sets a bar that is passable in two years and on which all objective observers would agree that HUD had passed; the other would certainly take years, as by definition, long-term results are just that, "long-term."

  We would ask that you clarify the standard and would hope that you maintain the one originally laid out of "reasonable progress" as you redraft your report. Moreover, if you do continue to single out HUD as high risk, we ask that you state clearly that HUD is no longer the highest risk agency in the government. There is substantial evidence which shows that HUD is on par in terms of risk with many other agencies. That must be stated clearly for your report to be accurate, even using such an ill-defined standard.

- **A PRE-DETERMINATION THAT IT WAS NOT POSSIBLE FOR HUD TO BE REMOVED FROM THE HIGH-RISK LIST IN THIS REVIEW.** We have maintained from the beginning that if GAO had determined up-front that HUD could not have taken actions in the past two years sufficient to remove it from the high-risk list, that fact must be stated prominently and clearly

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HUD's comment 7.

at the beginning of the report. In other words, if GAO believed that it was not possible for HUD to be removed from the list - because GAO required long-term results to certify removal (as may be the case based on repeated comment from senior GAO staff who say that they are looking for results, many of which could take 3-5 years or more to come in completely), because GAO believes that the long-standing nature of HUD's problems merit it staying on the high-risk list so that GAO can see three, five or ten years down the road if the 2020 reforms are sustained beyond one administration, or for other reasons - that working assumption must be stated explicitly or the report itself is deeply misleading to Congress and the Department.

If GAO maintains that it is possible for HUD to have taken actions in the past two years that would have removed it from the "high risk" list, ~~("high risk" here defined not as reasonable~~ progress but as proof of long-term results), we ask prior to the final drafting of this report that those suggested actions be enumerated in detail and provided to us. We simply ask you: what else could HUD have *reasonably* done in the past two years to reform the agency and address GAO's concerns? A test of reasonableness - which we believe would be the more accurate and fair one for GAO to apply - would clearly show that HUD has reduced risk sufficient to remove it from the "high" risk category, placing it with numerous other agencies that do pose an ongoing risk of fraud and abuse.

At a minimum, it should be clearly stated that HUD did everything it could to reduce risk over the past two years. In meetings with senior GAO staff, those staff have indicated that they were not sure if it was humanely or reasonably possible to reduce risk at HUD any more than we had. Moreover, they all agreed, as would any objective source, that HUD has done more in two years to reduce risk and reform itself than virtually any public or private institution has done in a similar timeframe in recent memory.

- **A FAILURE TO ADEQUATELY AND FULLY DESCRIBE THE SIGNIFICANT REDUCTION IN RISK TO HUD'S PROGRAMS OVER THE PAST TWO YEARS.** To be accurate and

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HUD's comment 8.

honest, the report, even if it does not remove the high risk label because GAO acknowledges that such removal was rejected up-front because of GAO's methodology and the long-standing nature of HUD's structural problems, would need to indicate the substantial and significant reduction of risk to HUD's programs and portfolio since the last time GAO conducted the biennial review. Senior GAO staff, in repeated discussions, say they believe that HUD has made substantial progress in reducing risk - that the agency's risk profile is significantly improved over the last time GAO conducted a review. Yet this view, strongly supported by an objective analysis of the reforms currently implemented at HUD, is entirely absent from the report. HUD has moved far from where it used to be when the high risk label was first applied and where it is at the end of 1998. You would not know that after reading the GAO draft. ~~To be fair and accurate, GAO would need to make a~~ clear statement about the reduction in risk to HUD's programs since its last review and devote a majority of the report to detailing those changes and improvements.

HUD's comment 9.

- **A FAILURE TO UTILIZE AND CITE INDEPENDENT AND OBJECTIVE STUDIES OF HUD'S REFORMS BY MANAGEMENT EXPERTS.** While the GAO does quote extensively from, and rely heavily upon, data collected and conclusions drawn by the HUD Office of the Inspector General, it ignores and/or dismisses as inaccurate or unreliable the analysis and conclusions of other independent, objective management experts including Booz-Allen and Hamilton, the Public Strategies Group and its president David Osborne, the author of Reinventing Government, and PriceWaterhouseCoopers. Each of these companies has done extensive analysis of the HUD 2020 reform efforts and these reports were provided to GAO at or near the beginning of its review; the PricewaterhouseCoopers study was just completed and provided to GAO. We ask that GAO either cite as credible sources and quote as extensively from those reports as it does from other entities outside the GAO, or that it provide us with a written explanation as to why GAO does not find these reports, and their authors, credible and reliable sources of expertise on HUD's reforms.

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- **EXTENSIVE OMISSIONS AND ERRORS OF FACT, LOGIC OR CHARACTERIZATION IN THE DRAFT REPORT.** Finally, as described in the remainder of this letter, the report either omits significant pieces of HUD's reforms or describes them in such a cursory way as to deliberately minimize them (one major reform is given a sentence) and contains numerous errors of fact, faulty logic and mistaken assumptions, or misleading characterizations of HUD's work. We ask that these be corrected - and that when these omissions are added, and errors corrected, that GAO, in response to these changes and to the serious issues raised above - thoroughly rewrite and reconsider the conclusions about HUD's risk status.

The balance of this letter is divided into three parts: Part I: Significant issues of concern with GAO's draft report. Part II: A brief description of HUD's reform ~~efforts and how they address GAO's areas of risk. And Part~~ III: A list of specific items in the GAO draft report that contain factual inaccuracies, misleading characterizations and/or faulty assumptions and conclusions.

HUD's comment 10.

In addition, GAO has withheld the conclusion section of the report from our review. The absence of a written conclusion, especially while senior staff are orally characterizing the report as maintaining the "high risk" label, and a national newspaper and a chairman of one of HUD's congressional committees is citing this same conclusion as well (see today's Washington Times), has severely compounded the difficulty in responding accurately and appropriately to the specific text of the report, because a review of the linkage between facts and conclusions, which should be clear and unambiguous, cannot be performed. Nonetheless, we have done our best to surmise GAO's probable conclusions from the limited information that was provided and tone in which it is presented, and offer the following comments and observations.

Part I: Significant Issues of Concern

The draft report is primarily a recapitulation of past GAO studies and reports and dwells in repetitive detail on the problems of the 1980's and early 1990's. Further, this report fails to consider the global impact of the HUD 2020 Management Reform Plan on Departmental operations and falls well short of recognizing the true significance of the changes that have occurred in the last 24 months. The HUD

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of today is far different from the HUD of yesteryear or even of February 1997. We will take this opportunity to highlight a few examples of the *significant* issues that were omitted, given short shrift, and/or overlooked by GAO, but which need to be included when you revise this draft report, if it is to be considered accurate and balanced.

HUD's comment 11.

1. **Financial Management Systems.** This area is characterized inaccurately given the many comprehensive accomplishments in systems improvements that have been made within the past few years. The discussion is focused almost entirely on process improvements and is not properly balanced by GAO's brief summary of major system accomplishments. For example:

   - The report states that "according to its CFO, HUD continues to make progress addressing systems problems by deploying systems and/or system modules to manage and monitor the Department's programs." GAO spent more than one year reviewing the systems integration efforts at HUD, and it should be clear to any objective reviewer that when a large number of systems have been successfully developed and deployed, a substantial improvement in the systems environment has inevitably occurred. However, GAO refuses to attest to such facts despite its one-year review, and only attributes this information to "CFO" hearsay.

HUD's comment 12.

   - GAO observed that HUD did not finalize the revised project plans for completing the core accounting system (HUDCAPS). **This is wrong.** During the initial phase of the one-year review of systems at HUD, GAO was provided a completed first year plan and a final draft of the second year plan, and last month, we submitted the complete project plan. So, in fact, all of the required information has been made available to GAO. Furthermore, the Department has recently installed a standard general ledger and chart of accounts that did not previously exist. This is a critical accomplishment that was barely mentioned and is a key to the Department publishing integrated financial statements for the entire agency.

HUD's comment 13.

HUD's comment 14.

   - The report dwells on the Department's efforts to evaluate whether our systems conform to the requirements of FMFIA and of OMB Circular A-127.

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First, HUD self-declared certain systems as non-compliant based on our interpretation of the general JFMIP criteria. HUD chose to apply a vigorous standard whereby if only one of the twelve criteria was unmet, then the system was labeled as non-compliant. We have yet to obtain any clear guidance from GAO, despite repeated inquiries, whether the Department is applying a significantly higher standard for systems non-compliance than other federal agencies. Notwithstanding HUD's self-imposed rigorous standards, all of our major accounting systems are in compliance. These financial systems are the systems of greatest relevance. More importantly, HUD's financial statements are now considered accurate (save for a single audit qualification issue on credit reform), despite the fact that just two years ago, HUD had a disclaimer of an audit opinion for its consolidated financial statements.

HUD's comment 15.

By any objective measure of performance, these improvements must be viewed as both credible and significant. More importantly, none of these systems existed at the time of the 1997 GAO high-risk report (which relied on testing completed in 1996), yet GAO simply says that "much work remains on HUD's information and financial management systems." We strongly believe that it is very important that these system accomplishments be both highlighted and discussed in greater detail, and that these changes are reflected in a changed GAO analyses of HUD's systems.

2. **Organizational Structure.** GAO's previous reports stated that HUD's organizational structure was dysfunctional. During the past two years, we have implemented a new organizational structure, in accordance with our 2020 reform plan. We have put in place an organizational structure that addresses previously identified management deficiencies. The most significant organizational changes are the creation of Centers that consolidate back-office operations (e.g. consolidate all single family processing from 81 offices to 4 centers) and/or addressed known problems related to the assessment of the physical and financial condition of real estate properties and the enforcement of HUD's programs. Responsibilities and authorities between

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Headquarters and field operations have been clearly delineated, and fundamental management accountability and responsibility have been established. Protocols are in place that delineate clear lines of responsibility and cross-cutting functions like property assessment and enforcement are centralized, enabling HUD staff to focus more precisely on their program administration work. GAO cites that not every "i" has been dotted and "t" has been crossed, to which we acknowledge, but again it fails to recognize the monumental changes made in HUD's organizational structure and program delivery. For example:

- **The Real Estate Assessment Center** (REAC) assesses the overall physical and financial condition of HUD's housing portfolio and enables the Department to better target its monitoring and enforcement resources. The REAC has standardized the way HUD conducts assessments of its multifamily and public housing real estate portfolio. The Center is generating an overall annual score for over 50,000 properties and projects from over 89,000 separate inputs to determine what projects are being operated in accordance with established standards for physical and financial integrity. The score also measures management performance and customer satisfaction.

  With respect to physical inspections of the 33,400 housing entities supported by HUD mortgage insurance, rental subsidy or public housing programs, the REAC has successfully developed and pilot-tested uniform housing quality standards and an electronic data collection process to capture, score and report on physical inspection results, as a basis for official housing, public housing, and enforcement decision-making action. In October 1998, the REAC initiated a national inspection process that is providing a physical inspection baseline on the entire HUD-supported housing portfolio. Through December 16 of this year, 11,934 inspections have been scheduled for the first two quarters of FY 1999, with 4,219 completed. Of the inspections completed, approximately 18% received a failing grade for the entire physical inspection. In addition to inspection results, the REAC's pilot and on-going inspections are updating and correcting property

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profile information in HUD's housing program data bases.

With respect to financial assessment of the HUD supported housing portfolio, the REAC has successfully pilot tested the first release of a Financial Assessment Subsystem (FASS) that will enable the REAC to electronically receive annual financial statement and audit data for use in scoring and reporting on the financial health and compliance of housing entities receiving HUD program support. In accordance with HUD's new rule on "Uniform Financial Reporting Standards for HUD Housing Programs," FASS is accepting multifamily project information beginning in January 1999. The multifamily housing scoring portion of the REAC's FASS will be completed March 31, 1999, and multifamily housing field staff will have systems access to the financial data received during the January to March 1999 period.

FASS represents a substantial improvement in the completeness, timeliness, usefulness and quality of financial information on HUD's multifamily housing programs. The REAC has also initiated a Multifamily Laboratory Project that is analyzing historical multifamily project financial data to provide support for 140 on-going and 210 planned Enforcement Center cases, and to improve the quality and usefulness of that historical data for future trend analysis.

- Under HUD's 2020 Management Reform Plan, two **Troubled Agency Recovery Centers** (TARCs) were established in Cleveland and Memphis. Out-stationed TARC staff are also located in the Department's Hubs. The TARCs are an important part of HUD's public housing reforms, since they develop and implement intervention strategies for "troubled" PHAs to help improve their operations -- a function never adequately performed at HUD. TARCs refer troubled PHAs that are not progressing satisfactorily to the Department's Enforcement Center for potential receivership action. At this time, 100% (approximately 50 HAs) of all confirmed troubled housing authorities are being administered by the TARCs.

The Troubled Agency Recovery Centers (TARCs) assist in the reduction of risk to the Department

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by changing the way the Department approaches troubled recovery. The TARCs will remove all "troubled" designated public housing authorities from the local HUD offices. This will allow the local offices to concentrate on marginal and at-risk authorities thus reducing the possibility of future "troubled" public housing authorities, which reduces additional risk to the Department, that is, by using specialized teams of HUD employees in an intensive care type operation.

- The 2020 Management Reform Plan established a cadre of 720 **Community Builders**, a new customer service position at HUD. Approximately 360 of these positions are career employees and another 360 employees are temporary employees called Community Builder Fellows, who will serve two- to four-year terms. These Fellows have completed intensive training that provided them with a deeper understanding of housing, economic and community development, neighborhood revitalization, job creation, and fair housing issues.

  Community Builders are serving as HUD's link to communities, and are responsible for assisting communities in identifying their needs and coordinating the development and implementation of Integrated Service Delivery Plans. More importantly, the establishment of Community Builders has allowed the Department, for the first time, to have a separation between customer service functions and program monitoring and enforcement functions. This separation allows the Department to clearly divide responsibilities between those staff who are relationship managers and those who are program managers and administrators with a more defined focus on oversight, and enforcement. Prior to HUD 2020, these responsibilities were inappropriately performed by the same person - an impossible task that too often left little focus on program monitoring.

- The Department has dramatically improved its **procurement operations.** HUD has hired a Chief Procurement Officer, who now reports directly to the Deputy Secretary. The Chief Procurement Officer and his staff have been working on

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numerous operational improvements. Specific changes include:

- Establishing a Contract Management Review Board to review and approve each program office's procurement strategy for contracts exceeding $1 million. The review of Fiscal Year 1999 plans has been completed. The Board is conducting periodic reviews of each program office's progress in implementing approved strategic plans and periodically samples active contracts to ensure quality and timeliness of performance.

- Legal reviews and input will be required on all contracts over $5 million. The Office of General Counsel will establish a team of contract specialists to review contract terms and assist in negotiations to assure contract legality. The Chief Procurement Officer has issued instructions on obtaining legal reviews.

- A Government Technical Representative (GTR) Certification Program has been established and GTRs are being trained in cost and price analysis. This training will be completed by the end of Fiscal Year 1999.

- Interfaces between the HUD procurement system and the accounting system have been made, and now provide HUD the capability for comprehensive financial reporting by contract at the transaction level.

- **The Enforcement Center** has consolidated the bulk of HUD's enforcement efforts into one Department-wide entity. The FBI-headed Enforcement Center addresses monitoring and internal control problems by combining non-civil rights compliance and enforcement actions into one organization with responsibility for:

  - Distressed multifamily properties that have failed physical and financial inspections and require corrective action by owners, lenders and management agents.

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- Instituting aggressive enforcement strategies; i.e., administrative and judicial receivership, for PHAs that have received a failing score on their annual assessment and have been referred to the Enforcement Center by the TARC.

- Enforcing all administrative and regulatory business agreements to include debarring or suspending individuals in non-compliance.

- Referring criminal cases to the OIG and submitting civil cases to the Department of Justice.

• The Department established **Processing Centers** to centralize certain functions previously performed in field offices. Specifically: 18 Multi-family HUBs with 33 program centers; 4 Single Family Home Ownership Centers; a Financial Operations Center; and a Section 8 Financial Management Center.

This new approach to organizing and managing the work of the Department, that is, consolidated processing and program administration via Hubs and centers, has already yielded major improvements. For example, multifamily project development now uses the Development Application Process (DAP) as a uniform and consistent method of the underwriting process. As a result, the Department has reduced the multifamily project development underwriting/application process from a high of three years to 3-6 months for endorsement. Moreover, we have created an underwriting committee in each Multifamily Hub which reviews and approves all deals emanating from field office communities within the jurisdiction. Again, we have instituted improved "checks and balances" or internal management controls which assure the integrity of the underwriting process and improve our business practices.

In the area of multifamily project management, the Department has already achieved demonstrable results which are directly related to the consolidation of major process functions. Our program managers are no longer required to perform such ancillary functions as marketing major programs (e.g. community connections, resident initiatives, etc.) answering resident complaints,

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and processing grant applications. More HUD field staff are able to devote their full time and attention to mainstream asset and development management functions. Additionally, the ratio of project managers to multifamily projects has now been reduced substantially from 1:100 to 1:60.

In Fair Housing and Equal Opportunity, which has also instituted the consolidated Hub/Center approach, there is more evidence of significant productivity improvements, as well as better use of management information systems. TEAPOTS, the Title 8 enforcement actions management information system, has been instrumental in helping the Department to reduce the backlog of cases; as well as, to move aggressively toward the goal of doubling fair housing enforcement actions by FY 2000.

Of course, the GAO is aware of the dramatic single family mortgage insurance processing improvements by the Homeownership Centers (HOCs), including reducing loan processing time from 4-6 weeks to an average of 2 to 3 days, per application.

3. **Staffing and Skills Mix**. In 1997, GAO reported that "HUD had made some progress since the previous report in addressing the problem with staff members' skills, resource management, and staff training, and had begun to implement a needs assessment process to plan future training." Without rehashing this assessment, we take strong exception to the current GAO conclusion that "because staffing reforms have not been fully implemented, their effectiveness in correcting management deficiencies cannot be demonstrated", and ergo, this remains a high risk area.

Under 2020, we have created the best alignment between workforce and workload quite possibly in the history of the Agency. We focused on our known problem areas and developed an organizational matrix that consolidates like functions and redeploys staff to critical areas. We established centers for: Enforcement; Troubled Agency Recovery; Real Estate Assessment; Section 8 Financial Management Processing; Accounting; Multifamily Development; Home Ownership; Grants Management; Special Applications; Administrative

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Service; Employee Service; and Title I Financial Operations.

The Department used an OPM approved model to develop the strategic approach to redeploy staff into critical needed areas through Super Postings and a Voluntary Reassignment Program. We concentrated our reform efforts on the areas identified by the GAO and OIG. We engaged "change agent" teams throughout the Department and all of our program areas did extensive analysis to determine how the improvements were to be made. We then went back and reexamined our decisions and staffing and, with the help of management consultants, reaffirmed the number of staff and the allocation of resources.

In a review of HUD's workload and staffing analysis for the 2020 Reform Plan, Booz-Allen and Hamilton found that "the reform sets in place systemic and operational changes at HUD that improve customer service and reduce staffing requirements." They also concluded that "HUD program offices used acceptable analytic techniques for establishing staffing levels." Also, a report conducted by The Public Strategies Group states "that HUD 2020 is a sound, well thought-out reform plan. It is tailored specifically to solve long-standing structural problems, uses appropriate reinvention strategies for HUD's specific challenges, and addresses the agency's core problems."

The implementation of HUD's Management Reforms has resulted in the creation of many new positions, many designed to specifically mitigate management deficiencies. In addition to Community Builders, new positions have been created in the consolidated operations centers, such as multifamily project managers, single family housing specialists, assessment auditors and inspectors, enforcement specialists and other new occupational disciplines. The Department has conducted extensive training for the employees who have been assigned to these positions. This training has been specific to the program organizations and has included instruction on the new operating procedures and data systems developed under 2020.

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This training was designed to ensure that employees have the skills to perform in their new positions. GAO's own interviews with HUD managers show that the Department training efforts have been effective and managers believe their staff are well trained for these jobs.

Finally, by separating customer service and relations from program administration functions, the Department has sharpened its focus on management controls, financial operations, and compliance with statutory and regulatory requirements. For example, while Community Builders now perform single family marketing and outreach function, Single Family Housing Specialists have been trained to provide better monitoring and program administration in local field offices. Managers in the program areas of Housing, Public and Indian Housing, and Community Planning and Development have been trained to identify internal control risks, and to apply effective corrective actions.

The HUD 2020 training plan for FY 1998 consisted of a broad range of technical and professional courses covering program monitoring and administration skills, financial analysis, real estate management, contract administration, information management, and general management and supervision. The number one priority of the FY 1999 training agenda is to train employees on what we call "core competency" skills, that is, to make sure that housing specialists can perform housing work, that enforcement specialists achieve acceptable levels of proficiency in their work requirements, and that all training develops skills, knowledge and abilities for achievement of performance expectations.

4. **Internal Controls**. It seems that GAO intends to again conclude that HUD's overall general internal control environment is weak, or that we have not made substantial advances in reducing risk, despite the significant control improvements made within the last two years. Specifically:

- During FY 1998, HUD trained over 1,100 field and Headquarters managers and supervisors in their internal control responsibilities for their programs. We used the GAO "Standards for Internal Control in the Federal Government", and

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OMB Circular A-123 as guidelines for this one-day training in risk management. Furthermore, GAO field and Headquarters staff were invited and attended training sessions in Boston, Chicago, Ft. Worth and Washington with mostly very favorable feedback to HUD CFO staff. Follow-up FY 1999 training is focusing on one of the critical GAO standards--monitoring. In the previous nationwide training, we established the link between agency goals and management accountability, and in this training, not only will the mechanics of monitoring be emphasized, but the roles of planning and reporting on integral parts of the monitoring process will be highlighted.

The Department completed a "hard scrub" of the corrective action plans for its nine material weaknesses and the CFO has been charged by me to work with the program offices to ensure long-lasting fixes to cure these material weaknesses. In fact, five of the outstanding material weaknesses are scheduled to be completed within Fiscal Year 1999.

HUD's comment 16.

- During the past year, the Department has aggressively tackled the issue of computer matching and income verification and improved subsidy verification. HUD established a task force with staff from PIH, Housing, PD&R, the Assessment Center and the CFO's Office to expand existing capabilities for ensuring that subsidies are paid based on correct tenant income.

