



OFFICE *of*
INSPECTOR GENERAL
★ ★ ★ ★
UNITED STATES DEPARTMENT OF
HOUSING AND URBAN DEVELOPMENT

U.S. Department of Housing and Urban Development

AUDIT OF HUD'S FISCAL YEARS 2022 and 2021
FINANCIAL STATEMENTS | 2023-FO-0004

November 17, 2022

Date: November 17, 2022

To: Vinay V. Singh
Chief Financial Officer, F

//signed//
From: Kilah S. White
Assistant Inspector General for Audit, GA

Subject: Transmittal of Independent Public Accountant's Audit Report on the U.S. Department of Housing and Urban Development's Fiscal Years 2022 and 2021 Financial Statements

Attached are the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) results of the audit of HUD's fiscal years 2022 and 2021 financial statements and reports on internal control over financial reporting and compliance with laws, regulations, contracts, and grant agreements and other matters.

We contracted with the independent public accounting firm of CliftonLarsonAllen LLP (CLA) to audit the financial statements of HUD as of and for the fiscal years ended September 30, 2022 and 2021, and to provide reports on HUD's 1) internal control over financial reporting; and 2) compliance with laws, regulations, contracts, and grant agreements and other matters, including whether financial management systems complied substantially with the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA). Our contract with CLA required that the audit be performed in accordance with U.S. generally accepted government auditing standards, Office of Management and Budget audit requirements, and the Financial Audit Manual of the U.S. Government Accountability Office and the Council of the Inspectors General on Integrity and Efficiency.

In its audit of HUD, CLA reported:

- The financial statements as of and for the fiscal years ended September 30, 2022 and 2021, are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles.
- One material weakness¹ for fiscal year 2022 in internal control over financial reporting, based on the limited procedures performed. The material weakness was related to (a) Federal Housing Administration's (FHA) financial accounting and reporting controls over borrowing authority and loan receivables and (b) HUD's financial reporting controls over grant accruals and Public and Indian Housing's cash management process.

¹ A material weakness is a deficiency or a combination of deficiencies in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of HUD's financial statements will not be prevented or detected and corrected on a timely basis.

- Two reportable matters for fiscal year 2022 of noncompliance with provisions of applicable laws, regulations, contracts, and grant agreements or other matters.
 - Noncompliance with federal financial management system requirements, federal accounting standards, and the U.S. Standard General Ledger at the transaction level.
 - Noncompliance with the Single Audit Act.

In connection with the contract, we reviewed CLA's reports and related documentation and inquired of its representatives. Our review, as differentiated from an audit of the financial statements in accordance with U.S. generally accepted government auditing standards, was not intended to enable us to express, and we do not express, opinions on HUD's financial statements or conclusions about 1) the effectiveness of HUD's internal control over financial reporting; 2) HUD's compliance with laws, regulations, contracts, grant agreements, or other matters; or 3) whether HUD's financial management systems complied substantially with the three FFMIA requirements. CLA is responsible for the attached Independent Auditors' Report, dated November 17, 2022, and the conclusions expressed therein. Our review disclosed no instances in which CLA did not comply, in all material respects, with U.S. generally accepted government auditing standards.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, appendix 8M, requires that OIG post its reports on the OIG website. Accordingly, this report will be posted at <https://www.hudoig.gov>.

If you have any questions or comments about this report, please call Brittany Wing, Audit Director, at (202) 320-7296.



Independent Auditors' Report

Inspector General
U.S. Department of Housing and Urban Development

Secretary
U.S. Department of Housing and Urban Development

In our audits of the fiscal years 2022 and 2021 financial statements of the U.S. Department of Housing and Urban Development (HUD), we found:

- HUD's financial statements as of and for the fiscal years ended September 30, 2022, and 2021, are presented fairly, in all material respects, in accordance with United States of America (U.S.) generally accepted accounting principles;
- one material weakness for fiscal year 2022 in internal control over financial reporting based on the limited procedures we performed; and
- two reportable noncompliance for fiscal year 2022 with provisions of applicable laws, regulations, contracts, and grant agreements we tested and no other matters.

The following sections discuss in more detail (1) our report on the financial statements, which includes emphasis-of-matter paragraphs related to the loans receivable and related foreclosed property, net, and loan guarantee liability line items and modified federal credit reform accounting, and the required supplementary information (RSI)¹ and other information² included in the Agency Financial Report (AFR); (2) our report on internal control over financial reporting; (3) our report on compliance with laws, regulations, contracts, and grant agreements and other matters; and (4) HUD's response to the audit report.

Report on the Audit of the Financial Statements

Opinion

We have audited the accompanying financial statements of HUD, which comprise the consolidated balance sheets as of September 30, 2022, and 2021; the related consolidated statements of net cost, changes in net position, and the combined budgetary resources for the fiscal years then ended; and the related notes to the financial statements.

