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HUD MANAGEMENT

Status of Actions to Resolve Serious Internal Control Weaknesses

GAO

Accountability * Integrity * Reliability

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Abbreviations

CFO	Chief Financial Officer
CIO	Chief Information Officer
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 Central Accounting and Program System
HEREMS	Housing Enterprise Real Estate Management System
IRS	Internal Revenue Service
I-TIPS	Information Technology Investment Portfolio System
JFMIP	Joint Financial Management Improvement Program
MTCS	Multifamily Tenant Characteristic System
NAPA	National Academy of Public Administration
OIG	Office of Inspector General
OMB	Office of Management and Budget
PA	program administrator
PAS	Program Accounting System
PHA	public housing authority
PIH	Office of Public and Indian Housing
QHWRA	Quality Housing and Work Responsibility Act
REAC	Real Estate Assessment Center
REMS	Real Estate Management System
SAAMS	Single Family Acquired Asset Management System
SFFAS	Statement of Federal Financial Accounting Standards
SGL	standard general ledger
SS	Social Security
SSA	Social Security Administration
SSI	Supplemental Security Income
TRACS	Tenant Rental Assistance Certification System

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Accountability * Integrity * Reliability

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

October 16, 2000

The Honorable Andrew M. Cuomo
The Secretary of Housing
and Urban Development

Dear Mr. Secretary:

A strong system of internal controls provides internal checks and balances against waste, fraud, abuse, and mismanagement and is an important component of any organization's ability to operate efficiently and effectively. Over the past several years, the Department of Housing and Urban Development's (HUD) Office of Inspector General, independent public accountants, and we have identified serious internal control weaknesses and other deficiencies in the management of HUD's activities. Taken together, these weaknesses and deficiencies have led us to designate HUD's programs as high risk since 1994. In 1997, HUD announced its 2020 Management Reform Plan, a set of proposals intended to, among other things, strengthen the Department's internal controls and correct its management deficiencies. In January 1999, we reported that HUD was making credible progress in correcting its internal control and other management problems and was demonstrating commitment to improving its operations.[1]

Nevertheless, HUD's Inspector General and independent public accountants have concluded that material internal control weaknesses—weaknesses that significantly increase the risk of undetected errors, fraud, or noncompliance in amounts that could be material—still exist at HUD.[2] These weaknesses negatively affect HUD's efforts to accomplish its mission efficiently and effectively. Accordingly, we evaluated the process HUD used during the 14-month period ending May 18, 2000, to address its material internal control weaknesses. We also assessed HUD's progress in

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

[2]A material weakness is a condition in which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that errors, fraud, or noncompliance in amounts that would be material to an organization's financial statements may occur and may not be detected on a timely basis by employees in the normal course of performing their duties.

resolving these weaknesses, determined what remains to be done, and identified obstacles HUD has encountered.

As such, this report summarizes the actions HUD has taken since March 1999 to resolve its material internal control weaknesses, including the actions it has taken since March 1, 2000, the date of the Inspector General's latest audit of HUD's financial statements. Additionally, the report presents our views on whether HUD's current strategy for addressing such weaknesses helps ensure their resolution.[3] Such a strategy is important because, as we reported in January 1999, resolving the weaknesses is an important aspect of addressing HUD's management deficiencies. Internal control weaknesses that are not considered material also adversely affect HUD, as they do many organizations; however, this report focuses primarily on the internal control deficiencies that were identified in reports by HUD's Inspector General on HUD's financial statements and meet the definition of "material weakness" for financial reporting purposes. Other internal control weaknesses may also exist that have not yet been identified by HUD, HUD's Inspector General, or us. (See app. I for a discussion of our scope and methodology.)

Our overall objective was to examine HUD's efforts from March 1999 through May 18, 2000, to address the eight material internal control weaknesses identified in the Inspector General's audits of HUD's fiscal year 1998 financial statements, including the results from the Inspector General's audits of the fiscal year 1999 financial statements.[4] To accomplish this objective, we addressed the following issues:

[3]HUD's Inspector General contracts with independent public accountants to audit the financial statements of HUD's Federal Housing Administration (FHA). The Inspector General's report on HUD's consolidated financial statement audit includes the material internal control weaknesses identified by the independent public accountants at FHA, as well as the material weaknesses identified by the Inspector General at HUD. Because the Inspector General is responsible for the FHA audit and reports on both FHA's and HUD's material weaknesses, this report refers to both sets of material weaknesses as material weaknesses identified by the Inspector General in its audits of HUD.

[4]See *Federal Housing Administration Audit of Fiscal Year 1998 Federal Basis Financial Statements*, Office of Inspector General (99-FO-131-0002, Mar. 12, 1999); *Federal Housing Administration Audit of Fiscal Year 1999 Federal Basis Financial Statements*, Office of Inspector General (00-FO-131-0002, Feb. 29, 2000); *U.S. Department of Housing and Urban Development Audit of the Fiscal Year 1998 Financial Statements*, Office of Inspector General (99-FO-177-0003, Mar. 29, 1999); and *U.S. Department of Housing and Urban Development Attempt to Audit the Fiscal Year 1999 Financial Statements*, Office of Inspector General (00-FO-177-0003, Mar. 1, 2000).

- What has HUD accomplished in resolving its material internal control weaknesses and what remains to be done?
- Does HUD have a process for resolving its material internal control weaknesses and overseeing the actions taken to address them?
- What obstacles has HUD encountered, if any, in addressing its material internal control weaknesses?

Results in Brief

Through May 2000, HUD made reasonable progress toward resolving all eight material internal control weaknesses. One material weakness was downgraded on the basis of corrective actions taken, and major corrective actions have been completed for others. Other actions are still under way or planned. In the audit of HUD's fiscal year 1998 consolidated financial statements, the Inspector General identified the following eight material internal control weaknesses. The Inspector General expressed these weaknesses as actions that needed to be taken to correct identified problems:

- HUD needs to complete improvements to its financial systems.
- Effective management of HUD's resources depends on successful completion of organizational changes.
- HUD needs to do more to ensure that rental subsidies are based on correct tenant income.
- Improvements [are] needed in multifamily project monitoring.
- HUD's Federal Housing Administration (FHA) must address staff and administrative resource issues.
- FHA must continue to place more emphasis on early warning and loss prevention for insured mortgages.
- FHA must improve federal basis and budgetary accounting.
- FHA's information systems must be improved in order to support business processes more effectively.

Most notable among HUD's accomplishments in addressing these eight weaknesses were the improvements it made in monitoring the insured mortgage portfolio. Because of these improvements, the Inspector General downgraded the material weakness on early warning and loss prevention for insured mortgages to a less severe category—an internal control deficiency. We also identified other significant accomplishments, including

- improvements related to the multifamily project monitoring weakness that focused on developing a standard physical inspection process and

substantially completing the first-ever physical inspection and financial assessment of HUD's multifamily housing inventory and
- improvements related to the HUD and FHA staff and administrative resource management weaknesses, including awarding contracts to acquire Section 8 contract administrators for multifamily housing and assigning management and marketing functions for single-family properties to contractors to free HUD staff for other work.

In addition to downgrading one material internal control weakness, HUD's Inspector General reassessed and no longer reports two material weaknesses related to resource management—(1) effective management of HUD's resources depends on successful completion of organizational changes and (2) FHA must address staff and administrative resource issues. However, the Inspector General still regards these two weaknesses as contributing causes to the other material weaknesses and a less severe category of internal control deficiency. For the five remaining material internal control weaknesses, we identified significant actions that are under way or remain to be done. For example, we found HUD has actions under way or planned to (1) bring core financial systems into compliance with federal financial systems requirements, (2) fully reconcile accounting and budget systems for loan guarantees to ensure that all credit subsidy amounts are recorded properly, (3) continue efforts to effectively verify tenant income to ensure that units are occupied by eligible families and that those families are paying the correct rents, and (4) continue modernizing FHA's information and financial management systems and reduce reliance on older systems, called legacy systems.

We also found that HUD's process for addressing its material internal control weaknesses includes developing corrective action plans for each weakness and tracking the resolution of the weaknesses in a centralized system. Each of the eight corrective action plans we reviewed contained activities to be accomplished, estimated completion dates, and strategies for addressing the cause of the weakness. HUD's Office of the Chief Financial Officer is responsible for overseeing the development of such plans and tracking and monitoring corrective actions. As such, the office tracks action items from corrective action plans, has recently initiated meetings with the Deputy Secretary to increase top-level management's involvement, and has developed a new automated tracking system that is intended to enhance management's attention to correcting material weaknesses. Since HUD has linked its actions to resolve some material internal control weaknesses to the implementation of its management reform plan, the resolution of such weaknesses depends, in part, on the

successful completion of HUD's reform plan. HUD has also addressed its material internal control weaknesses in its annual performance plans.

Despite HUD's progress, our analysis showed that HUD has encountered obstacles in addressing some of its material internal control weaknesses. These obstacles included difficulties in implementing improvements to information and financial management systems, the identification of new problems related to some material weaknesses, and delays in some actions. Because of these obstacles, HUD did not make as much progress as it had planned in resolving some of its material internal control weaknesses. According to HUD, the complex nature of some of the problems and aggressive time frames set for some actions contributed to the delays.

Nevertheless, HUD's strategy—which focuses on correcting identified material weaknesses, updating corrective action plans continually, linking action plans to management reform efforts, and tracking the Department's progress in resolving the material internal control weaknesses—should help HUD continue to make progress in resolving its remaining material weaknesses. HUD agreed with our assessment of the obstacles it has encountered and the progress it has made in addressing its material internal control weaknesses, noting that our draft report provided a generally current, accurate, and balanced assessment of its efforts to address these weaknesses. HUD commented that it was pleased with our draft report's acknowledgement that its strategy should help it continue to make progress in resolving the weaknesses.

Background

For many years, we have been concerned about the effectiveness of federal agencies' internal controls. We have brought problems that increase the risk of waste, fraud, abuse, and mismanagement to the attention of federal agencies and the Congress. We also have issued standards for internal control that provide the overall framework for establishing and maintaining internal control and for identifying and addressing major performance and management challenges and areas at great risk of fraud, waste, abuse, and mismanagement. Our *Standards for Internal Control in the Federal Government* defines internal controls as an integral part of an organization's management that provides reasonable assurance that the organization operates effectively and efficiently, provides reliable financial reporting, and is in compliance with applicable laws and regulations.[5] Internal controls comprise the plans, methods, and procedures used to meet an agency's mission, goals, and objectives, and they support performance-based management. They also serve as the first line of

defense in safeguarding assets and preventing and detecting errors and fraud. In short, internal controls help managers achieve desired results through the effective stewardship of public resources.

For financial statement audits required by the Chief Financial Officers Act of 1990 (P.L. 101-576), an agency's internal controls over its financial reporting must also be assessed. To assist auditors in assessing internal controls, we issued applicable standards in our publication entitled *Government Auditing Standards*, and the Office of Management and Budget (OMB) issued guidance on audit requirements for federal financial statements, including a definition of material internal control weaknesses.[6] For the purposes of financial statement preparation, internal control is a process designed to provide reasonable assurance that the financial results reported are reliable, the agency is in compliance with laws and regulations, and performance reporting is reliable. When the design of internal controls is weak, errors, fraud, or noncompliance with laws may occur that elevate the weakness to a material internal control weakness. OMB defines a material internal control weakness as a reportable condition in which the agency's internal controls do not reduce to a relatively low level the risk that errors, fraud, or noncompliance involving significant amounts may occur and may not be detected within a timely period by employees in the normal course of performing their assigned functions.[7]

Material Weakness Reporting Requirements

The Chief Financial Officer's Act of 1990 required that HUD, like other federal agencies, begin preparing agencywide financial statements beginning with fiscal year 1991. The financial statements were to be audited by the agencies' inspectors general, who could contract for this work with independent public accountants. The act, as amended, requires that the financial statement audits be completed by March 1, following the

[5] *Standards for Internal Control in the Federal Government* (GAO/AIMD-00-21.3.1, Nov. 1999).

[6] *Government Auditing Standards: 1994 Revision* (GAO/OCG-94-4, June 1994) and *Audit Requirements for Federal Financial Statements* (OMB Bulletin No. 98-08, Aug. 24, 1998).

[7] A reportable condition is defined by OMB as a matter coming to an auditor's attention that should be communicated because it represents significant deficiencies in the design or operation of internal controls that could adversely affect the organization's ability to provide reasonable assurance of the reliability of its financial reporting, performance reporting, and compliance with laws and regulations. It is a significant, yet less severe, category of internal control deficiency than a material weakness.

end of the fiscal year. Since 1991, HUD's Office of Inspector General has used independent public accountants to audit FHA's financial statements and, since fiscal year 1995, has itself audited HUD's consolidated financial statements.

HUD's *Audit Management System* handbook provides guidance to its program managers for responding to the Inspector General's financial audits and requires the development of corrective action plans to respond to all audit recommendations, including those related to material internal control weaknesses. The handbook requires that HUD develop a proposal to respond to the audit recommendations, including time frames to resolve the recommendations, and obtain a management decision from the Inspector General that the actions proposed will address the recommendations. This proposal and management decision form the basis for HUD's corrective action plans.

HUD's Material Internal Control Weaknesses

Table 1 summarizes the material internal control weaknesses reported by HUD's Inspector General for fiscal years 1998 and 1999 and identifies the year each was first reported as a material weakness.

Table 1: Summary of the Material Internal Control Weaknesses Reported by HUD's Inspector General in the Fiscal Year 1998 Financial Statement Audits and Changes Reported in the Fiscal Year 1999 Audits

1998 Eight material weaknesses	1999 Five material weaknesses	Reasons for 1999 changes, if any	Year first identified[a]
HUD needs to complete improvements to its financial management systems.	HUD's financial systems are not fully compliant with federal financial standards.	Refined to focus on the impact of systems problems on financial management.	1991
Effective management of HUD's resources depends on successful completion of organizational changes.	Not applicable.	No longer a separate material weakness because of corrective actions taken. Reassessed as a contributing cause of other material weaknesses and reportable conditions.	1992
HUD needs to do more to ensure that subsidies are based on correct tenant income.	HUD needs to do more to ensure that rental subsidies are based on correct tenant income.	Not applicable.	1995
Improvements [are] needed in multifamily property monitoring.	Improvements [are] needed in multifamily property monitoring.	Not applicable.	1991
FHA must address staff and administrative resource issues.	Not applicable.	No longer a separate material weakness. Reassessed as a contributing cause of other material weaknesses and reportable conditions.	1992
FHA must continue to place more emphasis on early warning and loss prevention for insured mortgages.	Not applicable.	Reduced to a reportable condition.	1991
FHA must improve federal basis and budgetary accounting.	FHA's budgetary and financial accounting controls must be improved.	Refocused to consider improvements made and provide more detail on remaining issues.	1998
FHA's information systems must be improved in order to support business processes more effectively.	FHA's information systems must be enhanced to more effectively support FHA's business processes.	Refined to focus more on financial management improvement.	1991

[a]Fiscal year 1991 was the first year that HUD's financial statements were audited under the Chief Financial Officer's Act of 1990.

Source: GAO's presentation of information reported by HUD's Inspector General.

Importance of Internal Controls to HUD

Sound internal controls are important to HUD for several reasons. HUD is one of the largest financial institutions in the United States. As of September 30, 1999, HUD was responsible for managing about $508 billion in insured mortgages and $570 billion in guarantees of mortgage-backed securities. It had about $33 billion in budget authority for fiscal year 2000. Equally important, directly or indirectly, HUD affects millions of Americans as it carries out the federal government's missions, policies, and programs for housing and community development. These wide-ranging missions

include making housing affordable by insuring loans for multifamily rental housing properties and providing assistance for about 4.5 million low-income residents, helping revitalize over 4,000 localities through community development programs, and encouraging homeownership by providing mortgage insurance to about 7 million homeowners who might not have been able to qualify for loans without federal support.

In addition, the management control tool of monitoring is particularly critical for HUD because its housing and community development programs rely extensively on the integrity of thousands of diverse entities and individuals, such as cities, public housing authorities, mortgage lenders, contractors, and property owners. For example, about 1,000 local governments throughout the United States administer HUD's $6-billion-a-year Community Planning and Development program. In fiscal year 1999 alone, about 10,000 lending institutions approved 1.3 million FHA-insured single-family mortgages valued at about $124 billion. About a third of these lenders have the authority to underwrite loans and determine eligibility for FHA mortgage insurance without prior HUD review.[8] HUD also relies on contractors to monitor some of its activities that are carried out by third parties, such as FHA mortgage lenders and Section 8 contract administrators. These contracts represent a significant amount of resources and workload. For fiscal year 2000, HUD requested $209 million for Section 8 contract administrators to manage about 13,600 of its 21,000 Section 8 contracts representing about 993,000 multifamily housing units. Additionally, the management of HUD's inventory of about 50,000 single-family homes was assigned to management and marketing contractors in 1999 and is estimated to cost about $927 million over 5 years.

HUD Has Made Progress in Addressing Its Material Internal Control Weaknesses, but More Remains to Be Done

HUD made reasonable progress from March 1999 through May 18, 2000, in implementing the action plans it had developed to resolve its eight material internal control weaknesses. In its March 1, 2000, report on HUD's financial statements, HUD's Inspector General found that five material weaknesses remained as of the end of fiscal year 1999. The Inspector General downgraded one of the eight material weaknesses reported in the fiscal year 1998 financial statements audit to a reportable condition because of improvements in FHA's ability to monitor its insured multifamily and single-family loans. Consequently, this weakness continues to represent a

[8] *Single-Family Housing: Stronger Oversight of FHA Lenders Could Reduce HUD's Insurance Risk* (GAO/RCED-00-112, Apr. 28, 2000).

significant internal control deficiency but no longer represents a weakness that can materially affect HUD's financial position. The Inspector General also reassessed two other material weaknesses on resource management, reported in fiscal year 1998, and reclassified them as contributing factors to the remaining weaknesses and reportable conditions. The reclassification occurred because of improvements made by HUD and FHA in resource management and monitoring. However, the Inspector General noted that it is critical for the Department to continue addressing these issues through the successful completion of ongoing plans.

Major actions are under way to resolve the five remaining material internal control weaknesses. HUD is continuing to address these weaknesses by completing its planned actions. Significant actions we identified that remain include continuing to follow up on health and safety issues at multifamily properties and bringing core financial systems into compliance with federal financial systems requirements. In addition to material internal control weaknesses, we and HUD's Inspector General have reported on other internal control weaknesses at HUD that are not considered material for financial statement purposes but can nevertheless adversely affect HUD's operation.

HUD's Accomplishments and Major Actions Remaining

From March 1999 through May 18, 2000, HUD's progress in addressing the eight material internal control weaknesses included major accomplishments. The most significant achievement was that the early warning and loss prevention weakness was downgraded to a reportable condition because of improvements FHA made in monitoring its insured mortgage portfolio. Among these improvements were efforts by FHA to begin collecting multifamily delinquency data from mortgagees electronically, substantially increase the number of physical inspections at insured multifamily properties, increase the number of quality assurance reviews, and expand the use of loss mitigation tools in managing single-family loans.[9]

[9]According to the Inspector General, this weakness remains a reportable condition because, among other things, FHA had not, at the time of the audit, fully implemented new initiatives to identify and manage risks in its insured portfolios and needed to increase its use of other data to identify and resolve its underwriting practices for high-risk **single-family** loans.

Other major accomplishments we identified that HUD made in addressing the eight material weaknesses from March 1999 through May 18, 2000, include the following:

- For the multifamily property monitoring and early warning weaknesses, HUD developed a standardized physical inspection process for multifamily properties and substantially completed physical inspections of its multifamily housing inventory–28,306 inspections of multifamily properties had been completed as of May 18, 2000.
- For the HUD resource management weakness, HUD accepted a study by the National Academy of Public Administration (NAPA) on its resource estimation practices that resulted in a resource estimation and allocation methodology that HUD plans to implement over the next 18 months.
- For the HUD and FHA resource management weaknesses, HUD selected single-family management and marketing contractors that began to manage and sell HUD's inventory of homes. Despite some problems, the number of sales of single-family properties increased, and the net recovery from those sales rose from 79.7 percent to 80.2 percent.[10]
- HUD assigned responsibility for the income verification material weakness to its Real Estate Assessment Center (REAC) and began a large-scale computer matching effort using federal income tax data. Public housing authorities' rate of reporting tenant information to HUD's Multifamily Tenant Characteristic System (MTCS) database also improved, rising from 64 percent to 90 percent, partly because of increased monitoring of the housing authorities' reporting. This information on tenants is essential for the income-matching project.

