



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

Audit of U.S. Department of Housing and Urban Development's Fiscal Years 2024 and 2023 Financial Statements

Audit Report Number: 2025-FO-0003

November 15, 2024

Date: November 15, 2024

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 2024 and 2023 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 2024 and 2023 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 Sikich CPA LLC to audit the financial statements of HUD as of and for the fiscal years ending September 30, 2024 and 2023,¹ 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 Sikich 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, Sikich reported

- That HUD's financial statements as of and for the fiscal year ending September 30, 2024, were presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles.
- No material weaknesses² for fiscal year 2024 in internal control over financial reporting, based on limited procedures performed.

¹ The accompanying financial statements as of and for the fiscal year ending September 30, 2023, were audited by other auditors, whose Independent Auditor's Report, issued on November 15, 2023, expressed an unmodified opinion on those financial statements.

² 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.

- One significant deficiency³ for fiscal year 2024 in internal control over financial reporting, based on the limited procedures performed. The significant deficiency was related to HUD's financial reporting controls over grant accruals.
- No reportable noncompliance issues for fiscal year 2024 with provisions of applicable laws, regulations, contracts, and grant agreements or other matters.

In connection with the contract, we reviewed Sikich's reports and related documentation and questioned 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, and grant agreements or other matters; or (3) whether HUD's financial management systems complied substantially with the three FFMIA requirements. Sikich is responsible for the attached Independent Auditors' Report, dated November 15, 2024, and the conclusions expressed therein. Our review disclosed no instances in which Sikich 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, as amended, 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 do not hesitate to call Brittany Wing, Audit Director, at (202) 320-7296.

³ 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.



333 John Carlyle Street, Suite 500
Alexandria, VA 22314
703.836.6701

SIKICH.COM

INDEPENDENT AUDITORS' REPORT

The Honorable Rae Oliver Davis, Inspector General
U.S. Department of Housing and Urban Development

The Honorable Adrienne Todman, Deputy Secretary Performing the Delegable Duties of the Secretary
U.S. Department of Housing and Urban Development

In our audit of the fiscal year 2024 financial statements of the U.S. Department of Housing and Urban Development (HUD), we found:

- The financial statements as of and for the fiscal year ended September 30, 2024, are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America;
- No material weaknesses in internal control over financial reporting based on the limited procedures we performed;
- One significant deficiency in internal control over financial reporting as of September 30, 2024; and
- No reportable noncompliance for fiscal year 2024 with provisions of applicable laws, regulations, contracts, and grant agreements that we tested.

The following sections contain:

1. Our report on HUD's financial statements, including an emphasis-of-matter paragraph related to disclosures regarding federal credit reform accounting, an other-matter paragraph related to the prior-period financial statements having been audited by a predecessor auditor, required supplementary information (RSI), and other information included with the financial statements; and
2. Other reporting required by *Government Auditing Standards*, which is our report on HUD's (a) internal control over financial reporting and (b) compliance and other matters. This section also includes HUD's comments on our report.

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

Opinion

We have audited the financial statements of HUD, which comprise the consolidated balance sheet as of September 30, 2024, and the related consolidated statement of net cost, consolidated changes in net position, and combined statement of budgetary resources for the fiscal year then ended, and the related notes to the financial statements (collectively, the basic financial statements).

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of HUD as of September 30, 2024, and its net cost of operations, changes in net position, and budgetary resources for the fiscal year then ended, in accordance with accounting principles generally accepted in the United States of America.



Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS); standards applicable to financial statement audits contained in Generally Accepted Government Auditing Standards (GAGAS), issued by the Comptroller General of the United States; and guidance contained in Office of Management and Budget (OMB) Bulletin 24-02, *Audit Requirements for Federal Financial Statements*. Our responsibilities under those standards and OMB Bulletin 24-02 are further described in the *Auditors' Responsibilities for the Audit of the Financial Statements* subsection 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 audit. 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, the majority of which are issued under the *Federal Credit Reform Act of 1990 (FCRA)* 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. These valuation estimates are developed using cash flow models that integrate historical data with economic and program forecasts to develop assumptions underlying the models. 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 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 is not subject to FCRA, but instead has implemented a "modified credit reform" process using program, financing, liquidating, and capital reserve accounts to process its cash receipts and disbursements through the U.S. Department of Treasury and to record upward and downward re-estimate transactions and negative subsidy payments. Ginnie Mae is in ongoing discussions with OMB and its legal counsel on whether the financing account is fully subject to the provisions of FCRA. HUD accounts for Ginnie Mae's MBS guarantee program in accordance with Statement of Federal Financial Accounting Standards (SFFAS) 51 – *Insurance Programs* while also performing modified credit reform accounting. Our opinion on HUD's financial statements is not modified with respect to this matter.

Other Matter

HUD's financial statements as of and for the year ended September 30, 2023, were audited by other auditors, whose Independent Auditors' Report thereon dated November 15, 2023, expressed an unmodified opinion on those financial statements and included an emphasis-of-matter paragraph on disclosures regarding FHA's federal credit reform accounting and Ginnie Mae's modified federal credit reform accounting. We were not engaged to audit, review, or apply any procedures to HUD's fiscal year 2023 financial statements and, accordingly, we do not express an opinion or any other form of assurance on the fiscal year 2023 financial statements.

Responsibilities of Management for the Financial Statements

Management is responsible for (1) the preparation and fair presentation of the financial statements in accordance with U.S. generally accepted accounting principles; (2) the preparation, measurement, and presentation of the RSI in accordance with U.S. generally accepted accounting principles; (3) the preparation and presentation of other information included in HUD's Annual Financial Report, and ensuring the consistency of that information with the audited financial statements and the RSI; and (4) the design, implementation, and maintenance of 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 conducted in accordance with GAAS, GAGAS, and OMB guidance will always detect a material misstatement 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 material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgments made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, GAGAS, and OMB guidance, 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 the 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. 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

Accounting principles generally accepted in the United States of America and OMB Circular No. A-136, *Financial Reporting Requirements*, require that the Management's Discussion and Analysis (MD&A) and other RSI be presented to supplement the basic financial statements. Such RSI is the responsibility of management and, although not a part of the basic financial statements, is required by the Federal Accounting Standards Advisory Board (FASAB) and OMB, who consider it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, and historical context.

We have applied certain limited procedures to the RSI in accordance with auditing standards generally accepted in the United States of America. These procedures consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit and we do not express an opinion or provide any assurance on the information because the limited procedures we applied do not provide us with 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. Management is responsible for the other information included in



HUD's Agency Financial Report. The other information comprises the *Summary of Financial Statement Audit and Management Assurances*, *OIG Report on Top Management Challenges Facing HUD in FY 2025*, *Response to OIG Report on Top Management Challenges*, *Payment Integrity Information Act Reporting*, *Civil Monetary Penalty Adjustment for Inflation*, *Grant Programs*, *Climate Related Financial Risk*, and *Agency Audit Resolution Report* sections of the Agency Financial Report but does not include the financial statements and our auditor's 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.

OTHER REPORTING REQUIRED BY GOVERNMENT AUDITING STANDARDS

Report on Internal Control over Financial Reporting and on Compliance and Other Matters

Internal Control over Financial Reporting

In connection with our audit 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 over financial reporting 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. Given these limitations, during our 2024 audit, we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses. However, material weaknesses or significant deficiencies may exist that have not been identified. We identified certain deficiencies in internal control over financial reporting that we consider to be a significant deficiency, described below and in Attachment A.