Part II: Brief Descriptions of HUD's Reforms

Throughout the report, GAO is remiss in not recognizing the breadth and depth of the numerous reforms implemented at the Department during the past two years - -advances that reduce risk in many areas. This part of the letter describes a sampling of these reforms. GAO has extensive backup documentation and substantial reports that describe these and other changes in detail. We refer you to these. This is not meant to be exhaustive, but indicative of the scope and status of the reforms we have put in place. It is brief, since there is some repetition from other sections of this letter and GAO already has extensive documentation that it appears not to have yet used. We have structured this section around the four GAO risk categories of

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organizational structure, staffing, internal controls and systems.

1. **Organizational Structure**

Summary of GAO Problem Description

GAO stated that our ineffective organizational structure has contributed to management problems throughout the Department. Such organizational problems have included overlapping and ill-defined responsibilities and authorities between HUD Headquarters and field organizations and a fundamental lack of management accountability and responsibility.

Summary of HUD's Reforms

Many of the HUD 2020 management reforms specifically addressed organizational structural problems previously cited in GAO reports.

Overall, the most significant organizational changes include:

- The creation of Centers that consolidate our back-office (location neutral) work. The establishment of these Centers has increased the efficiency of the Department's operations due to economies of scale and reduction in the duplication of effort; and has increased the effectiveness of the Department's operations by moving resources to areas that have been identified as deficient.

- The creation of Community Builders -- who are the external face of the Department and connect clients and communities to the internal program resources and services they need; and the split between Community Builders and Public Trust Officers.

- Creation of the department-wide cross-cutting functions, such as assessment and enforcement, which gives the agency these critical capabilities for the first time in its history.

As you re-review HUD's high risk status, please note these specific changes:

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- Created the Real Estate Assessment Center which, for example, allows program staff to place more emphasis on early warning and loss prevention of insured multifamily mortgages. The REAC identifies the most serious financial and physical problems of real estate properties, and refers them directly to the Enforcement Center for immediate action. In addition, we have initiated a national inspection process that is providing a physical inspection baseline on the entire HUD-supported portfolio, and is automating the submission of audited financial statements to the REAC.

- Created the Enforcement Center which consolidates all enforcement activities, that is, for Housing, Public and Indian Housing, Community Planning and Development, and FHEO, except civil rights, for the first time in the history of the Department. ~~From the standpoint of management controls, this~~ entity gives the Department the tools, techniques, and independent authority to pursue instances of noncompliance and program violations. The Enforcement Center has already accepted and begun to process compliance and enforcement actions involving "troubled" multifamily projects; to revitalize the Mortgagee Review Board as part of the Department's crackdown on lenders and mortgage brokers; and, staffed up the debarment and suspension function.

- Established distinct, clear lines of authority between Headquarters and the field offices. Assistant Secretaries have the authority to establish and implement policies and procedures with their staff in Headquarters and the field offices.

- Established new or enhanced quality assurance and quality control systems for all major program and administrative operations. Examples include: division of customer relations and program administration functions between community builders and public trust officers; procurement and contract planning, management, oversight, and evaluation system; financial and information systems, data standardization and clean-up.

- Developed and instituted a new management planning system and process called the HUD 2020 Business

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and Operating Plan (BOP). The BOP is linked directly to the HUD Annual Performance Plan (and budget operations cycle) required by the Government Performance and Results Act (GPRA). BOP Goals and Guidance, which were developed jointly by Headquarters and the field have been issued to field managers who, under the leadership of Secretary's Representatives and Senior Community Builders, are coordinating and collaborating on internal planning requirements, as well as conducting external customer service needs assessments. A quarterly/monthly reporting system exists to review performance against planned goals and targets. Also, a new management and employee performance planning and accountability process was developed, and the first phase was implemented in FY 1998 with new "performance contracts" for senior executives which tied their ratings to HUD 2020 program and management operations.

- Expanded the Department's Management Committee process to include field managers to ensure that changes in Headquarters and field roles and responsibilities are clearly communicated and understood.

- Established independent Centers to centralize non-core functions previously performed in the field offices such as:

  - 18 Multifamily Hubs with 33 program centers

  - 4 Single Family Homeownership Centers

  - 2 Multifamily Property Disposition Centers

  - Section 8 Financial Management Center

- Established two Troubled Agency Recovery Centers (TARCs) in Cleveland and Memphis. (See Section 1 for more details).

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2. **Resource Management/Staff and Skills Mix**

Summary of GAO Problem Description

GAO states that there are several concerns with HUD's staffing patterns including: assurance that HUD has the right number of staff with the proper skills; significant changes in workforce structure since the announcement of the HUD 2020 Management Reform Plan; staffing targets under the reform plan are uncertain; and a need to develop a process for identifying and justifying its staff resource requirements.

Summary of HUD's Reforms

Reforms include:

- Conducted a nation-wide merit staffing program using an OPM-approved model to develop the strategic approach to redeploy staff into critical need areas through Super Postings and a Voluntary Reassignment Program. These efforts provided HUD the capacity to implement its planned reforms in a methodical and seamless process. We concentrated our reform efforts on the areas identified by the GAO and OIG. We engaged "change agent" teams throughout the Department and all of our program areas did extensive analysis to determine how the improvements were to be made. We then went back and reexamined our decisions and staffing and, with the help of nationally recognized management consultants, reaffirmed the number of staff and the allocation of resources.

- Restructured and realigned organizations to improve operational effectiveness through consolidations and economies of scale. This allowed the Department to institute "back-room" operations for processing of documents and transactions; i.e., Homeownership Centers in 4 locations rather than 81 field offices and accounting operations in one centralized location, in lieu of 10 former regional offices.

- Developed a proposed resource management methodology in conjunction with the National Academy of Public Administration. Beginning in December 1998, two pilot studies are being

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conducted to test this methodology. These pilot studies will each be eight-weeks in duration and will be completed by the end of February 1999. Following the successful completion of these pilot studies, this resource management methodology will be considered for implementation throughout the Department for resource requirement determination and allocation. No other federal agency has attempted such a model for cost estimation and allocation.

- Completed the assignment and allocation process. GAO visited our field offices over 6 months ago when we were in transition and interviewed a very small sample of managers - apparently not a statistically valid sample. It is not uncommon during periods of significant change, especially for a large Department with over 9,000 employees, to experience some growing pains during initial operation. HUD is past this nascent stage and has the right people in place in the right locations to fulfill HUD's missions and reduce risk to our programs.

- Established Community Builders who are serving as HUD's link to communities and are responsible for assisting communities in identifying their needs and coordinating the development and implementation of Integrated Service Delivery Plans. More importantly, the establishment of Community Builders has allowed the Department for the first time to have a separation between Community Builder's functions and Public Trust Officer's functions. This separation means that Community Builders can concentrate on marketing, outreach, and technical assistance functions, and the Public Trust Officers can concentrate on monitoring and oversight, an area often overlooked at HUD.

3. **Internal Controls**

Summary of GAO Problem Description

Internal control weaknesses that GAO identifies include a lack of staff and resources to manage and monitor its real estate inventory, inadequate warning systems to prevent losses in its single-family and multifamily insurance programs, inadequate controls

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over rental assistance, inadequate automated systems and an inadequate management control system. In addition, GAO believes managers are not actively assessing risks in their programs and that monitoring of program participants continues to be problematic. Financial audits continue to reveal material weaknesses and nine material weaknesses remain open with 5 dating back to 1993 or earlier. Contract management is now a material weakness.

Summary of HUD's Reforms

As mentioned earlier, it seems clear that GAO intends to again conclude that HUD's overall general internal control environment is weak, despite the significant control environmental improvements made in the last two years. During FY 1998, HUD trained over 1,100 field and Headquarters managers and supervisors in their internal control responsibilities for their programs, using GAO "Standards for Internal Control in the Federal Government" and OMB Circular A-123. Follow-up FY 1999 training will focus on one of the critical GAO standards--monitoring. The Department completed a "hard scrub" of the corrective action plans for its nine material weaknesses and five of these nine material weaknesses will be corrected in Fiscal Year 1999, including contract management.

We have strengthened our control environment by establishing a Risk Management Office within the CFO which provides technical support and ensures risk assessments are being performed by managers. All "big ticket" 2020 items, i.e., all the new Centers, have been put through a detailed FERA. In fact, more FERAs were performed at HUD in the past two years than have been performed in the prior 10 years. Managers are clearly assessing risks. We have also enhanced our internal control environment by adding hundreds of Community Builders. This allows our cadre of Public Trust Officers to focus on monitoring and assessing program performance and prevent the occurrence of fraud, waste, abuse and mismanagement.

The creation of the REAC, TARCs and Enforcement Center with 5 fully functioning satellite field offices, will allow HUD to focus its monitoring, technical assistance and regulatory resources where they are needed most and where they can be more effective. As the REAC increases its data warehouse, opportunities for analyses will abound, and the Department can expect an increase in the accuracy and specificity of problem indicators/identifiers and more sophisticated early warning mechanisms in the REAC's

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HUD's comment 17.

systems. Concerning the Department's financial statements, HUD received its first ever qualified audit opinion two years ago (in prior years auditors issued disclaimers of opinion) and we are on track to receive an unqualified (clean) opinion for our FY 1998 consolidated financial statement. This is a keystone achievement and reflective of the changing attitude of HUD managers in recognizing their fiscal responsibilities and the vast improvement in HUD's financial systems and financial data. This Department has made significant strides in improving its overall control environment. More details follow in the examples below and in the many related areas throughout this response to GAO's draft report.

- Established a Department-wide task force to address the issues necessary to facilitate large-scale implementation of computer matching and income verification and improved subsidy verification. Six teams comprise the task force, ~~each headed by a project manager, and are assigned~~ tasks essential to expand existing capabilities for ensuring the subsidies are paid based on correct tenant income. Task force accomplishments include:

  - Conducted pilot test of large-scale computer matching at five housing agencies,

  - Conducted an analysis of four different income matching techniques, including the technique used for the pilot test mentioned above,

  - Expanded the nationwide income matching program by 40,000 households,

  - Conducted an extensive research effort to establish a complete and accurate count of units and families receiving rental assistance (for use in helping to ensure complete population of the tenant database),

  - Identified and resolved problems concerning the transmission of tenant data to HUD,

  - Developed plans for sending warning letters to major housing agencies that are not fully reporting tenant data to the MTCS,

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- Developed sanction notices to housing agencies (effective 1/99) and owners/agents (effective 4/99),

- Agreed on a standard Housing and PIH re-certification policy that will help reduce false positive matching results,

- Developed a proposed rule requiring housing agencies and owner/agents to penalize tenants who fail to report income as required and fail to sign repayment agreements, and

- Developed a detailed plan to initiate a 100% match of all clients who receive Section 8 assistance.

• Creation of the Real Estate Assessment Center (REAC) has allowed staff to place more emphasis on early warning and loss prevention of insured Multifamily mortgages. The REAC has the ability to identify the most egregious financial and physical problems and refer them directly to the Enforcement Center for immediate action. Additional accomplishments include:

- Improved monitoring which will result in early identification of problems and accelerated referrals to either the Assessment Center for remedial review and/or Enforcement Center for appropriate action.

- Establishment of a Quality Assurance unit within REAC that is responsible for the program management and operational aspects of quality assurance and risk management.

- Electronic transmission of audited financial statements for submission to the Assessment Center.

- Initiating a national inspection process that will provide a physical inspection baseline on the entire HUD-supported housing portfolio before the year 2000.

- Establishing integrated automated systems (e.g., the Real Estate Management System and

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the Annual Financial Statement system) for tracking, targeting, monitoring and analysis.

- Consolidating Single Family loss mitigation functions in Oklahoma City, outstationed from the Denver HOC.

- Exploring the use of automated Single Family underwriting and loss mitigation indicators by staff in Oklahoma City.

- Expanding the functions of the Single Family Quality Assurance Division in each HOC.

- The Department has made significant progress in improving HUD's procurement operations and curing the contract management material weakness. HUD has hired a Chief Procurement Officer. The Chief Procurement Officer and his staff have been working on numerous operational improvements. (See Part I of this letter for details)

- Designated Public Trust Officers who will perform monitoring and ensure that federal funds are used appropriately for the purpose intended, with zero tolerance to fraud, waste, and abuse.

- Created two Troubled Agency Recovery Centers to assist troubled housing authorities across the nation.

- Established a Section 8 Financial Management Processing Center to improve rental assistance payment processing, safeguard funds and achieve efficiencies through centralization and economies of scale.

- Created an Office of Risk Assessment within the CFO organization. This office will ensure risk assessments are performed when needed, track the correction of material weaknesses, contract for both management control reviews and corrective action verification reviews and monitor progress under HUD's Management Integrity Plan.

- Integrated FERA's into HUD's Management Control Process and taken steps to assess risks in new programs, proposed programs, and modifications to existing programs. FERAs have been completed for

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all seven new centers and 9 other FERAs within the various program organizations.

- Strengthened oversight of the audit resolution process by consolidation of Audit Liaison Officer functions in both Headquarters and the field, adoption of an effective certification process making managers accountable for taking final actions, and initiation of a quality assurance process by the CFO. Conducted a quality assurance review and issued a report on HUD's audit resolution process.

- Credit Reform initiatives (FY 97 qualification issue) within the Department have made significant progress. SFFAS No. 2 requires that agencies estimate and report cash flows relating to loans and loan guarantee commitments made after September 30, 1991, and that such cash flows be accounted for on a present value basis. FHA's mortgage insurance programs are currently presented in accordance with private sector GAAP, which differs from SFFAS No. 2 reporting requirements. FHA has received an unqualified (clean) opinion on these statements since 1993 from a major public sector accounting firm. HUD expects compliance with the requirements of credit reform in its FY 1998 Financial Statements, and significant work has already been accomplished.

HUD's comment 18.

4. **Financial Systems Integration**

Summary of GAO Problem Description

GAO says that systems are inadequate because they are poorly integrated, ineffective and generally unreliable. GAO believes that the systems do not satisfy the needs of management nor provide adequate controls because they are not in conformance with FMFIA.

HUD's comment 19.

Summary of HUD's Reforms

The problem as stated by GAO is outdated. Over 60% of our systems are compliant, including all of our major financial systems. Our financial statements are now considered accurate (save for a single audit qualification on credit reform) and thus, the underlying data is accurate—this was not true two years ago. The GAO reviewers of HUD downplay this accomplishment despite the significant

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HUD's comment 20.

attention focused on this goal by the Congress, OMB and GAO management. Also, significant work has been done to develop and promulgate both new accounting systems and new financial management systems. We now have a new, standard, fully compliant, HUD-wide general ledger. And, we have developed and deployed 11 new financial management systems. Finally, new management information tools, such as the community geographic information system can provide managers, the Congress and the public with greater access to HUD's databases. HUD's financial management systems are much more effective than in the past, are generally reliable, and plans are in place to make further improvements. Please note:

- The Department has made significant improvements in FMFIA compliance.

  - The Office of the CFO has established a coordinated and refined FMFIA review and analysis process which has clarified A-127 requirements and definitions of terms (e.g. distinctions between "financial systems and mixed systems"). Moreover, affected program organizations have responded effectively to this technical assistance and identified system deficiencies, as well as remediation plans. These efforts have resulted in the appropriate reclassification of systems, that is, from non-conforming to conforming.

  - At the end of FY 1997, only thirty-eight of ninety-two HUD systems were classified as non-conforming, compared to 85 at the end of FY 1996. Most of HUD's financial and mixed systems comply with FMFIA. Thus, 60% of our systems are compliant. This contradicts the GAO statement "that most of its systems did not comply with FMFIA and therefore could not be relied upon to provide timely, accurate, and reliable financial information and reports to management."

  - For FY 1998, we will report more systems in compliance and a reduction in the total number of financial and mixed systems. We will also show that of the non-compliant systems, five will not be material for timely, accurate, and reliable financial information and reports to management. We will be providing assessments

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on all new systems determined to be conforming by the program offices and for those non-compliant systems reclassified as compliant during FY 1998.

- All our major accounting systems are in compliance. These financial systems are the systems of greatest relevance. More importantly, HUD's financial statements are now considered accurate (save for a single audit qualification issue on credit reform), despite the fact that just two years ago, HUD had a disclaimer of an audit opinion for its consolidated financial statements.

- Even with the CFO's Office working closely with program offices to evaluate program system conformance with A-127 requirements, we recognize the need to conduct independent audits to evaluate the adequacy of the FMFIA assessments done by the program offices. We have a contract in place to conduct such audits. The first system review will be done in January. We anticipate that audits for about six more will be completed by the 3rd quarter of FY 1999.

HUD's comment 21.

- There have been major, comprehensive accomplishments in financial systems integration. The GAO should be able to state, based on the documentation submitted, that the following systems have been developed and deployed during the past few years:

  - The Integrated Disbursement and Information System was developed and deployed and is used by the Office of Community Planning and Development to monitor an estimated 950 community development grantees, and nine states.

  - The Integrated Business System was developed and deployed in seven modules and is used by the Office of Public and Indian Housing, and the Office of Native American programs to monitor their programs, including information related to all housing authorities in the country.

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- The HUD Procurement System was developed and deployed and is used by the Office of Administration to track and manage the Department's procurement activities.

- The Grants Evaluation Management System was developed and deployed and is used by the Office of Fair Housing and Equal Opportunity to monitor their two major grant programs.

- The HUDCAPS system was developed and deployed and is used by the CFO in several Departmental areas to handle the core accounting transactions and several key programs. The deployments to date include: the Section 8 tenant-based program, the S&E accounts, and the working capital account. In addition, as of October 1998, a consolidated HUD-wide general ledger with a new chart of accounts was deployed that will include, for the first time, summary transactions for all of HUD. A plan is in place to deploy fully and use HUDCAPS for all core accounting activities of the Department by October 1999.

- The Tenants Rental Assistance Certification System was developed and deployed and is used by the Office of Housing for tenant voucher processing, contract processing, and budget development and analyses.

- The Budget Formulation System was developed and deployed and is used by the CFO to formulate, prepare and monitor the annual budget.

- The Community 2020 Geographic Information System was developed and deployed and is used by the CFO, Community Builders, and Public Trust Officers to provide program and management information in a geo-coded format to users of HUD programs. In addition, the first stage of the Department's Executive Information System was prototyped using selected data from program and financial systems.

- The Budget Outlay Support System was developed and deployed and is used by the CFO to develop

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better and more timely outlay estimates of Section 8 programs, both tenant-based and project-based.

- The Single Family Premium Collection System was developed and deployed and is used by the Office of Housing to collect and account for premiums. The system improves internal controls, eliminates redundancies, improves service to lenders and streamlines reassessment of late fee refunds.

- The REMS Management System was developed and deployed and is used by the Office of Housing to monitor multifamily projects and to perform a variety of routine administrative activities.

- A data cleanup project was initiated during the 2nd quarter of FY 98, as part of the Financial Systems Integration Project, under the management of the HUD Chief Financial Officer. The project team developed HUD's Common Data Element Cleanup Method, based on best practices in both the federal and commercial sectors, in April 1998. The team then selected, prioritized and grouped data elements for FY 98, based on the initiatives begun under the Secretary's HUD 2020 Reform Plan.

  - When cleanup is completed, the Financial Systems Integration Project's Data Cleanup Team will conduct independent verification assessments on each major data set to ensure that they were not only cleaned, but were properly documented according to the HUD Data Cleanup Method. The Independent Verification Contractor has been selected and will begin verifications in early January 1999. At this time, the Department is ready to verify 3 of the 9 data sets. Two additional data sets will be ready for verification in February.

- Improvements in HUD's information technology capital planning.

  - In GAO's December 18, 1998, report, HUD agreed with the principal findings that the Department must improve its Information Technology (IT) Capital Planning Process. However, the report

HUD's comment 22.

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did not take note of several major accomplishments. In effect, it suggested that no process was in place. HUD has had in place a structured process for selecting IT investments since 1989 and has consistently made improvements to that process over the past decade. At the time of the passage of the Clinger-Cohen Act in 1996, HUD already had in place significant elements of sound IT Capital Planning practices that were compliant with the Act's requirements, in particular an executive level investment review board and a Departmental investment selection process. In addition, the Department continually improves its Capital Planning. For example, in 1996 the Department replaced the former investment review board with the current Technology Investment Board Executive Committee (TIBEC), which meets monthly to review IT Investment projects and issues, under the personal leadership of the Secretary and Deputy Secretary. HUD considers this direct participation in and leadership of the TIBEC by the Secretary and Deputy Secretary to be an IT Capital Planning best practice among cabinet-level agencies.

Over the past two years, and as indicated above, the Department has made significant improvements in the area of IT Capital Planning, and is currently underway with ambitious plans to establish in FY 1999, a complete, robust, and rigorous process to Control IT Investments. Furthermore, HUD is in the process of building upon established elements of a sound IT Investment selection process to establish a full IT Capital Planning and Investment Control process for the Department. This process, which is entirely in keeping with the goals and objectives of HUD 2020 Management Reform, will fully address the GAO IT Capital Planning model process of selecting, controlling, and evaluating the Department's IT Investments, and will bring the Department into full compliance with the Capital Planning and Budgeting requirements of Clinger-Cohen.

Part III: Examples Of Errors Of Fact, Logic And Characterization In The Draft GAO Report

The purpose of this part of the letter is to bring to GAO's attention instances of factual inaccuracies,

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inconsistencies of logic, faulty assumptions and mischaracterizations that lead the reader to erroneous inferences and conclusions. The following examples are provided for review and correction. They are not intended to be comprehensive but indicative of the depth of problems with the draft report.

1. GAO STATEMENT

HUD's comment 23.

Page 2, "Managers were not actively assessing risks in their programs as required under the management control Program."

HUD CORRECTION

This statement is totally false. For example:

- The Office of Housing has aggressively implemented the Departmental requirements of the CFO-established Risk Management program as evidenced by the front end risk assessments (FERAs) that have either been completed or are in process. All FERAs are performed in accordance with HUD Handbook 1840.1 REV2, which mandates that the minimum threshold for conducting a FERA is any new program totaling $10 million or more and/or for a substantially revised or administrative function if the increase or loss is greater than $10 million and/or if revision is equal to a change of 5% in a budget line item. Procedures for assessing risk are incorporated in HUD Handbook 1840.1 REV2, Chapter 8 and supplemental instructions from the CFO (February 12, 1997 memorandum on Front End Risk Assessments) and the Housing Comptroller (October 16, 1996 memorandum on Front End Risk Assessments).

Since FY 1996, the Office of Housing has completed five (5) FERAs which have an acceptable mitigation plan approved by the CFO. There are eight (8) others in various stages of completion. For seven (7) of these, FERAs have been received and mitigation plans have been submitted for review and approval by the CFO. A contract has been awarded (10/98) for another FERA and the date of completion has not been established.