In our opinion, the U.S. Department of Housing and Urban Development's financial statements referred to above present fairly, in all material respects, HUD's financial position as of September 30, 2022, and 2021, and its net cost, changes in net position, and budgetary resources for the fiscal years then ended in accordance with U.S. generally accepted accounting principles.

¹ The RSI consists of Management's Discussion and Analysis and the Combining Statement of Budgetary Resources, which are included with the financial statements.

² Other information consists of the OIG Report on Top Management Challenges Facing HUD in FY2022, Response to OIG Report on Management and Performance Challenges, Summary of Financial Statement Audit and Management Assurances, Payment Integrity Information, Secretary's Audit Resolution Report to Congress, Civil Monetary Penalty Adjustment For Inflation, and Grants Program Information.

INDEPENDENT AUDITORS' REPORT (Continued)

Basis for Opinion

We conducted our audits in accordance with U.S. generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 22-01, *Audit Requirements for Federal Financial Statements* (OMB Bulletin 22-01). Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of HUD and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter

As discussed in notes 1 and 7 to the financial statements, HUD discloses certain loans receivable, net, and negative loan guarantees of \$61,372 million and \$39,768 million, respectively, as of September 30, 2022, the majority of which are issued under the *Federal Credit Reform Act of 1990* and attributable to the Federal Housing Administration (FHA), a significant component of HUD. HUD values these Credit Reform direct loans and loan guarantees and related receivables from assigned notes and property inventories at the present value of their estimated future cash flows associated with these assets. Anticipated cash outflows primarily include lender claims arising from borrower defaults, premium refunds, and costs to maintain and sell foreclosed properties. Anticipated cash inflows primarily include insurance premium receipts, proceeds from asset sales and principal and interest collections on Secretary-held notes. The valuation estimates are developed using econometric models that integrate historical loan-level program and economic data with regional house price appreciation forecasts to develop assumptions about future portfolio performance. Subsidy costs are intended to estimate the long-term cost to the U.S. Government of its direct loan and loan guarantee programs. A subsidy re-estimate is performed annually and any adjustment resulting from the re-estimate is recognized as subsidy expense when net cash outflows are expected or subsidy surplus when net cash inflows are expected. Actual results may differ from the estimates. Our opinion on HUD's financial statements is not modified with respect to this matter.

As discussed in notes 1, 8, and 15 to the financial statements, HUD discloses that the Government National Mortgage Association (Ginnie Mae), a significant component of HUD, administers a mortgage-backed securities (MBS) guarantee program that does not follow the Federal Credit Reform Act but uses a program, financing, liquidating and capital reserve accounts to process its cash receipts and disbursements through the U.S. Department of Treasury. Ginnie Mae established this fund structure at the direction of the Office of Management and Budget (OMB) in 2012. Under this structure, OMB also instructed Ginnie Mae to annually record an upward and downward re-estimate and negative subsidy payment, for budgetary purposes only. Based on these estimates, Ginnie Mae transfers funds among its accounts. Ginnie Mae reflects these transfers in the spending authority from offsetting collections and new obligations and upward adjustments financial statement line items on HUD's combined statement of budgetary resources, and these transfers impact the amount held in fund balance with Treasury versus investments on HUD's balance sheet. Therefore, although HUD accounts for Ginnie Mae's MBS guarantee program in accordance with Statement of Federal Financial Accounting Standards (SFFAS) 51 – Insurance Programs³, it also performs modified credit reform accounting at the direction of OMB. Our opinion on HUD's financial statements is not modified with respect to this matter.

³ The accounting outlined in SFFAS 51 – Insurance Programs does not include the re-estimates and negative subsidy payment transfers described above. The transfers described above are most closely related to the accounting required under SFFAS 2 – Accounting for Direct Loans and Loan Guarantees. However, Ginnie Mae does not follow SFFAS 2 and has only implemented the transfers described for budgetary purposes at the direction of OMB.

INDEPENDENT AUDITORS' REPORT (Continued)

Responsibilities of Management for the financial statements

HUD management is responsible for (1) the preparation and fair presentation of the financial statements in accordance with U.S. generally accepted accounting principles; (2) preparing, measuring, and presenting the RSI in accordance with U.S. generally accepted accounting principles; (3) preparing and presenting other information included in the AFR, and ensuring the consistency of that information with the audited financial statements and the RSI; and (4) designing, implementing, and maintaining effective internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibilities for the Audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit of financial statements conducted in accordance with *Government Auditing Standards* will always detect a material misstatement or a material weakness when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements, including omissions, are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with *Government Auditing Standards*, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements in order to obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.
- Obtain an understanding of internal control relevant to our audit of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of HUD's internal control over financial reporting. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Perform other procedures we consider necessary in the circumstances.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

Required Supplementary Information

U.S. generally accepted accounting principles issued by the Federal Accounting Standards Advisory Board (FASAB) require that the RSI be presented to supplement the financial statements. Such information is the responsibility of management and, although not a part of the financial statements, is required by FASAB, which considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical

INDEPENDENT AUDITORS' REPORT (Continued)

context. We have applied certain limited procedures to the RSI in accordance with *Government Auditing Standards*, which consisted of inquiries of management about the methods of preparing the RSI and comparing the information for consistency with management's responses to the auditors' inquiries, the financial statements, and other knowledge we obtained during the audits of the financial statements, in order to report omissions or material departures from FASAB guidelines, if any, identified by these limited procedures. We did not audit, and we do not express an opinion or provide any assurance on the RSI because the limited procedures we applied do not provide sufficient evidence to express an opinion or provide any assurance.

