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GAO Audits of Accounting and Financial
Management Systems at the Federal
Housing Administration

Statement of
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Before the
Subcommittee on Housing and Urban Affairs
Committee on Banking, Housing and Urban Affairs
U.S. Senate



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Mr. Chairman and Members of the Committee:

We are pleased to appear here today to discuss GAO's efforts to conduct financial statement audits at the Federal Housing Administration (FHA) and the financial management problems at FHA that we have previously reported.

FHA and the Department of Housing and Urban Development (HUD) have received a great deal of publicity recently regarding various accounting and financial management problems. We have reported many of these types of problems for years. In addition, HUD's Federal Managers' Financial Integrity Act reports have consistently disclosed material weaknesses in FHA and HUD internal controls. FHA's serious accounting and financial management problems have been well documented in all of these reports, as well as in HUD Inspector General reports. Many of the problems have been long-standing. We have found that many of the deficiencies cited in earlier reports continue to be found in our more recent reviews.

Correction of FHA's problems will require multiyear solutions and a long-term management commitment. Strong action is needed by top management to address the very serious problems that continue to affect FHA. An action plan with milestones needs to be developed and implemented with independent monitoring and audit, particularly annual financial statement audits, to

ensure that progress is achieved and any obstacles are identified so that early resolution can be reached.

Before I get into the details of our various financial statement and program reviews, let me spend a few minutes discussing some background related to FHA.

BACKGROUND

FHA was established in 1934 under authority granted to the President by the National Housing Act (Public Law 73-479). In 1948, FHA became a wholly owned government corporation subject to the Government Corporation Control Act, as amended. FHA and its functions were transferred to HUD in 1965. After the transfer, FHA no longer had separate staff or facilities; its operations have been conducted, along with other housing activities, by HUD organizations.

The basic purpose of FHA programs is to encourage improvements in housing standards and conditions, provide an adequate home financing system through mortgage insurance, and exert a stabilizing influence on the mortgage market. To carry out this purpose, the Secretary of HUD administers FHA through four separate funds for its various mortgage insurance programs-- the Mutual Mortgage Insurance Fund, the Cooperative Management Housing Insurance Fund, the General Insurance Fund, and the

Special Risk Insurance Fund. As of September 30, 1987, FHA had \$277 billion of insurance-in-force and net government equity of \$1.2 billion. The Mutual Mortgage Insurance Fund, which is intended to be self-financing, is the largest fund with \$205 billion of insurance-in-force and government equity of \$3.4 billion as of September 30, 1987.

EFFORTS TO CONDUCT FINANCIAL STATEMENT AUDITS

FHA became subject to annual audits by the Comptroller General under the Government Corporation Control Act in 1948. In 1974, the Government Corporation Control Act was amended, and the requirement for an annual audit was changed to require that an audit be made at least once every 3 years.

Our fiscal year 1974 financial statement audit resulted in our issuance of an unqualified opinion indicating that, in our opinion, the financial statements presented fairly, in all material respects, FHA's financial position and results of operations in conformity with generally accepted accounting principles and with applicable federal laws. This was the last unqualified opinion issued on FHA's financial statements.

In 1975, serious problems with FHA's financial management operations began to surface. From 1975 until recently, we were not able to conduct full financial statement audits of FHA

because of very serious accounting and internal control deficiencies which prevented FHA from producing accurate financial statements. These deficiencies included unrecorded transactions, lack of detailed supporting records, and lack of reconciliation of several key accounts to detailed supporting records. For fiscal years 1975, 1976, and 1978, we issued disclaimers of opinion because we were not able to express an opinion on the fairness of FHA's financial statements.

For fiscal year 1981, due to continuing accounting and financial reporting deficiencies, we worked extensively with FHA to assemble a set of financial statements in accordance with generally accepted accounting principles. We issued a report to the Congress (GAO/AFMD-83-66, June 10, 1983), which included FHA's unaudited financial statements. We did not conduct an audit of the accounts because the effort to assemble the statements required a great deal of time and the additional time that would have been needed to gather evidence to support an opinion would have extended this audit into fiscal year 1984, the year of our next required audit. Also, the financial data would have been 3 years old.

In May 1984, we began our fiscal year 1984 financial statement audit, but terminated our efforts after several months because of the continuing serious accounting and financial reporting problems. We met with the HUD Assistant Secretary for

Administration and discussed the issues that needed to be addressed before we could conduct a successful audit. These issues included FHA's responsibility to

- improve internal controls over the general ledger system to ensure it would generate reliable data,
- test new computer systems before implementation to ensure proper operation, and
- reconcile key financial transactions and account balances to the supporting detailed records.

The Assistant Secretary responded to our discussion in a letter dated December 6, 1984, and stated that she was in overall agreement with us and that she had already begun to address a number of the issues that we had presented. To help her resolve these issues, the Assistant Secretary hired several accountants from GAO who were familiar with FHA's financial problems.