- CPD field offices routinely conduct risk assessments in all program areas. Through the Annual Comparative Review step of CPD's Grants Management System process, **each** grantee is placed through

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complete risk analysis procedures. If it is determined that the grantee is of a "high risk" category, provisions are made to provide immediate assistance to the grantee through technical assistance or on-site monitoring.

The creation of the REAC is also serving to provide HUD with project and portfolio level risk assessment information across its public and multifamily housing programs.

Moreover, we also question the validity of GAO's conclusion because GAO did not talk to a statistically significant number of managers.

2. GAO STATEMENT

HUD's comment 24.

The subtitle on Page 2 reads "2020 Reform Plan Directed Toward Internal Control Weaknesses".

HUD CORRECTION

The subtitle on page 2 is a misleading statement and needs revision to accurately reflect that the HUD 2020 Reform Plan was not solely directed toward internal control weaknesses and to state that the 2020 plan effectively addressed those problems. Substitute language should read something like: "Internal Control Weaknesses Were Effectively Addressed by HUD's 2020 Reform Plan." Also, GAO should note that over 1100 field and Headquarters managers received internal control training during FY 1998.

3. GAO STATEMENT

Page 3 states that "REAC will not be fully functional until 2000."

HUD CORRECTION

HUD's comment 25.

The new REAC organization is using a phased systems and operational development process to assure that basic housing portfolio assessment information is available for use by HUD's multifamily and public housing program staff, and the new Enforcement Center, as quickly as possible. GAO's report should acknowledge that significant aspects of REAC's housing assessment operations are already functioning well beyond any systems ever used at HUD. For example, REAC's new physical inspection data collection device and protocol

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are already in operational use, with over 4,200 inspections completed through mid-December 1998. GAO should further acknowledge that all critical components of REAC's housing assessment processes are scheduled to be functioning to improve HUD's housing monitoring and enforcement activity before the year 2000. In January 1999, Release 1.1 of REAC's Financial Assessment Subsystem (FASS) will be placed into production to collect and disseminate annual financial statement and audit data on all of HUD's multifamily housing portfolio.

In addition, while REAC is completing the initial development of its new assessment systems, they are operating various Laboratory Projects which are using current or historical housing project data to provide "advisory scores" and other useful information to strengthen HUD's monitoring and enforcement activity. For example, REAC is providing advisory Public Housing Assessment System (PHAS) scores for all PHA's, ~~beginning with PHAs with fiscal years ending September~~ 30, 1998. Initial PHA advisory scores have already been completed for several hundred PHAs. REAC is also assisting the new Enforcement Center with physical and financial assessments of 200 enforcement case referrals made by Multifamily Housing Program Center staff.

4. GAO STATEMENT

HUD's comment 26.

Page 4 states that "Although the Enforcement Center began operations on September 1, 1998, it is not scheduled to perform all of its centralized functions until around April 1999 when it is to begin receiving referrals of troubled multifamily properties from the Real Estate Assessment Center."

HUD CORRECTION

Since October, 1998, the Enforcement Center (EC) has been receiving cases and performing all of its centralized functions and is regularly receiving additional cases from Housing and Real Estate Assessment Center (REAC). To date, the Center has received 200 referrals, which is considered significant by any objective standards, and is performing all of its centralized functions including:

- Obtaining, organizing and reviewing project files; visiting properties; coordinating with the Offices of Housing, Inspector General, and Department of

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Justice; generating enforcement recommendations; preparing administrative records; updating automated systems (REMS); beginning actions on debarments; and providing legal counsel to all the above actions as well as to the Mortgagee Review Board (MRB), on 2530 clearances, and Civil Monetary Penalties.

- The Enforcement Center coordinates with the Real Estate Assessment Center on the physical and financial review of the over 200 properties already referred. The EC has continued to train all staff in critical core competency, as well as in the award of a major contract. It should be noted, that it was never intended that the Enforcement Center would handle all troubled projects at the time the EC became fully operational. We would ask what centralized "functions" is it not now performing that it will later perform? Moreover, GAO must recognize that in the past 18 months, prior to the "official" opening of the Enforcement Center, HUD has dramatically improved enforcement at the Agency, for example, increasing debarments of bad landlords by 300% over prior years.

5. GAO STATEMENT

HUD's comment 27.

Page 4 states "the FY 97 financial statements ... found continued material internal control weaknesses in the programs of HUD and FHA."

HUD CORRECTION

GAO is not satisfied to make a simple factual statement without making leading inferences to the reader that this phenomenon exists only at HUD. GAO would be more accurate if it stated that material weaknesses are found within the financial statements at **all** (emphasis added) federal agencies and departments. Most cabinet level agencies have on the average of 8-24 material weaknesses with DOD exceeding 50 open material weaknesses. This matter is not isolated to HUD and GAO needs to make this acknowledgment.

6. GAO STATEMENT

HUD's comment 28.

Page 4 states that HUD has a qualified audit opinion because of "its inability to account for its credit programs in accordance with federal accounting standards."

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HUD CORRECTION

GAO fails to tell the entire story particularly as HUD stacks up against other federal agencies regarding compliance with the reporting requirements as required under SFFAS No. 2. Approximately 60 % of the agencies that credit reform affects have not achieved full compliance.

However, FHA has achieved compliance for its credit programs in accordance with private sector accounting standards, referred to as Generally Accepted Accounting Principles, (GAAP). FHA has received an unqualified (clean) audit opinion under GAAP for its financial statements since 1993.

As a result of the qualification in HUD's FY 1997 consolidated financial statement audit, FHA has developed a plan to comply with the reporting ~~requirements of SFFAS No. 2. FHA has developed an~~ action plan, and is on schedule to comply with the credit reform requirements of SFFS No. 2.

HUD's work and accomplishments in this area have been praised in another GAO report titled "Credit Reform - Key Credit Agencies Had Difficulty Making Reasonable Loan Program Cost Estimates." There appears to be a tension, if not a direct contradiction, between this earlier report and the current draft.

Also, in this section, GAO should emphasize the accomplishment of receiving a qualified opinion. Two years ago, the Department was not able to receive any type of opinion on its financial statement.

7. GAO STATEMENT

HUD's comment 29.

Page 7 states that "Although HUD has reduced its material weaknesses from 51 in Fiscal Year 1991 to the 9 remaining open as of Fiscal Year 1997, some of the remaining weaknesses are long-standing -- one dates back to 1983 while four others date back to 1993-and some involve billions of dollars such as the weaknesses relating to the $18 billion dollars rental assistance program."

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HUD CORRECTION

GAO is very dismissive in its tone relating to the significant decrease in material weaknesses from 51 in FY 1991 to the 9 remaining for FY 1997. A simple deletion of the word "although" would be a more honest description of the situation. A cleaner rewrite without changing the GAO facts would be: HUD has reduced its material weaknesses from 51 in FY 91 to the 9 remaining open as of FY 97. Some of these remaining weaknesses are long-standing -- one dates back to 1983 while four others date back to 1993 -- and some involve billions of dollars such as the weaknesses relating to the $18 billion rental assistance program. Finally, such a sharp reduction in material weaknesses is rare among agencies and positively significant for an agency as long troubled as HUD. It represents real progress..

8. GAO STATEMENT

HUD's comment 30.

On page 7, GAO cites its July 1997 report on Housing Preservation: Policies and Administrative Problems Increase Costs and Hinder Program Operations.

HUD CORRECTION

The July 1997 GAO report dealt mainly with funding and targeting aspects of the Preservation program. Since the program is no longer funded, the remaining issues from that report relate to oversight of those projects that were funded and their compliance with affordability restrictions which owners agreed to in exchange for financial incentives. Since the report was issued in July 1997, the Department, and Multifamily Housing in particular, has taken significant steps that will greatly enhance our ability for project oversight to ensure compliance with program requirements. They are as follows:

- The Real Estate Management System (REMS) - This brand new system and its related data quality verification initiative, are the foundation that will enable project managers in the field to better oversee all multifamily projects, including the Preservation portfolio which can now be highlighted to increase the focus on continuing affordability and owner compliance.

- Training - As soon as the HUD 2020 Management Reforms were implemented in October 1997,

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transitional training for all Project Managers was provided nationwide in all 18 Multifamily Hubs. This training was critical in providing the broad overview of the more generalist perspective of the Project Manager. Additional satellite distance learning broadcasts were provided in Fiscal Year 1998, providing a closer focus on the functions of the Project Manager's activity. These sessions included an overview, including participation by industry representatives, called Meet Housing 1998. The series of training sessions covered such key areas as: Review of Annual Financial Statements, REMS (Real Estate Management System - 2 parts), Physical Inspections, Conducting Management Reviews, Business Agreements, Tenant Relations, Portfolio Monitoring, and Center Development and Implementation.

- The Real Estate Assessment Center (REAC) - REAC was created to perform uniform, timely assessments of multifamily projects; thereby, significantly reducing the workload burden on field staff so that more attention can be focused on compliance issues and regulatory oversight as well as increasing their ability to identify those projects needing attention.

- The Departmental Enforcement Center (EC) - will centralize many of the enforcement activities previously performed by Multifamily Housing Field Office personnel. The Enforcement Center will be dedicating resources with enforcement activities on the most troubled properties; thereby, freeing staff in the field offices from a significant portion of this demanding and time-consuming responsibility.

- The Office of Quality Assurance was implemented in May 1998 to ensure quality program delivery and oversight of the multifamily programs and portfolio. The Quality Assurance staff are responsible for the program management and operational aspects, including risk management for multifamily housing programs. They will be testing cases and project managers' follow-up to ensure that HUD's field offices are addressing the affordability and compliance requirements under the Preservation program, as well as other

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critical program issues.

The combination of these enhanced management and administrative improvements provides uniform, up-to-date systems and organizational capability to ensure, in the case of the Preservation portfolio, that owners are in compliance with the agreements for continuing affordability under the program. It is inexplicable that GAO would rely on an outdated report and choose to ignore major changes implemented since that report was issued.

9. GAO STATEMENT

HUD's comment 31.

Page 9 states that "HUD's inability to implement plans under 2020 for handling properties on which borrowers defaulted was due to a shortage of Single Family staff because of downsizing."

HUD CORRECTION

This is false and reflects the consistent lack of thorough research and analysis in this draft report. FHA has not yet implemented scheduled staffing reductions in Single Family Real Estate Owned (REO) property disposition or asset management divisions. Therefore, any GAO criticism of FHA performance in REO property disposition cannot be linked to reductions in single family staffing levels. Taken together, more than 450 FHA field staff presently work on Single Family REO property disposition. Many single family REO staff will be re-assigned to other divisions following implementation of the new Management and Marketing (M&M) contracts nationwide. However, none of these staff have been or will be released from their REO division assignments until new private sector property management and marketing contractors are fully operational in March, 1999.

The single family Home Ownership Centers (HOCs) currently are at a combined 99 percent staffing level. Out of 957 total positions, the four HOCs only have 10 vacancies at present, a very low 1% vacancy rate by anyone's standard.

As further evidence of adequate staffing levels in the HOCs, last year the Single Family field staff endorsed more than one million new loans (the third highest total in FHA's history) and the REO staff sold more than 64,500 REO properties, an increase of more

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than 10 percent over FY 1997 when FHA sold approximately 58,000 properties. These very impressive performance numbers indicate that FHA is operating at adequate staffing levels today. Documentation is readily available to attest to these facts.

10. GAO STATEMENT

HUD's comment 32.

On page 9, GAO extensively restates the findings of its May 1998 report on FHA single family loans in New Jersey and Ohio, but makes a cursory reference to the new home buyer protection plan HUD implemented in June 1998.

HUD CORRECTION

GAO gives only passing reference to the Home Buyer Protection Plan, in fact, just one sentence. As GAO staff have been informed, the Department is aggressively implementing Secretary Cuomo's Home Buyer Protection Plan, which was announced in June, 1998. This comprehensive reform effort includes the following elements:

- A comprehensive update of FHA appraisal guidelines and procedures, including reforms to the standard FHA appraisal forms and requirements. FHA staff are working with Arthur Andersen Consulting to streamline and condense dozens of mortgagee letters, field notices and HUD handbooks on appraisal requirements into one, up-dated appraisal handbook. In addition to compiling all FHA appraisal guidelines into one, more accessible handbook, this effort also includes many enhancements to FHA appraisal requirements. The FHA Valuation Conditions Form, for instance, is being enhanced to ensure that appraisers more thoroughly review the property physical condition, to better inform FHA borrowers of the potential for physical defects, and inform them of the potential need for further home inspections. Revisions to the Handbook also clarify appraisal requirements and responsibilities, the first step to facilitating easier enforcement of FHA appraisal requirements. A draft of the new appraisal handbook will be available on the HUD website for review and

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comment by HUD's industry and consumer partners in January, 1999.

- FHA also has considerably stepped up monitoring and enforcement efforts concerning appraisers. Across the country, FHA conducted detailed field reviews of 10 percent of all appraisals conducted for FHA loans. Taken together, this represents some 147,956 appraisal field reviews. These reviews involve a re-appraisal of the subject property to determine if the appraisal methodology was accurate.

- FHA also stepped-up enforcement efforts against appraisers. In the last quarter of FY 1998 alone, FHA referred approximately 30 appraisers to the Enforcement Center for appropriate action.

- As part of Secretary Cuomo's Home Buyer Protection Plan, the revised appraisal handbook will include clear guidelines regarding appraiser enforcement standards. The handbook will include a matrix clearly showing the enforcement action, including civil money penalties, suspension and debarment, associated with various infractions.

11. GAO STATEMENT

HUD's comment 33.

The concluding paragraph on pages 10-11 for internal controls states that "while HUD has initiated actions under the 2020 Management Reform Plan that could help to address its internal control weaknesses such as improving the management and oversight of its real estate inventory, the reforms are not fully implemented, and it is too soon to assess their effectiveness."

HUD CORRECTION

Giving only one sentence for such a major HUD reform is not only highly misleading to the reader but indicates a bias on GAO's part against documenting how substantially HUD has reduced risk. GAO takes the approach that unless operational perfection is attained, i.e., reforms are not fully implemented, then the work and efforts to date remain unrecognized,

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unmeasureable and without impact on the HUD operations. HUD has made significant strides in its internal control environment in the past two years: Front-End Risk Assessments (FERAs) have become a standard management tool; FERAs have been completed for all of the newly established centers, one-day training was provided to 1,100 field and Headquarters managers on internal control; there is significant high-level management attention paid to corrective action plans for material weaknesses; and demonstrable steps have been taken toward resolving several open material weaknesses. The recognition of these achievements and accomplishments is missing from the GAO report.

In its March 1998 Evaluation Report, Booz-Allen assessed the HUD 2020 Management Plan:

"As of February 1998, the HUD 2020 organization is in place and being staffed. Considerable progress has been made in implementing the revised organizations, structures, processes, new systems, and staffing shifts needed for HUD's transformation. In addition, HUD continues work on other operational improvements including: 1) redesigning budget and procurement processes; 2) enhancing internal controls by developing a program for financial systems integration; 3) conducting front end risk assessments, and; 4) developing revised protocols for assessing the physical and financial conditions of its portfolios."

12. GAO STATEMENT

On page 11, the section header reads that "Much Work Remains on HUD's Information and Financial Management Systems."

HUD's comment 34.

HUD CORRECTION

The section header mischaracterizes the work that HUD has done in the past two years. For example, we have developed and implemented 11 new systems and all of HUD's Accounting Systems are A-127 compliant. We suggest that the header be revised to give the appropriate inference: "Much Work Has Been Accomplished Relating To HUD's Information And Financial Management Systems." We can provide much greater detail if needed. GAO has already received numerous documents supporting this statement.

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HUD's comment 35.

13. GAO STATEMENT

Page 12 states that most of HUD's systems "did not comply with FMFIA and therefore could not be relied upon to provide timely, accurate and reliable financial information and reports to management."

HUD CORRECTION

This is a misleading statement given the documentation that has been previously provided to GAO indicating that all of HUD's major accounting systems are FMFIA compliant. The systems at HUD that affect financial transactions and disbursements have withstood the FMFIA standards for compliance; and HUD has had a far more vigorous standard for compliance than any other Federal agency. Some non-financial systems have work remaining to be FMFIA compliant, but the systems ~~having the most risk exposure for HUD are fully~~ compliant.

HUD's comment 36.

14. GAO STATEMENT

Page 13 negatively describes HUD's data clean-up efforts.

HUD CORRECTION

In the first full paragraph on page 13, GAO describes HUD's data clean-up efforts. The description has a dismissive tone that incorrectly ignores our work to date. To our knowledge, HUD is unique within the federal government in that we have developed a specific plan with specific timetables and a quality assurance plan to address cleaning up data elements in the department. In fact, HUD may well have made more progress in the last two years than in the last twenty years.

HUD's comment 37.

15. GAO STATEMENT

Page 14 discusses issues raised in the December 1998 GAO report on HUD Information Systems.

HUD CORRECTION

We agreed with the general recommendations in the December, 1998 report entitled "HUD Information Systems-Improved Management Practices Needed to Control

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Integration Cost and Schedule," but the thrust of the report is not properly focused, and in some instances is inaccurate. The report is not accurate concerning the dollars expended on the development of financial systems; the report does not properly compare like systems when year to year comparisons are made; and most importantly, the report does not cite in its conclusions the many system improvements that HUD has accomplished. In short, the conclusions and recommendations are focused almost entirely on process improvements and are not properly balanced by summarizing the major system accomplishments of the Department.

We agreed that the management and oversight of financial system integration projects can be improved by fully implementing and institutionalizing the provisions of the Clinger-Cohen Act and the Paperwork Reduction Act. We agreed that we should prepare complete life cycle costs and benefits of our systems strategy. And, we agreed that we should develop and use defined processes for estimating costs, such as the requisites identified by the Carnegie Mellon University's Software Engineering Institute. The Department will implement these recommendations. However, HUD was not given credit for the fact that we were one of the first agencies to implement Information Technology Investment Portfolio Systems (ITIPS), which is the CIO Council's standard. HUD has implemented the IT Investment Management Process and is currently finalizing the control and evaluation elements of the plan under the Technology Investment Board of HUD.

GAO also observed that HUD did not finalize the revised project plans for completing the core accounting system (HUDCAPS). We agreed that more work needs to be done in this area so that a finished plan is available to measure the costs and track milestones. However, GAO staff was provided a completed first year plan and a final draft of the second year plan. Earlier this month the final plan was provided. Furthermore, the Department has recently installed a standard general ledger and chart of accounts that did not previously exist-this accomplishment was barely mentioned and is key to the Department publishing integrated financial statements for the entire agency.

As the report is now written, accomplishments of the Department are scattered throughout the report and not properly brought together and highlighted;

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cumulatively they paint a very different picture of the agency's progress. Let us summarize what has been accomplished during the time frame reviewed in this report:

- The Integrated Disbursement and Information System (IDIS) was developed and deployed and is used by the Office of Community Planning and Development to monitor an estimated 950 community development grantees and nine states.

- The Integrated Business System was developed and deployed in seven modules and is used by the Office of Public and Indian Housing, and the Office of Native American Programs to monitor their programs, including information related to all housing authorities in the country.

- The HUD Procurement System was developed and deployed and is used by the Office of Administration to track and manage the Department's procurement activities.

- The Grants Evaluation Management System was developed and deployed and is used by the Office of Fair Housing and Equal Opportunity to monitor their two major grant programs.

- The HUDCAPS system was developed and deployed and is used by the Chief Financial Officer to handle the core accounting transactions and several key programs. The deployments to date include: the Section 8 tenant-based program, the S&E accounts, and the working capital account. In addition, as of October, 1998 a consolidated HUD-wide general ledger with a new chart of accounts was deployed that will include for the first time summary transactions for all of the Department. A plan is in place to fully deploy and use HUDCAPS for all core accounting activities of the department.

- The Tenants Rental Assistance Certification System was developed and deployed and is used by the Office of Housing for tenant voucher processing, contract processing, and budget development and analyses.

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- The Budget Formulation System was developed and deployed and is used by the Chief Financial Officer to formulate, prepare and monitor the annual budget.

- The Community 2020 Geographic Information System was developed and deployed and is used by the Chief Financial Officer to provide program and management information in a geo-coded format to users of HUD programs. In addition, the first stage of the Department's Executive Information System was prototyped using selected data from program and financial systems.

- The Budget Outlay Support System was developed and deployed and is used by the Chief Financial Officer to develop better and more timely outlay estimates of Section 8 programs, both tenant-based and project-based.

- The Single Family Premium Collection system was developed and deployed and is used by the Office of Housing to collect and account for premiums. The system improves internal controls, eliminates redundancies, improves service to lenders and streamlines reassessment of late fee refunds of money.

- The Real Estate Management System was developed and deployed and is used by the Office of Housing to collect and monitor data related to all multi-family structures in the Department.

By any measure of performance, these efforts are quite significant. None of these systems existed at the beginning of the time frame reviewed by GAO for this report. We think it very important that these accomplishments be highlighted.

Additionally, the report indicates that the initial cost of the Department's financial system integration strategy was $103 million and that the number increased to $206 million with the 1993 strategy and that by the end of FY 1999 it will cost approximately $540 million. This interpretation is misleading and inaccurate because it does not compare

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like systems, and does not differentiate between development costs, maintenance costs, and non-FSI costs.

Specifically, the scope of the effort represented by the $540 million is larger than just the financial systems integration strategy. For example, the initial $103 million includes development costs only. The $540 million includes development and maintenance. Furthermore, the $540 million includes investment dollars for systems related to the Enforcement Center, the Assessment Center, Kiosks, technology for the HUD storefronts, and a range of other systems not associated with the FSI effort. A more accurate estimate for the FSI effort is $250 million. This is a key point and the numbers and text should be corrected and the accomplishments placed in the correct context.

GAO also cites that HUD was, at one time, behind schedule on renovating 20 of its 30 mission-critical systems. You made a very weak mention of the fact that HUD completed renovation of ALL systems, both mission critical, and non-critical ahead of schedule. You also failed to mention that HUD is 93% complete with certification and 86% complete with implementation as of December 1998.

16. GAO STATEMENT

Page 15 states that "other problems with information and financial management systems continue to limit HUD's ability to effectively manage its programs."