Other Information

HUD's other information contains a wide range of information, some of which is not directly related to the financial statements. This information is presented for purposes of additional analysis and is not a required part of the financial statements or the RSI. HUD management is responsible for the other information included in the AFR. The other information does not include the financial statements and our auditors' report thereon. Our opinion on the financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the financial statements, or the other information otherwise appears to be materially misstated. If, based on the work performed, we conclude that an uncorrected material misstatement of the other information exists, we are required to describe it in our report.

Report on Internal Control over Financial Reporting

In connection with our audits of HUD's financial statements, we considered HUD's internal control over financial reporting, consistent with our auditors' responsibilities discussed below.

Results of Our Consideration of Internal Control over Financial Reporting

Our consideration of internal control was for the limited purpose described below and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies or to express an opinion on the effectiveness of HUD's internal control over financial reporting and therefore, material weaknesses or significant deficiencies may exist that were not identified. We identified a certain deficiency in internal control over financial reporting that we consider to be a material weakness, described below and in Exhibit A.

Weaknesses in Internal Control Over Financial Accounting and Reporting

Weaknesses in Internal Controls over FHA's Borrowing Authority and Loans Receivable

Weaknesses in FHA's preventive controls resulted in the erroneous classification of Federal Financing Bank (FFB) borrowings for direct loans as definite borrowing authority instead of indefinite borrowing authority, requiring FHA to make \$22.2 billion in absolute value accounting adjustments after HUD's year-end financial statements were prepared.

Weaknesses in FHA's preventive controls resulted in the erroneous receipt of \$6.9 billion in excess borrowings from the U.S. Department of the Treasury's Bureau of Fiscal Service (BFS) without adequate approvals from OMB leading to the omission of approximately \$110 million in interest expense within HUD's financial statements as of June 30, 2022.

INDEPENDENT AUDITORS' REPORT (Continued)

Weaknesses in FHA's detective controls, including key reconciliations, resulted in approximately \$843 million of misstatements in the reported borrowing authority within the HUD Statement of Budgetary Resources as of June 30, 2022.

Weaknesses in FHA's detective and monitoring controls over Single Family partial claims resulted in FHA making over \$500 million of reclassifying adjustments within the loans receivable balance after HUD's year-end financial statements were prepared.

Weaknesses in FHA's detective and monitoring controls over loans receivable within the Home Equity Conversion Mortgage (HECM) program resulted in several deficiencies noted with FHA's rights assertion, including whether FHA holds or controls the rights to the collateral property underlying certain HECM loans.

HUD's Internal Control Over Financial Reporting Needs to Be Strengthened

Weaknesses continue within the Office of Community Planning and Development's (CPD) grant accrual process and the related validation processes conducted by the Office of the Chief Financial Officer (OCFO) to validate CPD's estimate, impacting the accrued grant liabilities line item on HUD's balance sheet.

Weaknesses also continue with the accuracy and completeness of transactions related to the Office of Public and Indian Housing (PIH) prepayments and PIH's cash management process, impacting the advances and prepayments, accounts receivables, and account payable line items on HUD's balance sheet.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that even if the control operates as designed the control objective would not be met. A deficiency in operation exists when a properly designed control does not operate as designed or when the person performing the control does not possess the necessary authority or competence to perform the control effectively. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

During our 2022 audit, we identified deficiencies in HUD's internal control over financial reporting that we do not consider to be material weaknesses or significant deficiencies. Nonetheless, these deficiencies warrant HUD management's attention. We have communicated these matters to HUD management, and where appropriate, will report on them separately.

Basis for Results of Our Consideration of Internal Control over Financial Reporting

We performed our procedures related to HUD's internal control over financial reporting in accordance with *Government Auditing Standards*.

Responsibilities of Management for Internal Control over Financial Reporting

HUD management is responsible for (1) designing, implementing, and maintaining effective internal control over financial reporting relevant to the preparation and fair presentation of financial

INDEPENDENT AUDITORS' REPORT (Continued)

statements that are free from material misstatement, whether due to fraud or error; (2) evaluating the effectiveness of internal control over financial reporting based on the criteria established under 31 U.S.C. § 3512 (c), (d) (commonly known as the Federal Managers' Financial Integrity Act (FMFIA)); and (3) providing an assurance statement on the overall effectiveness of internal control over financial reporting included in management's discussion and analysis (MD&A).