HUD's Inspector General did not separately report two material weaknesses on HUD's and FHA's management of resources as material weaknesses in its fiscal year 1999 reports. Instead, the Inspector General reassessed these problems in light of improvements HUD made in addressing its resource issues. Among these improvements, the Inspector General cited the Department's continued contracting for labor-intensive functions, which allows HUD staff to focus more on monitoring. The Inspector General recategorized the weaknesses as causes contributing to the remaining material weaknesses and reportable conditions. However, the Inspector General noted that significant problems remain associated

[10] *Single-Family Housing: Stronger Measures Needed to Encourage Better Performance by Management and Marketing Contractors* (GAO/RCED-00-117, May 12, 2000).

with these issues. For example, the FHA audit report cited ongoing issues related to the monitoring of financial and operational processes in FHA's management of its insurance portfolio, notes, and acquired property. According to the Inspector General, it is critical for the Department to continue to address the previously identified problems by completing ongoing plans. Appendix II contains a detailed description of the resource management weaknesses and their significance.

After downgrading one material weakness and recategorizing two others, the Inspector General reported that five material internal control weaknesses remained at HUD at the end of fiscal year 1999. Our analysis showed that significant actions remain to resolve these material weakness. Among other things, HUD needs to continue to follow up on health and safety issues at multifamily projects, bring core financial systems into compliance with federal financial systems requirements, and complete the conversion of FHA's systems from a commercial to a federal basis.

The major HUD accomplishments we identified for the five material weaknesses remaining as of May 18, 2000, and the major actions remaining for each, are summarized in the following figures. (See app. III for more detailed information.)

Figure 1: HUD's Financial Systems Are Not Fully Compliant With Federal Financial Standards

Accomplishments	Major actions remaining
☑ Completed the benefit-cost analysis update and resolved issues associated with the financial systems integration project's scope, strategy, and management changes.	+ Bring core financial systems into compliance with federal financial systems requirements.
☑ Standardized financial management systems data elements and began cleaning up these data.	
☑ Established a structure to address the lack of integration between program and accounting systems that resulted in duplicate data entry.	

Figure 2: HUD Needs to Do More to Ensure That Rental Subsidies Are Based on Correct Tenant Income

Accomplishments	Major actions remaining
☑ Assigned responsibility for the income verification project to REAC.	+ Complete the mailing of income discrepancy letters to tenants and property owners/agents.
☑ Increased the monitoring of public housing authorities' reporting of tenant characteristics.	+ Study the long-term design of income-reporting requirements.
☑ Began a large-scale computer matching effort using federal income tax data.	

Note: HUD reported to us that as of October 2000 it had send letters to 211,000 tenants or substantially all of the tenants it plans to contact.

Figure 3: Improvements Needed in Multifamily Project Monitoring

Accomplishments	Major actions remaining
☑ Completed 98 percent of the physical inspections and almost all of the first-year financial assessments that were received.	+ Follow up on the remaining multifamily properties that did not submit financial statements.
☑ Awarded the first 24 contracts for administrative functions for project-based Section 8 rental assistance.	+ Complete the implementation of the contracts for Section 8 contract administrators.
	+ Continue to follow up on health and safety issues identified by physical inspections at multifamily properties.
	+ Continue to resolve deficiencies identified through annual financial statements.

Note: HUD reported to us that a total of 37 contracts were awarded as of October 2000.

Figure 4: FHA's Budgetary and Financial Accounting Controls Must Be Improved

Accomplishments	Major actions remaining
☑ Documented and trained staff on the cost allocation time survey process. Conducted the semi-annual cost allocation survey.	+ Enhance the multifamily insurance underwriting system to ensure the proper recording of credit subsidy commitments and endorsements, and automate the process for recording credit subsidy obligations.
☑ Revised cash flow models to incorporate additional improvements that reduced the risk of errors.	+ Modify financial systems to include budgetary accounting at the transaction level by standard general ledger account and continue training staff on financial statement preparation.
☑ Documented the federal basis financial statement and SF-133 preparation process and trained staff in these processes.	
☑ Updated FHA's contracts database and removed terminated contracts from the list of active contracts.	
☑ Performed monthly reconciliations of accounting and budget data and resolved differences.	

Figure 5: FHA's Information Systems Must Be Enhanced to More Effectively Support FHA's Business Processes

Accomplishments	Major actions remaining
☑ Developed the Real Estate Management System (REMS) to support multifamily housing.	+ Complete the integration of REMS with other systems, specifically those at REAC.
☑ Implemented the single-family mortgage collection subsystem to maintain detailed, case-level information on the receipt of mortgage insurance premiums on single-family loans.	+ Complete the implementation of a subsidiary ledger for converting FHA's financial management reporting from a commercial to a federal accounting basis.

Potential of Internal Control Weaknesses That Are Not Material to Affect HUD's Operations

While material internal control weaknesses identified during financial statement audits can significantly affect an organization's financial position, other internal control weaknesses that (1) are not determined to be material or (2) pertain to management control systems also exist. These problems also warrant attention because of their potential to adversely affect an agency's operations.

Both we and HUD's Inspector General have reported on internal control problems that have not been classified as material weaknesses in the Inspector General's financial statement audits. In a letter dated March 10, 2000, to the Secretary of HUD, we stated that 22 recommendations from our past work with major relevance to HUD's management deficiencies had not yet been fully implemented. Ten of these unimplemented recommendations related to internal control weaknesses in the operations of departmental programs.[11] For example, we reported on recommendations to implement a monitoring system to ensure that HUD's risk-sharing partners comply with demonstration programs' procedures, regulations, or risk-sharing agreements and require the Chief Financial Officer (CFO) to provide sufficient oversight to determine whether HUD's annual review of unexpended balances is adequate to identify unneeded balances and to ensure that they are deobligated. We have also pointed out that weak management controls have compromised the integrity of four HUD grant programs whose annual expenditures total about $6 billion.

In reporting on the fiscal year 1999 financial statements, HUD's Inspector General pointed out 12 reportable conditions at HUD and FHA that represent significant deficiencies in the design or operation of internal controls. These conditions include weaknesses in (1) controls over HUD's computer system environment and security, (2) HUD's processes for reviewing contract obligation balances, (3) FHA's review process for estimating reserves for the insured portfolio, and (4) the design and operation of security and data integrity controls over FHA's information systems.

The Federal Managers' Financial Integrity Act (FMFIA) requires management control programs and annual reports for federal agencies that (1) indicate whether management control systems provide reasonable assurance that the requirements of FMFIA are being met, (2) identify any

[11] *Status of GAO's Recommendations Related to High-Risk Issues at the Department of Housing and Urban Development* (B-284624, Mar. 10, 2000).

new material weaknesses and instances of nonconformance, and (3) include any corrective actions taken on previously identified material weaknesses. HUD reports on its compliance with the act's requirements in its annual accountability report, including a discussion of its material internal control weaknesses. In its fiscal year 1999 accountability report, HUD again certified that, except for the material weaknesses and certain other issues, its management controls are in compliance with the act's requirements. This certification means that, according to HUD, its controls are sufficient to provide reasonable assurance that obligations and costs are in compliance with applicable laws, funds and assets are properly safeguarded, and revenues and expenditures are properly accounted for and reported. HUD also stated that it was not in full compliance with FMFIA's systems requirements because it still needs to complete the conversion to an integrated financial management system and to ensure full compliance with capturing standard general ledger information at the transaction level. Even though HUD certified that its management controls are in compliance with FMFIA's requirements, the Inspector General reported that it continues to believe that HUD is not in compliance, given the magnitude of the problems that remain and the difficulties with the core financial systems.

HUD Has Developed Plans to Address Its Material Internal Control Weaknesses

HUD's process for addressing its material internal control weaknesses includes developing a corrective action plan for each weakness and a centralized system to track its progress in resolving the weakness. Each corrective action plan contains activities to be accomplished, estimated completion dates, and strategies for addressing the cause of the material weakness as identified by the Inspector General, as well as by HUD management and us. The planning and oversight process involves various HUD entities, and each plan is routinely updated.

In addition, HUD's corrective action plans include linkages to the Department's 2020 Management Reform Plan, and its material internal control weaknesses are addressed in its annual performance plans, prepared under the Government Performance and Results Act of 1993 (Results Act).[12]

[12]The Results Act seeks to shift the focus of government decision-making and accountability from activities to results.

HUD's Action Plan Process

We reviewed the action plans that HUD developed to corrects its material internal control weaknesses in August 1999, February 2000, and April/May 2000 (when such plans were available for weaknesses that remained after the fiscal year 1999 audit). The earlier plans contained actions to address the eight material weaknesses identified in the fiscal year 1998 financial statement audit reports. Five of the eight plans, which were developed by the Office of Housing (Housing), included (1) management strategies built around the audit recommendations and implementation strategies contained in HUD's 2020 Management Reform Plan, (2) corrective actions to implement the strategies, (3) estimated dates for completion, and (4) status information. One of the eight plans on verifying tenant income was developed by a project task force led by HUD's CFO with participation from REAC, Housing, and the Office of Public and Indian Housing (PIH). When the responsibility for tenant income verification was transferred to REAC in February 1999, REAC revised the plan to provide for a large-scale computer matching effort with specific tasks and status information for each task.

The remaining two plans on HUD's financial management systems and resource management material weaknesses were developed by the CFO and the Office of Departmental Operations and Coordination, with input from other HUD offices. The CFO's corrective action plan for HUD's financial management systems weakness described the deficiencies, corrective actions taken and planned, and estimated completion dates for some activities. The resources management plan was updated specifically for this review, according to officials from the Office of Departmental Operations and Coordination. It consisted of excerpts from the fiscal year 1998 financial statement audit report, with charts showing interim steps and completion dates for each of the recommendations, and a separate narrative description for two of the four recommendations.

All eight corrective action plans noted that some actions had been completed and some showed actions that would not be completed until late 2000, including one whose actions would not be completed until 2005. For example, the multifamily property monitoring action plan notes that some actions, such as the establishment of REAC and the Department's Enforcement Center, have been completed, as discussed above. However, it also showed that existing guidance related to multifamily operations will not be completely updated until September 30, 2001. The plan for HUD's financial systems weakness included interim dates for completing planning projects and the core financial system but did not report when the mixed systems transferred from the CFO to the Chief Information Officer (CIO)

were expected to be completed. HUD officials estimated that the mixed systems would be completed several years in the future. Also, some of the activities described in the plans overlapped, indicating the interrelationship of the problems underlying the material weaknesses. For example, four of the plans cited the establishment of REAC as important to addressing the related material weakness.

As of May 2000, the corrective action plans for the five remaining material internal control weaknesses were being updated to incorporate information and recommendations from the Inspector General's audit of the fiscal year 1999 financial statements. We obtained updated corrective action plans, where available, and discussed the planned actions with the responsible officials. Besides describing the major accomplishments and actions that remain for these five weaknesses, appendix III discusses the actions planned and the actions remaining for those new plans.

Management Oversight of Action Plans

HUD has several mechanisms to oversee corrective actions taken in response to audit report recommendations, including those for the material weaknesses. Responsibilities for developing action plans, monitoring actions, and reporting on the progress made in resolving material weaknesses are shared by the CFO, program offices and individual units, the Office of the Deputy Secretary, and HUD's Inspector General.

The CFO is responsible for overseeing the development of all material weakness action plans and tracking and monitoring corrective actions. The CFO's Risk Management Division tracks the status of corrective action plans. The Division also frequently discusses the status of plans, as well as problems encountered in implementing the plans, with the responsible program officials and with the Deputy Secretary, when warranted. The Risk Management Division has developed and implemented a new automated system to track material weakness corrective actions to replace the previous tracking system, as part of the Deputy Secretary's initiative to further enhance management's attention to correcting material weaknesses. This system is intended to track action items from the corrective action plans and automatically notify responsible staff when specific actions are due. In addition, on February 16, 2000, the Deputy Secretary announced a new process for monitoring material weaknesses, which began in May 2000. The new process will require program offices to update status information monthly to enable the CFO to prepare a monthly consolidated corrective action status report for the Deputy Secretary's use in overseeing progress. The responsible program official will meet with the

CFO and Deputy Secretary monthly to review the plans and progress. A working group, the Council of Comptrollers, will work with the CFO and act as a focal point for resolving material weaknesses and other financial and management control issues. The first monthly meeting of the Council of Comptrollers was held on May 4, 2000.

In addition to the CFO's monitoring of corrective action plans, HUD and the Inspector General maintain a centralized database for tracking audit findings and recommendations, including those related to the material weaknesses. HUD has a Departmental Automated Audits Management System that tracks and monitors all of the Inspector General's audit findings, recommendations, and corrective actions. It identifies trends and patterns and produces reports and data for use by the Inspector General and the CFO.

At the program level, Housing was responsible for five of the material weaknesses we reviewed, and it has a separate tracking and oversight process for the corrective action plans related to these weaknesses. As part of Housing's audit-tracking responsibilities, the Audit Liaison Officer maintains a consolidated material weakness action plan, which she sends out bimonthly to the multifamily and single-family program staff for update. Within the program offices, the information necessary to update the action plans is obtained, and responses are prepared. Housing provides data from its tracking system to the CFO for inclusion as part of the departmentwide tracking and reporting system. HUD reported to us that Housing's system will be replaced by the new automated tracking system once that system is implemented.

Link Between Correction of Material Weaknesses and Implementation of HUD's Management Reform Plan

In the most recent financial statement audit reports, the Inspector General noted that HUD's ability to address its management problems will improve if it completes its implementation of the 2020 Management Reform Plan. HUD announced the management reform plan in June 1997 to, among other things, address identified management weaknesses, including those involving internal controls. The reform plan outlined six major reforms, including reorganizing by function, consolidating similar functions within and across the agency's main program areas, and developing state-of-the-art financial management systems. In addition to increasing efficiency, the management reform plan is expected to increase HUD's effectiveness. For example, fewer public housing authorities and multifamily properties are expected to become "troubled" if staff can better focus on monitoring and improving the performance of authorities and properties that are

potentially troubled. The management reform plan noted that HUD must refocus its energy and resources on eliminating waste, fraud, and abuse in all of its programs and recognized that implementing stringent internal controls was essential to permanently improving HUD's management.

Seven of the eight action plans we reviewed were designed to correct long-standing material weaknesses and were linked to HUD's 2020 Management Reform Plan, making the resolution of these material internal control weaknesses dependent on the implementation of that effort. Five of these seven plans cited a strategy or plan to implement some aspect of the management reforms to address the applicable material weakness. The two remaining corrective action plans included actions that were fundamental to the overall implementation of HUD's management reform plan. Specifically, the plan for correcting the financial management systems weakness is consistent with one of the major reforms under the management reform plan–to modernize and integrate outdated financial management systems. Similarly, the plan for correcting the resources material weakness included steps HUD has undertaken to implement the management reform's structural changes, such as establishing REAC and increasingly contracting for functions that HUD does not have the capacity to handle properly, such as the management and marketing of HUD-owned properties.

The eighth corrective action plan, for the weakness that was newly identified in the audit report for FHA's fiscal year 1998 financial statement, relates to FHA's continuing effort to conform its accounting systems from the private-sector accounting standards that it had historically followed to federal accounting standards. Although FHA cited the importance of this issue in supporting HUD's and FHA's systems integration efforts, it did not specifically include strategies related to HUD's management reforms.

Relationship of Material Weakness Plans to the Results Act

HUD has also addressed its material internal control weaknesses in its annual performance plans, required under the Results Act. Most recently, HUD's fiscal year 2001 annual performance plan included a separate section on HUD's management challenges that described the Department's material internal control weaknesses and reported the current status of efforts to address them.[13] HUD's performance plans also include

[13] *U.S. Department of Housing and Urban Development: Fiscal Year 2001 Annual Performance Plan* (Mar. 1, 2000).

performance measures related to issues associated with the material internal control weaknesses, although not directly related to addressing the weaknesses themselves. For example, in its fiscal year 2001 performance plan, HUD included measures under the strategic goal to "ensure public trust" that its data systems (1) are rated highly for usefulness, ease of use, and reliability and (2) will earn data quality certifications based on objective criteria. The performance plan also includes other measures related to physical inspections of multifamily properties and housing authorities' verification of tenant income.

HUD Has Encountered Obstacles in Addressing Its Material Internal Control Weaknesses

Although HUD has made progress in implementing its corrective action plans, it has encountered various obstacles in trying to resolve the related material internal control weaknesses. These include problems in improving the Department's information and financial management systems, the identification of new problems related to some material weaknesses, and delays in implementing some components of the action plans. As a result, HUD did not make as much progress from March 1999 through May 18, 2000, as it had planned in resolving some of its material internal control weaknesses. According to HUD, the complex nature of some of the issues, particularly the information and financial management systems, and the aggressive time frames set for some of the actions contributed to these delays.

Information and Financial Management Systems

HUD has experienced a variety of problems in the course of improving its information and financial management systems. The most significant problem occurred when it converted its accounting records to a new general ledger system, a project it has been working on for several years. HUD had developed a new general ledger for use departmentwide—called the HUD Central Accounting and Program System, or HUDCAPS—which complies with Standard General Ledger requirements, and deployed 10 other new financial management systems.[14] However, when HUD implemented HUDCAPS as the departmentwide general ledger system, it encountered serious problems. Numerous transactions were rejected or incorrectly posted and had to be manually researched and corrected.

[14]The *U.S. Government Standard General Ledger* establishes a standard chart of accounts, including account titles, definitions, and uses. The primary purpose is to standardize federal agencies' accounting to support the external reports and financial statements required by OMB and Treasury and to provide comparable information among agencies.

Furthermore, no automated program was available to help reconcile the general ledger cash accounts to the Department of the Treasury's account balances. The reconciliation process to identify discrepancies fell behind schedule, and HUD made numerous adjustments to its general ledger fund balances to make them agree with Treasury's records. About 240 adjustments totaling about $59.6 billion were made to adjust HUD's fiscal year 1999 activities, but significant unexplained differences remained between HUD's fund balance and Treasury's records. HUD officials reported to us that, as of May 18, 2000, the Department was continuing to address data integration issues. According to the officials, HUDCAPS will be compliant with federal financial systems requirements by November 2000.[15]

On March 1, 2000, the Inspector General issued a disclaimer of opinion on HUD's consolidated fiscal year 1999 financial statements because the problems experienced by HUD in preparing auditable financial statements and reconciling fund balances prevented the Inspector General from completing the audit by the legislatively mandated reporting deadline. While the disclaimer on HUD's financial statements is an issue of concern for HUD management, the more significant issue from an internal control perspective is the need to correct the systems problems so that HUD can consistently produce the timely, reliable management and financial information necessary to manage its programs. HUD officials reported to us in May 2000 that the Department had completed the fiscal year 1999 fund balance reconciliation and has other actions under way to address the problems that resulted in the disclaimer. For example, HUD had initiated studies to improve its procedures for (1) posting corrective adjustments during the year and (2) reconciling its fund balances with Treasury's records. In its July 13, 2000, comments on this report, HUD reported that the Department had completed the fiscal year 1999 reconciliation of funds balance with the U.S. Treasury and no material adjustments were identified that would result in a need to restate the fiscal year 1999 financial statement balances.

HUD encountered other obstacles in improving its information and financial management systems. According to HUD CFO officials, the major obstacles to completing HUD's financial systems integration project are

[15]These requirements are detailed in the Financial Management Systems Requirements series issued by the Joint Financial Management Improvement Program and in OMB Circular A-127, *Financial Management Systems*.

FHA's deficient general ledger and subsidiary systems and HUD's continuing reliance on legacy systems. They also stated that legacy systems are becoming more difficult and costly to maintain and consume resources that are needed for implementing new systems. Moving from these systems to HUD's general ledger is complex and requires substantial resources, according to these officials. In May 2000, HUD officials told us that HUD has finished defining functional requirements for a new FHA subsidiary ledger and developed a plan for selecting and implementing the new system.

Finally, FHA officials told us that many of the resources they had planned to allocate to developing and improving their information and financial management systems were redirected to the Year 2000 computing issue. They explained that many of FHA's technical staff resources were focused on Year 2000 compliance during this time, limiting the resources available to work on systems development and integration. In fact, a moratorium was placed on the implementation of new systems from October 1999 through March 2000 to reduce the risks during the rollover to the millenium and the leap year day, February 29, 2000. Because of its efforts, HUD achieved full Year 2000 compliance and experienced no significant system failures.