HUD CORRECTION

GAO cites a budget authority issue with HUD, dealing with the magnitude of estimated recaptures from Project-Based Section 8, as an example of major system problems. What GAO does not say is that there was no dispute with any of the outlay estimates developed by HUD systems for the FY 1999 budget--an amount totaling over $15 billion--or for that matter, neither did the Congressional Budget Office. Instead, the report which suggests that Congress made budgetary decisions totaling $2.9 billion based upon GAO findings that there were HUD system errors is grossly misleading. The real issue had to do with policy not systems. Specifically, the policy question was: how much of a shortfall was there in budget authority over the

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duration of the Section 8 contracts, and whether it was wise to use current year excess funds to support the FY 1999 budget even though there were shortfalls in the out years? Ultimately, Congress decided to use the $2.9 billion for the 1999 budget and defer the concern for out year shortfalls. This was not a system--in fact, the data to make this decision was developed from HUD systems. More generally, GAO ignores the major improvements in HUD's systems since the last report and uses very subjective language to describe our current systems.

17. GAO STATEMENT

Page 15 paints an inaccurate picture of HUD's oversight of the tenant-based and project-based Section 8 assistance programs.

HUD CORRECTION

No Housing Authority was ever double paid on the Administrative Fees. In regard to tenant-based, Section 8, the double counting was in the initial submission of the Department's budget. It was quickly identified and adjusted. No one was given excess funding. It has not been repeated and checks and balances between the Program and Budget Offices have been established to ensure no reoccurrence.

The assertion that fees have been double-counted, in regard to project based Section 8 has not yet been agreed to by HUD. However, HUD disputes the reference to $1 billion and believes $1,416,000 (annual cost) would depict a more adequate accounting picture. Disputes of this nature will continue to arise as long as Congress forces HUD to submit budgets that have Section 8 spikes in the out years above what was expected in a level-funding scenario.

As with the above inaccurate linkage, the process model was appropriate, however, the GAO and Congress disagreed with the approach and assumptions which provided for a level funding of Section 8 increases over the budget period and application of current excesses under that leveling approach. The budget approach has therefore been revised to assume that all available budget authority will be expended prior to funding of increases and to identify and apply all available recaptures.

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18. GAO STATEMENT

Page 12 GAO states that "In 1997…we noted that HUD had reported most of its systems did not comply with FMFIA and therefore could not be relied upon to provide timely, accurate, and reliable financial information and reports to management."

HUD CORRECTION

This example is testimony to GAO's propensity to make one finding and, then, to find different ways to say the same thing over and over. In this instance, in which GAO has now repeated itself for the fourth time, the Department finds no fault with its own methodology to determine FMFIA compliance. HUD has asked OMB and GAO if the JFMIP and FMFIA guidance, in which it is determined that when even one of the twelve listed criteria fails the system is non-FMFIA compliant, is the correct methodology being applied within all Federal agencies. GAO has been silent on this issue, and consequently, we believe GAO should seriously consider rewriting this section in a more positive and non-dismissive tone.

19. GAO STATEMENT

On page 18 GAO paints a negative picture of FHA's compliance with the Credit Reform Act of 1990.

HUD CORRECTION

FHA, working with contractors, GAO, and the IG, developed a plan with milestones and has expended a tremendous amount of effort to bring HUD into compliance with the reporting requirements of SFFAS No. 2. HUD anticipates compliance with its Fiscal Year 1998 financial statements. The paragraph should be revised to reflect this significant effort and accomplishment. In fact, we are only aware of two other federal departments that received a clean opinion regarding compliance with the requirements of SFFAS No. 2 for Fiscal Year 1997.

The loan information referred to in this report is detailed credit reform data at the cohort and risk category level. Only one of FHA's many cash systems did not have this level of detailed data (Single Family Periodic Premiums). In October 1998, FHA took steps to gather the detailed data required under credit reform

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reporting. This data will be available for credit reform reporting/compliance in the second quarter of FY 1999.

The report states that FHA was unable to comply with reporting under federal accounting standards. FHA has restated its FY 1997 financial statements under federal accounting standards and will provide FY 1998 statements as required under federal accounting standards in January, 1999.

As the report states, we have focused considerable effort on gathering the data needed to support the credit subsidy estimates and in preparing financial statements as required under federal accounting standards. The report fails to mention that FHA has received clean (unqualified) audit opinions from its auditors since 1998.

~~FHA has engaged outside contractors to assist in~~ complying with the SFFAS No. 2 standards. GAO, in their December 1998 report titled "Key Credit Agencies Had Difficulty Making Reasonable Loan Program Cost Estimates" encourages us to continue with our plan to have these contractors assist us in accumulating sufficient, relevant and reliable data to estimate the costs of our credit programs. Page 30 of the report states that HUD, "with the assistance of independent contractors, has focused significant effort on this area and has made considerable progress towards developing the data necessary to estimate loan program costs."

FHA has committed extensive resources towards clearing the issues related to SFFAS No. 2 and FHA staff and its contractors meet with staff from GAO on a biweekly basis to discuss and resolve any remaining issues as they are uncovered.

HUD is aware of the fact that it needs to enhance its data system for monitoring the progress of credit enhancement projects under the "Risk-Sharing Demonstration." We have responded by creating a system that will track these projects. This system will be completed in January, 1999.

The system will track the "Risk Sharing" project's name, number of units, mortgage amount, percentage of risk, HFA, QPE, originating lender, servicing organization and date closed. Additionally,

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Multifamily Housing has created a Quality Assurance Unit that will include, as one of its responsibilities, the oversight of our risk sharing partners' performance. The Information Specialists in Quality Assurance are developing a program for tracking the performance of our risk sharing partners.

20. GAO STATEMENT

Page 22 states that "HUD expects to improve both the efficiency and effectiveness of its operations through these organizational changes."

HUD CORRECTION

The organizational changes implemented through the HUD Management Reform Plan are already improving the efficiency and effectiveness of HUD's operations.

In his report, David Osborne underscores the scope and effectiveness of HUD's reforms on its culture and operations. Its first five findings should be noted:

1. "HUD 2020 provides clarity to its mission. It separates service from compliance functions as stated in the twin mission statements of empowerment and restoring public trust. To meet this goal, the organization is divided into two distinct groups: 'Community Builders,' who will seek to empower communities; and 'Public Trust Officers,' responsible for guarding against waste, fraud, and abuse."

2. "When implemented, the 2020 Plan will provide improved customer service. To do this, HUD will reorganize into 'back-office' processing centers to take advantage of internal processing activities that cut across program lines and 'storefronts' to provide improved face-to-face customer service."

3. "When implemented, it will enhance the Department's ability to protect public trust. The centralized Enforcement Center and development of Public Trust Officers emphasizes HUD's new policy of zero tolerance of waste, fraud, and abuse. Public perception focuses on HUD's ability

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and the increased likelihood that it will take legal action against those not in compliance with HUD policies and regulations. HUD's development of the Real Estate Assessment Center centralizes critical functions, reduces redundancy, and seeks to improve the quality and consistency of its outputs."

4. "System and internal control improvements will restore its financial and management credibility. It addresses basic systems problems such as data cleanup, integration of financial systems, and internal controls. The plan also recognizes the importance of outsourcing functions that can be performed more efficiently and effectively by the private sector."

5. "HUD 2020 has begun to foster a sense of innovation, entrepreneurship, and cutting-edge technology more characteristic of a private company than a public organization."

Similarly, PriceWaterhouseCoopers reviewed the HUD 2020 Management Reform Critical Milestones and found significant implementation of key elements of the plan:

- "HUD's Community Builders, a new corps of 217 urban and rural development specialists, have been trained at Harvard University, and are on the job in communities across the nation. The Community Builders aim to improve customer service by serving as a single point of contact to help customers gain access to the full range of HUD programs and services. A new class of 230 Community Builders is scheduled for the first quarter of FY 1999.

- The new HUD Enforcement Center has begun operations. Under the direction of an FBI Special Agent and four Assistant U.S. Attorneys, the Enforcement Center promotes greater accountability and standardization of HUD's enforcement activities. Enforcement offices have been opened in Atlanta, Chicago, Fort Worth, New York, and Los Angeles.

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- The Real Estate Assessment Center is designed to perform physical and financial assessments of HUD's public and multifamily housing stock. The new system marks the first time a uniform inspection of federally subsidized housing has been conducted. Over 4,200 physical inspections have been completed since mid December of 1998; with HUD's total portfolio of 33,400 housing entities scheduled for inspections by December 31, 1999.

- HUD has taken action to reform its procurement system. A Contract Management Review Board comprised of senior personnel has been established to promote more effective use of HUD's contracting dollars. Government technical representatives have been trained in each of the program areas to more effectively monitor HUD's contracts.

- The first Storefront opened in May, 1998 in Washington D.C. HUD Storefronts are designed as consumer oriented service centers to provide friendly, accessible service to the community. Five more HUD Storefronts are scheduled to open across the country early next year.

- Troubled Agency Recovery Centers opened in Memphis and Cleveland. These centers provide technical assistance to troubled public housing agencies.

- The Financial Systems Integration project is underway with the creation of a General Ledger that will consolidate data from 89 separate systems into a single system."

21. GAO STATEMENT

Page 22 states that "the organizational changes were generally not based on empirical analysis or studies."

HUD CORRECTION

This is completely inaccurate. In a letter to Ms. Judy England-Joseph, dated March 5, 1998, I laid out the number of different analytical methods used to

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design the HUD 2020 Management Reform Plan. These included:

- **Review of Critical Reports.** At the outset, HUD reviewed the voluminous analyses, studies, and hearings conducted by the GAO, HUD's own Inspector General, the National Academy of Public Administration, and Congressional Committee hearings. These reports extensively documented HUD's management deficiencies and recommended solutions, many of which have been incorporated into HUD's plans. For example, the IG and GAO have repeatedly called for the need for integrated financial systems, enhanced enforcement efforts against troubled properties and reallocation of staffing to address key program priorities. HUD's management reform plans address each of these concerns.

- **Pilot Program Experience.** Perhaps the most critical changes to the HUD restructuring plans are the changes taking place in FHA's single family operations, where HUD is shifting from a retail approach in 81 field offices to a wholesale operation where single family mortgage applications are processed in four Homeownership Centers across the country. These changes are the linchpin to HUD's larger reform efforts because of the tremendous staffing reductions that are achieved through this consolidation.

The proposed consolidation to four Homeownership Centers follows on the proven track record productivity improvements of a consolidated Homeownership Processing center that has been operational in Denver for the past three years. Relying on fewer staff, but state-of-the-art technology, the Denver Center has reduced mortgage processing times from 4-6 weeks to less than three days, with projected improvements to meet the industry standard of one day on the horizon, while actually increasing the total number of loan applications processed.

The GAO appears to discount this "real world" demonstration of an effective reform by describing this substantial demonstration as "limited results of a pilot project."

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- **Change Agent Teams.** Secretary Cuomo established program office and cross-cutting function "Change Agent" teams consisting of more than 100 senior Headquarters and field staff to develop recommendations for reform. The dedication of cross-cutting senior managers to develop reform plans based on their experience and judgment is a device commonly used in both private- and public-sector restructuring efforts. Each change agent team undertook its own workload analysis and reviewed existing program structure, organizational structure, delivery systems, financial management systems, and internal controls before making their recommendations.

- **Consultations with Outside Experts.** Prior to the release of the June *HUD 2020* report, HUD consulted with management reform experts in both the public and private sector reform, including David Osborne, James Champy, and private management consultants Ernst and Young, LLP. While each provided a range of insights, all encouraged HUD to act swiftly, to undertake bold rather than incremental reforms and to continue to refine the plan even as implementation proceeded. HUD has heeded this advice.

- **Consultations with Affected Constituent Groups and Congress.** HUD has undertaken exhaustive consultations with affected constituent groups and with members of Congress and their staffs since the release of the HUD 2020 report. Such consultations have been critically important because they have provided feedback from the people who are using and delivering our programs. These consultations have resulted in substantial refinements of the original plan, and provided input into detailed implementation plans, including the decision to keep the Assessment and Enforcement Centers located in Washington, DC.

- **Consultations with HUD's Inspector General.** Senior HUD management staff have devoted

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extensive time reviewing HUD's management reform plans with the Inspector General and her staff. Implementation plans have incorporated numerous suggestions. For example, at the IG's suggestion, HUD will maintain enforcement responsibility for near-troubled properties in FHA's Multifamily Office. Also, the IG has provided suggestions which have been incorporated for improving the monitoring of FHA Multifamily Contract Administrators.

Outside experts support this. David Osborne's review of the HUD 2020 MRP concluded that the plan "uses appropriate reinvention strategies for HUD specific challenges, and addresses the agency's core problems." And finally, Booz-Allen & Hamilton said "The change required, of people and of the HUD institution, by this transformation is real, massive, and ~~is, in Booz-Allen's experience, almost unparalleled~~ in scale for a government agency transformation and certainly for HUD. Change of this scale is always difficult but, we believe HUD's approach of: (1) creating the management vision to meet its mission as defined by Congress; (2) designing a strategy; (3) implementing structural changes, including simultaneously creating organizations and shifting personnel; and (4) involving all elements of the Department in developing implementation plans is well conceived and is appropriate. Under the HUD 2020 plan, HUD has set out to reform by administrative action its management structures and systems - reforms which when implemented, should present a significant improvement in HUD's performance, lower the risk of fraud, waste and abuse of its programs, and position HUD to better serve America's communities. The HUD transformation initiative, emphasizing community-focused efforts balanced by public trust functions, is significant in scope and is fully responsive to Congressional mandates and Administration reinventing government thrusts. These are the foundations of HUD's reinvention efforts."

22. GAO STATEMENT

The header on p.24 says that "Organizational Structure is in Place, but Transfer of Functions and Responsibilities is in Transition."

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HUD CORRECTION

As previously stated and validated by PricewaterhouseCoopers, the Section 8 Financial Management Center, Real Estate Assessment Center and Enforcement Center are, in fact, performing significant functions which provide vital support to all of the Department's major program areas: For example:

- REAC has initiated physical inspections which are essential to the Section 8 rental assistance re-certification process.

- Section 8 FMC has, in fact, centralized management and operation of the PIH and Housing rental assistance programs. Phase I of the center's operations involves the full migration of the public workload. Phase II, involving the Housing rental assistance workload, is scheduled to being this Fiscal Year.

- The Enforcement Center has begun a phased workload migration of multifamily housing projects; has undertaken debarment actions, etc.

Moreover, other major management reforms in core program areas have been implemented fully. These reforms represent the broad cross-section of the Department's operations. Public Housing Hubs/Centers are fully functioning and servicing housing authorities nationwide. The PIH Grants Management Center has completed the consolidated processing of all major public housing grants. The Housing Multifamily Hubs/Centers are fully operational and have implemented major reforms in project development (DAP), as well as, asset management (REMS). In FHEO, the Hubs/Centers have initiated the new strategy for processing enforcement actions (TEAPOTS).

Community Builders and Community Builder Fellows have been fully deployed under the new HUD Business and Operation Plan system. All major communities (states, counties and cities) are having their housing and community development needs met via individual field office action plans.

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In short, the header and following description should be changed to accurately reflect the current state of HUD's reforms.

23. GAO STATEMENT

Page 25 makes a broad generalization that "most managers and staff said the transfer of functions was in transition and they generally did not know when it would be complete."

HUD CORRECTION

GAO visited only five HUD offices and a small number of Headquarters organizations. We believe GAO is reporting the results of a very small number of interviews held with HUD managers and other staff. If "most" and "generally" means that these views are representative of at least half of HUD staff, then at least 17 of 25 people ***selected at random*** would have to have made such statements. If fewer than 25 were interviewed, an even higher percentage would have had to make such statements. We suspect this is not the case and that GAO is reporting hearsay rather than statistically significant fact. We ask that GAO provide HUD with a detailed breakdown of the statistically valid samples used to reach these sweeping conclusions. Meeting reports that were provided from GAO's field office visits indicate that staff is fully informed of the implementation plan and schedule, and understand what their roles and responsibilities are during workload transition. HUD staff expressed support for the changes and felt it would have a positive effect on their workload.

Moreover, the PriceWaterhouseCoopers review found that HUD's implementation plan is on schedule.

24. GAO STATEMENT

Page 25 cites that "Although a new field organization structure is in place, staffing decisions were only recently completed, and some centers are significantly understaffed."

HUD CORRECTION

This is just wrong. As of the end of January, 1999, the Enforcement Center will have 148 (72%) staff on board. Twenty-six (26) additional positions (all in

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the field) have been posted and/or are in the final stage of the selection process. These will be filled in the next few weeks, bringing the Center to 84% of its total authorized staffing ceiling. The remaining 16% should be filled in February.

The EC staff has been trained appropriately and is able to handle the current and projected workload.

More broadly, the Department is currently substantially staffed in accordance with HUD 2020 plans. To date, the Office of Housing is 98% staffed to its HUD 2020 level, with 3356 staff on board against a ceiling of 3434. In accordance with the attached detailed analysis (Attachment 2), the Multifamily field offices are 98% at capacity, the HOC' are at 99% capacity, and the Financial Operations Center is at 98% capacity. The small number of vacancies remaining (78), which are not significant in light of normal attrition and personnel activity for an organization this size, are in the process of being merit staffed and we should reach full capacity by the second quarter of the fiscal year.

The staffing of the REAC is on target with its phased systems and operational development schedule. REAC's total estimated staffing level of 211 FTEs was arrived at using various work measurement and metrics analyses. However, REAC never intended to be at full staff capacity until its phased systems and operational development plans are completed. While significant systems development activity is still underway, REAC is using contracted development resources. Contracted resources are also supporting REAC's Laboratory Projects to produce interim results until development activities are substantially complete. Given the combination of in-house and contract resources, REAC considers itself to be adequately staffed at this juncture in its development life cycle.

The Troubled Agency Recovery Centers (TARC) are now at 86% of projected staffing levels with 122 people. This staffing level is more than acceptable. Currently, there are 52 troubled Public Housing Agencies' (PHA), and staff are in training to assume additional troubled agencies that may result from the implementation of PHAS.

The Grants Management Center (GMC), Special Applications and the Financial Management Center (FMC)

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are fully operational with 95% of projected staffing levels and all 3 are running efficiently. GMC has assumed NOFA processing and fund allocation. To date, FMC has migrated the Section 8 workload from 49 of its 52 field offices or 95%, a significant accomplishment.

25. GAO STATEMENT

Page 29 states that "staff losses were recovered after HUD decided in May 1998 to assign unplaced staff to permanent positions."

HUD CORRECTION

The statement fails to recognize one of the major goals of the HUD 2020 Management Reform Plan, which is to change the way the Department operates. Our new operations, whether in Hubs, Homeownership Centers, Troubled Agency Recovery Centers, Property Disposition Centers, the Enforcement and Real Estate Assessment Centers or the Section 8 Financial Management Center, are designed to improve and streamline program administration and enhance customer services, in some cases with less staff.

To ensure that the enhanced staff resources would also be utilized to address management deficiencies, unassigned staff were placed in areas that represented long-standing departmental problems that 2020 has addressed. We deployed unassigned staff as follows:

	Organization	No. of Staff Assigned	Priority Function
1.	Housing	851	• Multifamily Housing Operations • Single Family HOC Operations
2.	Public and Indian Housing	212	• PIH Hub Operations • TARC Operations • Grants Management • Financial Management • Section 8 Financial
3.	Community Planning and Development	46	• Field Operations and Monitoring • Management Information Systems
4.	Fair Housing and Equal Opportunity	81	• Civil Rights Compliance and Enforcement • Field Operations and Oversight

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5.	Real Estate Assessment	11	• Implementation of Physical Inspection and Financial Assessment process
6.	Enforcement Center	5	• Compliance and Enforcement Operations
7.	Field Policy and Management	116	• Customer Service Management • Technical Support
8.	Other Organizations (e.g. OGC, Administration and PD&R)	36	• Administrative, technical and policy support to HUD 2020 implementation

26. GAO STATEMENT

Page 30 of the report cites that "the Enforcement Center had only 62% of its staff.

HUD CORRECTION

As of the end of January, 1999, the Enforcement Center will have 148 (72%) staff on board. Twenty-six (26) additional positions (all in the field) have been posted and/or are in the final stage of the selection process. These will be filled in the next few weeks, bringing the Center to 84% of its total authorized staffing ceiling. The remaining 16% should be filled in February.

The EC staff has been trained appropriately and is able to handle the current and projected workload.

27. GAO STATEMENT

Page 30 states "to date there had not been a significant shift of workload from the field office to the centers, according to the staff and managers we interviewed from July through October 1998."

HUD CORRECTION

GAO's interviews must have been premature since this is a totally inaccurate statement. The Enforcement Center did not expect or receive cases until after the July to October period in which GAO

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conducted it's interviews. We consider the over 200 cases presently in the Enforcement Center as significant. In addition, debarment authority, which also created a shift of workload into the EC, was not delegated until October, 1998.

The FMC established a schedule to migrate all the Section 8 financial management processing from the 52 Public Housing field offices and ONAP between July 1 and December 1, 1998. As of December 1, the workload from 49 of the 52 offices had been migrated and is being performed at the FMC. The remaining two PH offices requested until January, 1999 to finish their preparations for moving the workload; ONAP requested slightly more time to complete the transfer of some units to new Housing Entities before migrating the workload. We consider the migration of 49 offices in less than six months to be a significant accomplishment. Once an office has migrated its workload to the FMC, that office's functions and responsibilities for Section 8 financial processing effectively end. Moreover, Community Builders are also assisting with the workload reduction at the field offices.

The Grants Management Center (GMC) has assumed the NOFA processing and fund allocation responsibilities for all major public housing programs. The Special Applications Center (SAC) is processing all demolition/disposition applications along with five home ownership applications which were previously handled by 52 field offices. The Troubled Agency Recovery Center (TARC) has migrated all work from the field to the two centers. This relieved the field of a tremendous amount of staff time and effort.

The migration of financial management workload from the Office of Housing is scheduled to begin in February, 1999, with the conversion of 3600 ACCs from PAS/LOCCS to HUDCAPS and their transfer to the FMC. A mid-to-late summer action will convert the remaining 1000 ACCs. The timing of this process has been determined by the schedule for the conversion of the Department's General Ledger, now planned for January 1999. Migration of the financial workload for the approximately 21,000 HAP contracts of the Office of Housing is dependent upon the selection and deployment of Contract Administrators to perform specific duties; the selection and contracting process is under the jurisdiction of the Office of Housing.

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28. GAO STATEMENT

Page 30 states that, "HUD's single family homeownership centers cannot handle the current workload of HUD's inventory."