Auditors' Responsibilities for the Consideration of Internal Control over Financial Reporting

In planning and performing our audit of HUD's financial statements as of and for the fiscal year ended September 30, 2022, in accordance with *Government Auditing Standards*, we considered HUD's internal control relevant to the financial statement audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of HUD's internal control over financial reporting or on management's assurance statement on the overall effectiveness on internal control over financial reporting. Accordingly, we do not express an opinion on HUD's internal control over financial reporting or on management's assurance statement on the overall effectiveness of internal control over financial reporting. We are required to report all deficiencies that are considered to be material weaknesses or significant deficiencies. We did not consider or evaluate all internal controls relevant to operating objectives as broadly established by the FMFIA, such as those controls relevant to preparing performance information and ensuring efficient operations.

Definition and Inherent Limitations of Internal Control over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition, and (2) transactions are executed in accordance with provisions of applicable laws, including those governing the use of budget authority, regulations, contracts, and grant agreements, noncompliance with which could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements due to fraud or error.

Purpose of Report on Internal Control over Financial Reporting

The purpose of this report is solely to describe the scope of our consideration of HUD's internal control over financial reporting and the results of our procedures, and not to provide an opinion on the effectiveness of HUD's internal control over financial reporting. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering internal control over financial reporting. Accordingly, this report on internal control over financial reporting is not suitable for any other purpose.

Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements and Other Matters

In connection with our audits of HUD's financial statements, we tested compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements consistent with our auditors' responsibilities discussed below.

We also performed tests of compliance with certain provisions of the Federal Financial Management Improvement Act (FFMIA). However, providing an opinion on compliance with FFMIA was not an objective of our audit, and accordingly, we do not express such an opinion.

INDEPENDENT AUDITORS' REPORT (Continued)

Results of Our Tests for Compliance with Laws, Regulations, Contracts, and Grant Agreements and Other Matters

Our tests for compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements disclosed instances of noncompliance or other matters for fiscal year 2022, described below and in Exhibit B, that are reportable under *Government Auditing Standards*. In addition, as described below and in Exhibit B, our tests of compliance with the FFMIA Section 803(a) requirements disclosed instances in which HUD's financial management systems did not comply substantially with (1) federal financial management systems requirements, (2) applicable federal accounting standards, or (3) application of the U.S. Government Standard General Ledger (USSGL) at the transaction level. However, the objective of our tests was not to provide an opinion on compliance with laws, regulations, contracts, and grant agreements applicable to HUD. Accordingly, we do not express such an opinion.

Noncompliance with FFMIA

HUD's noncompliance with FFMIA remained in fiscal year 2022 with its Tenant Rental Assistance Certification System (TRACS) not complying with federal financial management system requirements, federal accounting standards, and the USSGL at the transaction level.

Noncompliance with the Single Audit Act

Although improvements have been made, HUD continues to not comply with key provisions of the Single Audit Act at the departmental level. Specifically, HUD has not accumulated the information necessary to assess its efforts to ensure 1) audits are completed and received timely, 2) recipient corrective actions are appropriate and timely, and 3) it is improving the effectiveness of the single audit process based on performance metrics.

Basis for Results of Our Tests for Compliance with Laws, Regulations, Contracts, and Grant Agreements and Other Matters

We performed our tests of compliance in accordance with *Government Auditing Standards*. Our responsibilities under those standards are further described in the Auditors' Responsibilities for Tests of Compliance section below.

Responsibilities of Management for Compliance with Laws, Regulations, Contracts, and Grant Agreements

HUD management is responsible for complying with laws, regulations, contracts, and grant agreements applicable to HUD, including ensuring HUD's financial management systems are in substantial compliance with FFMIA requirements.

Auditors' Responsibilities for Tests for Compliance with Laws, Regulations, Contracts, and Grant Agreements

Our responsibility is to test compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements applicable to HUD that have a direct effect on the determination of material amounts and disclosures in HUD's financial statements, including whether HUD's financial management systems comply substantially with the FFMIA Section 803(a) requirements, and to perform certain other limited procedures. Accordingly, we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to HUD. We caution that noncompliance may occur and not be detected by these tests.

INDEPENDENT AUDITORS' REPORT (Continued)

Purpose of Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements and Other Matters

The purpose of this report is solely to describe the scope of our testing of compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements, and the results of that testing, and not to provide an opinion on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering compliance. Accordingly, this report on compliance with laws, regulations, contracts, and grant agreements is not suitable for any other purpose.

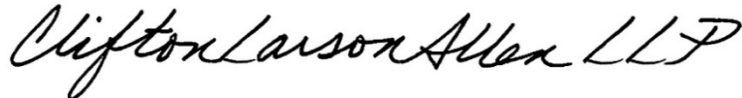
Status of Prior Year's Control Deficiencies and Noncompliance Issues

We have reviewed the status of HUD's corrective actions with respect to the findings and recommendations included in the prior year's Independent Auditors' Report, dated December 9, 2021. The status of prior year findings is presented in Exhibit C.