New Issues Identified

HUD's progress toward correcting its material weaknesses was further complicated by the Inspector General's identification of new problems that needed to be addressed. Specifically, in auditing the fiscal year 1999 financial statements, the Inspector General identified new problems and made new recommendations for four of the five remaining material weaknesses. For example, FHA officials initially told us they expected that the material weakness related to FHA's control over budgetary funds would be downgraded to a reportable condition as a result of improvements FHA made during fiscal year 1999. However, the weakness was not downgraded because, although FHA fully implemented some of the fiscal year 1998 recommendations, the Inspector General found other problems related to the weakness that resulted in its continued classification as a material weakness. The fiscal year 1999 audit report stated that FHA must (1) fully reconcile the accounting and budget systems for loan guarantee commitments and endorsements to ensure that all credit subsidy estimates are recorded properly and (2) implement the systems necessary to ensure compliance with federal accounting standards at the transaction level. According to HUD, the new problems relate to credit subsidy and federal basis budget and accounting requirements that are new to FHA's traditional

accounting requirement. HUD officials reported to us that these deficiencies are being addressed in that the current system is being phased out in fiscal year 2000 and will be replaced with a system that supports transaction-level detail in compliance with standard general ledger requirements.

Delays in Implementing Some Planned Actions

HUD experienced some delays in completing planned corrective actions related to its material weaknesses. For example, a large-scale computer matching effort using income tax data to verify tenant incomes is currently about 7 months behind schedule. HUD's corrective action plan called for letters to be sent to tenants notifying them of possible income discrepancies in October 1999; however, few such letters had been sent as of May 18, 2000.[16] Several issues contributed to this delay, including problems with the contractor that was to mail the letters, concerns by industry groups about the tone of the letter, and technological problems. HUD officials reported to us in May 2000 that REAC has modified its schedule to accommodate changes in the process and that some of the delays have been beyond its control.

HUD also experienced delays in awarding contracts to administer its Section 8 housing assistance contracts. HUD's multifamily monitoring plan called for the contracts to be awarded by December 1999, but because of delays in originally announcing the request for proposals during the summer of 1999 and in reviewing the proposals, the first contracts were not awarded until February 2000. HUD officials reported to us that as of October 2000, HUD had awarded 37 of the contracts, implemented a contract administration monitoring and oversight strategy, and moved the oversight of these subsidy contracts to a newly created Office of Subsidy Contract Administration in Housing. HUD officials also reported that HUD had assigned housing assistance contracts to 12 of the contract administrators. Additional HUD staff are being hired in headquarters and in the field to improve and support the administration of the subsidy contracts.

In its comments on this report, HUD attributed the delays in implementing its large-scale computer matching program and in awarding contracts for

[16]HUD stated that about 900 discrepancy letters had been sent as of May 18, 2000; by October 2000, the number of letters sent had increased to 211,000 or substantially all of the tenants it planned to contact.

administering its Section 8 housing assistance contracts to its having underestimated the time needed to develop, market, and implement these initiatives. Among other things, HUD said it had not allowed enough time for the housing industry and program participants to comment on and buy-into the initiatives.

Agency Comments

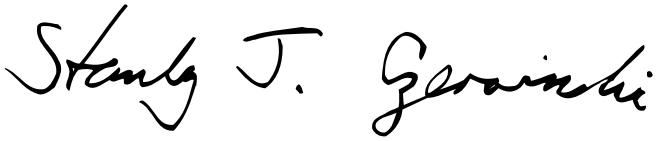
We provided copies of a draft of this report to HUD for its review and comment. HUD commented that the draft report provided a generally current, accurate, and balanced assessment of its efforts to address eight material internal control weakness issues during the 14-month period from March 1999 through May 18, 2000. In addition, HUD commented that despite some acknowledged setbacks and delays, it was pleased with our acknowledgement that its overall strategy for addressing its material internal control weaknesses should help it continue to make progress in resolving those that remain.

While acknowledging that it did not make as much progress as it had planned in resolving some of its material internal control weaknesses, HUD commented that our conclusion needs to be put in the context of the long-standing and significant nature of the problems it is trying to correct and the aggressive initial timetable it established for implementing the 2020 Management Reform Plan and other corrective actions. We modified the report to more clearly reflect HUD's concerns and the difficulties the Department confronts in resolving these issues; however, we did not change our observation that HUD did not make as much progress as it had planned.

HUD also provided detailed comments on our report. The complete text of HUD's comments and our responses are included in appendix IV.

We are sending copies of this report to the appropriate Senate and House committees and to the Honorable Jacob Lew, Director, Office Management and Budget. We will make copies available to others on request. If you or your staff have any questions about this report, please call me at (202) 512-7631. Key contacts and major contributors to this report are listed in appendix V.

Stanley J. Czerwinsk



Associate Director, Housing and
Community Development Issues

Objectives, Scope, and Methodology

Because we have reported that the resolution of the Department of Housing and Urban Development's (HUD) material internal control weaknesses is an important aspect of addressing the Department's long-standing management deficiencies, we reviewed HUD's efforts to correct these weaknesses so that we could present our views on whether HUD's current strategy for addressing such weaknesses helps ensure their resolution. Our overall objective was to examine HUD's efforts from March 1999 through May 18, 2000, to address the eight material internal control weaknesses reported by HUD's Inspector General in its fiscal year 1998 financial statements audit, including the results of the fiscal year 1999 financial statement audits. We also updated certain information through October 2000. To do this, we addressed the following issues:

- What has HUD accomplished in resolving its material internal control weaknesses and what remains to be done?
- Does HUD have a process for resolving the material internal control weaknesses and overseeing the actions taken to address them?
- What obstacles has HUD encountered, if any, in addressing its material internal control weaknesses?

Internal control weaknesses that are not considered material also affect HUD, as they do many organizations; however, this report focuses primarily on the internal control deficiencies, identified in reports by HUD's Inspector General on HUD's financial statements, that meet the definition of "material weakness" for financial reporting purposes.

To identify what HUD did to resolve its material weaknesses from March 1999 through May 18, 2000, we reviewed the action plans developed by HUD to resolve the eight material internal control weaknesses reported by the Inspector General in its audit reports for fiscal year 1998. We obtained copies of the most current corrective action plans available at the time we initiated this review in September 1999 for the eight material internal control weaknesses identified by the Inspector General in its fiscal year 1998 audit report. We also obtained and reviewed the updated plans for these weaknesses in February 2000 and April/May 2000. To identify the work that remained to be done, we limited the scope of our review to the most up-to-date information—the five material internal control weaknesses remaining at the end of fiscal year 1999, as identified by the Inspector General's audit. To identify and describe HUD's accomplishments on the eight material weaknesses and the work that remained for the five material weaknesses, we obtained information from HUD's action plans, centralized systems that track progress in resolving such weaknesses, and fiscal year

1999 Business and Operating Plan Results, as well as other audits by HUD's Inspector General and relevant GAO products. We interviewed HUD officials who had been designated as our contacts for each weakness about the content of the action plans and their oversight responsibilities. We met with the independent public accountants who performed the fiscal year 1999 Federal Housing Administration (FHA) audit under contract to the Inspector General to discuss the results of their audit. We also met with senior HUD management in May 2000 to discuss the results of the fiscal year 1999 audit and HUD's plans to respond to the issues raised. We updated HUD's accomplishments and work that remained using information provided by senior HUD officials on May 18, 2000.

To identify HUD's process for resolving its material internal controls weaknesses, we reviewed HUD guidance and procedures pertaining to audit recommendations and its management control program. We also interviewed HUD officials of the Office of the Chief Financial Officer and its Risk Management Division, Office of the Inspector General, and Office of Housing on their roles and responsibilities in responding to audit recommendations and monitoring the corrective actions taken. We also reviewed HUD's 2020 Management Reform Plan to obtain information on the impact of the reforms on HUD's internal control environment.

In identifying the problems and obstacles HUD encountered in addressing its material weaknesses, we limited our review to problems that arose in addressing the five material internal control weaknesses reported on March 1, 2000. We reviewed the Inspector General's financial statement reports for fiscal years 1998 and 1999 and interviewed HUD officials who were responsible for the corrective actions. We also interviewed officials from the Office of the Chief Financial Officer to obtain their insights on delays and obstacles experienced in implementing the planned corrective actions and the causes of the disclaimer of opinion resulting from the fiscal year 1999 audit. We also obtained information on other work performed by HUD's Inspector General and GAO on issues related to the material internal control weaknesses.

HUD and FHA Must Continue to Address Resource Management Weaknesses

Since 1992, HUD's Inspector General has identified HUD's and FHA's management of staffing and administrative resources as a material weakness.[1] Specifically, in its 1999 audit reports on the agencies' fiscal year 1998 financial statements, the Inspector General reported that (1) the effective management of HUD's resources depends on the successful completion of organizational changes and (2) FHA needs to address staffing and administrative resources. Both reports, however, noted that HUD has recognized the need to address its resource shortcomings. The audit report on HUD's consolidated financial statements noted that HUD has put extensive effort into restructuring its operations. Similarly, the audit report on FHA's statements noted that FHA had completed several critical milestones addressing staffing and administrative resource issues. As a result, in the reports on HUD's and FHA's fiscal year 1999 financial statements, the Inspector General reassessed the resource management material weaknesses, recategorizing them as contributing causes to other weaknesses or reportable conditions. The reports recognized that HUD and FHA have made some progress in addressing resource issues; however, the Inspector General noted that it is critical that HUD continue with the implementation of ongoing plans.

HUD and FHA took steps during fiscal years 1999 and 2000 to address the Inspector General's concerns related to both weaknesses reported as material in the fiscal year 1998 financial statements reports. Our review identified a number of corrective actions HUD has completed or is implementing. These actions, aimed at addressing the recommendations contained in the 1999 audit reports on HUD's and FHA's fiscal year 1998 financial statements, include the following:

- HUD is awarding contracts for third-party contractors to administer its project-based Section 8 housing assistance payments contracts. By contracting for this work, HUD plans to free its staff for other functions, such as monitoring the portfolio. As of May 2000, HUD had awarded 24 contracts and expected to award other contracts by the end of fiscal year 2000.[2]

[1]The HUD resource issue was first reported as a material weakness in the fiscal year 1992 financial statements audit report, was not separately reported as such in fiscal years 1993 and 1994, and has been reported as a material weakness since fiscal year 1995. The FHA resource weakness has been reported as a material weakness since fiscal year 1992.

[2]As of October 2000, HUD had increased the number of contracts awarded to 37.

- As of May 2000, the Real Estate Assessment Center (REAC) had completed 98 percent of the physical inspections of the multifamily properties in its portfolio. REAC had also received about 84 percent of the first-year annual financial statement submissions from these properties, processed financial assessments for almost all of them, and sent follow-up letters to those whose financial statement submissions were overdue.
- In response to widespread problems with the maintenance of single-family properties, HUD began contracting for the management and marketing of its single-family property inventory in March 1999. Despite some problems, the number of sales of single-family properties increased, and the net recovery from those sales rose from 79.7 percent to 80.2 percent.
- HUD transferred its income verification program from the Office of Public and Indian Housing (PIH) to REAC in March 1999. Staff from REAC, along with former PIH staff in Seattle and Chicago, are now responsible for this program's functions. According to the Inspector General, prior efforts to carry out income verification activities have been fragmented, with different headquarters organizations carrying out various activities and HUD staff in two field offices providing the majority of the staff support. Of the 72 staff required for the computer matching income verification program in all three locations, 48 were on board as of April 23, 2000, and, according to REAC, this staffing is sufficient for the program's initial implementation. The majority of these 48 staff members were previously assigned to PIH and had experience with the computer matching income verification program. In addition, they have all received some training. According to HUD, Chicago and Seattle staff have received a combined total of about 5 weeks of classroom and on-the-job training in the functions that support the large-scale income verification project.
- Two monitoring initiatives that HUD officials consider important are the Compliance and Monitoring Initiative and the Quality Management Review Initiative. The Compliance and Monitoring Initiative is designed to provide extensive training to about 2,000 Public Trust Officers in the field on the new Departmental Monitoring Desk Guide. As of May 2000, training was conducted for 1,200 Public Trust Officer staff in 34 field offices covering issues such as risk assessment and monitoring activities. In January 2000, HUD launched the Quality Management Review Initiative aimed at reviewing and supporting proficiency levels for performance in field office operating functions, especially monitoring activities. HUD conducted 5 reviews covering 11 field offices in fiscal year 2000 and plans additional reviews for fiscal year 2001.

In addition, HUD contracted with the National Academy of Public Administration (NAPA) to develop a departmentwide resource management model (Resource Estimation and Allocation Process), which, according to a HUD official, was accepted by the Deputy Secretary in March 2000 and will take about 18 months to implement departmentwide. This model is designed to assess staffing needs under HUD's current organization. HUD reported that the model will be implemented in three phases. Phase 1 will cover PIH, Administration, Housing, and Community Planning and Development from August 2000 to November 2000. Phases 2 and 3 will cover the remainder of the Department and will last until November 2001.

According to a HUD official, the most significant accomplishment aimed at eliminating the material weakness related to the Department's resource management is the implementation of HUD's 2020 Management Reform Plan, which consolidated similar operations in centralized locations. This official told us that all major organizations within the Department have been restructured and realigned in conformity with the plan and are carrying out HUD's mission. HUD considers the management reform plan to be fully implemented because the organization's mission, functions, staffing, control systems, and oversight systems are in place.

An FHA official told us that the most significant accomplishment aimed at eliminating the material weakness related to FHA's staffing and resources issues is the full implementation of REAC, as well as of the Departmental Enforcement Center and the management and marketing contracts. She said that FHA's goal was to realign its resources to free staff for other functions. According to a recent report by FHA on its management reforms, FHA continued to address this material weakness through five steps related to implementing HUD's 2020 Management Reform Plan[3]. The five steps include

- reorganizing and consolidating functions by establishing specialized processing centers;
- reengineering and streamlining processes;
- increasing staff capacity by providing comprehensive training to both experienced and newly hired staff;

[3]*Building the Public Trust: A Report to Congress on FHA Management Reform* (Feb. 2000).

- increasing the use of technology by expanding the use of certain applications and developing new systems, re-engineering existing systems, and cleaning up data; and
- increasing the use of contracting to complement a smaller, highly skilled, efficient workforce.

Even though their resource management weaknesses are no longer reported as material, HUD and FHA need to complete a number of actions to resolve problems related to these weaknesses. The Inspector General noted, in its March 2000 report on HUD's fiscal year 1999 financial statements, that it is still critical for HUD to address its resource issues through the successful completion of ongoing plans. Moreover, according to the Inspector General, many of HUD's weaknesses, especially those involving the monitoring of program recipients, are exacerbated by HUD's resource management shortcomings. While HUD continues to implement significant organizational changes to overhaul and improve its operations under the 2020 Management Reform Plan, HUD's critical structural changes need to be fully implemented before the new organization can effectively address these weaknesses, according to the Inspector General. The Inspector General also identified key HUD initiatives that were delayed, and continued to report on three recommendations from a prior report[4] that were reopened because corrective actions had not been fully implemented. The key initiatives that the Inspector General reported as delayed at that time were (1) transferring the workload associated with housing assistance contracts to contract administrators; (2) using REAC's physical and financial assessments to ensure the adequacy of HUD's housing portfolio; (3) demonstrating successful efforts to streamline and outsource activities related to the management and disposition of HUD-owned single family properties and notes; and (4) staffing the newly organized income verification program and demonstrating its effectiveness in reducing overpaid assistance.

The three reopened recommendations pertain to (1) establishing a more systematic approach for determining staffing requirements; (2) holding field offices and headquarters accountable for work accomplishments in line with available resources and established standards; and (3) ensuring that once greater efficiencies are implemented, staffing standards are realigned to be consistent with the revised workload.

[4] *The Office of Inspector General's Fiscal Year 1991 Financial Statements* (92-TS-179-0011).

Similarly, the fiscal year 1999 audit report for FHA noted that although FHA is now more focused on monitoring initiatives, its staffing and administrative resource issues are not yet fully resolved, primarily because of the continued outsourcing of labor-intensive functions. Recommendations in the audit report included the need for FHA to continue to (1) train multifamily property mangers in REAC's financial assessments and release financial statement data on all multifamily properties for use in the field, (2) expand the use of loss mitigation through training and outreach programs with single-family approved lenders, and (3) develop comprehensive oversight tools and management reports to facilitate effective monitoring of the management and marketing contractors while providing practical and useful feedback to the contractors.

In our review of HUD's s new single-family management and marketing contractors, we reported that since the program started in April 1999, HUD has experienced problems, including the termination of its largest contractor.[5] Although HUD selected replacement contractors from among the remaining firms, it then had performance problems with some of them. We found, among other things, that property maintenance and security remain significant problems. While monitoring improvements have strengthened HUD's ability to detect such problems, HUD has limited tools available to enforce contractors' compliance and improve performance.

According to a HUD official, the Department is working toward resolving its staffing and administrative resource issues throughout the organization. For example, HUD addressed the Inspector General's three reopened recommendations, stating that it (1) successfully pilot-tested the Resource Estimation and Allocation Process, in conjunction with NAPA, and expects full implementation by November 2001; (2) instituted the Business and Operating Plan in fiscal year 1999, which it will further support by implementing the new Performance Accountability and Communications System and Quality Management Review Program in fiscal year 2000; and (3) will use the Resource Estimation and Allocation Process to realign staffing so that it is consistent with the revised workload, with a target date of November 2001 for the realignment.

[5] *Single-Family Housing: Stronger Measures Needed to Encourage Better Performance by Management and Marketing Contractors* (GAO/RCED-00-117, May 12, 2000).

Status of HUD's Material Internal Control Weaknesses as of May 18, 2000

This appendix summarizes the background for and our observations and analysis of the five material internal control weaknesses remaining at HUD as a result of the Inspector General's audit of HUD's fiscal year 1999 consolidated financial statements. The appendix also includes updated information HUD reported to us on its accomplishments in resolving these five weaknesses from the issuance of the Inspector General's report on March 1, 2000, through May 18, 2000, with further updates provided through October 2000, where applicable.

Material Weakness: HUD's Financial Systems Are Not Fully Compliant With Federal Financial Standards

The Problem

In its audit report on the fiscal year 1999 financial statements, HUD's Inspector General stated that the Department's core financial system did not fully comply with federal financial systems requirements because the departmental general ledger was not updated with data from FHA each month and the data entry process was not timely or efficient. In addition, the departmentwide implementation of the general ledger in fiscal year 1999 adversely affected HUD's ability to prepare auditable financial statements and related disclosures in a timely manner. These implementation problems delayed financial reconciliation processes and resulted in numerous adjustments to make HUD's general ledger balances agree with the U.S. Treasury's records.[1]

According to the Inspector General's report, HUD has not yet corrected significant financial management systems deficiencies identified in previous years. Specifically, the report notes, HUD's financial systems

[1]According to HUD's Inspector General--see *U.S. Department of Housing and Urban Development Attempt to Audit the Fiscal Year 1999 Financial Statements* (00-FO-177-003, Mar. 1, 2000)--there were 42 adjustments totaling about $17.6 billion to adjust fiscal year 1998 ending balances and 242 adjustments totaling about $59.6 billion to adjust fiscal year 1999 activity balances.

integration (FSI) project (1) has not addressed 13 FHA/Office of Housing financial systems (out of a total of 18 HUD systems) that do not conform with the Federal Managers' Financial Integrity Act's requirements and (2) still suffers from frequent changes in scope, strategy, and management. Other uncorrected deficiencies include insufficient information on individual multifamily loans (including information needed to financially monitor the insured portfolio), deficient FHA general ledger and subsidiary systems, inadequate assurance about the propriety of Section 8 rental assistance payments, lack of integration between program and accounting systems necessitating duplicate data entry, inability to support adequate funds control for FHA, and inability to fully support the timely identification of unneeded excess funds remaining on expired project-based Section 8 contracts.

Status of Corrective Actions and What Remains to Be Done

Modernizing and integrating HUD's financial management systems with an efficient, state-of-the-art system is one of the six principal management reforms set forth in HUD's 2020 Management Reform Plan. The Chief Financial Officer's (CFO) most recent corrective action plan describes financial management systems deficiencies, corrective actions taken and planned, and estimated completion dates for some actions. This plan, issued in February 2000, shows that HUD's program offices continue to work on improving and replacing deficient systems, as well as integrating their program systems with HUD's core accounting (general ledger) system to eliminate duplicate data entry and provide program and financial information to management.