HUD CORRECTION

FHA has not yet implemented scheduled staffing reductions in single family REO property disposition or asset management divisions. Therefore, any GAO criticism of FHA performance in REO property disposition cannot be linked to reductions in single family staffing levels. Taken together, more than 450 FHA field staff presently work on single family REO property disposition. Many single family REO staff will be re-assigned to other divisions following implementation of the new Management and Marketing contracts nationwide. However, none of these staff have been or will be released from their REO division assignments until new private sector property management and marketing (M&M) contractors are fully operational in March, 1999.

The Single Family Home Ownership Centers (HOCs) currently are at a combined 99 percent staffing level. Out of 957 total positions, the four HOCs only have 10 vacancies at present, a relatively normal vacancy rate due to periodic turnover.

As further evidence of adequate staffing levels in the HOCs, last year the single family field staff endorsed more than 1 million new loans (the third highest total in FHA's history) and the REO staff sold more than 64,500 REO properties, an increase of more than 10 percent over FY 1997 when FHA sold approximately 58,000 properties. These very impressive performance numbers indicate that FHA is operating at adequate staffing levels today.

Benefits of M&M Contracts

FHA is in the process of implementing a new REO property management and marketing (M&M) contracting method that will rely entirely on private sector real estate professionals to perform all work related to maintaining, protecting, preserving and selling HUD-owned properties. Full implementation of this proven contracting model will allow for a substantial

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realignment of HUD staff. In their report on HUD 2020 reform, Booz-Allen Hamilton stated that this privatization of the FHA REO property disposition process would significantly reduce the FHA's staffing needs in the single family home ownership centers.

Rather than relying on REAM contractors to manage properties and HUD field office staff to sell properties, FHA now will contract with private sector real estate professionals to perform virtually all functions related to both management and marketing of HUD REO properties. This M&M contracting approach is based on a successful pilot program run by FHA in Maryland, Louisiana and Sacramento, California over the last two years. During FY 1997, the pilot contractor was able to dispose of properties significantly faster than HUD in all three pilot sites. This resulted in properties returning to private ownership much more quickly. In addition, at two of the pilot sites, the average sales price under the pilot increased and the average FHA profit per property sold increased or remained constant.

Now FHA is expanding this successful contracting model nationwide. After making some adjustments to the program based on recommendations in a generally favorable audit of the pilot performed by the HUD Inspector General, including reducing the number of pass through expenses to HUD, FHA issued a request for proposals in August, 1998 for sixteen contracts to cover the entire country. The M&M procurement is on schedule and FHA plans to award M&M contracts to qualified private sector real estate professionals in the second quarter of FY 1999, with the contractors slated to be begin operation in March 1999.

By using private contractors to market and manage foreclosed properties, FHA will be able to take full advantage of the expertise and experience that private sector enterprise can bring to this process. M&M contractors will use private sector methods, such as multiple listing services and Internet advertising to reach a broader audience potential home owners. Relying on private sector contractors to perform more REO management and marketing functions also will permit FHA to substantially reduce the number of single family staff assigned to REO property disposition, and also free remaining staff to focus their effort and resources on monitoring and oversight of the M&M contractors.

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29. GAO STATEMENT

Page 31 states that, "Because of the workload situation, it is taking HUD longer to sell the properties and, as a result, the OIG estimates the agency is incurring additional costs of $1 million a day."

HUD CORRECTION

It is wholly inaccurate to state that FHA is spending an **additional** $1 million a day on REO. When GAO staff were told of this error, they said they were merely citing an OIG report and do not routinely check the accuracy of such OIG reports, but merely report their findings. While the number of REO properties in inventory is up slightly, the cost of maintaining REO properties in inventory is a cost which has been historically associated with default/foreclosure experience. To clarify, GAO seems to have arrived at this estimate by multiplying the number of total properties in inventory, approximately 40,000 properties, by FHA's average holding cost per day. While this is the cost of maintaining FHA's REO inventory per day, it is misleading to represent this as additional cost to the Government and the taxpayer due to perceived delays in property sales. As stated above, FHA sold more than 64,500 properties last year, a more than 10 percent increase over the previous fiscal year. Therefore, it is not accurate to assume that the size of the inventory of REO properties is due to inadequate sales. Furthermore, FHA's daily holding costs are consistent with similar costs incurred by other large REO holders such as Fannie Mae and Freddie Mac. There are statistics that can be provided to amplify our assertion.

A well reasoned assessment of the cost of FHA's REO inventory would consider not only the flow of properties sold on the back end, which was in excess of 70,000 properties in FY 98, up from 59,600 in FY 97, but also the flow of properties coming into the inventory due to insurance claims. In FY 1998, FHA claims were up, contributing to the number of properties in inventory, as FHA continued to bear the brunt of a delayed recovery of some isolated real estate markets.

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30. GAO STATEMENT

Page 31 states that, "because staffing reforms have not been fully implemented, their effectiveness in correcting management deficiencies cannot be demonstrated."

HUD CORRECTION

This statement is wrong for two reasons, First, the HUD 2020 staffing plan and placement actions are, for the most part, completed and implemented. Nine thousand placement actions have been completed by the Department, as part of establishing new and operational management reform organizations.

Secondly, as indicated throughout this letter, management reform operations are well underway. This is evidenced by the actual performance of workload requirements by all program and consolidated centers.

Given the current state of operations, it is illogical to conclude that the effectiveness of corrective action to address management deficiencies "cannot be demonstrated." In fact, effective internal controls are in place, the new organization structure and management planning process (Business and Operating Plan) are working, financial and management information systems are routinely providing timely, accurate and reliable information, and HUD staff have been trained and assigned to perform the most mission-critical functions.

The Department's major program areas, including Housing, PIH, CPD, FHEO, OGC, and Administration are all staffed to perform their required functions. The EC and REAC are staffed to meet the needs of their current operational workload schedules and requirements. The internal merit staffing process has resumed its normal pace of operations.

31. GAO STATEMENT

Page 6 cites as a material weakness HUD's "inadequate emphasis on providing early warning of, and preventing losses due to defaults on insured mortgages."

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HUD CORRECTION

Over the last several months, FHA has taken a number of steps to enhance three distinct strategies to monitor insured loan performance and mitigate losses due to defaults on insured mortgages. These strategies include FHA lender monitoring and enforcement, automated systems to monitor insured loan performance and the FHA loan loss mitigation program designed to provide troubled borrowers effective options to foreclosure, and thereby reduce the number of FHA defaults and claims. Specific enhancements in these areas include:

- **FHA has developed a new automated system for monitoring loan performance data by lender and geographic Area.** In May, 1998, Single Family implemented the Neighborhood Watch system, which was designed to track FHA insured loan performance by several different characteristics include the originating lender, the FHA loan program, specific loan characteristics, and geographic areas. With the ability to provide these detailed loan characteristics in real estate markets across the country, Neighborhood Watch gives FHA staff a powerful automated tool for monitoring defaults and making relative comparisons of lender performance. To date, the system's focus has been on early payment defaults and claims, and access has been limited to HUD staff. In 1999, the system will be made available to lenders through FHA's secure Internet gateway, the FHA Connection. Also in 1999, the system will be enhanced to add comparisons of servicing performance. It is FHA's expectation that lenders will use this tool for self-policing.

- **FHA opened a new National Loss Mitigation Center located in Oklahoma City in FY 1998.** This new center, with thirty-seven staff dedicated entirely to loan loss mitigation servicing, opened the Summer of 1997 and became fully operational with thoroughly trained staff in February, 1998. FHA staff in the Oklahoma Center provide foreclosure avoidance counseling to FHA homeowners in default, on-site training to high volume servicing lenders, and training seminars on

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the FHA loan loss mitigation program to FHA loan servicers across the country.

- **FHA is experiencing increased use of the Loan Loss Mitigation program.** After a somewhat slow start to FHA's new Loan Loss Mitigation program, which was introduced in the middle of FY 1996, FHA now is seeing a dramatic increase in the number of homeowners in default who are gaining access to one or more foreclosure avoidance options offered by FHA. In FY 1998, FHA helped more than 11,000 homeowners in default take advantage of foreclosure avoidance options, with the number of assisted families increasing each month as the program continues to gain momentum.

- **FHA is preparing to launch a new performance-based lender enforcement program.** The Quality Assurance Division in HUD Headquarters is on schedule to restart the Credit Watch/Termination initiative in FY 1999. This initiative is designed to improve lender origination performance by regularly reviewing mortgagees' early payment default and claim rates by branch office within regional markets, and alerting mortgagees of deficient performance. If a mortgagees' default and claim rate is excessive in comparison to area averages, the mortgagee can be placed on probation (Credit Watch status) or be suspended from FHA programs (Termination of Origination Approval Agreement), depending on the severity of its poor performance. FHA anticipates this powerful new lender monitoring and enforcement program will dramatically enhance lenders' underwriting and servicing performance.

- **FHA also has increased the number of lender monitors and mortgagee reviews.** In FY 1997, the Department increased the number of monitors from approximately 23 to 74, and in FY 1998 that number more than doubled to 154 monitors. The number of on-site monitoring reviews grew from 256 in FY 1997 to 430 in FY 1998, rising at somewhat a slower pace than

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the staffing levels as newer monitors were trained and gained experience. In FY 1999 FHA has established a goal of performing 900 on-site reviews for FY 1999. This increase in activity, naturally, increases lender awareness of FHA program requirements, and again, is designed to improve lender performance and mitigate losses due to defaults and claims.

- **Finally, over the last year, FHA has also taken a number of steps to ensure that monitoring priorities, procedures and recommended remedies are consistent, including:**

  - *Documenting Goals and Strategies.* Senior Single Family management met in December, 1997, to plan a consistent approach to lender monitoring as responsibility for these functions transferred to the Home Ownership Centers. The results of those discussions were published as the "Quality Assurance Division Guide" which was distributed to all current and new mortgagee monitors, and Single Family management. This guide describes methods of targeting, risk factors to consider, the review process, forms used, bases for referrals, and performance expectations.

  - *Routine Communications and Shared Systems.* There has been and continues to be a concerted effort to make QAD practices and communications consistent. The five QAD Directors (i.e. Headquarters plus the four HOCs) hold monthly conference calls to raise and resolve issues. All monitoring efforts are tracked through a national computer system. This system is also the source of reports on accomplishments towards the monitoring goals. An electronic file of past

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"findings letters" (i.e. correspondence to mortgagees describing their deficiencies) has been created and will be made available to the HOCs in January, 1999. In addition, systems are being enhanced to aid in targeting poorly performing lenders.

- *Training*. All monitors and QAD management received refresher training in March, 1998, on the techniques of conducting origination, servicing and Title I reviews, risk factors and priorities, documentary support, targeting tools and other topics. For the newly assigned/reassigned monitors, this classroom training was followed by many weeks of on-the-job training and mentoring by more senior monitors.

32. GAO STATEMENT

Page 25 states that "The lack of sufficient travel funds to conduct on-site monitoring of program activities is a problem. According to some officials, the scarcity of travel funds has prevented them from conducting some on-site reviews."

HUD CORRECTION

This is another example of how GAO takes isolated comments garnered from a non-statistically significant base and extrapolates into broad generalizations and then does not even check the underlying facts. This statement is grossly inaccurate. HUD's travel budget has significantly increased from $13.5 million, $15.6 million to $19.0 million for Fiscal Years 1997, 1998 and 1999, respectively. Moreover, GAO does not appear to have any statistically valid evidence of how an alleged lack of travel funds has led to insufficient monitoring.

33. GAO STATEMENT

Page 25 states that "Program officials and a community builder in one HUD field office (emphasis added) identified a need for HUD to clarify the authority of the community builders in dealing with HUD

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GAO's Responses to HUD's Comments on the Major Challenges and Program Risks Identified in GAO'S Statement of Facts

Note: References to page numbers refer to those of HUD's letter of December 28, 1998.

1. HUD's Comment, p. 1

HUD commented that "Comprehensive reorganization, major system developments and deployment, carefully crafted staffing reforms, and the hallmark achievement of HUD's first ever audited financial statements are all glossed over by GAO as minor advances and are presented as interesting interim movements toward some unknown mark on an undefined measuring stick."[1]

GAO's Response

We disagree. In the statement of facts we provided HUD on December 15, 1998, we described the major actions it has taken and the achievements it has realized since it launched its 2020 Management Reform Plan in June 1997, including each of the items mentioned above by the Department. In addition, we discussed HUD's goals under the plan for the areas where we identified management deficiencies: internal controls, systems, organization, and staffing. Beyond the statement of facts provided to HUD, in our final report[2] our "Overview" included a summary of HUD's achievements since the 2020 plan was announced and our conclusion that HUD has made credible progress in laying the framework for improving its management.

HUD's comment implies that our statement of facts lacked clear criteria for evaluating its progress. See our response to comment 3 for a discussion of our criteria for evaluating HUD's progress and related matters.

2. HUD's Comment, p. 2

HUD commented that under its 2020 Management Reform Plan, "the Department implemented a bold initiative to fundamentally re-design the manner in which HUD delivers its programs." According to HUD, "The profound significance of . . . [its] major achievements and accomplishments is missing in the report, as well as a corresponding

[1]HUD was referring to its fiscal year 1997 financial statements, upon which it received a qualified audit opinion. After HUD responded to our statement of facts, HUD's Inspector General issued, on March 29, 1999, its unqualified opinion on HUD's consolidated federal accounting-based financial statements for fiscal year 1998, which is further discussed under HUD's comment 17.

[2]Major Management Challenges and Program Risks Department of Housing and Urban Development (GAO/OCG-99-8, Jan. 1999).

description of reduced risk at the agency. The Department has developed and implemented a detailed plan for reform—a plan that has reduced the risk of waste, fraud, and abuse." According to HUD, "the tenor of GAO's draft report leaves the reader to conclude that, since there are not absolute measurable results in all areas, little that is positive has happened at the Department during the past two years."

GAO's Response

As mentioned, the statement of facts we provided HUD described a number of positive achievements made by HUD since it launched its 2020 reforms. We stated, among other things, that HUD's reforms could help to address internal control weaknesses facing the agency and described HUD's establishment and implementation of risk assessments for programs that were established or substantially revised; development and deployment of information and financial management systems; and establishment and operation of various HUD offices, including its specialized and nationwide centers that consolidate processes and functions within and across program areas.

While the 2020 reforms may help reduce HUD's risks, we were not aware of significant evidence demonstrating that risks had actually been reduced at the time of our work regarding major management challenges and program risks. In addition, HUD's comments on our statement of facts do not present evidence demonstrating that its risks have been reduced. HUD's fundamental contention is that since it has made plans and begun implementing changes in the way it delivers programs, risks have been reduced. The only evidence HUD provided in its December 28, 1998, letter demonstrating that its risks have been reduced is a 300-percent increase in debarments, which appears to be based on the increase in debarments from 30 debarments in 1996 to about 100 in 1997. Our January 1999 report on HUD's major management challenges and program risks included this information.

HUD's characterization of the tenor of our report may, in part, be attributable to the fact that as a statement of facts, the document provided to HUD did not include the "Overview" that appeared in the final report. As explained previously, the "Overview" provided our views on the significance of the 2020 plan reforms.

3. HUD's Comment, pp. 2 and 3

HUD expressed concern that we had not provided the specific criteria for the "high-risk" designation to be removed since the Department raised the question in a June 23, 1998, letter from the Department's Acting Deputy Secretary to GAO's Acting Comptroller General. In that letter, HUD requested that we present established and objective criteria that had been and would be used to determine what programs in an agency constitute high risk and what makes an entire federal agency high-risk.

GAO's Response

Our conclusion that HUD's programs are high-risk is based on the status of four serious, long-standing Department-wide management deficiencies that, taken together, have placed the integrity and accountability of HUD's programs at high risk since 1994. We have issued numerous reports and testimonies over the past 15 years pointing to these significant management deficiencies that cut across HUD's program areas. We and others (i.e., HUD's Inspector General and external auditors) have observed these management deficiencies. Because HUD is one of the nation's largest financial institutions responsible for managing about $454 billion in insured mortgages, about $531 billion in guarantees of mortgage-backed securities, and about $24 billion in current budget authority and because these four weaknesses continue largely unresolved or recent reforms to address them are in the early stages of implementation (and it is too soon to tell whether they will resolve the deficiencies), our professional judgment is that HUD's programs continue to be a high-risk area.

On several occasions, we have discussed with HUD officials our criteria for designating a program or agency high-risk. In addition, we included our criteria in our 1997 High-Risk Series report[3] and in our written response to HUD's Acting Deputy Secretary's June 23, 1998, letter on this subject. We have pointed out that our criteria for designating programs or agencies as high-risk areas stem directly from our professional and objective judgment about patterns of significant management deficiencies uncovered over time in our audits, as well as those of inspectors general and others, that remain largely unresolved. We stated in our response to HUD's June 23, 1998, letter that programs and agencies for which we have removed our high-risk designation are those that have demonstrated results in overcoming management deficiencies. We further stated that it is important to note that while reform initiatives are important, plans for reform are not sufficient in and of themselves. Rather, it is the results of

[3]High-Risk Series: Department of Housing and Urban Development (GAO/HR-97-12, Feb. 1997).

such reform initiatives—demonstrating that management problems have been corrected—that count.

As mentioned above, our February 1997 High-Risk Series report on HUD clearly laid out the actions—such as eliminating material internal control weaknesses—that we believed were necessary to reduce the risks to the agency's programs. We also met with HUD officials in August 1997 and provided them with a list of corrective actions that would need to be substantially completed to address the deficiencies that made HUD high-risk in our opinion, such as completing improvements to its financial and information management systems. The list largely mirrored the discussion in our February 1997 report.

As pointed out in our January 1999 report on HUD's major management challenges and program risks, our recent work indicates that internal control weaknesses and problems with information and financial management systems persist at the Department. Furthermore, recent reforms to address the Department's organizational and staffing problems are in the early stages of implementation, and it is too soon to tell whether or not they will resolve the major deficiencies that we and others have identified. Consequently, we continue to believe, as we reported in 1995[8] and 1997, that these deficiencies, taken together, place the integrity and accountability of HUD's programs at high risk.

4. HUD's Comment, p. 3

HUD asserted that we have has been unable to articulate what constitutes high risk at the Department and for all agencies and in fact have acknowledged that no such governmentwide test of high risk exists. HUD also stated that it should be provided specific criteria used to determine whether an agency is high-risk; the data used to determine whether an agency is high-risk; the data showing how other agencies stood when we applied that objective, standardized high-risk test; and the analysis we used in comparing the data on HUD to the high-risk criteria.

GAO's Response

As discussed in our response to comment 3, we have informed HUD officials about what constitutes high risk at the Department in our opinion, what the Department needs to accomplish to remove the designation, and what is not sufficient to remove the designation.

[8]High-Risk Series: Department of Housing and Urban Development (GAO/HR-95-11, Feb. 1995).

In response to HUD's request that it be provided the criteria we use to determine whether any agency is high risk and how the agencies compared when we applied our criteria, we have informed HUD officials that the criteria we apply to the Department are the same criteria we have applied to other agencies. Our criteria included considering factors such as the significance of HUD's management deficiencies, their impact on program operations, past successes achieved in resolving the deficiencies, and the amount of risk inherent in HUD's operations.

We also have informed HUD officials that different agencies' functions, programs, and organizational units have been removed and added each time we have updated our high-risk designations. Because different agencies present different exposures to risk and management deficiencies can differ in their impact on programs, we have advised HUD officials that independent, professional, and objective judgment of knowledgeable GAO professionals plays a role in determining whether a program is high-risk. We have also advised them that professional judgment will also play a role in determining at what point improvements made by HUD in resolving its management deficiencies will mean that the agency overall will no longer warrant the designation high-risk, but that individual functions and/or specific programs within the agency may instead be designated high-risk.

In our January 8, 1999, response to HUD's Deputy Secretary's letter of December 28, 1998, we pointed out our consistent application of our criteria for high-risk designations. We explained that we reached our conclusion about HUD and all of our determinations of which government operations are considered to be high-risk in our January 1999 Performance and Accountability Series reports[9] using the same methodology and criteria, which were the same as those used for our February 1997 High-Risk Series reports.

5. HUD's Comment, pp. 3 and 4

HUD stated that senior GAO staff had indicated that no high-risk test was being applied to all federal agencies, that the label of high risk was applied on the basis of the professional judgment of GAO staff, and that a high-risk test of having four or more agencywide problems had not been applied to any other agency.

GAO's Response

[9]Major Management Challenges and Program Risks: A Governmentwide Perspective (GAO/OCG-99-1, Jan. 1999).

HUD's assertion is incorrect. Senior GAO officials have told HUD officials that we consider the implications of all management deficiencies in determining whether an agency is high-risk or not. The fact that a specific number of agencywide problems exist at a particular agency does not automatically mean that an agency or program is high-risk. To apply such a limited test would discount the effect of such factors as the prevalence of the deficiencies, past successes achieved by agencies in resolving them, and exposure to risk.

Overall, the intent of our special effort to review and report on federal government program areas that we consider at greater risk is to focus our resources and attention as well as those of the Congress and agency management on actions needed to correct the most serious problems in selected areas. Our criteria for designating programs as high-risk areas stem directly from our professional and objective judgment about patterns of significant management deficiencies in the federal government uncovered over time in our audits, as well as those of inspectors general and others, that remain largely unresolved. A determination includes our consideration of factors such as the seriousness of the management deficiencies identified; their cumulative impact on program operations, federal spending, and the ability of an agency to carry out its mission; the results achieved by past efforts to resolve the deficiencies; and the amount of risk of fraud, waste, and abuse inherent in an agency's operation.

In addition, as we pointed out in our January 1999 performance and accountability series, an increasing amount of information is becoming available through the implementation of the performance-based management legislation that the Congress has enacted. This information makes it both possible and appropriate for GAO to periodically reassess the methodologies and criteria it uses to determine which operations, functions, and entities should be included in the performance and accountability series reports and which should be identified as "high-risk."

We also pointed out in this January 1999 report that we plan to undertake a comprehensive review and reassessment of this area during 1999. In conducting this review and reassessment, and in accordance with our normal practices, we will consult with key stakeholders, including selected congressional and agency representatives, before completing our approach to the 2001 series.

Our review effort likely will result in new ways of determining and presenting major management challenges and program risks, especially in connection with selected functions (e.g., strategic planning, organizational alignment, human capital strategies, and contract management) as well as at the overall department and agency level. This reassessment may also result in the consolidation of GAO's current high-risk series as an important component of an expanded performance and accountability series. The ultimate determination of what should be included in this series and what should be deemed to be "high-risk" will continue to involve the independent, professional, and objective judgment of GAO professionals.