HUD's Internal Controls Over Financial Reporting of the Grant Accrual Need to Be Strengthened

Deficiencies remain within the internal control environment surrounding HUD's grant accrual estimate; specifically, there is a lack of governance and effective collaboration, communication, and documentation amongst and between the two stakeholders: the Office of the Chief Financial Officer (OCFO) and the program office of Community and Planning Development (CPD). This lack of governance, communication, and collaboration, coupled with the significant recent growth of the estimate and increasing complexity, subjectivity, and inherent risk factors surrounding the estimate, have substantially increased the risk of estimation uncertainty and susceptibility to misstatement of HUD's Grant Accrual.

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 material weakness is a deficiency, or 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 fiscal year 2024 audit, we also 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 GAGAS and OMB audit guidance.

Responsibilities of Management for Internal Control over Financial Reporting

HUD management is responsible for designing, implementing, and maintaining effective internal control over financial reporting 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 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, 2024, in accordance with GAGAS, 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. Accordingly, we do not express an opinion on HUD's internal control over financial reporting. We are required to report all deficiencies that are considered to be significant deficiencies or material weaknesses. We did not consider all internal controls relevant to operating objectives, 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.

Intended 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 GAGAS in considering internal control over financial reporting. Accordingly, this report on internal control over financial reporting is not suitable for any other purpose.

Compliance and Other Matters

In connection with our audit 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.

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 no instances of noncompliance or other matters for fiscal year 2024 that would be reportable under GAGAS. 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.

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 GAGAS and OMB audit guidance.



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.

Auditors' Responsibilities for Tests of 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 that have a direct effect on the determination of material amounts and disclosures in HUD's financial statements, 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.

Intended 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 GAGAS in considering compliance. Accordingly, this report on compliance with laws, regulations, contracts, and grant agreements and other matters is not suitable for any other purpose.

HUD's Comments

HUD's comments on this report are included in Attachment B. HUD concurred with the finding in our report.

Sibich CPA LLC

Alexandria, VA
November 15, 2024

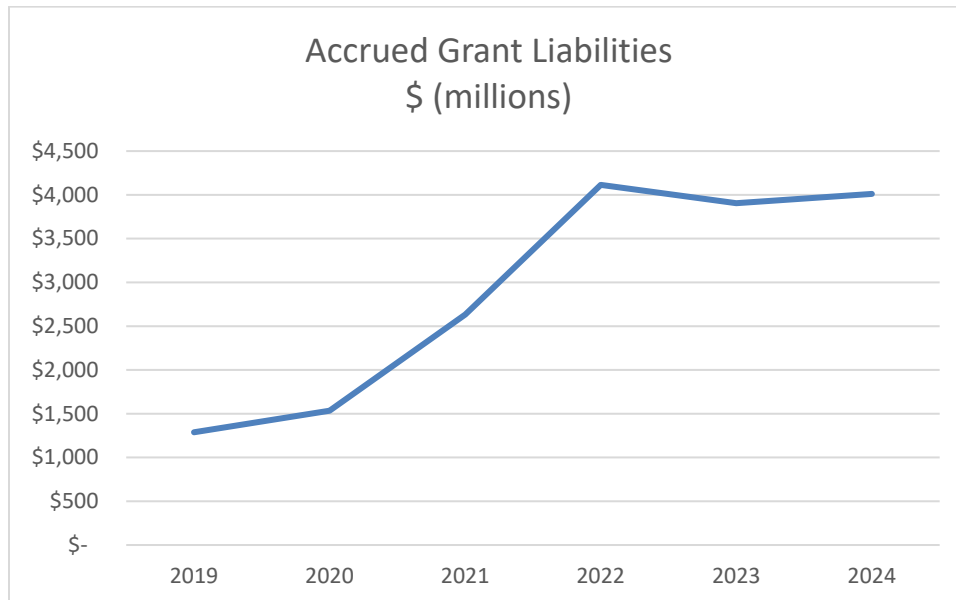
ATTACHMENT A: SIGNIFICANT DEFICIENCY

During our engagement to audit the fiscal year (FY) 2024 U.S. Department of Housing and Urban Development (HUD) financial statements, we identified deficiencies in internal control over financial reporting. These deficiencies include one significant deficiency, as described in this attachment.