Table 2 describes the major components of the CFO's February 2000 corrective action plan; HUD's accomplishments through May 18, 2000; and the work remaining, as of the same date, to complete the planned corrective actions. The Office of the CFO provided the updated information through May 18, 2000.

Table 2: Status of Corrective Actions for the 1998 Material Weakness: HUD's Financial Management Systems

Major components of the February 2000 plan	Accomplishments as of May 18, 2000	What remains to be done to complete the corrective actions as of May 18, 2000
HUD's FSI project has not addressed 13 FHA/Office of Housing financial systems (out of a total of 18 HUD systems) that do not conform with the Federal Managers' Financial Integrity Act's requirements. This weakness was again reported in the Inspector General's March 1, 2000, report on HUD's fiscal year 1999 financial statements.	In coordination with HUD's CFO, FHA has defined a corrective action plan with milestones for implementing a new subsidiary ledger system that complies with the Joint Financial Management Improvement Program's (JFMIP) requirements. FHA has also developed functional requirements for the subsidiary ledger and initiated a market survey of available system solutions.	FHA, in coordination with HUD's CFO, will have to execute its corrective action plan to conform its systems with the Federal Managers' Financial Integrity Act's requirements.
Develop and document an updated project strategy and an implementation plan for completing the FSI project. This weakness was again reported in the Inspector General's March 1, 2000, report on HUD's fiscal year 1999 financial statements.	On March 1, 2000, Arthur Anderson, LLP, completed a benefit-cost analysis for the revised 1997 FSI strategy and identified options for completing the FSI project. HUD's acting CFO redefined the objective and scope of the FSI project to provide a JFMIP-compliant core general ledger system by November 2000. Other components of the project, previously included as part of the FSI project, such as the Departmental Grants Management System and Enterprise Data Warehouse, have been removed from the project and transferred to the Chief Information Officer for completion. The CFO will continue participation to ensure compliance with requirements and integration with HUD's Central Accounting and Program System (HUDCAPS) general ledger.	Fully implement corrective action plans to bring the HUDCAPS general ledger into compliance with JFMIP's requirements and ensure that posting models are accurate and interfaces from systems providing subsidiary ledger summaries function properly.
Develop and document a plan to address how the core financial system, program accounting systems, and consolidated database will be implemented and integrated. This weakness was again reported in the Inspector General's March 1, 2000, report on HUD's fiscal year 1999 financial statements.	HUD continues to address the integration of HUDCAPS and the Program Accounting System (PAS) and is currently improving the PAS-to-HUDCAPS interface to enhance core financial system integration as required by JFMIP and the Office of Management and Budget's (OMB) Circular A-127. Other systems, such as FHA's general ledger, will also be integrated with the HUDCAPS general ledger to facilitate closings and reconciliations. The data warehouse will be used to produce financial management reports once the general ledger in HUDCAPS is stabilized.	Implement improvements to the interface and bring HUDCAPS into full compliance with JFMIP's core financial management system requirements, beginning with those requirements that have causal relationships with the material weaknesses.

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Major components of the February 2000 plan	Accomplishments as of May 18, 2000	What remains to be done to complete the corrective actions as of May 18, 2000
Control changes to the FSI project's scope, strategy, and management. This weakness was again reported in the Inspector General's March 1, 2000, report on HUD's fiscal year 1999 financial statements. The report noted that the frequent changes have made it difficult for the department to measure performance and progress, and control costs.	As noted above, Arthur Anderson, LLP, identified options for completing the FSI project. HUD's acting CFO substantially reduced the scope and revised the strategy and management of the FSI project. The project is expected to be completed by November 2000.	As noted, HUD will have to fully implement corrective action plans to bring the HUDCAPS general ledger into compliance with JFMIP's requirements and ensure that posting models are accurate and interfaces with subsidiary ledger systems function properly.
Develop performance management reports for individual tasks to better monitor and control the FSI project. This weakness was no longer discussed in the Inspector General's March 1, 2000, report on HUD's fiscal year 1999 financial statements.	HUD developed a comprehensive project plan that included schedules, procedures, and cost-tracking tools to assess the progress of the project. In fiscal year 1999, analyses were performed for each project task, and earned value reports have been prepared since the first quarter of that year.	No further action required.
Develop information systems capability to provide sufficient information on individual multifamily loans. The lack of information makes assessing and quantifying credit risk difficult and adversely affects efficient, ongoing reporting of credit risk to senior management and effective monitoring of multifamily properties. This weakness was again reported in the Inspector General's March 1, 2000, report on HUD's fiscal year 1999 financial statements.	HUD implemented software releases for the Real Estate Management System, Financial Assessment Subsystem, and Multifamily Development Application Processing System, and implemented the Housing Enterprise Real Estate Management System database and the Multifamily Delinquency and Default System. Systems have been implemented to address all the deficiencies cited with the exception of the need to develop an accurate database for evaluating Section 8 project-based obligations. This was classified as a reportable condition in the Inspector General's March 1, 2000, audit report. A corrective action plan has been developed to address this remaining deficiency.	Implement the corrective action plan to develop an accurate database for evaluating Section 8 project-based obligations.

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Major components of the February 2000 plan	Accomplishments as of May 18, 2000	What remains to be done to complete the corrective actions as of May 18, 2000
Develop information systems capability to correct deficient FHA general ledger and subsidiary systems that impede better case-level reporting, budgetary accounting, and compliance with credit reform legislation. This weakness was no longer discussed in the Inspector General's March 1, 2000, report on HUD's fiscal year 1999 financial statements.	FHA addressed the fiscal year 1997 financial statement audit qualification on the need to comply with Statement of Federal Financial Accounting Standards (SFFAS) No. 2, Accounting for Direct Loans and Loan Guarantees. In fiscal year 1999, HUD implemented the Single Family Premium Collection Subsystem-Periodic to address noncompliance with credit reform legislation. HUD also implemented a consolidated departmentwide general ledger. FHA has developed functional requirements for the subsidiary ledger, which, according to HUD's CFO, address case-level reporting, single general ledger requirements, and compliance with credit reform legislation.	No further action required.
Develop information systems capability to provide adequate assurance about the propriety of Section 8 rental assistance payments. This weakness was again reported in the Inspector General's March 1, 2000, report on HUD's fiscal year 1999 financial statements. The report stated that HUD's control structure does not provide reasonable assurance that subsidies paid under these programs are valid and correctly calculated considering tenant income and contract rents.	Release 1 of the Tenant Assessment Subsystem was implemented in November 1999 and provides the ability to conduct large-scale computer matching of income and federal tax data, follow-up, resolution of identified discrepancies, and recovery of funds.	Release 2 of the Tenant Assessment Subsystem is expected to be implemented in July 2000 to provide additional functionality.[a]

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Major components of the February 2000 plan	Accomplishments as of May 18, 2000	What remains to be done to complete the corrective actions as of May 18, 2000
Develop information systems capability to provide complete information on FHA's operations by program, geographical area, or other relevant components. This weakness was no longer discussed in the Inspector General's March 1, 2000, report on HUD's fiscal year 1999 financial statements.	The Real Estate Management System was enhanced to provide capability for integrating data from a variety of systems and provide complete information to project managers for effective monitoring and risk management of their portfolios. Twenty-nine standard reports were implemented nationwide for property- and portfolio-level reporting. Multiple data elements can be used as selection criteria for each report. Selection criteria include program categories (e.g., section of act, client group), geographic location (e.g., field office, city, state, zip code, census tract), and other significant data (e.g., property status, Section 8 contract number, FHA number, financing type, owner/management agent). Since the implementation of the Single-Family Data Warehouse in fiscal years 1996-97, FHA has had an integrated single-family database. This warehouse is a repository/history of all single-family records and contains various geographic indicators, as well as program and subprogram identifiers. Data extracts of both single-family and multifamily records containing program, geographic, and many other data elements now make a key contribution to HUD's systems integration by feeding to the departmental Empowerment Information System, one of HUD's 2020 management initiatives.	No further action required.
Develop information systems capability to blend financial and program data to develop meaningful performance measures. This weakness was no longer discussed in the Inspector General's March 1, 2000, report on HUD's fiscal year 1999 financial statements.	HUD continues to improve the scope and quality of the performance measures it develops under the Government Performance and Results Act of 1993.	No further actions were listed in the February 2000 corrective action plan, and HUD provided no updates.

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Major components of the February 2000 plan	Accomplishments as of May 18, 2000	What remains to be done to complete the corrective actions as of May 18, 2000
Develop information systems capability to provide integration between program and accounting systems to avoid duplicate data entry. This weakness was again reported in the Inspector General's March 1, 2000, report on HUD's fiscal year 1999 financial statements.	HUD implemented the prototype of the Enterprise Information System and data warehouse using selected Community 2020 and financial data. A data interface was established with the HUD Geographic Information System to use the consolidated data.	No further actions were listed in the February 2000 corrective action plan, and HUD provided no updates.
Correct security weaknesses in general and specific application controls. This weakness was again reported in the Inspector General's March 1, 2000, report on HUD's fiscal year 1999 financial statements. The report acknowledged some improvements but stated that progress in improving computer security controls has been slow.	HUD continued action to strengthen computer security controls to address the Inspector General's remaining audit recommendations.	Implement actions to address the Inspector General's remaining audit recommendations[b]

[a]In its July 13, 2000, comments on this report, HUD stated that release 2 of the Tenant Assessment Subsystem was implemented in June 2000 to provide additional functionality.

[b]In its July 13, 2000, comments on this report, HUD stated that its corrective actions include establishing configuration management for all critical systems by December 31, 2000, and for all systems by September 30, 2001; implementing a network monitoring tool by August 31, 2000; completing business resumption plans for all field locations by August 31, 2000; and strengthening personnel security policies and practices.

Source: GAO's presentation of information provided by HUD.

HUD completed a number of corrective actions from March 1999 through May 2000 to address the material weaknesses. According to CFO officials, the most significant financial management systems accomplishments since the issuance of the Inspector General's audit report on HUD's fiscal year 1998 financial statements are the following:

- HUD completed the implementation of HUDCAPS as the departmentwide general ledger and budget execution system.
- HUD completed initial releases of some key systems related to multifamily loans. This action includes implementing software releases for the Real Estate Management System (REMS) and the Multifamily Development Application Processing System and implementing the Housing Enterprise Real Estate Management System (HEREMS) database and the Financial Assessment Subsystem. According to CFO

officials, these actions start to address the insufficiency of information for quantifying credit risk and establish a basis for the effective monitoring of multifamily projects.

- HUD implemented computer-matching enhancements that enable it to (1) conduct large-scale federal tax data computer matching and (2) identify, track, and follow up on discrepancies when investigating tenant eligibility. This capability will strengthen assurances that Section 8 and public housing tenants receive appropriate levels of rental assistance, according to CFO officials.
- HUD updated the benefit-cost analysis for the FSI effort and narrowed the scope of the effort to provide a JFMIP-compliant core general ledger system by November 2000.
- HUD standardized financial management system data elements and has efforts under way to clean up financial data.
- HUD implemented the prototype of the Empowerment Information System and data warehouse using selected Community 2020 and financial data.

In addition to these accomplishments, CFO officials stated that HUD has begun to address the problem of incomplete information for identifying FHA's operations by program and geographical area, has established a structure to address the lack of integration between program and accounting systems that necessitates duplicate data entry, and has developed procedures to request changes to HUDCAPS software. The officials also said HUD is meeting concerns about its inability to blend financial and program data to develop meaningful performance measures by continuing to improve the scope and quality of its compliance with the Government Performance and Results Act, addressing security weaknesses in general and specific application controls, and improving the management of the FSI project.

HUD's Office of Inspector General recognized the Department's efforts to improve financial management systems in its audit report on the fiscal year 1999 financial statements. However, the material weakness remains because HUD's core financial system does not fully comply with federal financial systems requirements and HUD has not yet corrected significant financial management systems deficiencies that were identified in previous years.

Plans to Address Weaknesses Identified in the Fiscal Year 1999 Report

The Office of Inspector General's March 1, 2000, audit report on HUD's fiscal year 1999 financial statements identified new and restated existing deficiencies. These issues were not addressed in HUD's latest corrective action plan because the Inspector General's report was issued after the February 2000 corrective action plan. However, the CFO provided information on HUD's efforts to address these issues.

Table 3 describes the new or restated financial management system deficiencies, corrective actions taken and planned by the CFO, and work remaining to complete the planned actions.

Table 3: Plans to Address Fiscal Year 1999 Material Weakness: HUD's Financial Management Systems

Fiscal year 1999 issues	Actions taken or planned as of May 18, 2000	What remains to be done to complete the corrective actions as of May 18, 2000
HUD's core financial system does not fully comply with federal financial systems requirements. This is not an entirely new issue. Even though an unqualified opinion was rendered on HUD's fiscal year 1998 financial statements, it was noted that FHA's general ledger was not fully compliant with federal standard general ledger (SGL) requirements. This material weakness addresses several issues, including numerous rejections or incorrect transaction postings, adjustments bypassing the normal general ledger posting process, and delays in reconciling fund balances with the U.S. Treasury's accounts.	The CFO reported taking the following actions. HUD —reduced the number of rejected Program Accounting System documents from 11,777 in January 2000 to 124 in March 2000. —initiated a study to improve procedures for posting corrective adjustments during the year and making and documenting adjustments during financial statement preparation. The study was expected to be completed by the end of June 2000.[a] —completed the fiscal year 1999 fund balance reconciliation and expected to complete the reconciliation of all the fund balances through the first two quarters of fiscal year 2000 by the end of June 2000.[b] —initiated a study to improve the procedures for reconciling the fund balance with U.S. Treasury. The study was expected to be completed by mid-June 2000.[a]	Complete the fund balance reconciliation for the first two quarters of fiscal year 2000 by June 30, 2000, reconcile the third quarter by the end of July 2000, and perform timely monthly reconciliations of the fund balance with the Treasury, thereafter[b]. Consider recommendations from the comprehensive study of posting and adjustments processes, which is to be completed in June 2000, and implement recommendations, as appropriate.[a]

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Fiscal year 1999 issues	Actions taken or planned as of May 18, 2000	What remains to be done to complete the corrective actions as of May 18, 2000
Inability to support adequate funds control for FHA.	FHA is developing an automated funds control process, including detailed instructions and process maps, to prevent an overexpenditure or overobligation of an apportionment. As an immediate measure, FHA is working with HUD staff to incorporate summary-level obligation and disbursement data into HUDCAPS on a daily basis.	In the long term, FHA plans to implement a new subsidiary ledger that will provide for proprietary and budgetary accounting, thereby fully meeting funds control requirements for FHA.
Inability to fully support the timely identification of unneeded excess funds remaining on expired project-based Section 8 contracts.	Housing is planning to implement an improved automated recapture process. It is expected to be implemented by January 2001.	Execute the plan to implement an automated recapture process.

[a]HUD officials reported to us that as of October 2000 these studies had been completed and corrective action initiated.

[b]HUD officials reported to us that the first three quarters of fiscal year 2000 reconciliations had been completed as of October 2000.

Source: GAO's presentation of information provided by HUD.

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

The Problem

In the audit report on HUD's fiscal year 1999 financial statements, HUD's Inspector General reported that HUD's internal control structure did not provide reasonable assurance that subsidies paid under its major rental assistance programs were valid and correctly calculated considering tenant incomes and contract rents. As a result, HUD could not ensure that federally subsidized housing units were occupied by eligible families and that those families were paying the correct rents.

In fiscal year 1999, HUD estimated, on the basis of a statistical sample, that tenants failed to report more than $3.5 billion of income and that, as a result HUD paid approximately $935 million in excess rental subsidies.[2] Although HUD requires housing authorities and property owners/program administrators (PA) to verify reported sources of applicant and tenant income with third parties, these controls do not adequately prevent or detect cases of unreported income. This condition has been reported since fiscal year 1991, when the first financial statement audits were performed under the Chief Financial Officer's Act of 1990.[3]

In fiscal year 1999, HUD spent about $18.6 billion on rent and operating subsidies that benefited over 4 million lower-income households through a variety of programs. HUD's principal rental assistance programs are its Section 8 and public housing programs. These programs help eligible low-income families obtain decent, safe, and sanitary housing by paying a portion of the rent. Tenants' self-reported income is a major factor affecting eligibility for housing assistance; the amount of assistance a household receives; and, indirectly, the amount of subsidy HUD pays. Generally, HUD pays the difference between 30 percent of a household's adjusted income and the housing unit's actual rent. When tenants do not report or underreport income and this reporting problem is not detected, HUD can make excessive subsidy payments.

HUD began estimating for financial reporting purposes the extent of its excess subsidy payments in fiscal year 1996. Annually, HUD selects a statistical sample of tenants and matches income data obtained from the Internal Revenue Service (IRS) and the Social Security Administration (SSA) to tenant-certified information captured in its tenant databases. HUD staff investigate each income discrepancy that exceeds an established threshold to determine the reasons for differences in the amounts and whether such differences contributed to the payment of excess subsidies. Table 4 shows the amount of estimated overpayments that have occurred by year in relation to program expenditures since HUD began estimating the extent of its excess subsidy payments.

[2]For the financial statement audits, HUD calculates the excess subsidy amount on the basis of an analysis of the incomes of assisted households that received rental assistance during the prior calendar year, which is the most recent year for which data are available for computer matching purposes.

[3]HUD has reported this issue as a material weakness in its annual Federal Managers' Financial Integrity Act report since fiscal year 1996.

Table 4: Estimated Excess Subsidy Payments, Fiscal Years 1996-99

Dollars in millions

Fiscal year reported[a]	Estimated excess subsidy payments	Program expenditures	Percentage of excess subsidies
1996	$538[b]	$19,257	2.8%
1997	$804	$18,069	4.4%
1998	$857	$18,600	4.6%
1999	$935[c]	$18,606	5.0%

[a]The estimated excess subsidy payments are reported in footnotes to HUD's annual financial statements for HUD fiscal years ending September 30 of each year; however, the estimates are computed from data for the preceding calendar year.

[b]HUD's Inspector General concluded, in the audit of HUD's fiscal year 1996 financial statements (97-FO-177-0003), that HUD's $538 million estimate of excess subsidies was understated because HUD did not include Supplemental Security Income in the computer matching. In addition, the Inspector General expressed concerns about the completeness of HUD's tenant databases. HUD reported to us that subsequent analysis shows that underreported SSI income has a nominal effect on the estimate of excess subsidies.

[c]Although HUD's Inspector General disclaimed an opinion on HUD's fiscal year 1999 financial statements (00-FO-177-0003), the reasons for the disclaimer did not relate to HUD's estimate of its excess subsidy payments.

Status of Corrective Actions and What Remains to Be Done

HUD is currently engaged using calendar year 1998 data in a large-scale computer matching and income verification program aimed at detecting and deterring future abuses of its rental assistance programs by tenants who do not fully report their income. HUD is also determining whether some tenants may have overpaid rents. However, at this time, we believe it is too soon to tell whether HUD's program will fully resolve this material weakness or whether HUD will need to pursue additional measures to eliminate this weakness.

HUD began laying the groundwork for its current large-scale computer matching and income verification program in May 1998 when its CFO unveiled a multifaceted corrective action plan. The plan included steps to (1) continue and expand HUD's income-matching programs, (2) strengthen recertification policies and procedures, (3) expand computer matching with SSA, (4) ensure that HUD's information systems contain complete and accurate tenant data, (5) institute penalties for overpayments of rental assistance, and (6) perform monitoring and oversight functions.

The plan broke these broad objectives down into detailed tasks with associated milestone dates and identified the organizational units responsible for the various tasks. Some of the tasks in the plan were aimed at addressing specific recommendations by the Inspector General relating to this issue, whereas other tasks focused more on long-term refinements to the income verification process.

To implement this plan, HUD formed the Income Verification Task Force and placed it under the direction of the CFO. The task force included staff from PIH, Housing, the offices of the CFO and General Counsel, and REAC. PIH and Housing carried out various income-matching projects to test a variety of income-matching methodologies while setting housing policy, including initial eligibility criteria, recertification policies, and enforcement measures. PIH, Housing, and REAC focused on improving HUD's monitoring of PAs. PIH and Housing were also responsible for ensuring that their respective tenant databases contained complete and accurate information so as to facilitate HUD's computer matching projects.