6. HUD's Comment, p. 4

HUD asserted that GAO has a shifting standard for determining if HUD is high-risk. HUD stated that senior GAO staff initially indicated that they would apply a standard for removing HUD from the high-risk list if "reasonable progress" was achieved in implementing the 2020 reforms and at another time stated that the standard would be "results" and a demonstration that HUD's problems have been fixed completely—that there were substantial, long-term results bearing out the success and sustainability of the reforms.

GAO's Response

Senior GAO officials informed HUD officials that we would be fair in assessing the progress made by the Department and that reasonable progress in successfully resolving its management deficiencies by means of verifiable results was the standard we would apply in our review. HUD is incorrect in asserting that the standard we said we would apply was reasonable progress in implementing the 2020 plan reforms.

7. HUD's Comment, p. 5

HUD commented that if we believed that it was not possible for HUD to be removed from the list, that working assumption must be stated explicitly in the report or the report would be misleading.

GAO's Response

Our views on the difficulties faced by HUD in resolving its management deficiencies and removing the high-risk designation were communicated to the Department and others over a year ago. In testimony before the

Subcommittee on Housing Opportunity and Community Development, Senate Committee on Banking, Housing, and Urban Affairs, on May 7, 1998, we said that HUD's management deficiencies have had a long history, that they did not happen overnight, and that it will not be easy for HUD to overcome many of them. In addition, in response to a specific question from Chairman Connie Mack regarding whether HUD was still high-risk and the likelihood of removing the agency from our next series of high-risk reports, GAO's Director of Housing and Community Development Issues, made the following comments: "They are high-risk today, and there's a very good chance that they will be high-risk early next spring, when we issue our next report. However, I think we will be recognizing the progress that the agency has made. And the big point is realizing that this is a multiyear effort. It is not an easy task that they have set out." A copy of the draft hearing transcript was attached to our July 24, 1998, letter to the Acting Deputy Secretary.

Our January 1999 report on HUD's major management challenges and program risks included the statement that, given the severity of HUD's management deficiencies, it would not be realistic to expect that the Department would have substantially implemented its reform efforts and demonstrated success in resolving its management deficiencies in the 2 years since we issued our last report.

8. HUD's Comment, p. 6

HUD asserted that senior GAO staff, in repeated discussions, said they believed that HUD had made substantial progress in reducing risk, that the agency's risk profile was significantly improved over the last time GAO conducted a review. Yet, HUD asserted, this view was absent from the report.

GAO's Response

In reports, testimonies, and meetings, senior GAO officials have complimented HUD officials for undertaking reforms of its programs. The GAO officials have characterized these reforms as representing solid progress, as being far-reaching, as affecting nearly all operational aspects of the Department, and as constituting credible progress.

However, they have not characterized these reforms as reducing risk or significantly improving HUD's risk profile. Rather, they have consistently maintained that it must be demonstrated that reforms have led to

substantial and verifiable results in resolving management deficiencies to remove the high-risk designation. At the same time, as we discuss in our responses to comments 4 and 5, the independent, professional, and objective judgment of knowledgeable GAO professionals plays a role in determining whether a program is high-risk.

9. HUD's Comment, p. 6

HUD commented that GAO's draft report failed to use and cite three independent and objectives studies of the Department's reforms by management experts—Booz-Allen and Hamilton, the Public Strategies Group, and PricewaterhouseCoopers.

GAO's Response

While GAO's statement of facts mentioned the Booz-Allen and Hamilton, Inc., report, the thrust of this report was not discussed in detail in our statement of facts. This was because this report as well as the Public Strategies Group and PricewaterhouseCoopers reports were primarily aimed at describing the progress made in implementing the 2020 reforms, and not at developing evidence demonstrating that the reforms have led to substantial and verifiable results in resolving HUD's management deficiencies. In our January 1999 report on HUD's major management challenges and program risks, we included information on the Public Strategies Group report in addition to the Booz-Allen and Hamilton, Inc., report.

10. HUD's Comment, p. 7

HUD commented that GAO had withheld the conclusion section of the report from HUD's review and that senior GAO staff were orally characterizing the report as maintaining the high-risk label for HUD. The absence of the section, HUD said, severely compounded its difficulty in responding accurately and appropriately to the specific text of the report.

GAO's Response

The statement of facts we provided HUD officials for review did not contain conclusions. This is because this statement was provided to HUD officials to obtain their comments on the accuracy and completeness of the information we obtained and analyses we made. We did not obtain agency

comments on the draft conclusions of any of our reports in the January 1999 series on major management challenges and program risks.

11. HUD's Comment, p. 8

HUD asserted that we characterized its financial management systems inaccurately, given the many comprehensive systems improvements that have been made within the past few years. HUD stated that our discussion was focused almost entirely on process improvements and was not properly balanced by the brief summary of major system accomplishments.

HUD cited the statement in our report, "According to its CFO [Chief Financial Officer], HUD continues to make progress addressing system problems by deploying systems and/or system modules to manage and monitor the Department's programs," and stated that "it should be clear to any objective viewer that when a large number of systems have been successfully developed and deployed, a substantial improvement in the systems environment has inevitably occurred." However, HUD stated, "GAO refuses to attest to such facts despite its one-year review and only attributes this information to 'CFO' hearsay."

GAO's Response

We disagree. Our statement of facts (1) noted that HUD had developed and deployed a number of systems or components for systems; (2) provided examples of these systems; and (3) referred to our report entitled HUD Information Systems: Improved Management Practices Needed to Control Integration Cost and Schedule (GAO/AIMD-99-25, Dec. 18, 1998), which included a more detailed discussion of HUD's major system accomplishments. In our December 1998 report, we reported that although HUD had developed and deployed various systems or modules for 12 of 14 systems integration projects, the Department did not know when the systems integration effort would be completed, or at what cost, because the Department had not yet finalized detailed project plans or cost and schedule estimates for this effort. We concluded that without such plans, the Department is likely to continue to spend millions of dollars, miss milestones, and still not fully meet its objective of developing and fully deploying an integrated financial management system.

We also disagree with the implications of HUD's comment that our December 1998 report on HUD's information systems should have

concluded that when a large number of systems have been successfully developed and deployed, a substantial improvement in the systems environment has inevitably occurred. Successfully developing and deploying systems depend on several factors, including whether user requirements were met, existing material or internal control weaknesses were eliminated, and the systems were developed and deployed using sound methodologies. Given the objectives and scope of our review, we could not conclude in our December 1998 report whether HUD had successfully developed and deployed a large number of systems or had made substantial improvements in its systems environment.

12. HUD's Comment, p. 8

HUD believed that our observation that it did not finalize the revised project plans for completing the core accounting system (HUDCAPS) was wrong. HUD stated that during the initial phase of the 1-year review of systems at HUD, it provided us with a completed first-year plan; a final draft of the second-year plan; and, in November 1998, the complete project plan.

GAO's Response

HUD's comment relates to our December 1998 report on HUD's information systems and not our statement of facts. We agree that HUD provided us with copies of the fiscal year 1998 and fiscal year 1999 project plans for HUDCAPS. However, we found that the fiscal year 1999 plan was incomplete because it did not include a schedule that showed key milestones, tasks, task dependencies, and a critical path demonstrating how HUDCAPS would be completed and integrated with other systems by October 1999, the date projected by HUD for completing an integrated core financial system. In addition, on December 4, 1998, HUD provided to us what the Department referred to as a complete project plan for the core accounting system, HUDCAPS. This was 22 days after HUD provided us with official comments on our draft report and 35 days after we had requested comments. By that time, our report was already being printed for publication and, consequently, was issued without noting whether a project plan for HUDCAPS had been completed. Also, in our December 1998 report, we pointed out that HUD had not yet finalized other detailed project plans that are necessary to complete the systems integration effort.

13. HUD's Comment, p. 8

HUD commented that it had recently installed a standard general ledger and chart of accounts that did not previously exist. It asserted, "This is a critical accomplishment that was barely mentioned by GAO and is key to the Department's publishing integrated financial statements for the entire agency."

GAO's Response

HUD's deployment of a Department-wide standard general ledger was mentioned in our statement of facts. However, detailed information on it was not included in our statement because it had been in effect for so little time during the period of our review. The new standard general ledger was not used to prepare HUD's fiscal year 1998 consolidated financial statements but will be used to prepare its fiscal year 1999 consolidated financial statements, for which an audit report will be prepared in the spring of 2000. In addition, while the new standard general ledger and chart of accounts should greatly improve the efficiency of preparing integrated financial statements for the entire agency, HUD was already able to produce integrated financial statements prior to these improvements.

14. HUD's Comment, p. 9

HUD commented that our statement of facts dwelt on the Department's efforts to evaluate whether its management systems conform to the requirements of Federal Managers' Financial Integrity Act (FMFIA) and of the Office of Management and Budget (OMB) Circular A-127. HUD also stated that it self-declared certain systems as noncompliant based on its interpretation of the general Joint Financial Management Improvement Project (JFMIP) criteria. HUD asserted that it chose to apply a vigorous standard whereby if only 1 of the 12 criteria was unmet, then the system was labeled as noncompliant. HUD also stated that it had yet to obtain any clear guidance from GAO, despite repeated inquiries, on whether the Department was applying a significantly higher standard for systems noncompliance than other agencies.

GAO's Response

HUD's comments imply that it was holding itself to a higher standard than other federal agencies because it declared systems nonconforming if only 1 of the 12 JFMIP criteria was unmet. However, HUD's records show that most of the 38 systems it declared not in conformance with FMFIA criteria in 1998 did not conform with 3 or more of the 12 criteria. According to

HUD's records, 21 of 38 nonconforming systems did not meet 3 or more of the 12 criteria, and 10 of the 21 nonconforming systems did not meet 10 or 11 criteria. Three of the 38 systems were reported as nonconforming because they did not meet one criterion; 9 did not meet two criteria; information on why 4 systems were not in conformance was not available; and another system, although reported to be nonconforming, was actually conforming.

We have not reviewed the standards applied by other federal agencies in determining their systems' compliance with JFMIP criteria and therefore cannot offer any comments on the standards they follow.

15. HUD's Comment, p. 9

HUD stated, "We strongly believe that it is very important that these system accomplishments be highlighted and discussed in greater detail, and that these changes are reflected in a changed GAO analyses of HUD's systems."

GAO's Response

See our response to comment 11.

16. HUD's Comment, p. 18

HUD commented that during the past year, the Department had aggressively tackled the issue of computer matching and income verification and improved subsidy verification. HUD established a task force with staff from Public and Indian Housing; Policy Development and Research; the Assessment Center; and the Chief Financial Officer's (CFO) Office to expand capabilities for ensuring that subsidies are paid on the basis of tenants' incomes that are correct.

GAO's Response

Our statement of facts pointed out the material internal control weakness over the process of uncertain verification of tenants' incomes. The statement also explained that in fiscal year 1998, HUD unveiled a multifaceted plan to address this weakness. The effectiveness of the steps HUD has taken to address this issue, however, will most likely not be known until the fiscal year 1999 financial statement audit is completed in the spring of 2000.

17. HUD's Comment, p. 25

Concerning the Department's financial statements, HUD commented that it received its first-ever qualified audit opinion 2 years ago (in prior years, auditors issued disclaimers of opinion) and that it was on track to receive an unqualified (clean) opinion for its fiscal year 1998 consolidated financial statement. According to HUD, "This is a keystone achievement and reflective of the changing attitude of HUD managers in recognizing their fiscal responsibilities and the vast improvement in HUD's financial systems and financial data."

GAO's Response

Our statement of facts on HUD's major management challenges and program risks pointed out that HUD had received a qualified opinion on its fiscal year 1997 financial statements. Beyond the statement of facts provided to HUD, in our final report our "Overview" pointed out HUD's improvement in receiving a qualified opinion on its fiscal years 1996 and 1997 financial statements.

After we issued our report on HUD's major management challenges and program risks, HUD's Inspector General issued, on March 29, 1999, its unqualified opinion on HUD's consolidated federal accounting-based financial statements for fiscal year 1998. The Inspector General stated in this report that in previous fiscal years, she was unable to conclude that HUD's consolidated financial statements were reliable in all material respects. Therefore, her ability to conclude that HUD's fiscal year 1998 financial statements were reliable was noteworthy. We agree that obtaining an unqualified opinion on its fiscal year 1998 financial statements was a noteworthy accomplishment for HUD. However, the Inspector General also stated that because of continued weaknesses in HUD's internal controls and financial management systems, this accomplishment came only after HUD and its contractors went through extensive ad hoc analyses and special projects to develop account balances and necessary disclosures.

18. HUD's Comment, p. 28

HUD commented that credit reform (the reason for the qualified opinion in fiscal year 1997) initiatives within the Department have made significant progress. The Federal Housing Administration (FHA) has received from a major public sector accounting firm an unqualified (clean) opinion on its

statements since 1993, HUD explained. The Department expected compliance with the requirements of credit reform in its fiscal year 1998 financial statements and stated that significant work has already been accomplished.

GAO's Response

Our January 1999 report on HUD's major management challenges and program risks included material recognizing that during 1998, HUD, with the assistance of independent contractors, focused significant effort on improving its ability to prepare loan program cost estimates in accordance with federal accounting standards and credit reform requirements. Our January 1999 report also stated that HUD has developed a plan that, if fully implemented, should help it prepare reasonable estimates of loan program costs in the future. Also, although FHA received an unqualified audit opinion on its fiscal year 1997 financial statements, the amounts reported for FHA's loan program costs were derived using private sector generally accepted accounting principles that are significantly different from those prepared on the basis of federal accounting standards.

After we issued our report on HUD's major management challenges and program risks, HUD's Inspector General and the public accounting firm KPMG LLP issued unqualified audit opinions on HUD's consolidated and FHA's federal accounting-based financial statements for fiscal year 1998. These unqualified opinions indicate that HUD and FHA were able to develop reasonable estimates of loan program costs for fiscal year 1998. However, the Inspector General also noted that this required extensive ad hoc efforts by HUD's Office of Housing and contractor support personnel.

19. HUD's Comment, p. 28

HUD commented, "GAO says that [the Department's systems are inadequate because they are poorly integrated, ineffective and generally unreliable." Disagreeing, HUD stated that over 60 percent of its systems are compliant, including its financial systems. In support of this, HUD stated, "Our financial statements are now considered accurate (save for a single audit qualification on credit reform) and thus, the underlying data are accurate-which was not true two years ago." HUD contended that we downplayed this accomplishment despite the significant attention focused on this goal by the Congress, the Office of Management and Budget, and GAO management.

GAO's Response

HUD's comment on our characterization of its systems misstated the statement of facts we provided to the Department. Our characterization appeared in a passage that began, "However, these systems have been inadequate because . . ." and went on to summarize the information we had reported in our 1997 High-Risk Series report regarding information and financial management systems. In our January 1999 report on HUD's major management challenges and program risks, we added the phrase "we have reported in the past" to make it clearer that the statement referred to HUD's past problems.

20. HUD's Comment, p. 29

HUD commented that significant work has been done to develop new accounting and financial management systems: "We now have a new standard, fully compliant HUD-wide general ledger. And, we have developed and deployed 11 new financial management systems."

GAO's Response

See our response to comment 13 for a discussion of HUD's general ledger.

Our January 1999 report on HUD's major management challenges and program risks recognized the development and deployment of the 11 financial management systems. Our December 1998 report on HUD's information systems contained additional information on the status of HUD's systems integration projects.

21. HUD's Comment, pp. 30-32

HUD asserted that there have been major, comprehensive accomplishments in financial systems integration. Accordingly, HUD said that we should be able to state, on the basis of the documentation submitted, that the listed 11 systems have been developed and deployed during the past few years: the Integrated Disbursement and Information System; the Integrated Business System; the HUD Procurement System; the Grants Evaluation Management System; HUDCAPS; the Tenants Rental Assistance Certification System; the Budget Formulation System; the Community 2020 Geographic Information System; the Budget Outlay Support System; the Single Family Premium Collection System; and the Real Estate Management System.

GAO's Response

Our statement of facts mentioned that HUD was continuing to make progress addressing system problems by deploying systems or modules to manage and monitor departmental programs and provided examples of these systems. Our December 1998 report on HUD's information systems included a detailed discussion on the status of HUD's financial systems integration and the systems that have been developed and deployed to support it. (Also, see our response to comment 11.)

22. HUD's Comment, pp. 32 and 33

HUD commented that the Department agreed with a principal finding of our December 1998 report on its information systems—that the Department must improve its information technology capital planning process. However, according to HUD, our report did not take note of several major accomplishments and, in effect, suggested that no process was in place. HUD commented that it has had in place a structured process for selecting information technology investments since 1989 and has consistently made improvements to that process over the past decade.

GAO's Response

We disagree. Our statement of facts and December 1998 report stated that HUD did not have an effective process to manage its information technology investments. This is not the same as stating that there was no process in place, as suggested by HUD's comments.

Specifically, in our December 1998 report, we explained that we reviewed HUD's recent selection and control processes beginning with fiscal year 1997 and found that both processes were incomplete and inadequate to make sound investment decisions and properly manage the selected investments. The major deficiencies we found with HUD's processes were that (1) investment decisions were made without reliable, complete, up-to-date project-level information and (2) oversight was not based on project-specific measures, which are required to effectively monitor and control information technology projects.

23. HUD's Comment, p. 34

HUD asserted that the statement, "Managers were not actively assessing risks in their programs as required under the management control

program," was totally false. HUD went on to discuss risk assessments that have been prepared since 1996, as well as its Community Planning and Development's grants management system.

GAO's Response

The statement HUD quoted was in a paragraph in our statement of facts that began, "In February 1997 we reported. . . ." This paragraph summarized the information we had reported in our 1997 High-Risk Series report regarding internal controls. Our January 1999 report on HUD's major management challenges and program risks reiterated the phrase "we reported in 1997" at the end of the paragraph to make it clearer that this statement referred to past problems at HUD.

Contrary to the implications of HUD's comments on risk assessments, our statement of facts discussed the Department's activities regarding the preparation of risk assessments for its nationwide centers, as well as other programs. In addition, our statement discussed a number of other activities HUD initiated to address its internal control problems, including the establishment of the Risk Management Division and real estate and enforcement centers and the development of a risk evaluation database. Also, in our February 1997 High-Risk Series report, we pointed out that in July 1994, HUD began implementing its new management planning and control program, which was based on front-end risk assessments of certain programs.

At the time of our work on HUD's major management challenges and program risks, we were completing a review of HUD's Community Planning and Development's grant management system. Subsequently, on April 27, 1999, we issued a report entitled Community Development: Weak Management Controls Compromise Integrity of Four HUD Grant Programs (GAO/RCED-99-98).

24. HUD's Comment, p. 35

HUD commented that the heading "2020 Reform Plan Directed Toward Internal Control Weaknesses" was a misleading statement and needed to be revised to accurately reflect that the plan was not solely directed toward internal control weaknesses and to state that 2020 effectively addressed those problems. HUD also noted that 1,100 field and headquarters managers received internal control training during fiscal year 1998.

GAO's Response

Our statement of facts described actions initiated by HUD under its 2020 reform plan that were intended to address its internal control problems as well as its other management deficiencies. In the "Overview" section of our statement, which was not provided to HUD, we stated that HUD's 2020 reform plan addresses more than its management deficiencies.

However, we disagree that HUD's actions effectively addressed the internal control weaknesses that we and others previously reported. Our statement of facts and January 1999 report on HUD's major management challenges and program risks showed that internal control problems persist at HUD. As pointed out in those documents, material internal control weaknesses persist in its (1) management of the Section 8 subsidy payment process, which provides $18 billion in rental assistance; (2) management of staff resources; (3) management of losses resulting from defaults in the single-family and multifamily housing insurance programs; (4) implementation of automated systems to provide needed management information or reliable data; (5) monitoring of multifamily properties and single-family and multifamily housing notes inventories; and (6) contracting procedures. Furthermore, since we issued our February 1997 High-Risk Series report on HUD, we have reported that the Department has not adequately monitored, among other things, its real estate asset management contractors, the performance of appraisers of properties purchased with FHA-insured loans, and its process for deobligating funds no longer needed for Section 8 project-based rental assistance contracts.

Finally, the statement of facts recognized that as of September 30, 1998, the CFO's Risk Management Division completed risk management training for headquarters and field managers and supervisors at or above the GS-13 level. Our January 1999 report on HUD's major management challenges and program risks included the information that over 1,100 HUD headquarters and field managers completed risk management training.

25. HUD's Comment, p. 35

HUD commented that the statement, "REAC [the real estate assessment center] will not be fully functional until 2000," does not acknowledge that "significant aspects of REAC's housing assessment operations are already functioning well beyond any systems ever used at HUD." As an example, HUD explained that the center's new physical inspection data collection

device and protocol are already in operational use, with over 4,200 inspections completed through mid-December 1998. HUD felt that we "should . . . acknowledge that all critical components of REAC's housing assessment processes are scheduled to be functioning to improve the Department's monitoring and enforcement activity before the year 2000." In addition, HUD explained, the center has completed initial advisory scores for several hundred public housing authorities and is assisting the enforcement center with physical and financial assessments of 200 enforcement case referrals made by the multifamily housing program center's staff.

GAO's Response

Our statement of facts pointed out that as part of its reform plan, HUD established a real estate assessment center, which had issued regulations on the physical and financial assessments of multifamily properties and public housing authorities. It also pointed out that the center would not be fully functional until 2000 because it would not begin financial assessments of multifamily properties until around April 1999, when audited financial statements on the properties were to be submitted to HUD. Lastly, our statement of facts pointed out that although physical inspections of public housing authorities would start in 1999, financial assessments would not begin until 2000. The additional year is needed to give housing authorities time to convert their annual financial statements from HUD's accounting guidance to generally accepted accounting principles in accordance with the uniform financial standards for HUD's housing programs.

In addition, our statement of facts discussed the potential benefits that HUD expects to achieve through the establishment of the real estate assessment center and acknowledged that HUD plans to physically and financially assess the total inventory of multifamily properties and public housing authorities. However, to date neither HUD nor we are able to evaluate the extent to which this reform has led to substantial and verifiable results in resolving management weaknesses.

Regarding the inspections completed by the center, our January 1999 report on HUD's major management challenges and program risks recognized that 4,200 inspections had been completed as of late-December 1998. Our report also recognized that 200 cases had been referred to the enforcement center. In this regard, it should be noted that

HUD's portfolio of multifamily properties totals around 32,000, and more than 13,000 public housing developments nationwide.