HUD's Response to Audit Findings and Recommendations

Government Auditing Standards requires the auditor to perform limited procedures on HUD's response to the findings and recommendation identified in our report and described in Exhibit D. HUD's response was not subjected to the auditing procedures applied in the audits of the financial statements, and accordingly, we express no opinion on the response.

CliftonLarsonAllen LLP

A handwritten signature in cursive script that reads "CliftonLarsonAllen LLP".

Greenbelt, MD
November 17, 2022

EXHIBIT A Material Weakness

1. Weaknesses in Internal Control Over Financial Accounting and Reporting

a. Weaknesses in Internal Controls over FHA's Borrowing Authority and Loan Receivables

Certain weaknesses were identified within FHA's internal control over financial accounting and reporting. For details, see FHA financial statement audit report dated November 16, 2022, issued in OIG audit report 2023-FO-0003.

b. HUD's Internal Control Over Financial Reporting Needs to Be Strengthened – Controls over Accrued Grant Liabilities

Background:

HUD must recognize and report balances due to or advanced to grantees at the end of the reporting period. Adjustments are needed to provide for eligible expenses that grantees have incurred as of the reporting date but have not yet reported to the agencies. Since these adjustments are based upon estimates, they are referred to as "accrual estimates."

Condition:

Weaknesses remain in CPD's processes to estimate accrued grant liabilities and OCFO's processes to validate CPD's estimate. Specifically, we found that 1) the assumptions within CPD's methodology were not supported or reevaluated based on the prior year validation and 2) OCFO's validation contained errors and was unreliable because of the significant range totaling over \$1.9 billion.

Criteria:

The Government Accountability Office's (GAO), *Standards for Internal Control in the Federal Government*, state the five components of internal control must be effectively designed, implemented, and operating together in an integrated manner, for an internal control system to be effective. The five components are control environment, risk assessment, control activities, information and communication, and monitoring.

OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, provides guidance to federal managers on improving accountability and effectiveness of federal programs and operations by establishing, assessing, correcting, and reporting on internal controls. Management is responsible for establishing and maintaining internal control to achieve the objectives of effective and efficient operations, and reliable financial reporting.

FASAB's Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government*, states "A liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events. General purpose federal financial reports should recognize probable and measurable future outflows or other sacrifices of resources arising from (1) past exchange transactions, (2) government-related events, (3) government-acknowledged events, or (4) nonexchange transactions that, according to current law and applicable policy, are unpaid amounts due as of the reporting date."

FASAB's Federal Financial Accounting and Auditing Technical Release 12: *Accrual Estimates for Grant Programs* provides specific guidance and framework for developing and documenting reasonable estimates of accrued grant liabilities and states, "For existing programs, management

EXHIBIT A

Material Weakness

should ensure that adequate documentation is available for accrual estimates relating to existing grant programs. Typical support documentation may include (1) support for the calculation of the estimate, including the underlying assumptions used, and (2) historical data supporting the assumptions.”

Cause:

The grant accrual validation control activities and governance structure are not formalized because they are not sufficiently outlined in HUD’s policy. While HUD issued Departmental Grant Accrual Policy, Handbook No. CFO-14-002 in August 2014, it has not been updated to provide specific policies regarding the grant accrual validation. Additionally, there is no standalone policy establishing roles and responsibilities between OCFO and the program offices to include a structured process for preparing, reviewing, evaluating, and monitoring the grant accrual validation’s development, execution, and results.

In addition, there is a lack of a structured process to take the validation information into consideration to determine what changes are needed within the CPD grant accrual estimation process to ensure that grant accrual assumptions are supported, documented, and reevaluated based on prior year validation results. While CPD did make a change to its accrual estimate based on the OCFO’s validation, the change was a top-level adjustment to the grant accrual, and the underlying assumptions and methodology were not reevaluated.

Effect:

Due to weaknesses in HUD’s grant accrual and validation processes, CPD’s fiscal year 2021 accrued grant liabilities is estimated to be understated by \$253 million. Further, these conditions increase the risk of material misstatement to HUD’s fiscal year 2022 accrued grant liabilities.

Recommendations:

We are recommending the Chief Financial Officer:

1A. Develop and issue a departmental grant accrual validation policy or update the existing grant accrual policy to include the validation process. The policy should include 1) specific control activities over the grant accrual validation and outline all of the specific roles and responsibilities; 2) a periodic review of the grant accrual validation to evaluate and reassess its continued relevance and control effectiveness, and ensure any changes are designed and implemented appropriately; and 3) a clear communication plan that requires formal and documented communications between appropriate program offices and OCFO to ensure the validation results are used to update the grant accrual methodology and subsequent period’s estimate, as appropriate.

1B. Develop and document internal procedures to ensure the OCFO’s responsibilities specified within the new or updated grant accrual validation policy are addressed.