In January 1999, senior HUD managers from Housing, PIH, REAC, and the CFO's office met and discussed the task force's progress and additional actions needed to remedy this material weakness. Building on the efforts and improvements made by the task force, the group decided that it was both feasible and necessary for HUD to immediately embark on a large-scale computer matching and income verification program.

In February 1999, HUD's CFO recommended to Secretary Andrew Cuomo that he approve plans to implement the large-scale matching program and that the responsibility for this program be transferred from the CFO's office to REAC. In March 1999, these recommendations were approved, and REAC assumed the lead responsibility for addressing this material weakness. PIH and Housing retained their responsibilities for establishing and enforcing housing policy, and, along with representatives of the CFO's office, were to coordinate with REAC.

When REAC assumed the lead for this weakness, the CFO's office stopped tracking the status of the uncompleted segments of its action plan because it no longer had responsibility for the plan. However, according to HUD program officials, work continues to this day on certain components of that plan. Since March 1999, REAC has devoted many of its resources toward implementing the large-scale matching effort. REAC has developed a detailed plan and time line for completing the effort but to date has not kept pace with its original schedule. HUD's Inspector General reported that, as of March 1, 2000, REAC was already more than 4 months behind schedule with this project. Further delays have since occurred, primarily because of concerns raised by tenant and industry groups about the tone of HUD's income discrepancy letters. HUD redrafted these letters but as of May 31, 2000, had not mailed most of them.[4] HUD initially planned to mail the letters in October 1999. Additionally, to address other tenant and industry concerns, REAC has expanded the scope of its large-scale matching effort to examine instances of tenants' overreporting their income and, as a result, paying more rent than would be required. REAC officials told us that they expect the entire income-matching and verification program, including the expansions, to be implemented in calendar year 2000.

Table 5 summarizes the key actions completed through May 2000 under both the action plan developed by the CFO before the verification program was transferred to REAC and the current action plan being implemented by REAC. The table also lists key actions that remain to be completed and that, according to HUD, the Department still intends to pursue. Bolded sections of the table represent actions responding to recommendations made by HUD's Inspector General since fiscal year 1996.

[4]According to HUD, 211,000 letters had been mailed to tenants as of October 2000, or substantially all of the tenants HUD plans to contact.

Table 5: Status of Corrective Actions for the 1998 Material Weakness: Tenant Income Verification

Major corrective actions[a]	Completed actions	Planned actions that have not been completed
Income verification actions	**HUD completed or substantially completed work on several smaller-scale income-matching projects aimed at testing various income-matching methodologies.** REAC implemented computer matching to compare Social Security (SS) and Supplemental Security Income (SSI) records with HUD's tenant income records for Housing's rental assistance programs. By September 1999, HUD had established a secure Internet facility that provides direct delivery of the SS and SSI data to the end user. HUD continued SS and SSI matching for PIH rental assistance programs. Currently over 3,000 housing authorities receive SS and SSI data via the Internet, and others obtain the data through the mail before annual tenant recertifications. **REAC has been established as the entity responsible for HUD's income-matching program.** **HUD finished staffing the income verification function at headquarters and in the field.** HUD developed the Tenant Assessment Subsystem to enhance the Department's federal tax data computer matching capabilities. **REAC matched data for tenants nationwide, identifying approximately 280,000 potential cases of unreported income exceeding established thresholds.**[c]	**Issue final reports on prior years' income-matching projects.** Complete the mailing of the income discrepancy letters to tenants and PAs.[b] Complete the analysis and report on the results of the large-scale matching effort. Continue to pursue legislation to permit the redisclosure of income-matching results to program administrators. Implement a process to match SS and SSI benefits for newly approved tenants within 48 hours of certification.

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Major corrective actions[a]	Completed actions	Planned actions that have not been completed
Supporting actions	PIH and Housing agreed on a standard policy for when tenants must report increases in their incomes. However, the passage of the Quality Housing and Work Responsibility Act (QHWRA)[d] has precluded the implementation of this policy. **HUD significantly increased the rates of reporting to its Multifamily Tenant Characteristic System (MTCS) by (1) correcting software problems that hampered timely reporting by housing authorities and (2) increasing its monitoring of housing authorities' reporting.** **HUD established administrative sanctions for those who fail to report tenant data through MTCS and the Tenant Rental Assistance Certification System (TRACS).** HUD drafted a rule outlining penalties and enforcement measures but never issued a final rule because of inconsistencies with the newly enacted QHWRA. HUD obtained legislation that requires tenants to disclose to PAs any income discrepancy letter received from HUD. REAC established a Quality Assurance Team to review the adequacy of the independent public accountant's audits required by the Single Audit Act.[e] REAC completed guidance for auditors to use during field reviews of income discrepancy-resolution activities.	Study the long-term redesign of income-reporting requirements. Continue to monitor reporting rates in for MTCS and TRACS and enforce administrative sanctions as needed. Finalize and publish a rule on penalties in the Federal Register. **Complete hiring and training of REAC auditors who will visit and assess PAs' income verification efforts.** Improve monitoring of current contract administrators. Complete the transfer of monitoring responsibilities for Section 8 properties to contract administrators. Complete PIH-sponsored training planned for the 4th quarter of fiscal year 2000 of public housing authorities (PHA), resident leaders, and HUD field staff on the implementation of QHWRA, including modules devoted to income verification, tenant and PHA income verification responsibilities, and best practices

[a]These actions include significant efforts from both the CFO's action plan and HUD's current action plan being implemented by REAC.

[b]HUD officials reported to us that as of October 2000 tenant mailings had been completed.

[c]According to HUD, REAC subsequently reduced to 215,000 the number of tenants to be sent letters, primarily by eliminating the tenants who no longer receive rental assistance.

[d]QHWRA policies generally took effect on October 1, 1999, and, among other things, provided housing authorities with significant flexibility in setting housing policy. However, according to HUD, some QHWRA provisions, such as minimum rent, were in effect on the date QHWRA was signed—October 21, 1998.

[e]Single audits are performed annually for entities meeting certain criteria. These audits examine, among other things, the entities' compliance with programs' established eligibility policies and procedures.

Source: GAO's presentation of information provided by HUD.

HUD's large-scale computer matching and income verification program is much broader in scope than any prior income-matching project. According to REAC officials, approximately 2.4 million households, or about 60 percent of all HUD's assisted households, are included in this program.[5] Prior income-matching efforts have either been conducted on a sample basis or been limited to specific housing authorities or properties. HUD officials said they believe the broad scope of this program, coupled with penalties for failing to fully report incomes, will ultimately have a significant deterrent effect on tenants who may be inclined to underreport their incomes.

REAC has completed its large-scale computer matching of calendar year 1998 tenant income data with federal tax information maintained by IRS and SSA. Through this effort, it initially identified about 280,000 cases in which income discrepancies exceeded established thresholds. Subsequently, the number of tenants to be sent discrepancy letters was reduced to 215,000, primarily by eliminating tenants who no longer receive rental assistance. According to HUD, it had sent letters to about 72,500 tenants as of June 30, 2000, and had temporarily suspended further mailings until it could resolve further concerns raised by tenant groups and industry.[6] Upon receiving these notices, tenants are required by law to contact their PAs to resolve the identified discrepancies or face the possibility of losing their housing assistance. As discrepancies are resolved, REAC requires the PAs to report to HUD via the Internet how each case was resolved, including whether it was determined that HUD had paid excess subsidies and what actions were being taken to collect these overpayments. As an additional quality control measure, REAC plans to recruit auditors who will visit various PAs to ensure that they have complied with HUD's guidelines for resolving income discrepancies.

While we support HUD's large-scale matching program, it is too soon to tell if this process will ultimately resolve this material weakness. Currently, a significant amount of work remains to be done. One of the most critical steps is to analyze PQA discrepancy resolution past reports. It remains to be seen whether the deterrent effect HUD anticipates will materialize and

[5]REAC purposely excluded certain households from the large-scale match in order to minimize the number of false positive computer matching results--i.e., indicators of unreported income that, when analyzed, do not identify actual abuses.

[6]HUD reported to us that as of October 2000 it had send letters to 211,000 tenants or substantially all of the tenants it plans to contact.

whether the PAs will cooperate with HUD or have the resources to pursue and resolve the income discrepancies.

Another concern we have is that additional measures may ultimately be needed to resolve this weakness. Many of HUD's efforts so far, including the large-scale computer matching, have been geared toward detecting abuses after HUD has provided benefits rather than preventing applicants or tenants from receiving initial or continued assistance. As prior HUD income-matching studies have shown, once benefits have been paid, there is little chance of ever fully recovering these amounts. However, efforts to improve controls at the front end face significant legal and practical limitations, such as privacy constraints, complex program requirements, and the large number (more than 20,000) of local rental assistance program administrators.

HUD recognizes that to prevent tenants from not reporting or underreporting income, the ideal solution would be an on-line automated process that would verify a tenant's income before the tenant is admitted to a rental assistance program or is recertified[7] to receive further assistance. However, as a practical matter, HUD officials believe such a system is not likely to be implemented anytime soon, given current legislative protections of the personal privacy of housing assistance recipients.[8] For example, current legislation prohibits HUD from disclosing IRS income data directly to the PAs responsible for performing income verifications. Similarly, current law denies HUD access to the National Directory of New Hires database, a central federal repository of quarterly state wage, unemployment, and new hires data that could be used to help HUD avoid making improper payments. In its July 13, 2000, comments on this report, HUD stated that it has sent letters to all governors encouraging the exchange of state wage data between state agencies and public housing authorities to improve up-front verification. HUD also stated that it is planning to develop a best practices guide on the most effective and viable state income verification programs.

[7]Recertification is the process tenants go through to report changes that would affect their continued eligibility for a housing program as well as to adjust the amount of rent they pay. Typically, recertifications are performed annually except that QHWRA now allows housing authorities to recertify the incomes of **households selecting flat rents** every 3 years. Interim recertifications may also be required under certain conditions.

[8]We are currently performing a separate study on data sharing across the federal government that focuses on, among other programs, HUD's public housing and tenant-based Section 8 programs.

HUD has implemented, within current legislative constraints, an up-front income verification process to be used during tenant recertifications. Each month, HUD matches a list of tenants scheduled to be recertified within the next 3 to 4 months to SS and SSI income data maintained by SSA. HUD then makes this information available to the PAs via a secure Internet facility or through the U.S. mail. PAs can compare the data with the SS and SSI benefits that the tenants report at their upcoming recertification.

While this process is a good first step toward improving controls at the front end, HUD recognizes that SS and SSI benefits are not the major source of total household income. HUD's analysis of the estimated $538 million in excess subsidy payments reported in fiscal year 1996 indicated that just 6 percent of the estimated overpayments were attributable to unreported SS and SSI benefits. REAC officials acknowledge that earned income (i.e., wages and salaries from employment) constitutes the majority of the total tenant income and is therefore the key source of under- or unreported income. In its July 13, 2000, comments on this report, HUD stated that REAC would examine other alternative sources for wage data as they become legally available and practical to use.

Material Weakness: Improvements Needed in Multifamily Project Monitoring

The Problem

Since 1991, HUD's Inspector General has reported that HUD's monitoring of multifamily properties was a material internal control weakness. In its March 2000 report on HUD's fiscal year 1999 financial statements, the Inspector General concluded that because of this weakness, the Department cannot be sure that the funds it expends to support multifamily grant and subsidy programs are consistent with the laws and regulations authorizing them and are provided only to eligible tenants for allowed activities.

Specifically, the Inspector General found that (1) REAC had problems implementing electronic submissions of annual financial statements from owners of multifamily properties; (2) the documentation of criteria for goals and requirements for monitoring the multifamily portfolio was often

outdated, incomplete, inconsistent, or absent; (3) HUD field offices performed far fewer management and occupancy reviews of troubled and potentially troubled properties than HUD policy requires; and (4) the field offices visited during the audit did not review Section 8 contract administrators (contractors that administer Section 8 housing assistance payments contracts for HUD) in their jurisdictions.

HUD provides rental assistance to about 21,000 multifamily property owners who, in turn, provide housing assistance to benefit primarily low-income households. This assistance includes FHA mortgage insurance and funds under several subsidy programs to benefit low-income households and the elderly and disabled.[9]

Status of Corrective Actions and What Remains to Be Done

To effectively monitor the multifamily portfolio, Housing's corrective action plan encompasses management strategies and corrective actions linked to HUD's 2020 Management Reform Plan and to the Inspector General audit recommendations. As of May 2000, HUD had completed a number of the planned multifamily tasks, some were in progress, and some were in the development phase. Estimated time frames to complete individual corrective actions under the plan range from fiscal year 1998 through late fiscal year 2001, with several actions continuing during and beyond fiscal year 2001. According to a Housing official, the multifamily monitoring action plan is aimed at improving internal controls because it addresses and increases accountability by making certain individuals and entities responsible for monitoring the multifamily portfolio. In its July 13, 2000, comments on this report, HUD stated that it does not agree with the Inspector General that the multifamily project monitoring issue should remain a material internal control weakness.

Table 6 describes the major components of HUD's most recent (Feb. 2000) corrective action plan, HUD's accomplishments as of May 2000, and the planned actions remaining to be completed. Some of the accomplishments and remaining actions stem from updated information HUD provided in May 2000.

[9]In its audit of HUD's fiscal year 1998 financial statements, the Inspector General reported that for the fiscal year ending September 30, 1998, HUD provided approximately $9.1 billion in subsidies and grants for these programs.

Table 6: Status of Corrective Actions for the 1998 Material Weakness: Multifamily Project Monitoring

Major components of the February 2000 plan	Accomplishments as of May 2000	What remains to be done to complete the corrective actions
Implement specialized centers—REAC to enhance capacity to improve property monitoring and the Departmental Enforcement Center to centralize and improve enforcement activities on the most troubled properties.	Both centers were completed in fiscal year 1999. REAC has completed 98 percent of the physical inspections of properties. REAC has received 84 percent of the financial statements from properties that are required to submit them and has reviewed and released nearly all of them. Follow-up letters have been sent for late submissions. The Departmental Enforcement Center is reviewing troubled properties for enforcement action.	Continue to follow up on the remaining 16 percent of properties that did not submit financial statements, determine if they are overdue or if the Real Estate Management System (REMS) database is not reflecting a legitimate waiver, and take appropriate action.
Establish senior project manager positions.	A total of 106 senior project managers have been selected, received training, and are located in field offices.	Completed.
Award third-party contracts for Section 8 administrators and hire a contractor to devise a plan for HUD staff to oversee them.	HUD issued a request for proposal for third-party Section 8 contract administrators and awarded 24 contracts; completed and implemented the monitoring and oversight strategy; created a new Office of Subsidy Contract Administration for Multifamily Housing; and is currently hiring more staff in headquarters and the field to support this effort.[a]	Award the remaining Section 8 third-party contracts and have the contractors on board and fully functional.
Increase efforts to conduct management and occupancy reviews of troubled and potentially troubled properties, including those with health and safety issues identified by REAC, occupancy responsibilities, and other address concerns, such as poor financial histories or a lack of information on the physical condition of properties whose inspections were delayed pending the establishment of REAC.	Although HUD does not agree that increased efforts are needed to conduct management and occupancy reviews[a], several steps have been taken, including completing assessments of most of the financial statements that have been submitted; recording performance /compliance actions in REMS; putting community builders in place to provide insight on the issue; and awarding Section 8 third-party contracts.	This process will be ongoing.
Develop a comprehensive strategic plan and monitoring goal for fiscal year 2000 that includes using REAC's data to target properties for monitoring and corrective action and completing data verification in REMS.	REAC's physical inspection and financial assessment data are nearly complete and are being delivered. Property managers have been trained and are being monitored to ensure that corrective actions occur. REMS is being updated on an ongoing basis to verify data accuracy.	This process will be ongoing.

(Continued From Previous Page)

Major components of the February 2000 plan	Accomplishments as of May 2000	What remains to be done to complete the corrective actions
For fiscal year 1999, develop controls to follow up on critical findings in the fiscal year 1998 audit when monitoring is conducted by contract administrators; establish the capability for field offices to monitor contract administrators; and determine what controls and tasks should be included in the contract for oversight of contract administrators.	Field offices are taking corrective actions on deficiencies identified during REAC's inspections and are monitoring contract administrators via the development and implementation of the Section 8 oversight and monitoring strategy and the creation of the Office of Subsidy Contract Administration for Multifamily Housing. Controls and tasks included in the Section 8 request for proposal were discussed beforehand with OMB and the Inspector General and were included in the request for proposal.	This process will be ongoing.
Establish the capacity to issue and maintain program and procedural guidance for all criteria, including handbooks, directives, guidance, and policy statements.	Responsibility was delegated to HUD's Office of Business Products. Discussions with industry groups and HUD staff are ongoing. HUD plans to award a contract for technical services to support this effort.	HUD estimates it will develop a plan by March 2000 and procure a contractor to provide technical assistance and complete all guidance by September 2001.[b]
Set goals in the Management Plan to monitor contract administrators and perform timely analyses of annual financial statements.	Training in compliance and monitoring is being provided to 100 percent of the multifamily staff in field offices.	Setting goals for monitoring contract administrators is expected to be an objective of the fiscal year 2001 Business and Operating Plan goals process. The estimated completion date for finalizing these goals is November 2000.

[a]In its July 13, 2000, comments on this report, HUD stated that it had conducted about 2,000 management and occupancy reviews from the beginning of fiscal year 2000 through June 2000, a 10-fold increase in the number of such reviews conducted in fiscal year 1999. HUD reported to us that as of October 2000 it had awarded 37 contracts to administer Section 8 contracts.

[b]HUD officials reported to us in October 2000 that this plan has been altered. However, a contracted resource is still planned to be procured to supplement Housing's in-house capacity.

Source: GAO's presentation of information provided by HUD.

The two major multifamily property monitoring tools contained in the action plan are (1) establishing REAC and the associated Departmental Enforcement Center and (2) obtaining third-party Section 8 contract administrators. HUD established REAC and the Enforcement Center to consolidate functions previously performed by individual field offices and to support the effective monitoring of its multifamily portfolio. For each multifamily property, REAC provides the appropriate field staff with physical inspection and financial assessment data derived from a centralized location using a standardized format. The Enforcement Center focuses on enforcement activities related to the most troubled properties identified by the physical inspections and financial assessments. Obtaining third-party Section 8 contract administrators to administer housing assistance payments contracts for HUD is aimed at freeing HUD field office

staff so they can perform other functions related to overseeing and monitoring the contract administrators' performance.

As of May 2000, HUD had completed a number of the multifamily planned tasks relating primarily to monitoring activities by REAC, awarding some contracts for Section 8 contract administrators, and procuring a contractor to help develop a plan for the monitoring and evaluation of these contract administrators. According to a Housing official, the most significant accomplishments to date, aimed at addressing this material weakness, are

- implementing in fiscal year 1999 the specialized centers to ensure that housing quality standards are being met and to improve asset management activities to minimize risks and losses in HUD's multifamily portfolio,
- implementing REMS, an integrated system that comprises all of the business activity related to multifamily asset management on an ongoing basis to assist field staff in managing the portfolio, and
- announcing in fiscal year 1999 a request for proposal for contract administrators to perform processing and oversight of Section 8 contracts.

Other monitoring improvements that HUD officials consider notable include the implementation and enhancement of two electronic data systems. The Multifamily Delinquency and Default Reporting System was implemented in fiscal year 1999 to shorten the time it takes for HUD staff to identify mortgage payment problems and take immediate remedial actions, if possible. In addition, HUD is enhancing the Active Program Participant System, which is expected to allow multifamily staff to review and approve requests for participation in multifamily housing programs.

As of February 2000, HUD had begun but not completed several tasks in its corrective action plan for monitoring multifamily properties. These tasks relate to (1) correcting the deficiencies identified at individual multifamily properties through REAC's physical inspections and review of annual financial statements, (2) continuing to verify the accuracy of REMS data; (3) monitoring multifamily property mangers to ensure they are correcting the deficiencies identified by REAC, (4) establishing working relationships among HUD's multifamily housing program unit and other HUD program units to achieve a continuous flow of information and guidance to field staff and program participants, (5) discussing new procedures and guidance with industry groups and HUD field staff, and (6) awarding the remaining contracts for Section 8 contract administrators.

Still under development is the establishment of a team to update and revise all criteria, such as handbooks, directives, guidance, and policy statements. This task is not scheduled for completion until 2001. Another outstanding task, which does not yet have an estimated completion date, is to develop a strategy to assess the performance of state housing finance agencies.