26. HUD's Comment, p. 36

HUD commented that our statement, "Although the Enforcement Center began operations on September 1, 1998, it is not scheduled to perform all of its centralized functions until around April 1999, when it is to begin receiving referrals of troubled multifamily properties from the Real Estate Assessment Center," did not recognize that the enforcement center had been receiving cases and performing all of its functions and was regularly receiving additional cases from Housing and the real estate assessment center. To date, HUD reported, the enforcement center had received 200 cases, and the Department had dramatically improved enforcement at the agency, for example, increasing debarments of bad landlords by 300 percent over the years.

GAO's Response

HUD's comment that the enforcement center had received 200 cases from Housing and the real estate assessment center is inconsistent with other statements made in the letter, which said that the 200 referrals came from the Office of Multifamily Housing (see comment 25). On January 8, 1999, an enforcement center official advised us that all referrals had come from the Office of Multifamily Housing only.

As discussed previously, our January 1999 report on HUD's major management challenges and program risks recognized the 200 cases received by the enforcement center and the increase in debarments.

27. HUD's Comment, p. 37

HUD commented that we would be more accurate if we stated that material weaknesses are found within the financial statements at all federal agencies and departments. According to HUD, "Most cabinet level agencies have on the average 8-24 material weaknesses with DOD [the Department of Defense] exceeding 50 open material weaknesses." Consequently, HUD felt that this problem is not isolated to HUD and that we needed to make this acknowledgment.

GAO's Response

Our statement of facts and January 1999 report on HUD's major management challenges and program risks were about HUD and not other federal agencies. Other GAO reports have been prepared on such challenges and risks faced by other agencies. However, it should be noted that on the basis of fiscal year 1997 audits, there were six federal entities that had no material internal control weaknesses. Also, we have designated DOD's financial management as high-risk since 1995.

28. HUD's Comment, pp. 37 and 38

HUD commented that "GAO fails to tell the entire story," particularly about how HUD compares to other federal agencies regarding compliance with the reporting requirements under credit reform and Statement of Federal Financial Accounting Standards (SFFAS) No. 2. Approximately 60 percent of the agencies that credit reform affects have not achieved full compliance, HUD stated.

However, HUD pointed out, FHA has achieved compliance for its credit programs in accordance with private sector accounting standards—that is, FHA has received an unqualified (clean) audit opinion under generally accepted accounting principles for its financial statements since 1993. As a result of the qualification in HUD's fiscal year 1997 consolidated financial statement audit, FHA has developed a plan to comply with the reporting requirements of SFFAS No. 2.

HUD asserted that its work and accomplishments in this area had been praised in another GAO report titled Credit Reform: Key Credit Agencies Had Difficulty Making Reasonable Loan Program Cost Estimates. (Our credit reform report was a draft report at the time HUD made these comments). HUD concluded, therefore, that there appeared to be a tension, if not direct contradiction, between this other report and the statement of facts.

Also, HUD stated that we should emphasize the accomplishment of receiving a qualified opinion because 2 years ago, the Department was not able to receive any type of opinion on its financial statement.

GAO's Response

Our report on credit reform entitled Credit Reform: Key Credit Agencies Had Difficulty Making Reasonable Loan Cost Estimates (GAO/AIMD-99-31) was issued on January 29, 1999. This report showed that

three out of the five key credit agencies we reviewed were not able to comply with credit reform, including HUD. The discussion in that report related to HUD's ability to comply with credit reform was entirely consistent with our January 1999 report. For example, our credit reform report stated, "HUD was unable to provide adequate supporting data for its fiscal year 1997 financial statements estimates of its loan program costs, which resulted in a qualified audit opinion from HUD's IG [Inspector General] on those financial statements. This lack of supporting data also raises questions about the integrity of loan program cost information submitted for budgetary purposes." The report also contained a discussion of the effort made by HUD in 1998 to resolve this problem and the plan it developed.

(Also, see our response to HUD's comment 18 on the fiscal year 1998 financial statement audits.)

29. HUD's Comment, p. 38

HUD commented that our statement, "Although HUD has reduced its material weaknesses from 51 in fiscal year 1991 to the 9 remaining open as of fiscal year 1997, some of the remaining weaknesses are long-standing," was very dismissive in its tone, so HUD suggested deleting the "although." HUD maintained that the reduction was real progress.

GAO's Response

Our statement intended to provide evidence of the progress HUD has made since 1991 in this area. At the same time, it is important to note that some of the nine material weaknesses remaining open as of fiscal year 1997 are indeed long-standing—one dates back to 1983, while four others date back to 1993—and some, such as those relating to the $18 billion rental assistance program, involve billions of dollars.

It should also be noted that in our February 1997 High-Risk Series report, we reported that at the end of fiscal year 1995, HUD reported that it had nine material internal control weaknesses, the same number as in 1997. Since our February 1997 report, HUD has removed four material weaknesses and added four, so the total remains at nine. The four areas in which material weaknesses were removed were community development block grant entitlements, Section 236 excess rental income, Section 235 accounting system, and the title II prepayment and preservation program. The four material weaknesses added involved the monitoring of insured

mortgages and multifamily projects, Secretary-held multifamily and single-family mortgage notes, income verification, and contracting.

We deleted the word "although" in our January 1999 report, as suggested by HUD.

30. HUD's Comment, p. 39

HUD questioned the use of material from our report Housing Preservation: Policies and Administrative Problems Increase Costs and Hinder Program Operations (GAO/RCED-97-169, July 18, 1997) as an illustration of monitoring problems at HUD. The Department pointed out that the program is no longer funded and that the remaining issues from that report relate to oversight of those projects that were funded and their compliance with affordability restrictions that owners agreed to in exchange for financial incentives. According to HUD, since the report was issued in July 1997, the Department, along with Multifamily Housing in particular, has taken significant steps that will greatly enhance its ability for project oversight to ensure compliance with program requirements. HUD also explained the steps it has taken to enhance its ability to ensure compliance with program requirements.

GAO's Response

The description in our statement of facts of the problems we found in HUD's preservation program was accurate. Contrary to HUD's assertion that the report dealt mainly with funding and targeting aspects of the program, substantial segments of the report dealt with problems in HUD's management and oversight of the program. As noted in our report, these problems contributed to the program's high cost and hampered its effectiveness. One of the key problems we identified was that headquarters' oversight of its field offices' implementation of the program was limited. For example, headquarters did not conduct systematic reviews of field offices that processed preservation transactions, and the information received by headquarters was generally limited to the aggregate dollar amounts of the preservation incentives approved by field offices. As a result, HUD headquarters was not in a position to identify or respond effectively to problems and issues that arose. We also questioned whether some of the reviews performed by HUD field offices of applications for preservation funding were sufficient to ensure that the costs were prudent and represented the best use of preservation funds.

While the Congress terminated funding for the preservation program, a key factor in the Congress's decision was HUD's poor management of the program—a point clearly stated in our statement of facts we provided to the Department. HUD remains responsible for ensuring that property owners who participated in the program comply with affordability restrictions that were placed on their properties and stated that its newly created Office of Quality Assurance will be testing cases and project managers' follow-up to ensure that HUD's field offices are addressing the affordability and compliance requirements under the preservation program. While we have not performed any recent work to assess HUD's actions in this area, the Department did not indicate that any such reviews have been performed or that it has formulated any specific guidance for its field offices to follow on how they should monitor property owners' compliance with affordability restrictions (a weakness identified in our report).

31. HUD's Comment, p. 41

According to the Department, GAO's statement, "HUD's inability to implement plans under 2020 for handling properties on which borrowers defaulted was due to a shortage of Single Family staff because of downsizing." was false. HUD asserted that it has adequate staffing in its single-family housing operations.

GAO's Response

HUD's comment misstated the statement of facts we provided to the Department. Our statement of facts said that the Inspector General reported that "The problem [of oversight of contracts] was due to a shortage of single-family staff because of downsizing and HUD's inability to implement plans under 2020 for handling properties on which borrowers defaulted." Our statement of facts did not state or imply that HUD's inability to implement the 2020 plan was due to a shortage of staff because of downsizing. Also, we attributed the assessment to HUD's Inspector General in her December 1998 semiannual report to the Congress.

However, we revised the above statement in our January 1999 report on HUD's major management challenges and program risks to reflect the specific wording used in the Inspector General's semiannual report and to more fully describe her reasons for characterizing the oversight of contractors as inadequate.

32. HUD's Comment, p. 42

HUD commented that we gave "only passing reference to the Home Buyer Protection Plan, in fact just one sentence." HUD explained that it is aggressively implementing the plan, which was announced in June 1998.

GAO's Response

We disagree that more information on the Home Buyer Protection Plan was needed in our January 1999 report. Many of the plan's procedures and operations had not been finalized or implemented at that time. Therefore, we are unable to comment on whether the Home Buyer Protection Plan has led to substantial and verifiable results in improving HUD's appraisal process. After we issued our report on HUD's major management challenges and program risks, in April 1999 we issued a report on HUD's appraisal process, which discussed, among other things, potential changes to various processes resulting from the Home Buyer Protection Plan.[4]

33. HUD's Comment, p. 43

HUD disagreed with our statement that it is too early to assess the effectiveness of the reform efforts to address internal control weaknesses. HUD stated that giving only one sentence for such a major reform is misleading to the reader and indicates a bias against documenting how substantially HUD has reduced risk. HUD stated that we are taking the approach that unless "operational perfection is attained . . . then the work and efforts to date remain unrecognized, unmeasurable, and without impact on the HUD operations." HUD also stated that our statement of facts did not recognize the risk assessments that had been completed, the internal control training provided to its managers, the high-level management attention paid to corrective action plans, and the demonstrable steps taken toward resolving several open material weaknesses. HUD also pointed to the Booz-Allen Hamilton study issued in March 1998 as further evidence that progress is being made.

GAO's Response

Our statement of facts recognized the steps HUD has taken to address its internal control weaknesses, such as risk assessments that have been and are being performed and internal control training provided to its

[4]Single-Family Housing: Weaknesses in HUD's Oversight of the FHA Appraisal Process (GAO/RCED-99-72, Apr. 16, 1999).

managers, as discussed in our response to comment 23. We also recognized in our statement of facts that the 2020 reform plan has potential for addressing HUD's deficiencies.

Our basic point on internal control weaknesses and HUD's other management deficiencies is that HUD is making significant changes and has made credible progress since 1997 in laying the framework for improving the way the Department is managed. However, given the nature and extent of the challenges facing the Department, it will take time to implement and assess the impact of any related reforms. While major reforms are under way, several are in the early stages of implementation, and it is too soon to tell whether or not they will resolve the major deficiencies that we and others have identified. Consequently, we continue to believe, as we reported in 1995 and 1997, that these management deficiencies, taken together, place the integrity and accountability of HUD's programs at high risk.

HUD indicated that a study by Booz-Allen is further evidence that progress is being made. This review, which primarily involved Booz-Allen's review and analyses of HUD's staffing requirements under the 2020 reorganization, was conducted from December 19, 1997, through February 27, 1998. Booz-Allen obtained information for its study primarily by reviewing HUD's implementation plans and assessing the adequacy and reasonableness of the staffing levels proposed in each plan. While the Booz-Allen study noted that the 2020 organization is in place, as stated in HUD's comments, it also characterizes some of the changes under the reorganization much the same as we did, namely, as being in process. For example, the study stated that the organization "is being staffed" and that "progress has been made in implementing the revised organizations." The study did not offer evidence of substantial and verifiable results in resolving HUD's management deficiencies as a result of the 2020 reforms. Furthermore, the study is dated March 1998, before all of the centers were operational, HUD's downsizing was officially halted, or the "unplaced" staff were given permanent assignments.

34. HUD's Comment, p. 44

HUD commented that the heading in our statement of facts "Much Work Remains on HUD's Information and Financial Management Systems" mischaracterized the work that the Department has done in the past 2 years. For example, HUD stated that it has developed and implemented 11 new systems and that all of its accounting systems are A-127 compliant.

HUD suggested that the heading be revised to "Much Work Has Been Accomplished Relating To HUD's Information and Financial Management Systems."

GAO's Response

Our statement of facts and December 1998 report on HUD's information systems noted that progress has been made in developing and deploying systems. However, our December 1998 report concluded that while the Department has developed and deployed various modules and systems for 12 of the 14 different projects initiated under the 1993 and 1997 financial systems integration strategies, the systems integration effort has not yet been completed. Additional work that must be completed before HUD has integrated its financial management and information system includes (1) developing interfaces between the mixed systems and the core financial management system and (2) completing the individual systems integration projects (i.e., the mixed systems) such as the Grants Evaluation Management System, FHA's Mortgage Insurance System, and the FHA Financial Data Warehouse. In addition, as pointed out in our 1999 report on HUD's major management challenges and program risks, work on cleaning and verifying certain data elements from 18 different financial and mixed systems is in process.

35. HUD's Comment, p. 45

HUD commented that our statement that most of HUD's systems, "did not comply with Federal Managers' Financial Integrity Act (FMFIA) and therefore could not be relied upon to provide timely, accurate and reliable financial information and reports to management," was misleading, given the documentation that had been provided to us. HUD also stated that it has had far more vigorous standards for compliance with FMFIA than any other federal agency. While HUD noted that some nonfinancial systems are not yet compliant with the act, it stated the systems that have the most risk exposure for HUD are fully compliant.

GAO's Response

HUD's comment misstated the statement of facts we provided to the Department. The statement appeared in a paragraph that began, "In 1997 we reported. . . ." This paragraph summarized the information we had reported in our 1997 High-Risk Series report regarding information and financial management systems. We reported that at that time, 93 of HUD's

116 systems did not comply with FMFIA. In our January 1999 report on HUD's major management challenges and program risks, we reiterated the phase "in our 1997 report" to make it clearer that the statement referred to HUD's past problems.

In our statement of facts, we acknowledged that HUD in 1998 reported that 38 of its 92 systems were not in compliance with FMFIA. However, we also reported that for three systems we reviewed, HUD's determination that the systems complied with FMFIA requirements was based upon staff members' knowledge, without any verification or documentation. In addition, our statement of facts reported that the Inspector General's March 1998 report to the Congress pointed out that 21 of the 31 systems that HUD had reclassified as conforming in 1998 did not have detailed assessments and justifications available, as required by HUD's CFO. HUD's internal guidance for these reviews did not stipulate when or how the program staff should verify that the systems met OMB's requirements.

(Also see our response to comment 14 regarding the Department's assertion that it may have more vigorous standards for complying with FMFIA than any other federal agency.)

36. HUD's Comment, p. 45

HUD commented that our statement of facts negatively described HUD's data clean up efforts and that our description had a dismissive tone that incorrectly ignored its work to date.

GAO's Response

We disagree. Our statement of facts presented a factual discussion of the status of HUD's data cleanup efforts, which we said were ongoing, and concluded that it was too soon to assess their impact.

37. HUD's Comment, p. 45

HUD commented that it agreed with the general recommendations in our December 1998 report on HUD's information systems but that the thrust of our report was not properly focused and was in some cases inaccurate.

According to HUD, "The report is not accurate concerning the dollars expended on the development of financial systems; the report does not properly compare like systems when year to year comparisons are made;

and most importantly, the report does not cite in its conclusions the many system improvements that HUD has accomplished. In short, the conclusions and recommendations are focused almost entirely on process improvements and are not properly balanced by summarizing the major system accomplishments of the Department."

GAO's Response

The majority of these comments are associated with our December 1998 report and do not relate to issues discussed in our statement of facts. HUD's comments and our responses to those comments were contained in our December 1998 report and are discussed in the following passages—items 38 through 43.

38. HUD's Comment, pp. 46-49

HUD commented that our December 1998 report was not accurate about the dollars expended on the development of financial systems. HUD also commented that the report indicated that the initial cost of the Department's financial systems integration (FSI) strategy was $103 million; that the number increased to $206 million with the 1993 strategy; and that by the end of fiscal year 1999, the cost would be approximately $540 million. According to HUD, this interpretation was misleading and inaccurate because it did not compare like systems and did not differentiate development costs, maintenance costs, and non-FSI costs. "A more accurate estimate for the FSI effort is $250 million. This is a key point," HUD asserted, "and the numbers and the text should be corrected. . . ."

GAO's Response

In our December 1998 report and statement of facts we stated the Department expects to spend about $239 million for development costs plus $132 million for maintenance costs. However, we also reported that HUD had not yet finalized the plans, cost, and schedule to complete its current FSI strategy, and, therefore, FSI costs continue to be uncertain. Accordingly, HUD's estimates have fluctuated considerably, as reflected in various documents we received from the CFO and his staff. For example, cost estimates have changed from the $540 million reported by HUD in June 1998, to the $255 million cited in the Department's November 12, 1998, comments on our draft report on information systems, to the $239 million that HUD reported a week later. However, we found that the

$255 million and the $239 million estimates did not include at least $132 million associated with maintaining FSI systems. As pointed out in our December 1998 report, HUD's continuing uncertainty as to what the total cost estimate is for FSI through September 1999, demonstrates the Department's need to develop and use well-defined cost-estimating processes to prepare reliable cost estimates.

39. HUD's Comment, p. 46

HUD commented that our December 1998 report did not properly compare like systems when year-to-year comparisons were made.

GAO's Response

In our December 1998 report, we responded to this comment by stating that we were asked to identify the initial objectives; development, deployment, and maintenance costs; and completion dates for HUD's FSI effort and how they had changed. Our report described the systems and the estimated costs that were included as part of the three plans and strategies for achieving integrated financial management systems. In addition, in our December 1998 report, we explained that HUD's underlying strategy to implement integrated financial management systems had changed three times. In finalizing the December 1998 report, we also clarified estimates for the FSI strategies and the expected costs through fiscal year 1999.

40. HUD's Comment, p. 46

According to HUD, we did not cite the many system improvements that HUD has accomplished.

GAO's Response

As described, HUD's comment relates to our December 1998 report. We responded to this comment in our December 1998 report by summarizing the actions taken by HUD to date in our conclusions and adding information to our discussions of various FSI systems throughout the report.

41. HUD's Comment, p. 46

HUD commented that it was not given credit for the fact that it was one of the first agencies to implement the Information Technology Investment Portfolio System (I-TIPS).

GAO's Response

Our December report gave HUD credit for deploying I-TIPS to select information technology investments. However, it did not state that HUD was among the first agencies to implement I-TIPS because our work did not focus on comparing HUD to other federal agencies in implementing I-TIPS. Our objective was to determine whether HUD had followed industry best practices and had implemented the provisions of the Clinger-Cohen Act of 1996 and the Paperwork Reduction Act of 1995 that are required to manage FSI projects as investments.

42. HUD's Comment, p. 46

HUD commented that we also observed that the Department did not finalize the revised project plans for completing the core accounting system, HUDCAPS. HUD explained that it provided the final plan for completing HUDCAPS to us earlier. Furthermore, the Department pointed out that it recently installed a standard general ledger and chart of accounts, which the Department felt was barely mentioned in the statement of facts.

GAO's Response

See GAO's response to comments 12 and 13.

43. HUD's Comment, pp. 46 and 47

HUD felt that the accomplishments of the Department were scattered throughout and not properly brought together and highlighted; "cumulatively," HUD asserted, "they paint a very different picture of the agency's progress."

GAO's Response

HUD's comment is primarily associated with our December 1998 report on the Department's information systems. To respond to HUD's comment, we summarized the status of HUD's FSI effort to date and expanded the discussion of individual FSI projects to reflect the new information provided by HUD. Also, for our January 1999 report on HUD's major

management challenges and program risks, we added information stating that HUD had told us that it had developed and deployed various modules and systems for 11 financial management systems.

44. HUD's Comment, p. 49

HUD commented that we made "a very weak mention" of the fact that the Department had completed its Year 2000 renovation of all systems, both mission critical and noncritical ahead of schedule. HUD also stated that we failed to mention that it was 93 percent complete with the certification of its systems and 86 percent complete with its implementation as of December 1998.

GAO's Response

Our January 1999 report on HUD's major management challenges and program risks was updated to reflect that recently HUD reported that the certification of its systems was 93 percent complete and its implementation was 86 percent complete.

45. HUD's Comment, p. 49

HUD disputed our use of the weaknesses we reported in its estimates of project-based Section 8 amendment needs and recaptures of project-based Section 8 funding as an example of a financial management systems problem.[6] (The reports in question are our reports entitled Section 8 Project-Based Rental Assistance: HUD's Processes for Evaluating and Using Unexpended Balances Are Ineffective (GAO/RCED-98-202, July 22, 1998) and Section 8 Tenant-Based Housing Assistance: Opportunities to Improve HUD's Financial Management (GAO/RCED-98-47, Feb. 20, 1998). HUD asserted that the Congress's decision to reduce budget authority associated with project-based Section 8 amendments by $2.9 billion was a policy decision rather than attributable to a systems problem.

GAO's Response

While the Congress's decision to reduce the funding for Section 8 amendments was ultimately a policy decision, HUD failed to note that the decision was reached only after we identified serious flaws in the

[6]Amendment funding is provided to Section 8 contracts that have insufficient funding available for HUD to make rental assistance payments through the remaining life of the contracts. In contrast, for project-based Section 8 contracts for which expenditures have been less than anticipated, funds may be recaptured and used to help fund other Section 8 contracts.

estimates of the project-based Section 8 amendment needs that HUD had provided to the Congress in connection with its fiscal year 1999 budget request. More specifically, we found that HUD had substantially overestimated its long-term funding needs for project-based Section 8 amendments and had underestimated the amount of recaptured funds that could be used to meet its fiscal year 1999 amendment needs. These problems occurred because HUD did not ensure that the data used to analyze project-based Section 8 amendment needs were complete, accurate, and current. HUD also did not sufficiently review the analyses of amendment needs that a HUD contractor performed to ensure that they were reliable. We found substantive errors in these analyses. When these errors were corrected and the analyses were updated to take into account the OMB's then-current economic assumptions, the estimate of long-term shortfalls in Section 8 amendment needs decreased from $19 billion to less than $2 billion. Furthermore, while HUD's budget request indicated that only $463 million in recaptured funds could be used to offset fiscal year 1999 Section 8 amendment needs, the revised analyses indicated that HUD would be able to recapture almost $3.7 billion from Section 8 contracts expiring in fiscal years 1998 and 1999, a substantial portion of which could be used to offset these needs. We also note that in responding to our December 1998 report, HUD agreed with our recommendation for improvements in its preparation of future budget requests for the Section 8 project-based program.