1C. Develop and implement procedures to ensure that planning for the CPD grant accrual validation is done early in the accounting cycle to allow for:

- Sufficient resources to be available to perform the validation of the prior year grant accrual.
- Validation efforts to start earlier to allow for follow-up on non-responsive grantees or grantees that provided incomplete information.
- Materiality risk to be considered when planning and evaluating the CPD grant accrual validation.

EXHIBIT A

Material Weakness

1D. Revise CPD Validation Review Instructions to specify documentation requirements similar to those provided to the grantee and specify verification of dates for when the costs were incurred.

We recommend that the Principal Deputy Assistant Secretary for CPD:

1E. Develop and document internal procedures to ensure that they will address the Program Office's responsibilities within the departmental grant accrual validation policy.

We are recommending the Principal Deputy Assistant Secretary for CPD reopen the following recommendation reported in audit report 2021-FO-0003-001-H:

1F. Re-evaluate and adequately document justification for the establishment of the percentages and other key assumptions used to determine the accrual amount for each program in CPD's accrued grant liabilities estimate.

We are recommending the Chief Financial Officer reopen the following recommendation reported in audit report 2021-FO-0003-001-D:

1G. As part of the validation process for CPD's accrued grant liabilities, review CPD's accrued grant liabilities estimation methodology to ensure that it is based on verifiable grantee supporting documentation and all assumptions and variables used for the grant accrual estimate were properly established, supported, and documented.

c. HUD's Internal Control Over Financial Reporting Needs to Be Strengthened – Controls over PIH's Cash Management Process

Background:

HUD's prepayment balances include estimates for certain disbursements made to public housing agencies (PHAs) that are in excess of their expenses. These estimates are required as HUD does not have a system in place to provide real-time information on PHA expenditures or automatically reconcile PHA expenditures with HUD's disbursements.

Condition:

HUD's financial reporting process does not recognize PIH prepayments when funds are disbursed to PHAs as advances or timely recognize expenses at the transaction level when funds are spent by PHAs. Instead, OCFO records an expense for the total HUD prepayment to PHAs upon disbursement. Quarterly, OCFO then records manual journal entries to adjust the PHA expense and prepayment balances in its general ledger to agree to its quarterly PIH prepayment estimate⁴.

In addition, for fiscal year 2022, PIH completed semiannual cash reconciliations, which identified that it had overpaid and underpaid PHAs \$183 million and \$255 million, respectively, as of December 31, 2021. However, no corresponding receivables and payables were recorded by HUD to recognize its cash claim to PHAs for overpayment and underpayment liability owed to PHAs.

⁴ Quarterly, OCFO utilizes PHA disbursement data from its general ledger and PHA expense information provided by PIH to estimate PIH's prepayment balance.

EXHIBIT A

Material Weakness

Criteria:

GAO-14-704G, *Standards for Internal Control in the Federal Government, Principle 10 - Design Control Activities* 10.03 Accurate and timely recording of transactions states, "Transactions are promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from its initiation and authorization through its final classification in summary records. In addition, management designs control activities so that all transactions are completely and accurately recorded."

FASAB's SFFAS 1, *Accounting for Selected Assets and Liabilities*, states:

"Accounts receivable arise from claims to cash or other assets. A receivable should be recognized when a federal entity establishes a claim to cash or other assets against other entities, either based on legal provisions, such as a payment due date (e.g., taxes not received by the date they are due), or goods or services provided."

"Advances and prepayments should be recorded as assets. Advances and prepayments are reduced when goods or services are received, contract terms are met, progress is made under a contract, or prepaid expenses expire."

"Accounts payable are amounts owed by a federal entity for goods and services received from, progress in contract performance made by, and rents due to other entities."

Cause:

PIH relied on untimely expenditure data submitted by PHAs through the Voucher Management System (VMS) and manual cash reconciliations. In addition, PIH did not have a system capable of capturing PHA expenses in real time or performing reconciliations between HUD's disbursements and PHA expenses at the PHA level.

Effect:

HUD's accounts payable and accounts receivable were understated and HUD's PIH prepayment was overstated by the amount that should have been recognized as a receivable.

In addition, because prepayments, accounts receivable, and accounts payable transactions were not recorded by HUD at the point of the transaction date, the HUD recording process did not comply with FFMIA.

Recommendations:

We are recommunicating the following open recommendations reported in audit reports 2014-FO-0003 and 2016-FO-0003:

- 2014-FO-0003-002-C: Implement a cost-effective method for automating the cash management process to include an electronic interface of transactions to the standard general ledger.
- 2014-FO-0003-002-E: Review the cash management process to identify all financial events to be recognized in accordance with GAAP. Establish procedures to account for the cash management activity in a timely manner in compliance with GAAP.
- 2014-FO-0003-002-G: Ensure that PIH's automation of its cash management process complies with Federal financial management requirements.
- 2016-FO-0003-002-D: Establish a process to track the amount HUD owes to PHAs to cover prepayment shortages and provide the information to OCFO so that it can be properly recognized as accounts payable.