In May 2000, HUD provided us with updated information on its accomplishments and plans to continue addressing this material weakness:

While acknowledging the need to update its formal handbooks and guidance and recognizing that this task is a high priority for Housing, HUD reported that it has continually provided pertinent, timely guidance for property-monitoring activities since 1998. Examples include incremental guidance and instruction materials, such as a management review policy, REAC's physical inspections and financial assessments, REMS, and the Business and Operating Plan goals.

Although Housing recognized the importance of reviewing properties and resolving problems, it disagreed with the Inspector General's recent recommendation that it increase efforts to conduct management and occupancy reviews of multifamily properties. HUD's policy changed in 1998 when REAC and REMS were created under HUD's 2020 Management Reform Plan. HUD's current policy is to undertake management and occupancy reviews only when they would generate information that cannot be obtained from other sources, such as REAC's physical inspections and financial assessments, the Departmental Enforcement Center, other HUD program offices, local governments and local housing industry representatives, and reviews and reports by HUD's Inspector General and GAO. According to Housing, it has instituted enough field and headquarters follow-up procedures to ensure the resolution of troubled property indicators.

Plans to Address Weaknesses Identified in the Fiscal Year 1999 Report

The Inspector General's March 2000 report on HUD's fiscal year 1999 financial statements made new recommendations addressing several aspects of HUD's oversight and monitoring of its multifamily portfolio. Specifically it recommended that HUD, among other things, finalize plans to improve the administration of the Section 8 housing assistance payments contracts that remain HUD's responsibility after the transfer to contract administrators is completed; design an oversight strategy and establish organizational responsibilities; and address, among other things,

- management and occupancy reviews,
- rental adjustments,
- health and safety issues identified by physical inspections, and
- deficient annual financial statements and inspection results.

Housing began to update its multifamily property monitoring action plan in May 2000. The action plan contains several tasks and milestones to be completed during calendar year 2000 to address the recommendations from the Inspector General's March 2000 audit report.

Material Weakness: FHA's Budgetary and Financial Accounting Controls Must Be Improved

The Problem

Weaknesses in budgetary and financial accounting controls were first reported in the audit of FHA's fiscal year 1998 financial statements and generally persisted throughout fiscal year 1999. By implementing some of the 1998 audit recommendations, FHA made credible progress during fiscal year 1999 in addressing these weaknesses. However, problems remained with budgetary funds control and certain aspects of financial reporting. These problems were primarily caused because FHA's accounting and budgeting systems are not integrated and the process for reconciling the two is inadequate. Federal agencies are required to maintain adequate systems and internal controls to provide reasonable assurance that the agencies are generating reliable financial and budgetary data. Until the problems in these areas are corrected, FHA will continue to be at risk of obligating funds in excess of budgeted amounts, and it will lack accurate, timely, and properly presented financial information essential for effectively managing its programs.

As a result of the audit of the fiscal year 1998 financial statements, the Inspector General reported a material weakness related to FHA's financial and budgetary accounting. Specifically, FHA's

- obligations needed to be reviewed and reconciled to deobligate amounts related to expired contracts and purchase orders;

- general ledger was not compliant with the standard general ledger (SGL)[10] at the transaction level and Report on Budget Execution (SF-133) [11] was not well documented;
- method for allocating costs in accordance with the Statement of Federal Financial Standard No. 4 (SFFAS No. 4), *Managerial Cost Accounting*, was not documented and implemented throughout the year; and
- method for calculating the liability for loans guaranteed needed to be refined.

As discussed in the following section on the status of corrective actions, during fiscal year 1999, FHA fully implemented some of the fiscal year 1998 audit recommendations. Specifically, the agency improved its method for estimating the liability for loans guaranteed and documented and implemented a method of allocating costs in accordance with the requirements of SFFAS No. 4. As a result, these problems were no longer considered part of the material weakness. However, the 1999 audit report continued to include deficiencies related to (1) reconciling the accounting and budget systems for loan guarantee commitments and endorsements and (2) accounting systems that did not comply with the SGL. In addition, upon completion of the fiscal year 1999 audit, the independent public accountant reported that FHA lacked adequate funds controls to provide reasonable assurance that it did not obligate more money than was budgeted. As determined by the independent public accountant, FHA had no functioning manual or automated system in place to prevent an overexpenditure or overobligation of an apportionment. FHA relied solely on manual detective controls to identify and correct any overexpenditure.

Among the underlying reasons for both the 1998 and 1999 weaknesses was the lack of integration between FHA's accounting and budgetary systems. Before 1998, FHA followed private-sector accounting standards. As a result, FHA's financial systems and processes were configured to support

[10]The SGL provides a standard chart of accounts and standardized transactions that agencies must use in all their financial systems.

[11]The Standard Form 133 (SF-133) Report on Budget Execution is a quarterly report that agencies are required to file with OMB to report (1) the amount of budgetary resources available to finance future obligations; (2) the status of budgetary resources, including the amounts obligated, amounts that continue to be available for obligation, and amounts not available for obligation; and (3) the amount of obligations in relation to outlays. The SF-133 provides historical data that can be used to help prepare the President's Budget, as well as program operating plans and estimates of the rate at which agencies spend their budgetary resources.

this accounting basis. However, in 1998, FHA converted its financial information to comply with federal accounting standards–sometimes called the federal basis of accounting–so that FHA's financial data could be more readily included in HUD's consolidated financial statements.

Reconciliation of Obligations and Funds Control

To comply with federal budget guidance and internal control standards and generate reliable financial data on an ongoing basis, agencies with nonintegrated budget and accounting systems should perform periodic reconciliations between amounts recorded in the two systems and resolve any differences. However, a contributing cause of both the 1998 and 1999 weaknesses was that FHA's reconciliation process was inadequate to ensure that all transactions were properly recorded in both systems. While the agency staff reconciled current-year activity between the two systems, they had not reconciled the ending balance of commitments and obligations resulting from loans guaranteed during years prior to the audit. At the independent public accountant's request, for fiscal year 1999, FHA staff reconciled the ending balance and identified several errors, including (1) recording duplicate obligations for contracts totaling $21 million, (2) not recording $168 million in obligations, and (3) not recording expenditures totaling about $16 million and about $19 million in accounts payable in the financial statements.

OMB Circular A-34, *Instructions on Budget Execution*, states that a federal agency shall establish and maintain a system of accounting and internal controls that provides (1) reliable accounting for the activities of the agency, (2) the basis for preparing and supporting the budget requests of the agency, (3) the financial information required to formulate the President's budget, and (4) the basis for executing the budget. Furthermore, Circular A-34 states that the agency shall maintain records in a manner that facilitates audits and reconciliations. In addition, the *Standards for Internal Control in the Federal Government* states that an agency should periodically compare its budget resources and recorded transactions to reduce the risk of errors. Circular A-34 also establishes requirements for an agency's system of funds controls to provide reasonable assurance that the agency does not obligate or expend more money than available, and it states that the agency's fund control system must be fully supported by the accounting systems.

SGL Noncompliance

In its fiscal year 1999 audit report, as in its fiscal year 1998 report, the Inspector General stated that FHA's general ledger did not comply with SGL requirements in that it lacked the transaction-level detail required by OMB Circular A-127, *Financial Management Systems*. Specifically, FHA's

subsidiary accounting systems did not contain transaction details and did not provide the necessary reports to allow reconciliation with amounts reported in the general ledger. In addition, FHA did not maintain detailed reports supporting aggregate amounts recorded in the general ledger and the Report on Budget Execution.

Status of Corrective Actions and What Remains to Be Done

As of March 31, 2000, FHA had completed many of the actions it had planned to address the fiscal year 1998 financial and budgetary accounting material internal control weakness and had other actions in progress. Estimated completion dates for the remaining individual corrective actions ranged from fiscal year 1999 to fiscal year 2001. According to HUD's Deputy CFO, FHA has closed the action plan to address the fiscal year 1998 material weakness and has prepared a separate corrective action plan, dated April 2000, to address the revised material weaknesses as described in the fiscal year 1999 audit report.

The action plan to address the fiscal year 1998 material weakness contained specific actions to address the recommendations made by the independent public accountant following the fiscal year financial statement audit, estimated completion dates, and the status of accomplishments. FHA's corrective action plan included short-term actions as well as long-range system improvement initiatives and interim measures that extended beyond the Inspector General's recommendations. According to FHA, these actions were aimed at (1) providing the ability to perform real-time funds control and queries of financial data, (2) eliminating many manual processes that have been necessary, (3) having improved cost information, and (4) establishing an SGL-compliant budgetary trial balance for use in generating the SF-133.

Table 7 describes the February 2000 corrective action plan, which addresses the status of actions planned to resolve the fiscal year 1998 financial and budgetary accounting material weakness. This table summarizes the (1) major components of the action plan, which mirror the fiscal year 1998 audit recommendations; (2) accomplishments as of March 31, 2000, that FHA considers to be significant to resolving the material weakness; and (3) actions that remain to fully address the independent public accountant's fiscal year 1998 recommendations.

Table 7: Status of Corrective Actions for the 1998 Material Weakness: FHA's Budgetary and Financial Accounting

Major components of the February 2000 plan	Key accomplishments as of March 31, 2000	What remains to be done to complete the corrective action
Implement routine procedures to analyze unliquidated obligations for contracts and purchase orders and deobligate expired contracts on a timely basis.	Developed procedures for a monthly review and orderly termination of contracts and purchase orders. Updated FHA's contracts database and removed the terminated contracts from the list of active contracts during fiscal year 1999.	Completed.
Reconcile the accounting and budget systems for loan guarantee commitments and endorsements to ensure that all credit subsidy amounts are recorded properly.	Reminded field offices of the requirement to request fund reservations from Budget. Performed monthly reconciliations of accounting and budget data, researching and resolving discrepancies.	Enhance the multifamily insurance underwriting system to ensure the proper recording of credit subsidy commitments and endorsements and automate the process for recording credit subsidy obligations. Estimated completion is during fiscal year 2000.[c]
Prepare formal documentation of the process to prepare federal basis[a] financial statements and the SF-133, including crosswalks of private-sector accounts to the federal basis accounts and identify all required sources of budgetary system information.	Documented the federal basis financial statement and SF-133 preparation processes, with all required sources of budgetary system information and crosswalks identified. Trained staff in preparing the financial statement and SF-133.	Modify financial systems to include budgetary accounting at the transaction level by SGL account and continue training staff in financial statement preparation. Estimated completion date is December 2000.
Prepare formal documentation of the cost allocation time survey process[b] and conduct the survey periodically during the year.	Documented the cost allocation time survey process. Trained staff in the cost allocation time survey. Conducted the survey semiannually during fiscal year 1999 to comply with SFFAS No. 4.	Completed.
Implement existing plans to address identified financial management issues related to the liability for loan guarantees.	Revised cash flow models to incorporate additional improvements that reduce the risk of error. Documented the budget cash flow models, including detailed operating instructions. Developed formal policies and procedures that include a formal supervisory review process.	Completed.

[a]As previously indicated, the independent public accountant refers to financial information that complies with federal accounting standards as the federal basis of accounting.

[b]Because FHA uses HUD employees to run its programs and does not have its own employees, the cost allocation time survey is used to allocate the salary and related payroll expenses of HUD employees to FHA for the work they perform on FHA's programs and functions.

[c]HUD officials reported to us that as of October 2000 estimated completion is scheduled for fiscal year 2001.

Source: GAO's presentation of information provided by HUD.

As of March 31, 2000, as noted in table 7, FHA had completed most of the planned tasks relating primarily to (1) analyzing unliquidated obligations, (2) documenting the methodology for allocating costs in accordance with

SFFAS No. 4, and (3) refining the methodology for calculating the liability for loan guarantees.

Plans to Address Weaknesses Identified in the Fiscal Year 1999 Report

During the fiscal year 1999 audit, the Inspector General reevaluated the internal controls related to FHA's financial and budgetary accounting. Because of the progress that had been made during fiscal year 1999 addressing the methodologies for allocating costs in accordance with SFFAS No. 4 and calculating the liability for loan guarantees, the Inspector General no longer considered these issues part of the material weakness. However, the Inspector General determined that further improvements in financial systems and processes are needed to resolve this material weakness. As a result, the recommendations in the Inspector General's fiscal year 1999 audit report were revised to provide more detail on the remaining issues. Specifically, the Inspector General recommended that FHA

- reconcile the accounting and budget systems for loan guarantee commitments and endorsements to ensure that all credit subsidy amounts are recorded properly and
- implement the processes or systems necessary to provide reasonable assurance of FHA's compliance with the SGL at the transaction level.

Furthermore, the Inspector General issued three new recommendations in the fiscal year 1999 audit report related to the revised budgetary funds control material weakness. Specifically, the Inspector General recommended that FHA

- implement a reconciliation and review process for the ending balance of all obligations to related systems, to ensure that budgetary status and accounting information is complete, accurate, and timely to prepare both the SF-133 and financial statements;
- complete the plan to implement funds control in all FHA systems and processes, submit it to OMB, and implement it; and
- revise the current process for preparing the SF-133 so that the FHA Comptroller's Office may be part of the preparation and review.

Table 8 describes the April 2000 corrective action plan, which addresses the status of actions planned to resolve the fiscal year 1999 financial and budgetary accounting material weakness. This table summarizes the (1) major components of the action plan, which mirror the fiscal year 1999 audit recommendations; (2) accomplishments as of May 18, 2000, that FHA

considers to be significant to resolving the material weakness; and (3) actions that remain to fully address the Inspector General's fiscal year 1999 recommendations.

Table 8: Status of Corrective Actions for the 1999 Material Weakness: FHA's Budgetary and Financial Accounting

Major components of the plan	Key accomplishments as of May 18, 2000	What remains to be done to complete the corrective action
Implement a reconciliation and review process for the ending balance of obligations to ensure that budgetary status and accounting information is complete and accurate.	Reconciliation of monthly activity has been completed. A review of reconciling items is under way.	Adjust prior year-end balances for commitments and obligations resulting from loans guaranteed during prior years. Estimated completion date is August 30, 2000.[b]
Complete the development of a plan to implement funds control in all FHA systems and processes.	FHA is developing an automated funds control process, including detailed instructions and process maps. FHA is working with HUD staff to incorporate summary-level obligation and disbursement data into HUDCAPS[a] on a daily basis.	Complete efforts to develop and implement an automated funds control process, including implementing a new subsidiary ledger that will adequately provide funds control. Submit plans to OMB. Estimated completion date is December 2005.
Revise the SF-133 preparation process to include preparation and review by the Comptroller's Office.	Developed a database to import general ledger balances monthly and convert applicable proprietary balances into the SGL budgetary trial balance. The December 1999 and March 2000 SF-133s were prepared using this database.	Completed.
Reconcile the accounting and budget systems for loan guarantees to ensure that all credit subsidy amounts are recorded properly.		Examine all outstanding unliquidated obligations and deobligate/recapture obligations that are no longer valid. Review disbursement records to determine if undisbursed obligated balances should be deobligated and expired. Check remaining obligations against obligated balances on the SF-133. Estimated completion date is September 30, 2000.[b]
Implement the processes or systems necessary to ensure compliance with the SGL at the transaction level.	Identified and documented detailed functional requirements. Budgetary accounts have been established in FHA's subsidiary system. The antiquated subsidiary system that was primarily responsible for noncompliance at the transaction level has been phased out.	Identify the system that best meets FHA's subsidiary ledger needs. Complete the conversion of 19 feeder systems. Define new FHA accounting classification structure values. Define and execute a detailed implementation plan for the new subsidiary ledger. Implement operational feeder systems interfaces. Estimated completion is December 2005.

[a]HUDCAPS is HUD's central general ledger, funds control, and program system. Currently, this system also receives summary-level data from FHA.

[b]HUD officials reported to us that as of October 2000 these activities had been completed.

Source: GAO's presentation of information provided by HUD.

Material Weakness: FHA's Information Systems Must Be Enhanced to More Effectively Support FHA's Business Processes

The Problem

The Inspector General's audit report on FHA's fiscal year 1999 financial statements stated that FHA's information technology systems must be enhanced to better support the agency's business processes. The Inspector General noted that weaknesses have been reported in FHA's financial management systems environment for a number of years and that FHA's and HUD's inability to acquire or implement modern information technology has continued to deter FHA's efforts to be a more efficient and effective housing credit provider. FHA has made some improvements to its systems environment, but it still relies on legacy systems to conduct day-to-day business, forcing it to collect data and report information in less efficient ways.

The lack of a modern information technology environment also adversely affected the internal controls related to accounting and reporting financial activities. The Inspector General reported that some manual procedures must be used to process financial transactions through FHA's nonintegrated systems. The manual procedures could adversely affect internal controls. In addition, key FHA systems do not provide the functionality required to adequately manage and account for financial transactions in accordance with federal regulations on financial systems. Furthermore, the Inspector General reported that improvements to FHA's financial systems are required to help ensure that management receives accurate and timely information for funds control and decision-making purposes, as well as to address a material weakness that "controls over budgetary funds must be improved."

FHA recognized the need for improving its systems in a December 1999 document entitled FHA Vision of Financial Management. This document provides an overview of the current state of FHA's financial management

and identifies planned improvements, such as automated interfaces between FHA's financial systems and general ledger. However, the Inspector General report notes that detailed plans and completion dates are needed to achieve the vision.

HUD is also currently developing an enterprise architecture, which is to be the agency's information technology investment planning methodology. It is important that this effort include an assessment of where new systems or system enhancements can be implemented to better support FHA's business and financial operations, according to the Inspector General's report.

Status of Corrective Actions and What Remains to Be Done

FHA prepared a corrective action plan to address the material weakness and to help address the goal, set forth in HUD's 2020 Management Reform Plan, of modernizing and integrating HUD's financial management systems with an efficient, state-of-the-art system. The plan contains management strategies and summarizes progress to date. The planned corrective actions are intended to improve financial reporting and information systems support for multifamily and single-family housing programs.

Table 9 describes the major components of FHA's February 2000 corrective action plan, as well as the accomplishments as of May 18, 2000, and the work remaining to complete the planned corrective actions.

Table 9: Status of Corrective Actions for the 1998 Material Weakness: FHA Information and Financial Management Systems

Major components of the February 2000 plan	Accomplishments as of May 18, 2000	What remains to be done to complete the corrective actions
Implement a subsidiary ledger for converting FHA's financial management reporting from a commercial to a federal accounting basis.	FHA has defined major steps and milestone dates for implementing a new JFMIP-compliant subsidiary ledger system. FHA has also completed the development of detailed functional requirements for the subsidiary ledger system and initiated a market survey of available system solutions.	Plan, select, and implement a new JFMIP-compliant subsidiary ledger system. FHA estimates that it will select a system by October 31, 2000[a], and develop a detailed implementation plan by November 30, 2000. It estimates that it will implement the new system interfaced with at least one of the operational feeder systems by March 2002 and interfaced with all 19 operational feeder systems by December 2005.
Develop the Real Estate Management System (REMS).	According to FHA, the implementation of REMS greatly enhances FHA's ability to manage the multifamily portfolio, reduce staff time entering data, and improve data integrity.	Integrate REMS with systems being developed for the Real Estate Assessment and Departmental Enforcement centers. To be completed in the 3rd quarter of fiscal year 2000.[b]
Develop and implement the Housing Enterprise Real Estate Management System (HEREMS) database.	The database provides information to support various functions involving multifamily programs, such as enforcement activities and real estate assessment.	Completed in November 1999.
Enhance the Single Family Acquired Asset Management System (SAAMS).	The enhanced system supports the management and sale of acquired properties by HUD's management and marketing contractors.	Improvements are planned to enhance Web functionality. Completion date is not estimated.
Enhance the Single Family Premium Collection Subsystem-Upfront, to provide better service on the collection of premiums at the date of purchase.	Enhancement is completed. FHA states that it provides better information on the amount of premiums owed and received.	By early 2001, FHA intends to add the capability to make refunds by electronic fund transfer.
Develop the Single Family Premium Collection Subsystem-Periodic to provide the case-level detail required to comply with credit reform requirements.	This subsystem brought FHA into compliance with credit reform requirements.	Completed in September 1999.

[a]In its July 13, 2000, comments, HUD stated that FHA now estimates it will select a new JFMIP compliant subsidiary ledger system by September 30, 2000.