46. HUD's Comment, p. 50

HUD commented that we painted an inaccurate picture of its oversight of the Section 8 tenant-based and project-based assistance programs. HUD pointed out that no housing authority had ever double-paid administrative fees and that it had not yet agreed with our assertion that fees have been double-counted for project-based assistance. HUD disputed the reference to $1 billion and believed that $1,416,000 (annual cost) would depict a more adequate accounting picture. HUD also asserted that its process model was appropriate, although we and the Congress disagreed with the approach and assumptions that provided for level funding of increases for Section 8 over the budget period and the application of current excesses.

GAO's Response

We agree that language in our statement of facts could have been construed to mean that administrative fees to housing agencies had been double paid in both the tenant- and project-based programs, although this

was not the statement's intent. Our January 1999 report on HUD's major management challenges and program risks clarified that the double-counting occurred only in the budgeting process and did not involve the project-based portion of the Section 8 program.

However, our statement that HUD in September 1997 submitted to the Congress a revised budget estimate that was over $1 billion less than its original estimate for renewing Section 8 housing assistance contracts was correct. Furthermore, the principal reason for this amended budget request was, as HUD stated in its comments on our report, the identification of the double-counting error and its subsequent adjustment.

Regarding project-based Section 8 amendments, HUD was incorrect in stating that we and the Congress disagreed with the approach and assumptions that provided for a level funding of Section 8 increases over the budget period. Our concerns with HUD's estimates of Section 8 amendment needs had nothing to do with the concept of leveling out funding shortfalls. The revised analyses cited in our report on project-based Section 8 unexpended balances all used the leveling methodology that HUD built into its Budget Forecasting System model. Under this approach, HUD spreads estimated funding shortfalls over the remaining term of a Section 8 contract rather than beginning to recognize them in the year in which the contract is projected to run out of funds. Instead, as discussed in our response to the previous comment, our concerns related to the fact that HUD's estimates of amendment needs were overstated because of errors, omissions, and methodological weaknesses.

47. HUD's Comment, p. 51

HUD commented that we repeated our statement, "In 1997... we noted that HUD had reported most of its systems did not comply with FMFIA and therefore could not be relied upon to provide timely, accurate, and reliable financial information and reports to management." four times and that HUD finds no fault with its methodology to determine compliance with FMFIA. HUD suggested that we rewrite this section in a more positive tone.

GAO's Response

HUD is incorrect. This statement was not repeated in our statement of facts, although we did mention FMFIA a number of times in describing HUD's management deficiencies in internal controls and information systems. As in the other sections of our statement of facts, we began the discussion of

information and financial management systems with a summary statement of concerns described in our 1997 High-Risk Series report, which included this statement. We then discussed the current status of systems' compliance and HUD's determination of their conformance with FMFIA standards. In our statement of facts, we also discussed FMFIA under the section on internal controls. That discussion focused on the material internal control weaknesses identified through HUD's FMFIA assessment, and we noted that HUD had reduced the number of weaknesses identified. We did not reword the lead-in paragraph to this section, as HUD suggested, because it was a restatement of facts in an issued GAO report.

Material weaknesses reported under FMFIA are those management control deficiencies that the agency head determines are significant enough to be reported in the annual FMFIA report. In addition, government auditors are also required to identify management control weaknesses that, in their opinion, pose a risk or threat to the internal control systems of an audited entity, such as a program or operation, even if the management of the entity would not report the weaknesses outside of the agency. HUD's Office of Inspector General uses the terms "material weaknesses" and "reportable conditions" to identify these weaknesses.

48. HUD's Comment, p. 51

HUD commented that we painted a negative picture of FHA's compliance with the Credit Reform Act of 1990.

GAO's Response

See our responses to comments 18 and 28. In our January 1999 report, we moved the paragraph to which HUD referred and combined it with the discussion of credit reform in a section on internal controls.

49. HUD's Comment, p. 53

HUD commented that our statement, "HUD expects to improve both the efficiency and effectiveness of its operations through these organizational changes," did not reflect that HUD's organizational changes, implemented through the HUD Management Reform Plan, were already improving the efficiency and effectiveness of operations. As proof, HUD cited excerpts from two reports prepared by HUD consultants.

GAO's Response

As described in our statement of facts, while HUD's organizational structure is in place, it is too early to assess whether the problems we identified in the past have been corrected. Specifically, the enforcement, financial management, and real estate assessment centers will not be performing all of their centralized functions until 1999 and 2000, when the transfer of functions from the field offices to the centers has been completed. Consequently, we cannot yet determine if these reform efforts have led to substantial and verifiable results in resolving HUD's management deficiencies.

Moreover, neither HUD nor the consultants it cited provided any evidence demonstrating that the organizational changes have led to substantial and verifiable results in resolving management deficiencies. Rather, one of the consultants, David Osborne, endorsed the 2020 plan's concept and discussed improvements that will occur to HUD's operations once the plan is implemented. The other consultant, PricewaterhouseCoopers, in its December 1998 report on HUD's 2020 reforms, found that implementation of some of the 2020 plan's reforms—such as the establishment of the community builders and the enforcement, real estate assessment, and troubled agency recovery centers—is well under way, with each project meeting or substantially meeting all of the critical milestones that HUD established for completion as of September 1; however, the report did not address the effectiveness of the changes being made or completed.

50. HUD's Comment, p. 55

HUD commented that our statement, "the organizational changes were generally not based on empirical analysis or studies," was completely inaccurate. HUD referred to a March 5, 1998, letter to GAO, which laid out different analytical methods used to design the 2020 plan, including the review of critical reports; pilot program experience; change agent teams; and consultations with outside experts, affected constituent groups, the Congress, and HUD's Inspector General.

HUD also commented that it consulted with recognized management experts prior to the June 1997 release of the 2020 plan, and with affected constituent groups and the Congress after the plan's release. In addition, HUD stated that it had incorporated the Inspector General's suggestions into its implementation plans.

GAO's Response

HUD's March 5, 1998, letter was in response to a draft of our report entitled HUD Management: Information on HUD's 2020 Management Reform Plan (GAO/RCED-98-86, Mar. 20, 1998). In both that report and our statement of facts, we stated that the efficiencies HUD claimed under the 2020 plan were generally not based on detailed empirical analyses or studies. Instead, HUD relied on a variety of factors, including workload data; the limited results of one pilot project; best practices identified in HUD field offices; benchmarks from other organizations, and managers' and staff members' experience and judgment.

We agree that consultations with management experts, affected constituent groups, the Congress, and HUD's Inspector General are useful in improving the reforms being undertaken (including organizational changes) and building support for them. However, the purpose of our January 1999 report was to provide information on HUD's analytical support for the efficiencies it expects from the reforms—that is, the extent of data supporting the anticipated quantitative and qualitative benefits stated in the 2020 reform plan.

51. HUD's Comment, pp. 58-60

HUD commented that our heading "Organizational Structure Is in Place, but Transfer of Functions and Responsibilities Is in Transition" and the information following it should be changed to reflect that centers established under the 2020 plan are "performing significant functions which provide vital support to all of the Department's major program areas." HUD discussed the operations of some of the centers, other management reforms in program areas, and the efforts of the community builders and community builder fellows.

GAO's Response

We believe that our heading was supported by the information we included in the section and that it provided an accurate description of HUD's status in implementing its organizational changes under the 2020 reforms. For example, when the transfer of the financial management workload for approximately 21,000 housing assistance contracts from the Office of Housing field offices to the financial management center occurs will depend on when contract administrators are selected and deployed. According to the director of the financial management center, the transfer may not take place until late 1999 or early 2000.

Our basic point is that although a new field organization structure is now in place and operational, it is too early to assess the effectiveness of this structure in correcting organizational deficiencies. The enforcement, financial management, and real estate assessment centers will not be performing all of their centralized functions until 1999 and 2000, when the transfer of functions from the field offices to the centers has been completed.

52. HUD's Comment, p. 60

HUD commented that we made a broad generalization in saying that "most managers and staff said the transfer of functions was in transition and they did not know when it would be complete." Since we visited "only five HUD offices and a small number of headquarters organizations," the Department asserted, we were "reporting hearsay rather than statistically significant fact."

GAO's Response

From July through October 1998, we interviewed HUD officials in the Denver homeownership center; the Ft. Worth, Chicago, Houston, and New Orleans field offices; the troubled agency recovery center at Memphis; and the real estate assessment and enforcement centers in Washington, D.C., about various aspects of their operations before the 2020 reforms were implemented and after their implementation. We also interviewed randomly selected professional staff from each of the program areas in those locations. In total, we interviewed over 50 program managers and professional staff from 25 programs at the locations we visited. The purpose of our interviews was not to obtain a statistically valid sample of HUD employees' views on the reorganization. Rather, it was to obtain information from program managers and staff at selected locations affected by the reorganization. In response to HUD's comment, however, our final report, where appropriate, indicated that the views expressed are those of the HUD staff that were interviewed only.

53. HUD's Comment, p. 60

HUD commented that our statement, "Although a field organization structure is in place, staffing decisions were only recently completed, and some centers are significantly understaffed," was "just wrong." HUD stated that staffing at the enforcement center would be completed in

February and that staffing at the real estate assessment center was on target with its phased systems.

GAO's Response

It was not the intent of our statement of facts to imply criticism about staffing levels but, rather, to provide evidence on the status of staffing. As we stated in our statement of facts, staffing decisions for about 1,300 employees were completed in September 1998, when the unplaced staff were given permanent assignments. The reported staffing levels at the centers were based upon our interviews through October, and the time frames were noted in our statement of facts. We also recognized in our statement of facts that HUD managers expected to advertise the unstaffed positions in 1999. In its comments, HUD also noted that full staffing at the centers had not yet been achieved.

We deleted the word "significantly" from the discussion of staffing levels in our January 1999 report on HUD's major management challenges and program risks.

54. HUD's Comment, p. 62

HUD commented that our statement, "Staff losses were recovered after HUD decided in May 1998 to assign unplaced staff to permanent positions," failed to recognize one of the major goals of the 2020 plan, which is to change the way the Department operates. According to HUD, to ensure that additional staff addressed management deficiencies, unassigned staff were placed in areas that represented long-standing departmental problems that 2020 had addressed.

GAO's Response

It is not clear to us what HUD intended with this statement. The point of this section of our statement of facts was to demonstrate that staffing under HUD's new organizational structure was in transition because some positions were only recently filled and some of the centers established under the 2020 plan were not yet fully staffed.

55. HUD's Comment, p. 63

HUD commented that we should update our statement that "the Enforcement Center had only 62% of its staff" to reflect the staffing level it

intended to achieve by the end of January 1999. HUD also noted that the remaining positions were due to be filled by February 1999.

GAO's Response

Our statement of facts noted what HUD's staffing levels were as of the time of our work and stated that the managers of the centers planned to advertise the remaining positions in 1999. To add material to our final report on when expected staffing levels would be met would not have been appropriate in our opinion because of the degree of uncertainty that surrounded some of HUD's staffing expectations. For example, the director of the enforcement center told us that he was not sure whether positions would be filled at the center because they had been advertised previously but had not been filled.

56. HUD's Comment, p. 63

HUD commented that our interviews must have been premature because our statement, "to date there has not been a significant shift of workload from the field offices to the centers, according to the staff and managers we interviewed from July through October," was totally inaccurate. HUD provided an example of 200 referrals of troubled projects to the enforcement center and spoke of the shift of some work to the financial management center and the grants management center.

GAO's Response

Our statement of facts reflected the status of workload transfers at the time of our review. As pointed out in our January 1999 report on HUD's major management challenges and program risks, the real estate assessment, enforcement, and financial management centers will not be performing all of their centralized functions until 1999 and 2000. While the real estate assessment center had inspected over 4,200 multifamily properties as of December 1998, it would not begin financial assessments of multifamily properties until around April 1999, and it will not begin its physical inspections and financial assessments of public housing authorities until 1999 and 2000, respectively. In this regard, it should be noted that HUD's portfolio of multifamily properties totals around 32,000 and more than 13,000 public housing developments nationwide.

Furthermore, the enforcement center was not scheduled to begin receiving referrals of multifamily properties from the real estate

assessment center until around April 1999. The transfer of the Section 8 financial management processing workload from HUD's public housing field offices to the financial management center was expected to be completed in January 1999. However, the transfer of the Section 8 financial management workload relating to 4,600 annual contribution contracts from the Office of Housing field offices to the financial management center was not to begin until February 1999 and was expected to be completed in mid- to late summer 1999. Also, when the transfer of the financial management workload for approximately 21,000 housing assistance contracts from the Office of Housing field offices to the center occurs will depend on when contract administrators are selected and deployed. According to the director of the financial management center, the transfer may not take place until late 1999 or early 2000.

In addition, we do not believe that the referral of 200 cases of troubled projects to the enforcement center represents a significant shift in workload because HUD has at least 2,500 troubled multifamily projects in inventory, and, by some of its own estimates, the total may be as high as 5,000. In addition, a significant function of the financial management center relates to the Office of Housing's workload, which has yet to be transferred.

57. HUD's Comment, p. 65

In reference to our statement that "HUD's single family homeownership centers cannot handle the current workload of HUD's inventory," the Department stated that FHA had not yet implemented scheduled staffing reductions in the single-family HUD-owned property disposition or asset management divisions and that any criticism of FHA's performance in this area could not be linked to a reduction in staffing levels for single-family properties. HUD also pointed out that the fact that about 60,000 properties were sold indicates that staffing levels are adequate. HUD also stated that FHA is in the process of implementing new marketing and management contracts to maintain, protect, and sell HUD-owned properties, which will allow for a realignment of HUD staffing. The contract is based on a pilot program operated in three locations over the last 2 years.

GAO's Response

We revised our January 1999 report on HUD's major management challenges and program risks, deleting the reference to inadequate staffing as a reason for not being able to handle the workload. Our statement was

based on HUD's Inspector's General's December 1998 report to the Congress.

HUD's conclusion that selling 60,000 properties indicates that staffing is adequate is questionable. When the 1989 HUD scandals occurred, HUD was selling a large number of properties. The problem was not selling properties; rather, it was exercising proper control over the agents who were doing the selling and over the properties while they were in HUD's inventory.

It should be noted that in discussing the contracting pilot, HUD focused on its successful aspects and did not mention other aspects of the pilot that were less successful. For example, HUD stated that at two pilot sites, the average sales price increased and FHA's average profit per property sold increased or remained constant. This is not the complete story. According to HUD's evaluation of the pilot, the sales price at one office increased by 17 percent, but the increase at the other site was minimal—less than 1 percent. The third site experienced an 8-percent loss. Regarding profit, one site experienced a 15-percent increase, a second experienced a 2-percent decrease, and at the third there was a "dramatic" decrease (the percentage is not cited in HUD's analysis). Thus, while the new approach seems to offer potential, it is not clear how much more successful the new approach will be than HUD's traditional approach.

58. HUD's Comment, p. 67

HUD commented that our statement, "Because of the workload situation, it is taking HUD longer to sell the properties and, as a result, the OIG [Office of Inspector General] estimates the agency is incurring additional costs of $1 million a day," was "wholly inaccurate."

GAO's Response

Our statement was based on a December 1998 HUD Inspector General report to the Congress and was so attributed in our statement of facts. Because we had not independently verified this information, we deleted this sentence from our January 1999 report on HUD's major management challenges and program risks.

59. HUD's Comment, p. 68

HUD maintained that our statement, "Because staffing reforms have not been fully implemented, their effectiveness in correcting management deficiencies cannot be demonstrated," was wrong for two reasons. First, HUD stated that the 2020 staffing plan and placement actions were, for the most part, completed and implemented. According to HUD, "Nine thousand placement actions have been completed by the Department, as part of establishing new and operational management reform organizations." Second, HUD stated that reform operations were well under way, as "evidenced by the actual performance of workload requirements by all program and consolidated centers."

GAO's Response

We revised our January 1999 report on HUD's major management challenges and program risks to state that, "Because staffing reforms and workload transfers from the field offices to the centers are still in transition, the effectiveness of HUD's changes in correcting staffing deficiencies cannot be determined." While we agree that the bulk of the staffing decisions resulting from the 2020 reforms have been made, we disagree that there is evidence that the resulting staffing levels are adequate to meet workload needs. As previously stated, workload transfer from the field offices to the centers is still in a transitional phase. Until most of that transfer takes place, neither the field offices nor the centers will know whether they can handle the workload. The director of the financial management center told us, for example, that the center's authorized staffing level would be inadequate once it assumed its full workload in about a year. In addition, as pointed out in our statement of facts and January 1999 report, both we and HUD's Inspector General reported that monitoring and oversight of programs continues to be a problem at HUD.

60. HUD's Comment, p. 68

HUD noted that we cited HUD's material internal control weakness of "inadequate emphasis on providing early warning of and preventing losses due to defaults on insured mortgages" in our statement of facts. HUD provided information on actions it had planned or taken to address this weakness.

GAO's Response

The material internal control weakness cited by HUD was reported by independent public accountants in their audit of FHA's fiscal year 1997 financial statements. On March 12, 1999, after the issuance of our January 1999 report on HUD's major management challenges and program risks, the same material internal control weakness was reported by an independent public accountant in its audit of FHA's fiscal year 1998 financial statements.

61. HUD's Comment, p. 72

Criticizing a point we made about travel funds ("The lack of sufficient travel funds to conduct on-site monitoring of program activities is a problem. According to some officials, the scarcity of travel funds has prevented them from conducting some on-site reviews"), HUD characterized the statement as "another example of how GAO takes isolated comments garnered from a non-statistically significant base and extrapolates into broad generalizations and then does not even check the underlying facts." HUD pointed out that the travel budget has significantly increased from $13.5 million to $15.6 million to $19 million for fiscal years 1997, 1998, and 1999.

GAO's Response

We disagree with HUD's characterization of our statements. In our statement of facts, we clearly established that the information obtained was from interviews of managers and staff conducted during visits to six field locations. The information was not intended to be nor was it presented as the views of a larger group of HUD employees. Nevertheless, we revised our January 1999 report on HUD's major management challenges and program risks to specify that 15 of the program managers and groups of staff out of the 38 we interviewed expressed concerns regarding the availability of travel funds for monitoring.

We also included in our January report HUD's comments regarding the increase in the budget for travel funds. However, it should be noted, as pointed out in the report, that increases in travel funds do not necessarily translate into more travel funds for monitoring programs. Finally, HUD's Inspector General has also reported that it has been told that travel funds for program monitoring may not be adequate.

62. HUD's Comment, p. 72

HUD commented that our statement, "Program officials and a community builder in one HUD field office identified a need for HUD to clarify the authority of the community builders in dealing with HUD staff, locally elected officials, and industry representatives," reflected an isolated instance that had been dealt with in training; therefore, HUD felt the statement should be deleted.

GAO's Response

We had included this example in our statement of facts because the incident that prompted both the community builder and program officials to bring it to our attention was in our opinion, and theirs, very serious. However, we deleted the example from our final report.

Major GAO Reports on HUD's Management

Community Development: Weak Management Controls Compromise Integrity of Four HUD Grant Programs (GAO/RCED-99-98, Apr. 27, 1999).

HUD Information Systems: Improved Management Practices Needed to Control Integration Cost and Schedule (GAO/AIMD-99-25, Dec. 18, 1998).

Section 8 Project-Based Rental Assistance: HUD's Processes for Evaluating and Using Unexpended Balances Are Ineffective (GAO/RCED-98-202, July 22, 1998).

Home Improvement: Weaknesses in HUD's Management and Oversight of the Title I Program (GAO/RCED-98-216, July 16, 1998).

Appraisals for FHA Single-Family Loans: Information on Selected Properties in New Jersey and Ohio (GAO/RCED-98-145R, May 6, 1998).

Housing Finance: FHA's Risk-Sharing Programs Offer Alternatives for Financing Affordable Multifamily Housing (GAO/RCED-98-117, Apr. 23, 1998).

Single-Family Housing: Improvements Needed in HUD's Oversight of Property Management Contractors (GAO/RCED-98-65, Mar. 27, 1998).

Year 2000 Computing Crisis: Strong Leadership Needed to Avoid Disruption of Essential Services (GAO/T-AIMD-98-117, Mar. 24, 1998).

HUD Management: Information on HUD's 2020 Management Reform Plan (GAO/RCED-98-86, Mar. 20, 1998).

Section 8 Tenant-Based Housing Assistance: Opportunities to Improve HUD's Financial Management (GAO/RCED-98-47, Feb. 20, 1998).

Housing Preservation: Policies and Administrative Problems Increase Costs and Hinder Program Operations (GAO/RCED-97-169, July 18, 1997).

High-Risk Series: Department of Housing and Urban Development (GAO/HR-97-12, Feb. 1997).

HUD: Field Directors' Views on Recent Management Initiatives (GAO/RCED-97-34, Feb. 12, 1997).

Multifamily Housing: Effects of HUD's Portfolio Reengineering Proposal (GAO/RCED-97-7, Nov. 1, 1996).

Housing and Urban Development: Limited Progress Made on HUD Reforms (GAO/T-RCED-96-112, Mar. 27, 1996).

Homeownership: Mixed Results and High Costs Raise Concerns About HUD's Mortgage Assignment Program (GAO/RCED-96-2, Oct. 18, 1995).

Housing and Urban Development: Public and Assisted Housing Reform (GAO/T-RCED-96-25, Oct. 13, 1995).

Federally Assisted Housing: Expanding HUD's Options for Dealing With Physically Distressed Properties (GAO/T-RCED-95-38, Oct. 6, 1994).

Federally Assisted Housing: Condition of Some Properties Receiving Section 8 Project-Based Assistance Is Below Housing Quality Standards (GAO/T-RCED-94-273, July 26, 1994).

Section 8 Rental Housing: Merging Assistance Programs Has Benefits but Raises Implementation Issues (GAO/RCED-94-85, May 27, 1994).

HUD Information Resources: Strategic Focus and Improved Management Controls Needed (GAO/AIMD-94-34, Apr. 14, 1994).

Multifamily Housing: Status of HUD's Multifamily Loan Portfolios (GAO/RCED-94-183FS, Apr. 12, 1994).

Multifamily Housing: Impediments to Disposition of Properties Owned by the Department of Housing and Urban Development (GAO/T-RCED-93-37, May 12, 1993).

HUD Reforms: Progress Made Since the HUD Scandal, but Much Work Remains (GAO/RCED-92-46, Jan. 31, 1992).

Increasing the Department of Housing and Urban Development's Effectiveness Through Improved Management (GAO/RCED-84-9, Vols. I and II, Jan. 10, 1984).

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