To help us fulfill our audit responsibility for fiscal year 1987, we contracted with the independent certified public accounting firm of Price Waterhouse. Although improvements had been made to the accounting and financial systems, the magnitude of accounting and reporting problems still present made it impractical to audit FHA's consolidated statements of operations

and changes in financial position for fiscal year 1987. Therefore, Price Waterhouse's 1987 work focused on auditing FHA's statement of financial position as of September 30, 1987, so as to establish a baseline for a 1988 audit. For fiscal year 1988, Price Waterhouse will provide an opinion on a full set of audited financial statements, as well as reports on internal accounting controls and compliance with laws and regulations.

After FHA agreed to numerous adjustments totaling some \$1.9 billion, Price Waterhouse expressed an unqualified opinion on the fairness of FHA's consolidated statement of financial position as of September 30, 1987. In our opinion, and consistent with the opinion of Price Waterhouse, FHA's statement of financial position was fairly presented. Our report to the Congress incorporated Price Waterhouse's report (GAO/AFMD-89-3, May 12, 1989).

The fiscal year 1988 audit is well underway and is expected to be completed by the end of August. Our report will be issued shortly thereafter. In addition to the opinion on the financial statements and reports on FHA's internal accounting controls and compliance with laws and regulations, Price Waterhouse is developing a separate report on those items identified during its audits which it believes management needs to correct. After the Congress returns from recess, I would welcome the opportunity to discuss the results of our work on the 1988 statements.

REVIEWS OF FINANCIAL OPERATIONS

REVEALED SERIOUS DEFICIENCIES

In addition to our financial audit work at FHA, we have also performed reviews of various FHA programs and over the years have issued many reports that describe serious deficiencies in FHA's operations. The reports identified a wide range of financial management problems including internal control weaknesses, accounting system deficiencies, and management inattention. Many of the problems noted in our more recent reports are the same problems cited in earlier reports. Attachment I to this statement includes a list of these reports. I would like to highlight for you the problems we found during a few of our major reviews in the last several years.

-- In 1984, based on an overall general management review of HUD, we reported (GAO/RCED-84-9, January 10, 1984) that HUD's management information systems do not provide timely and accurate data necessary to establish accountability for, and control over, housing and urban development programs. One of these key systems involved the process for underwriting FHA's single-family mortgage insurance. We reported that, although HUD spends millions each year to gather data, much of the data cannot be relied upon for controlling and monitoring

programs, and information needed by managers is not accurate, timely, or readily available.

In addition to program functions, we found that accounting activities would benefit from better systems. Although HUD started automating its accounting systems in the 1950s, these systems are not fully automated and extensive manual effort is needed for accounting functions. Historically, these functions have received limited top-management emphasis and lower priority in systems development. The result has been, as stated in our report, that systems do not include the necessary internal controls to adequately protect against fraud, waste, and mismanagement; do not comply with GAO's principles and standards; and do not provide management with timely and accurate financial data needed for oversight, program implementation, and budgetary analysis.

-- In May 1985, we reported (GAO/RCED-85-4, May 13, 1985) that HUD needed to strengthen its internal controls over procedures for approving insurance on single-family home loans. We found that HUD relies on lenders to obtain and verify information needed to determine the financial capacity of borrowers to repay and does not independently

verify the credit information submitted by the lender, like other properly managed mortgage insurance programs.

Because HUD's single-family loan insurance program protects lenders from the risk that they will not be repaid, making an FHA-insured home loan is virtually risk free for the lender. Because of the weaknesses we reported in HUD's procedures, in a much-publicized case, a single lender was able to make many loans to home buyers who had no credit history and, in some cases, information regarding the identity of the borrowers and their financial qualifications was misleading.

-- In 1985 (GAO/RCED-86-22, October 8, 1985), we reviewed HUD's second-year implementation of the Federal Managers' Financial Integrity Act of 1982 (FMFIA). The act was intended to help reduce fraud, waste, and abuse in federal government operations by requiring agencies to assess and report annually on the adequacy of their internal controls and accounting systems. Our review found that HUD needed to improve its process of identifying, evaluating, and correcting internal control problems. Also, our review noted that HUD's systems were not in conformance with GAO's standards and requirements.

-- In June 1986, in reporting internal control actions taken on the basis of recommendations made by the HUD Secretary's Single Family Task Force and in our May 1985 report, we found that controls over monitoring loan defaults and verifying loan data submitted to HUD by lenders still needed to be improved (GAO/RCED-86-172, June 3, 1986).

-- In September 1987, we reported (GAO/RCED-87-165, September 30, 1987) on the continuing weaknesses in FHA's home appraisal program. HUD's 1983 FMFIA report identified material weaknesses in its method of selecting and reviewing home appraisals, which opened the program to fraud and abuse, and contributed to FHA's mounting losses. Appraisals were inappropriately selected for review, reviews were inadequate, appraisers were used as reviewers, and computer controls over appraiser assignments were routinely overridden.

FHA has a mortgage monitoring system, and we have been reviewing FHA's management controls to ensure they are being implemented as intended to eliminate fraud, waste, and abuse. The early results of our review of the monitoring system show the following.