[b]In its July 13, 2000, comments on this report, HUD stated that the integration of the systems will be completed by September 30, 2000.

Source: GAO's presentation of information provided by HUD.

FHA completed a number of corrective actions to address the material weaknesses identified in the Inspector General's March 12, 1999, audit report on the fiscal year 1998 financial statements. The most significant accomplishments, according to FHA officials, are that FHA:

- Completed detailed functional requirements and initiated a market survey of available system solutions for a new subsidiary ledger to enable the agency to perform federal basis and budgetary accounting as required by federal financial systems standards. According to FHA, the system will provide the ability to perform real-time funds control.
- Developed and implemented the Real Estate Management System (REMS). According to FHA, the system greatly enhances the ability to monitor the multifamily portfolio, reduces staff time entering and manipulating data, and improves data integrity.
- Developed and implemented the Housing Enterprise Real Estate Management System (HEREMS) database. This database provides information to support various functions involving multifamily programs, such as enforcement activities and real estate assessment.
- Enhanced the Single Family Acquired Asset Management System (SAAMS). This was done to support the management and sale of acquired properties by HUD's management and marketing contractors. Further improvements are planned for this system.
- Enhanced the Single Family Premium Collection Subsystem-Upfront. This was done to improve effectiveness in monitoring the receipt of mortgage insurance premiums paid upon the purchase of a single-family dwelling. FHA states that this system allows more efficient monitoring of whether all money owed to FHA has been collected.
- Developed and implemented the Single Family Premium Collection Subsystem-Periodic. This was done to comply with credit reform requirements, which specify that detailed, case-level information be kept on FHA's receipt of monthly mortgage insurance premiums on single-family loans. The Inspector General closed out its recommendation on this matter, stating that FHA is now in compliance with credit reform requirements. This system, according to FHA, will also save the agency the approximately $800,000 a month that it has been paying for a contractor to collect this information.

The Inspector General recognized, in its audit report on the fiscal year 1999 financial statements, that FHA has made some improvements to its systems environment. The material weakness remains, however, because FHA's information systems do not effectively support its business and financial operations and FHA has not corrected deficiencies that the Inspector General has reported for a number of years.

Plans to Address Weaknesses Identified in the Fiscal Year 1999 Report

The Inspector General's February 29, 2000, audit report on FHA's fiscal year 1999 financial statements identified some new and restated some existing weaknesses associated with FHA's information systems environment and included new recommendations to address them. FHA updated its corrective action plan on April 27, 2000, to address the new or restated issues.

Table 10 describes the new or restated FHA information and financial management systems issues, the corrective actions taken or planned by FHA, and the work remaining to complete the planned corrective actions.

Table 10: Plans to Address Fiscal Year 1999 Material Weaknesses: FHA's Information and Financial Management Systems

New or restated issue	Actions taken or planned as of April 27, 2000	What remains to be done to complete the corrective actions
Ensure that FHA's systems environment is given a high priority during the drafting of HUD's enterprise architecture, which is HUD's information technology investment planning methodology, currently under development. These planning efforts should ensure that the cost and benefits of currently operating FHA systems are considered and should assess where new systems or enhancements to existing systems can be implemented to better support FHA's business and financial operations.	To support the development of the enterprise architecture, FHA has initiated analyses of its business processes and systems needs. Architecture workshops were held to obtain information on FHA's business processes and technology infrastructure. FHA is also analyzing the costs and benefits of current and potential new systems.	Complete the analyses of FHA's business processes and system needs, as well as the costs and benefits of current and potential new systems. Use these analyses to help in the development of HUD's enterprise architecture.
Develop detailed FHA systems project planning information to be included in HUD's Information Technology Investment Portfolio System (I-TIPS). This planning information should also complement FHA's systems included in HUD's enterprise architecture.	FHA is currently revising information system project plans and will include them in I-TIPS.	Complete the revision of the information systems project plans and ensure that the plans complement HUD's enterprise architecture.

(Continued From Previous Page)

New or restated issue	Actions taken or planned as of April 27, 2000	What remains to be done to complete the corrective actions
Develop a complete approach to support FHA's Vision of Financial Management and ensure that this plan is linked to HUD's enterprise architecture.	FHA has defined major steps and milestones for implementing a new JFMIP-compliant subsidiary ledger system. FHA also completed detailed functional requirements for the system and initiated a market survey of available system solutions.	Plan, select, and implement a new JFMIP-compliant FHA subsidiary ledger system that is linked to HUD's enterprise architecture. FHA estimates that it will select a system by October 31, 2000, and develop a detailed implementation plan by November 30, 2000[a]. It estimates that the new system will be interfaced with at least one of the operational feeder systems by March 2002 and interfaced with all 19 operational feeder systems by December 2005. In addition, to support its Vision of Financial Management, FHA needs to continue to develop and implement plans to ensure that its operational systems are JFMIP-compliant.
Ensure that FHA's systems are developed and maintained in accordance with HUD's system development methodology.	FHA's technology division is currently coordinating revisions of system project plans where needed and is stressing the need for compliance with HUD's system development methodology.	Review systems projects to ensure compliance with HUD's system development methodology.

[a]In its July 13, 2000, comments, HUD stated that FHA now estimates that it will select a new JFMIP compliant subsidiary ledger sytem by September 30, 2000.

Source: GAO's presentation of information provided by HUD.

Comments From the Department of Housing and Urban Development

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

July 13, 2000

Mr. Stanley J. Czerwinski
Associate Director, Housing and
Community Development Issues
U.S. General Accounting Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. Czerwinski:

Thank you for the opportunity to review and comment on the General Accounting Office's (GAO) draft report entitled "HUD Management: Status of Efforts to Resolve Serious Internal Control Weaknesses" (GAO/RCED/AIMD-00-230, Code 385816). We found that the draft report provides a fairly current, accurate, and balanced assessment of HUD's efforts to address eight material internal control weakness issues during the 14-month period March 1999, through May 18, 2000.

The GAO's draft report concludes that "HUD made reasonable progress towards resolving all eight material internal control weaknesses." Recognition was given to the fact that HUD reduced the number of material weakness issues from 8 to 5 during this period, as confirmed by information reported in the HUD Office of Inspector General's March 1, 2000, audit report on HUD's Fiscal Year 1999 financial statements. For the five remaining weaknesses, the GAO identified significant actions that are underway or remain to be done. Furthermore, there was recognition that HUD's process for addressing its material internal control weaknesses includes developing corrective action plans for each weakness, tracking the resolution of the weaknesses in a centralized system, and oversight of the process by the Office of the Chief Financial Officer and the Deputy Secretary.

Most notable among HUD's recognized accomplishments were improvements made in monitoring the insured mortgage portfolio, resulting in downgrading the material weakness on early warning and loss prevention for insured mortgages, and significant improvements related to the multifamily project monitoring weakness. Also, improvements made on two separate material weaknesses on HUD's and FHA's resource management resulted in those areas no longer reported as

material weaknesses. These resource management issues were largely addressed through the implementation of the HUD 2020 Management Reform Plan, which fundamentally altered HUD's management control environment to enable HUD to more effectively utilize its limited staff resources to better oversee and control its major housing and community development programs.

See comment 1.

While it is true that "HUD did not make as much progress as it had planned in resolving some of its material internal control weaknesses," this secondary conclusion by the GAO needs to be put in the context of both the long-standing and significant nature of the problems HUD is trying to correct, and the aggressive initial time table HUD established for implementing the 2020 Management Reform Plan and other corrective actions. Despite some acknowledged setbacks and delays, it is heartening that the GAO concludes that HUD's overall strategy for addressing its material internal control weaknesses "should help HUD continue to make progress in resolving its remaining material weaknesses."

Enclosed is a matrix providing detailed comments on the subject draft report for your staff's consideration in preparing the final report for issuance. I wish to thank the GAO for the professional manner in which they have conducted this review. In looking forward to the GAO's upcoming biennial "high risk" series update, I believe the GAO will find even further substantive progress in addressing HUD's long-standing management deficiencies. Given that continuing progress, and the general improvements to the management control environment of the Department, I am confident that you will agree that HUD no longer warrants the "high risk agency" designation.

Should your staff have any questions on our enclosed comments, please have them contact James M. Martin, Deputy Assistant Chief Financial Officer for Financial Management, on (202) 708-0638.

Sincerely,

Saul N. Ramirez, Jr.

Enclosure

U. S. Department of Housing and Urban Development's Detailed Comments On Draft GAO Report on HUD Management: Status of Efforts to Resolve Serious Internal Control Weaknesses (GAO/RCED-00-230, Code 385816)

	Page No.	Specific Reference (Paragraph/Sentence, Etc.)	HUD Comment for GAO's Consideration
See comment 2.	Cover	Report Title: Status of Efforts to Resolve Serious Internal Control Weaknesses.	Inasmuch as the report is based on observations of "Actions" undertaken (that are, for the most part, completed or substantially completed), it is suggested that the term "Actions" be substituted for the term "Efforts" in the report title.
see comment 3.	N/A	General comment	The report's focus on actions that have not been completed or that are behind a proposed implementation schedule may give the impression that the "materiality" or scope of a weakness remains unchanged, despite enormous progress and improvement in an internal control area. With regard to Multifamily (MF) Housing Project Monitoring in particular, one might see the report as describing a glass that is 10% empty as opposed to a glass that is 90% full. As we commented on the Statement of Facts (SOF) that preceded the draft report, the Office of Multifamily Housing maintains that discussion drawn from prior HUD OIG audit report opinions are arguable in that they reflect outdated and questionably supported opinions, as opposed to established current facts. MF Housing does not agree with the IG's position, or with inferences in the GAO report based on dated input from the IG, that Multifamily Project Monitoring remains a Material Weakness.
See comment 4.	N/A	General comment	In many places the report refers generally to a Housing internal control that, in some cases, involves only Single Family or Multifamily operations. It would be clearer to the reader of the report if, where appropriate, internal controls weaknesses that apply only to Single Family or Multifamily operations be so defined.
See comment 5.	5	1st paragraph, last sentence	The sentence should be worded in the past tense, as follows, so as not to confuse readers into thinking that this is OIG's current position: "The Inspector General expressed these weaknesses as actions that needed to be taken to correct identified problems."
See comment 6.	7	2nd paragraph (and related material on pages 23 - 27)	In discussing the obstacles that HUD encountered in addressing some of its weaknesses, the contributing causes of the identified difficulties, new problems and delays should also be discussed. In general, HUD set extremely aggressive time frames for the corrective actions planned to address its long-standing management deficiencies and material internal control weaknesses. While much progress has been made, it is not surprising that some set-backs and delays were also experienced. • The difficulties in implementing improvements to HUD's financial management systems stemmed from a project scope that was too broad to provide needed incremental progress in a timely manner. This has been corrected. • The new problems cited relate to credit subsidy and Federal basis budget and accounting requirements that are new to FHA's traditional corporate accounting environment. As GAO correctly acknowledges, progress is being made in fulfilling these new requirements for the FHA. • The delays in fully implementing HUD's large-scale tenant income computer matching program, and further outsourcing

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		of Section 8 housing assistance contract administration, are attributed to an underestimation of time needed to develop, market and implement these major initiatives, including sufficient time for housing industry and program participant input and buy-in as a necessary step in the regulatory process and the practice of good governance. Again, HUD continues to move forward with these large, complex improvements.
10	Column 3 of Rows 1 and 5 of the Table	Suggest that the wording on the 1999 changes to the HUD and FHA resource issues be revised to read: "No longer reported as a separate material weakness, based on corrective actions taken. Remaining deficiencies were reassessed as contributing causes of other material weaknesses and reportable conditions."
10	Column 3 of Row 3 of the Table	While the statement "No substantial change" appears to be related to the OIG's description of the general scope of the weakness issue, readers may inappropriately misconstrue the statement to mean that HUD made no substantial progress in addressing the tenant income verification issue in 1999. Substantial progress was made in designing the structure of HUD's large-scale computer matching program in 1999, although the program had not yet been implemented. To avoid misinterpretation, either acknowledge the progress made, or change the wording to read: "Not applicable"
10	Column 3 of Row 4 of the Table	The statement "No substantial change" is misleading in the context of the multifamily project monitoring weakness, considering the substantial progress made in implementing the physical and financial assessment components of the new multifamily monitoring processes. The statement is contradicted by the GAO statement that this was an area of significant accomplishments, in accordance with the first bullet on page 6 of the report. To avoid misinterpretation, either acknowledge the progress made, or change the wording to read: "Not applicable"
12	Last paragraph under "Importance of Internal Controls to HUD" section.	The report cites following up on exigent health and safety (EHS) conditions at MF projects as a significant action remaining to be completed. This is not accurate because EHS conditions are already identified by REAC inspections and are required to be corrected within 72 hours. Just as with the other physical deficiencies identified by future inspections, there will continue to be ongoing follow-up for new EHS conditions identified. However, the issue here is that correction of EHS findings as well as non-EHS physical deficiencies is a top priority for the field offices, and MF Housing has already instituted procedures that have effectively addressed the issue of physical inspection deficiencies.
13 and 33-34	Second bullet on page 13 addresses the issues of the management resource weakness. Page 33-34 addresses staffing and resource management.	For further information, the Resource Estimation and Allocation Process (REAP) is being implemented in three phases over 18 months. Phase One will cover the PIH, Administration, Housing and CPD program areas from July, 2000 to November, 2000. Phases Two and Three will cover the rest of the Department and last until November 2001. <u>Study Stage</u> Each phase will involve multi-disciplinary teams performing work measurement studies to estimate the resources necessary for the Department to operate on a day-to-day basis under the HUD 2020 Management Reform Plan.

See comment 7.

See comment 8.

See comment 9.

See comment 10.

See comment 11.

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		Implementation Stage As REAP is implemented, it will be possible to realign staff consistent with changes to workload and operating conditions.
14	2nd paragraph, 3rd sentence	The statement "HUD needs to follow-up on health and safety issues at multifamily projects" should be deleted as an example of remaining actions needed, because HUD already has processes in place to address these problems when they are identified.
15	Figure 2, 2nd item under "Major Actions Remaining"	The report cites as a major action remaining: "Issue final reports on prior years' income-matching projects." We do not consider issuance of the reports as a *major* action remaining. The reports document prior sampling results. Results of those projects have been considered in the development of the large-scale computer matching project. Three final reports on prior projects will be issued in July 2000; these reports have been drafted and few additional revisions will be required to issue the final reports. Delete the cited item from the list of "Major Actions Remaining."
15	Figure 3, last 2 "Major Actions Remaining"	Suggest that these 2 remaining actions respectively start out with the lead phrases "Continue to follow-up…" and "Continue to resolve…" in recognition of the fact that HUD has already begun these on-going processes as part of its improved internal control structure.
17-18	The entire section on non-material internal control weaknesses	It is requested that this section be deleted as it appears outside the stated objectives and scope of the GAO review, as described on page 28 of the report. Furthermore, there appears to be overlap and duplication of the listed issues, both with components of HUD's actual material weakness issues, and between the issues attributed to GAO versus the OIG. This overlap and duplication tends to falsely lead the reader to conclude that HUD has more problem issues than it actually does.
18	2nd paragraph, 2nd sentence	This sentence would be more correct if the following were added at the end of the sentence: "…as identified by the Inspector General, the General Accounting Office, or HUD management."
19	2nd paragraph, last 2 sentences	HUD had corrective action plans to address its resource management issues prior to initiation of this GAO review. Much of the HUD 2020 Management Reform Plan was designed to address HUD's resource management weaknesses. These sentences should be revised to more correctly read: "The resources management plan was updated specifically for this review, according to officials from the Office of Departmental Operations and Coordination. The updated plan consisted of excerpts from the fiscal year 1998 financial statement audit report, with charts showing interim steps and completion dates for corrective actions on each of the prior year audit recommendations, and a separate narrative description for two of the four recommendations."
19	Last paragraph, last line on page which carries-over to page 20	To the uninformed reader, the implication of this reference is that major organizational and operational changes have been made without the benefit of guidance or instructions. This is certainly not the case. Throughout implementation of the 2020 Reform Plan, organizational (e.g., REAC, DEC) and operational (e.g., Sec 8 CA, MAP, REMS) changes, pertinent, timely guidance has been provided. In the area of project monitoring, this included: the July

See comment 12.

See comment 13.

See comment 14.

See comment 15.

See comment 16.

See comment 17.

See comment 18.

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		1, 1998 Guidance Memo to the Field on Management Review Policy; the September 28, 1999 Memo to MF Field Office Directors on handling REAC Physical Inspections; and the REAC Financial Assessment Subsystem (FASS) Users Guide and training materials provided all MF field staff in concert with the release of audited financial statement FASS reviews. In addition, the following guidance materials, both web-based and hard copy, have been issued: the Multifamily Accelerated Processing (MAP) Guide; the Section 8 Contract Administration Draft Monitoring Policies and Procedures Guide; the Draft DEC Processing Guide; The OMHAR Guide; the Real Estate Management System (REMS) User Handbook and training materials provided in conjunction with the release of REMS, Phase 3; and Guidance to MF staff for tracking and reporting Business Operating Plan (BOP) Goals. Indeed, MF Housing has a longer-term goal of updating its various Handbooks to reflect the changes and guidance above. However, the more important issue that pertinent, up-to-date guidance concerning 2020 Management Reform implementation has been thoroughly addressed.
23	Paragraph 2, line 8	The report refers to a fiscal year "20001" performance plan. Correct this typographical error to refer to a fiscal year 2001 performance plan.
25	At the end of the first partial paragraph, consider adding the following new sentence.	"As result of HUD's completion of the FY 1999 reconciliation of the funds balance with Treasury, the CFO's office has advised us that no material adjustments were identified that would result in a need to restate HUD's FY 1999 financial statement balances."
25	After the 2nd full paragraph, consider adding the following new paragraphs	"During the Year 2000 or Y2K moratorium period in the first half of FY 2000, FHA's Multifamily Housing did succeed in releasing and implementing the Housing Enterprise Real Estate Management System (HEREMS) database (completed November 1999) In addition, Multifamily Housing proceeded to identify requirements, define needs, and develop plans and budget proposals. While action to complete development work through to test and implementation was limited, the moratorium did not prevent FHA Multifamily from developing functional requirements, starting early design work, and documenting business needs and rules. As with Multifamily, FHA Single Family continued its efforts as evidenced by work completed during the moratorium that provided the new Management and Marketing service contractors with access to data in the acquired property system, SAMS, and other enhancement that provided new data access and reporting capabilities needed to support major improvement in asset management for Single Family Housing. Now that the Y2K barrier has been successfully passed, and the constraints imposed by the efforts required to prepare for Y2K are no longer needed, FHA has been able to focus its resources and efforts on systems development and integration. In the case of Multifamily Housing, the new focus builds on the notable progress made in the areas of Multifamily Housing's REMS system and its related modules. In addition to the integration successes already

See comment 19.

See comment 20.

See comment 21.

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		evidenced by the HEREMS database, the Multifamily Integration Project (proposed for FY 2001) is designed to build on the integration progress made in REMS and HEREMS by taking charge of the database design and administration through data standardization, coordinating of project plans, integration testing and release control with the express purpose of integrating REAC, and Departmental Enforcement Center efforts with Multifamily Housing. With respect to Single Family Housing, FHA can now concentrate its resources as demonstrated by its proposals to make significant investments to modernize the supporting data systems. This builds on the major strides already taken to provide our external business partners with a modern WEB based interface to the basic business process. FHA has also proposed to apply its financial and staff resource skills to several major initiatives starting in FY 2001. These include a major portion of the work to modernize the system supporting Single Family underwriting."
26	2nd paragraph, line 5	Regarding, the statement that "letters had not been sent as of May 18, 2000," please cite the number of letters sent to tenants as of June 30, 2000 in the text of the report or in a footnote to the report. About 900 letters were sent to tenants before May 18, 2000, and REAC has sent about 72,500 letters to tenants as of June 30, 2000.
26	2nd paragraph, 4th sentence beginning on line 6	Revise this section to reflect that the primary reasons for delays in sending letters to tenants were: internal Departmental clearance on the Income Discrepancy Resolution Guide, and actions required to respond to issues raised late in the process by tenant groups and industry associations. Other factors cited in the GAO draft report were not causes for delays in sending letters. The QHWRA which affects the rental assistance program starting in October 1999, had no effect on the calendar year 1998 matching. REAC had developed the automated system needed to create the letters to tenants as originally scheduled. All of the delays noted above, and a computer processing error at the Internal Revenue Service in September 1999, were beyond REAC's control.
26 and 27	2nd paragraph under section entitled: "Delays In Implementing Some Planned Actions".	The report notes that the award of Section 8 CA contracts, initially projected by December 1999, did not commence until February 2000. While the report highlights a relatively minor lapse in meeting a target date, it glosses over the accomplishments demonstrated in terms of implementing the Section 8 CA contract initiative. The report should reflect the considerable effort needed and expended towards the planning, preparation, coordination, and training involved in carrying out this initiative. First, to update the contract award status it should be noted that, as of the June 9 reporting, 35 CA contracts have been awarded as opposed to the 24 CA award figure shown in the report. And no doubt, by the time HUD's comments on the Draft report are read by the GAO, additional contracts will have been awarded. More importantly, the actual transfer of workload associated with these contracts has begun, with 9 Contract Administrators commencing work in June and July of 2000, on schedule with our plans. There are also many other important steps that have been achieved: establishment and staffing of a (new) Office of Housing Assistance

See comment 22.