EXHIBIT B

Noncompliance Findings

2. Noncompliance with FFMIA

HUD's noncompliance with FFMIA remained in fiscal year 2022 with one system not complying with federal financial management system requirements, federal accounting standards, and the USSGL at the transaction level.

Tenant Rental Assistance Certification System

The Office of Housing is responsible for the Tenant Rental Assistance Certification System (TRACS) application. TRACS is the official contract management repository for the Office of Multifamily Housing Programs' rental assistance project-based contracts, including budget projections and funding for contracts. TRACS is designed to process subsidy contracts, tenant rental assistance information, and owner requests for payment (vouchers) for project-based programs. TRACS did not comply with federal financial management system requirements, federal accounting standards, and the USSGL at the transaction level due to weaknesses in monitoring executed repayment agreements between HUD and multifamily property owners.

HUD management indicated that it decided to incorporate the Housing Opportunity Through Modernization Act of 2016 (HOTMA) requirements into the upcoming TRACS release. The new regulations under HOTMA require HUD Form changes to collect data on tenant income calculations and OMB approval under the Paperwork Reduction Act (PRA). As a result, changes to TRACS to address open recommendations have not been implemented.

We are recomunicating the following open recommendations reported in audit report 2021-FO-0003:

- i. 2021-FO-0003-001-J: We recommend that the Assistant Secretary for Housing – Federal Housing Commissioner review all executed repayment agreements in TRACS to determine which repayment agreements have not been fully repaid and represent an amount owed to HUD and work with OCFO to record these receivables.
- ii. 2021-FO-0003-001-K: We recommend that the Assistant Secretary for Housing – Federal Housing Commissioner include a field in TRACS to identify which repayment agreements represent an amount owed to HUD and implement controls to ensure the accuracy of the listing in TRACS.

3. Noncompliance with the Single Audit Act

While HUD has some internal controls to address single audit requirements at the program office level, the Single Audit Accountable Official cannot assess and demonstrate HUD's compliance with 2 CFR § 200.513(c) at the departmentwide level. Compliance with this guidance is required under the single audit act.

HUD has made some progress in developing internal controls for assessing HUD's compliance with OMB's federal awarding agency guidance outlined in 2 CFR § 200.513(c). However, HUD has not, in fiscal year 2022, implemented those internal controls to accumulate information for assessing HUD's efforts regarding:

- Ensuring audits are completed and received in a timely manner.
- Follow-up on audit findings ensuring that the recipient takes appropriate and timely corrective action.
- Improving the effectiveness of the single audit process based on performance metrics.

EXHIBIT B

Noncompliance Findings

The HUD Single Audit Accountable Official's lack of oversight could result in delays in non-federal entities (i.e., Public Housing Agencies, Performance Based Contract Administration, and grantees) having single audits conducted or delays in HUD issuing management decisions, which could potentially delay corrective actions and the recovery of sustained questioned costs.

We recommend that the CFO:

3A. Establish a formal policy addressing HUD's federal awarding agency responsibilities under 2 CFR § 200.513(c). The policy should identify those involved in the process and their roles in addressing this single audit oversight function. The policy should also address how it will be carried out and documented.

We are recomunicating the following open recommendations reported in audit report 2022-FO-0004:

- i. 2022-FO-0004-004-B: Establish controls to determine if single audits for HUD grantees are being completed and reported in a timely manner in accordance with §200.512.
- ii. 2022-FO-0004-004-D: Establish controls to determine if follow-up is being conducted to determine if the recipient has taken appropriate and timely corrective action. That follow-up must include the following:
 - Issuing a management decision letter as prescribed in §200.521.
 - Monitoring the recipient taking appropriate and timely corrective action.
 - Using cooperative audit resolution mechanisms (see §200.25) to improve federal program outcomes through better audit resolution, follow-up, and corrective action.
 - Developing a baseline, metrics, and targets to track, over time, the effectiveness of HUD's process to follow-up on audit findings and on the effectiveness of single audits in improving recipient accountability and their use by HUD in making award decisions.
- iii. 2022-FO-0004-004-F: Establish a control to hold HUD's Single Audit Accountable Official responsible for improving the effectiveness of the single audit process based on single audit metrics that HUD will establish.

EXHIBIT C
Status of Prior Year Findings

Our assessment of the current status of the findings related to the prior year audit is presented below:

<i>FY 2021 Findings</i>	<i>Type</i>	<i>Fiscal Year 2022 Status</i>
<p>Weaknesses in Internal Control Over Financial Reporting</p> <ul style="list-style-type: none"> a. Weaknesses in Controls over FHA’s Financial Accounting and Reporting b. HUD’s Internal Control Over Financial Reporting Needs to Be Strengthened - Controls over Accrued Grant Liabilities c. HUD’s Internal Control Over Financial Reporting Needs to Be Strengthened - Controls over PIH’s Cash Management Process 	Material Weakness	<ul style="list-style-type: none"> a. Closed b. Modified Repeat – see fiscal year 2022 Material Weakness 1.b. c. Repeat - see fiscal year 2022 Material Weakness 1.c.
Weaknesses in Controls over FHA’s Econometric Modeling Activities	Significant Deficiency	Closed
HUD Noncompliance with FFMIA	Noncompliance	Repeat - see fiscal year 2022 Noncompliance 2.
HUD Noncompliance with the Single Audit Act	Noncompliance	Modified Repeat - see fiscal year 2022 Noncompliance 3.