-- FHA's system is not adequate for monitoring regional and field offices, lenders, fee appraisers, and counseling agencies. The system does not include all necessary monitoring to ensure that lender quality control plans are adequate, sanctions are imposed for poor performance, and appropriate management uses are made of the results of monitoring.

-- FHA does not have a complete and reliable system for tracking audit findings and recommendations.

In addition to identifying breakdowns in FHA's management controls, I would also like to point out that our work has indicated that there are opportunities to reduce costs by improving program policies and procedures. For example, in April 1988, we reported that in fiscal year 1987 FHA lost \$1.2 billion on the sale of properties acquired because of loan defaults, and we identified changes to improve controls over the foreclosure process to reduce costs. For example, we pointed out that FHA encourage lenders to obtain property deeds from delinquent borrowers willing to offer deeds in lieu of undergoing prolonged foreclosure proceedings which are costly to FHA. Based on our observations, HUD has implemented this and several other procedural changes that, if properly implemented, could result in multimillion dollar savings to the government.

CONCLUSIONS

I have mentioned a few examples of the many reports we have issued over the years describing various deficiencies in many of FHA's programs. FHA's accounting and financial management problems have been long-standing and well documented. Correction of these problems will require multiyear solutions and a long-term commitment by top management.

Although there are no easy fixes to the problems in federal financial management, the development of accurate and reliable financial statements is a very important step in addressing the accountability for assets, recognition of liabilities, and accounting for operations. I have often stated in testimony before the Congress that annual audits, including reviews of internal accounting controls and compliance with laws and regulations, would focus attention on an agency's major problems. To improve accountability, I strongly believe top management needs to develop an action plan with milestones addressing the improvements needed in FHA/HUD's accounting and financial management systems. The plan should also provide for the accountability and discipline of financial statements and the performance of annual financial audits. Agency management and the Congress can monitor HUD's progress through an annual review of the independent auditor's opinion, reports on internal accounting controls and compliance with laws and regulations, and

management's report required by the Federal Managers' Financial Integrity Act.

This concludes my statement, Mr. Chairman. We will be pleased to respond to any questions you or members of the Committee may have.

LIST OF SELECTED GAO REPORTS RELATING TO FHA--1975-1988

Housing Programs: HUD Policies to Minimize Costs in Acquiring Foreclosed Properties (GAO/RCED-88-141BR, April 18, 1988)

Weaknesses in HUD's Single Family Housing Appraisal Program (GAO/RCED-87-165, September 30, 1987)

Housing Programs: Agency Actions to Discourage Single Family Mortgage Insurance Fraud (GAO/RCED-86-172BR, June 3, 1986)

Debt Collection: Billions Are Owed While Collection and Accounting Problems Are Unresolved (GAO/AFMD-86-39, May 23, 1986)

HUD's Second-Year Implementation of the Federal Managers' Financial Integrity Act (GAO/RCED-86-22, October 8, 1985)

Stronger Internal Controls Over HUD Single-Family Mortgage Insurance Programs Would Discourage Fraud (GAO/RCED-85-4, May 13, 1985)

Increasing HUD Effectiveness Through Improved Management
(GAO/RCED-84-9, January 10, 1984)

Problems Continue in Accounting for and Servicing HUD-Held Multifamily Mortgages (GAO/AFMD-82-18, August 18, 1982)

Defaulted Title I Home Improvement Loans--Highly Vulnerable to Fraud, Waste, and Abuse (GAO/AFMD-82-14, December 7, 1981)

HUD Should Make Immediate Changes in Accounting for Secretary-Held Multifamily Mortgages (FGMSD-80-43, May 16, 1980)

Housing and Urban Development's Efforts to Improve Its Accounting System for Mortgage Insurance Premiums (FGMSD-80-27, March 19, 1980)

Delays in Implementing the Department of Housing and Urban Development's Accounting System for its Mortgage Insurance Program (FGMSD-80-37, March 4, 1980)

Weaknesses in Servicing and Accounting for Home Mortgages Held by HUD (FGMSD-79-41, August 16, 1979)

Action Being Taken to Correct Weaknesses in the
Rehabilitation Loan Program (FGMSD-79-14, March 14, 1979)

Weaknesses in the Department of Housing and Urban
Development's Financial Management System (FGMSD-77-75,
December 28, 1977)

Millions of Dollars in Delinquent Mortgage Insurance
Premiums Should Be Collected by the Department of Housing
and Urban Development (FGMSD-77-33, September 8, 1977)

Second Interim Report on Review of HUD's Accounting System
for Billing and Collection of Federal Housing Administration
Mortgage Insurance Premiums From Mortgagees (FGMSD-77-7,
December 13, 1976)

Action Being Taken to Correct Weaknesses in the System of
Paying Taxes on Acquired Residential Properties (FGMSD-76-
24, November 26, 1975)

Need for Improvements in the Automated Payroll System of the
Department of Housing and Urban Development (FGMSD-75-31,
June 18, 1975)