See comment 23.

See comment 24.

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		and Contract Administration Oversight (HACAO) in MF Headquarters; reorganization of field office staff to designate Contract Administrator Oversight Monitors who will work under the guidance of the HQ HACAO Office; training for HUD staff and CA contractors; transition meetings and file transfers between field offices and contractors; and briefing organizations involved in MF's assisted housing programs on the new organization and Section 8 CA implementation. The report takes little note of the many aspects of the Section 8 CA contracting process that have been handled - and handled extremely well - in order that the conversion to CA contractors goes smoothly. MF Housing feels that minor slippage in meeting an implementation target date is a minor issue in what has been an orderly, controlled conversion.
31	2nd bullet, 3rd sentence	This sentence on initial M&M contract problems that have since been overcome should be deleted as irrelevant and unnecessary. A more appropriate statement is the point already made by the GAO on this topic in the 3rd bullet on page 13 of the draft report.
31	3rd bullet, last line	Delete the word "some" in the last line of the third bullet, and consider the following details on staff training. A combined total of over five weeks of classroom on-the-job training was provided to Chicago and Seattle Technical Assistance Center (TAC) staff in March and April 2000, in their new functions that support the large-scale income verification project. Additional training was provided to Seattle TAC staff in June 2000, regarding the customer support function to address implementation issues and to establish baseline performance measures. Training will be provided in the July/August 2000 timeframe, as results from the Seattle experiences is gained and the installation of telephony infrastructure is completed. To date the Seattle TAC has responded to approximately 4,000 tenant/public housing authority/owner agent telephone calls. Formal training materials are available on all aspects of the training provided. Further, Chicago and Seattle TAC staff are knowledgeable and experienced in the income verification process for rental assistance programs based on their prior work assignments.
32	top paragraph, 5th and 6th lines	Suggest rewording "HUD plans to review 12 field offices in..." to say "HUD plans six reviews covering 13 field offices in ..."
33	1st paragraph, 4th sentence and 2nd paragraph	It needs to be clarified that OIG reopened the three prior year recommendations in its April 1997 audit report on HUD's FY 1996 financial statements, not the March 2000 audit report on the FY 1999 financial statements. The current content of these two paragraphs incorrectly implies prolonged continuing delays on these issues. In fact, by the time of the issuance of OIG's March 2000 report, HUD had already established and pilot tested a new resource estimation and allocation methodology, and had firmly established its Business and Operating Plan (BOP) process to hold field office and headquarters resources accountable for work accomplishments in line with available resources and established standards.
33	1st paragraph, 5th sentence	This sentence needs to be worded in the past tense, so as not to falsely lead the reader into believing these are current problems or continuing areas of delay. Suggested rewording is: "The key initiatives that the OIG reported as having been delayed at that time were: (1)..."

See comment 25.

See comment 26.

See comment 27.

See comment 28.

See comment 29.

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See comment 30.	39	!st row, 2nd and 3rd column of the Table	The Tenant Assessment Sub-system (TASS) is the name of the new System that replaced the Tenant Eligibility Verification System. In late June 2000, REAC released a new version of TASS that facilitates reporting to REAC on the resolution of income discrepancies. Change the system name to the Tenant Assessment Sub-system. Also, change the statement about expecting to release additional functionality in July 2000, to actually releasing software with additional functionality in June 2000.
See comment 31.	40	Last item in Table 2: "Correct security weaknesses in general and specific application controls"	The following actions have been taken and/or are in process: Configuration Management (CM) - All critical systems will be under CM by the First Quarter of FY 2001; all other systems will be placed under CM no later than 9/30/01, with CM funded on an ongoing basis in the maintenance and development of all systems. Network Monitoring Tool - A network monitoring tool is being put into place to cover all production file servers in HQ and in the field, with installation complete by 8/31/00. Business Resumption Plans (BRP) - BRP's have been developed for Headquarters and are being completed for all Field locations by 8/31/00, with periodic testing of various systems at disparate locations on a random intermittent basis documented. Personnel Security - A revised personnel security handbook is underway, with the OCIO providing expert advice on process and procedure. Efforts are being made to strengthen the background investigation process, while at the same time, streamlining the effort. Personnel Security measures are being further institutionalized, with responsibility and accountability accorded the Security Administrators and their supervisors. The CIO is undertaking the responsibilities of policy development and lending support to the security effort. A system has been developed to process and track background investigation requests, with funding for additional enhancements to the system requested through the budget process.
See comment 32.	40	2nd bullet, 2nd sentence	The system for collecting and assessing annual financial statements on multifamily housing projects was fully developed and placed into production in October 1999. This sentence should be revised to correctly state: "...(HEREMS) database, and the Financial Assessment Subsystem."
See comment 33.	40	3rd bullet	Revise the last sentence of the bullet to state that: "This capability will strengthen assurances that Section 8 <u>and</u> public housing tenants receive appropriate levels of rental assistance."
See comment 34.	42	Column 2 of the 1st row of the Table, items (a) and (c)	Correct item (a) by adding the word "of" before the word rejected, and update item (c) by reflecting a revised target date of the end of July 2000 for completing the reconciliation of the first two quarters of FY 2000. The revision of this target date was necessitated by a diversion of resources to support the OIG's on-going audit of the completed FY 1999 reconciliations to establish opening balances for the FY 2000 financial statement audit.
See comment 35.	42	Column 2 of the last row of the Table	The first word, "FHA," should be changed to "Housing," as Section 8 is a Housing program, not an FHA program.
See comment 36.	43	2nd paragraph	The statement that "This condition has been reported and continues to exist relatively unchanged since fiscal year 1991" appears unfair, given the known barriers to more effective controls and the extent of HUD's efforts to improve its controls. Consider adding a new last sentence giving HUD credit for the major initiatives it has been

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		pursuing for the past several years, which are nearing full implementation, including the large-scale computer matching and income verification project, and the nationwide matching of social security (SS) and supplemental security income data (SSI).
44	1st full paragraph	Consider adding a new last sentence to this paragraph that indicates that: "HUD is verifying its estimate with a baseline analysis. The estimates may be high and will be offset by the effects of households' income overreporting or agencies' failure to provide all allowable exclusions/deductions."
44	Table 4, 1st column	It should be clarified that while the estimates are reported in footnotes to HUD's annual financial statements for HUD fiscal years ending September 30th of each year, the estimates are computed from data that applies to the preceding calendar year.
46	1st paragraph, 7th sentence	The sentence would be more correct if it were restated as follows: " HUD has redrafted these letters, but as of May 31, 2000, still has not completed the mailing of all of the letters." Alternatively, it can now be said that about 72,500 tenant letters had been mailed as of June 30, 2000.
46 & 47	Chart	The chart should mention that Asst. Sec. Lucas sent letters to all governors encouraging the exchange of State wage data between State wage agencies and PHAs, to improve up-front verification. The chart should include as planned action PIH is developing an Income Integrity Best Practices Guide based on the most effective and viable State income verification programs.
47	1st row of Table, 3rd bullet	It is true that REAC did perform a nation-wide match of tenants identifying approximately 280,000 potential cases of unreported income exceeding established thresholds. However, since then, HUD has eliminated from further analysis tenants who have moved out since the initial matching, and corrected an error in the creation of the Multifamily Tenant Characteristics System universe that reduced the number of tenants with potential unreported income. Add the following to the language to the end of this bullet: "REAC subsequently reduced the number of tenants to be sent letters to 215,000, primarily by eliminating tenants who no longer receive rental assistance."
47	Footnote # 6	The sentence should be qualified to say QWARA policies took effect generally 10/01/99 although some provisions, like minimum rent, were in effect 10/21/98, the date QWARA was signed.
48	1st full paragraph	This paragraph should be revised in consideration of prior above comments on the revised focus on 215,000 versus 280,000 tenants, and the current status of the mailing of letters. As of June 2000 REAC sent letters to 72,500 tenants. The mailings were temporarily suspended in late June 2000 pending resolution of further tenant group and industry concerns regarding administrative actions required.
48	Footnote 9 (Last sentence)	Delete "for certain families" and add "for households selecting flat rents."
48-49	Paragraphs 4 and 3, respectively	GAO needs to more fully and fairly present the limitations that HUD is up against in improving internal controls in this area. Page 48 contains a statement that: "Many of HUD's efforts so far, including the large-scale matching, have been geared toward detecting abuses after HUD has provided benefits." Page 49 recognizes the social security and supplemental security income

See comment 37.

See comment 38.

See comment 39.

See comment 40.

See comment 41.

See comment 42.

See comment 43.

See comment 44.

See comment 45.

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		"up-front" matching, and states that this is a small percentage of the total tenant income. The last paragraph on page 49 ends with a statement that leads the reader to believe that there is something else HUD could presently be doing concerning "front-end" wage matching that HUD is not doing. The report states that excess subsidy payments reported in fiscal year 1996 indicated that 6 percent of the estimated overpayments were attributable to unreported SS and SSI. Neither GAO and the OIG have identified any other legally permissible and practical techniques that HUD could presently use for "up-front" computer matching. The 6 percent estimate of overpayments attributable to unreported SS and SSI applies to calendar year 1996. The last paragraph on page 49 should conclude that HUD is taking all legally permissible and practical steps it can take to resolve the problem within existing legislative constraints. REAC will examine other alternative sources for wage data matching as they become legally available and practical to use. Further, the paragraph should recognize that substantially resolving the problem is extremely complex, given the extensive privacy constraints, complex program requirements, and the more than 20,000 local administrators of HUD's rental assistance programs. We suggest that the second paragraph include statements that social security (SS) and supplemental security income (SSI) represent about 40 percent of total household income shown in MTCS data. One analysis of unreported household income indicated that about 6 percent of the excess rental assistance was attributable to unreported SS and SSI benefits.
52	Appendix III, Table 6, 4th item - Increase efforts to conduct management and occupancy reviews of troubled and potentially troubled projects.	The reports notes, correctly, that MF Housing disagreed with the IG recommendation to increase the number of management and occupancy reviews conducted in order to meet an outdated handbook reference. In fact, management and occupancy reviews are now only one of a number of strategies for following up on troubled and potentially troubled projects. Nonetheless, as of the date of the Draft report, the MF field offices had conducted almost 2,000 management and occupancy reviews - a ten-fold increase in the number of such reviews conducted in FY1999.
63--67	Entire discussion regarding "FHA's Information Systems Must Be Enhanced to More Effectively Support FHA's Business Process"	The GAO's observation that FHA relies on a number of legacy systems that may be less efficient is a concern shared by FHA. FHA is pursuing a vigorous course of modernization and replacement of systems that will provide the efficiency, integration, and responsiveness needed to support FHA's business needs. This investment builds on the notable progress made in the Multifamily Housing area's REMS system and its related modules, the integration evidenced by the HEREMS database, and steps to date to integrate the related efforts in the Departmental Enforcement Center and Real Estate Assessment Center. This report notes the steps made to date and the scheduled actions. The proposals in this area for FY 2001 build on the level of progress and include a distinct and unique project that will be solely responsible for integration of these efforts. The Multifamily Integration Project will be in charge of the database design and administration, data

See comment 46.

See comment 47.

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		standardization, coordinating project plans, integration testing, and release control. In the area of Single Family Housing, the programs have undergone significant changes and streamlining in the past several years. Single Family presents an opportunity for significant modernization of systems and challenge. This program area has a very large transaction volume and relies on several of FHA's oldest legacy systems. FHA proposes to make significant investments to modernize the supporting data systems. This builds on the major strides already taken to provide our external business partners with a modern WEB based interface to the basic business process. FHA has proposals to apply its financial and staff resource skills to several major initiatives starting in FY 2001. These include a major portion of the work to modernize the system supporting Single Family Underwriting. FHA agrees with the GAO that its systems need to be given a high priority, both in terms of the overall Enterprise Architecture and in terms of an acceptance of the need for FHA to apply its financial and staff resources to the program needs of FHA. The FHA programs insure assets of over half a trillion dollars serving millions of Americans. Assigning a high priority to its systems will allow FHA to act in a timely and effective manner to manage the programs and ensure proper oversight and internal controls. It will ensure FHA controls application of its financial and skill resources to meet the business requirements of the FHA programs.
64	Table 9, 2nd item	Integration of REMS with the applicable REAC and Enforcement Center systems is to be completed by 9/30/2000.
67	Table 10, top item on page	FHA now estimates that it will select a new JFMIP compliant subsidiary ledger system by 9/30/00, and develop a detailed implementation plan by 11/30/00.

See comment 48.

See comment 49.

The following are GAO's comments on the Department of Housing and Urban Development's letter dated July 13, 2000.

GAO's Comments

1. We modified our report to clarify the complex nature of some of the obstacles affecting HUD's efforts to resolve its material internal control weaknesses. Also see comment 6.

2. We modified our report's title to address this concern.

3. Our report accurately describes what HUD has accomplished in resolving its multifamily project monitoring material weakness and what remains to be done. We added HUD's comment to our report, noting that the Department disagrees with the Inspector General's assessment that multifamily project monitoring remains a material weakness. However, HUD's Office of Inspector General will determine, after auditing HUD's fiscal year 2000 financial statements, whether this material weakness should be downgraded in light of HUD's recent actions. An audit report on these statements will be prepared in the spring of 2001.

4. We modified our report, where appropriate, to clarify whether we were addressing specific actions related to single-family or multifamily housing. However, it is important to note that most of the material internal control weaknesses, as stated, are addressed to HUD or FHA overall and, except for those involving rental subsidies and multifamily project monitoring, are not specific to single-family or multifamily housing.

5. We modified our report to address this concern.

6. We modified our report, where appropriate, to include the contributing causes of the delays reported by HUD. Also see comment 1.

7. We modified our report to clarify that the resource issues are no longer reported as separate material weaknesses, but we did not include HUD's comment that the "remaining deficiencies" were reassessed because this statement is more specific than the Inspector General's report.

8. We modified our report to clarify that no changes were made in the Inspector General's description of this material weakness.

9. We modified our report to clarify that no changes were made in the Inspector General's description of this material weakness.

10. We modified our report to emphasize the need for HUD to continue its efforts to resolve problems identified by its physical inspections and financial assessments. Also see comments 12 and 14.

11. HUD provided further information on the Resource Estimation and Allocation Process, which we included in appendix II of our report.

12. We modified our report to emphasize the need for HUD to continue its efforts to resolve problems identified by its physical inspections and financial assessments of multifamily projects. See comments 10 and 14.

13. We modified our report to address this concern.

14. We modified our report to address this concern. Also see comments 10 and 12.

15. We agree that HUD's nonmaterial internal control weaknesses are not the primary focus of our report. The purpose of this section of the report is to indicate that such less severe weaknesses also exist at HUD, as they do at other organizations, and could affect HUD's operations. Without a discussion of these nonmaterial internal control weaknesses, our report could be viewed as incomplete—and therefore misleading—because such weaknesses could adversely affect HUD's operations. In response to HUD's comments on duplication, we excluded those open recommendations related to the material weaknesses.

16. We modified our report to clarify that HUD considers the recommendations not only of the Inspector General, but also of GAO and HUD management, when developing the Department's corrective action plans.

17. We modified our report to address this concern.

18. We modified our report to address this concern.

19. We modified our report to correct the date.

20. We updated our report to reflect the information HUD provided.

21. As noted in our report, HUD officials told us that addressing the Year 2000 computer issue was an obstacle because it consumed many of the technical staff resources they expected to use on information systems

improvements. We do not state or imply in our report that HUD made no improvements in its information systems during the year.

22. We updated our report to reflect the June 30, 2000, information provided by HUD. Also see comment 39.

23. Our report states that delays in implementing the large-scale computer matching were caused by concerns raised by tenant groups and technological problems. Both the redrafting of the income discrepancy letters and issues involving the Income Discrepancy Resolution Guide were the result of concerns raised by tenant groups. We modified our report to delete the reference to QHWRA.

24. The purpose of this discussion was to present information on some of the obstacles HUD has encountered in addressing its material internal control weaknesses. Other sections of our report discuss HUD's major accomplishments in resolving its material internal control weaknesses, including its awarding of contracts for third parties to administer Section 8 housing assistance contracts. We believe that the delay HUD experienced in awarding these contracts is significant. HUD's multifamily monitoring plan called for all of the contracts to be awarded by December 1999. Although the first contracts were awarded in February 2000, all contracts had not been awarded as of June 9, 2000. HUD reported to us that as of June 9, 2000, 35 contracts had been awarded and that more contracts will be awarded, but it did not specify how many more such contracts will be awarded. We revised our report to update the number of contracts awarded to 35 from the 24 noted in our report as of May 18, 2000.

25. We modified our report to acknowledge HUD's accomplishments regarding the management and marketing of its single-family inventory and clarify the discussion of problems requiring further attention from HUD.

26. We modified our report to include HUD's comments on the training received by its Chicago and Seattle staff.

27. We added the information that HUD is planning six reviews covering 13 field offices.

28. We modified our report to clarify that the Inspector General continued to report on three reopened recommendations from a prior report.

29. We modified our report to clarify that, according to the Inspector General's report, the initiatives were delayed during fiscal year 1999.

30. We updated our report to include the new name of the system and the information from HUD that the additional software, expected to be completed in July 2000, was released in June 2000.

31. We updated the our report to reflect new information on specific actions HUD is planning to improve computer security.

32. We updated our report to indicate that the Financial Assessment Subsystem was implemented.

33. We updated our report to show that public housing tenants would also be included in the computer matching effort.

34. We updated our report to show that the completion date for the reconciliation of the first two quarters of fiscal year 2000 was changed from the end of June 2000 to the end of July 2000.

35. We modified our report to show that Housing will implement the recapture process.

36. We modified our report to focus on the fact that this problem was first reported in fiscal year 1991.

37. We did not modify our report to indicate that HUD's excess subsidy estimate may be overstated. This estimate is based on a valid statistical sample of tenant households. Also, HUD's disclosure of this estimate in the footnotes to its financial statements gives no indication that this amount may be overstated for the reasons provided by HUD.

38. While this information was included elsewhere in the report, we added a note to the table to specify that the estimated excess subsidy payments are computed from data that apply to the preceding calendar year.

39. We updated our report to include the number of tenant letters that HUD had mailed as of June 30, 2000. Also see comment 22.

40. We modified our report to indicate that HUD has encouraged the exchange of wage data between state agencies and public housing

authorities and that HUD is planning to develop a best practices guide on the most effective and viable state income verification programs.

41. We updated our report to include the information HUD provided on the reduction in the number of tenants to be sent discrepancy letters and the reason for the reduction. Also see comments 39 and 43.

42. We modified our report to indicate that the minimum rent provisions generally were effective the date the Quality Housing and Work Responsibility Act was signed.

43. We updated our report to indicate that the number of tenants receiving letters had been reduced and that about 72,500 letters had been mailed to tenants as of June 30, 2000. Also see comments 39 and 41.

44. We modified our report to indicate that QHWRA allows housing authorities, every 3 to 5 years, to recertify the incomes of households selecting flat rents.

45. We modified our report to clarify that HUD faces significant limitations in its efforts to ensure that the appropriate amount of rental assistance is provided to eligible households.

46. We updated our report to include the number of management and occupancy reviews conducted by HUD in fiscal year 2000 through June 2000.

47. Because HUD agreed with our observations on FHA's financial and information management systems and suggested no changes, we did not modify our report.

48. We incorporated the revised completion date of September 30, 2000.

49. We revised the dates for selecting a new subsidiary ledger system and developing a detailed implementation plan.

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