Overall, our assessment of the audit of HUD’s fiscal year 2022 financial statements concluded that 25 prior year audit recommendations remained open at the end of fiscal year 2022.⁵

⁵ These assessments are based on CLA’s review of audit evidence provided by the Department. These assessments may not necessarily reconcile with the recommendation status in HUD’s Audit Resolution Corrective Action Tracking System.

EXHIBIT D

HUD's Response to Audit Findings and Recommendations




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

OFFICE OF THE CHIEF FINANCIAL OFFICER

HUD OCFO MEMO 22-12

November 14, 2022

MEMORANDUM FOR: Rae Oliver Davis, Inspector General, HUD, GAF

FROM: Vinay V. Singh, Chief Financial Officer, F 

SUBJECT: Response to Draft Independent Auditor's Report on HUD's Fiscal Year 2022 Financial Statements

Thank you for the opportunity to review the draft Independent Auditor's Report on HUD's Fiscal Year 2022 Financial Statements. The high level of professionalism, technical expertise, commitment, and collaboration along with the integrity demonstrated by the HUD Offices in this year's audit contributed greatly to the Department's successful results. I appreciate the report recognizes our efforts and provides insights to advance our mission while continuously seeking to improve HUD's financial management capabilities. I would like to thank the Office of Inspector General (OIG), the independent public accounting firm, CliftonLarsonAllen (CLA), and our team for its dedication and commitment to both HUD and the integrity of the financial statement audit process.

We are building upon agency-wide positive and collaborative relationships across the department and with our OIG/CLA. I believe a productive working relationship with the OIG/CLA, and a sound financial statement audit approach are critical to our success in addressing and continuing to resolve our remaining audit findings. The OIG's audit report reflects the significant improvements we have made in the financial controls and highlights the need for further improvements.

I want to celebrate the progress HUD has achieved, as represented by a series of tangible results.

- First, we have established a strong financial management environment that enabled the Department to receive an unmodified audit opinion for the third consecutive year.
- We matured our Accountability, Integrity, and Risk program to determine HUD operational reliability and strengthen weak operations through more thoughtful policies, enhanced risk assessments and traceability of representations and assurances, implementing a structured process to strengthen controls more effectively, and innovated our compliance with laws and regulations review.

EXHIBIT D

HUD's Response to Audit Findings and Recommendations

- We further enhanced mission execution by validating the right funds reach the right recipient at the right point in time. We tested the full payment lifecycle for our CPD Disaster Recovery funds which resulted in a projected error rate of less than 0.2%.
- We helped to detect potential fraud, waste, and abuse through data analytics. In collaboration with program offices, we developed a Single Audit data analytic tool that performs data analytics by exploring, combining, and analyzing massive datasets to find hidden patterns, unseen trends, and discover correlations.
- HUD improved program office insights into performance with “FINSight”, an initiative that features a comprehensive data strategy and several analytics products that improved decision-making while reducing FTE time and effort.
- We took the lead role in a complex effort with PIH to prepare transactional templates and subsequent record 70,000 transactions with a value of more than \$16M.
- We supported the Department in improving the Office of the Chief Information Officer's Information Technology Fund budget execution for FY 2022.
- HUD is a federal leader in implementing a government-wide mandate, G-Invoicing Implementation whereby HUD is currently only one of two cabinet level federal agencies that are green on the G-Invoicing Implementation status tracker.
- We developed the HUD Budget Dashboard that provides an easily accessible means for Departmental leadership to quickly review status of funds, execution rates, and object class details for use in decision making.
- We developed our FY22-26 HUD Strategic Plan. The Plan was built with input from all HUD program offices, HUD leadership, and comments from external HUD partner organizations.
- We revised security/privacy documentation and migrated the Line of Credit Control System off the mainframe to the Microsoft Azure Cloud, and New Core Interface Solution to the new Oracle Cloud Infrastructure that is modernized and secure environments.
- Finally, over the last 18 months, our integrated teams have analyzed the grants management life cycle operation to lay the foundation for continuous progress.

While more opportunities remain to continue transforming how we do business and sustain long-term sound financial management, primarily with the use of technology, we will build upon a firm foundation of financial excellence. I expect we may uncover additional challenges from past practices, service provider transitions, and manual processes as we continue to strengthen our operations and control environment. I remain committed to working with HUD leadership and the workforce to address and fix these deficiencies as we find them. These foundational efforts position us to continue to enable HUD's mission during unprecedented market forces and embrace new opportunities.