SIGNIFICANT DEFICIENCY 1: HUD’S INTERNAL CONTROLS OVER FINANCIAL REPORTING OF THE GRANT ACCRUAL NEEDS TO BE STRENGTHENED

HUD does not have sufficient governance, including effective collaboration, communication, and documentation between the program office (CPD) and the financial office (OCFO), to support the effective development, review, and execution of both the grant accrual calculation and the accrual validation.

Background: Although various HUD program offices are responsible for calculating HUD’s quarterly and year-end grant accruals, the Office of Community Planning Development (CPD) is responsible for calculating the majority of these accruals (approximately 94 percent). The grant accruals represent HUD’s estimate for its obligations/ liabilities for work completed in its grant programs but not yet billed to HUD. HUD’s grant accrual has undergone significant increases since 2019, as shown in the following chart:



This increase in the estimate has also significantly increased the risk of estimation uncertainty, giving rise to inherent subjectivity and variation in measurement outcomes. In calculating the accounting estimate, HUD selects and applies various methodologies using assumptions and data that require significant judgment and complex measurements. The susceptibility to misstatement for this estimate is driven by the effects of increasing complexity, subjectivity, and other inherent risk factors.

A specific key control performed by the Office of the Chief Financial Officer (OCFO) around the relevance and accuracy of HUD’s grant accrual is the grant accrual validation process¹. HUD’s grant accrual validation is performed annually, in two stages. The first stage is conducted in the year after the year-end estimate is recorded and is called the “preliminary validation”. The second stage is conducted in the second year after the same year-end estimate is recorded and is called the “final validation”. For example, OCFO’s preliminary validation of the FY 2023 grant accrual was conducted in FY 2024 and determined whether a sample of transactions from October 2023 through February 2024 (i.e., the first 5

¹ During this validation process, the OCFO’s objective is to determine how close the program office’s year-end grant accrual estimate compares to actual grant expenses.

months of FY 2024) represented expenses that were incurred during FY 2023 or FY 2024. OCFO then estimates the program expenses for March through September 2024 (i.e., the subsequent 7 months of FY 2024) using proxy data from the prior two years' expenses. OCFO uses both the preliminary validation and the proxy data to validate the FY 2023 accrual in FY 2024. Later, in FY 2025, OCFO will review a sample of transactions that occurred from March through September 2024—which it previously estimated using the proxy data—to determine whether the expenses were incurred in FY 2023 or in FY 2024. OCFO will use the results of this review to determine the final grant accrual validation for FY 2023.

Condition:

When developing CPD's grant accrual methodologies and calculating and validating the CPD grant accrual, CPD and OCFO made decisions based on incomplete analysis, unilateral and unsupported rationale, and erroneous information. Specifically, we noted the following issues in fiscal year 2024:

Grant Accrual Calculation

- a. We noted several errors in the second and third-quarter FY 2024 grant accrual calculation that CPD prepared for the Community Development Block Grant Disaster Recovery (CDBG-DR) program.
 - i. For the second quarter, CPD did not calculate the CDBG-DR grant accrual estimate using the correct cumulative outlays. Specifically, CPD erroneously used the outlays from February 2023 to January 2024, instead of the outlays from April 2023 to March 2024.
 - ii. For the third quarter, CPD incorrectly calculated the CDBG-DR grant accrual. Specifically, we determined that CPD had miscalculated one of the cash-on-hand (COH) ratios² dividing the FY 2021 final point estimate by the FY 2022 outlays, instead of to the FY 2021 outlays. We also determined that CPD had miscalculated another COH ratio because OCFO provided CPD with an incorrect point estimate. OCFO was supposed to provide CPD with the CDBG-DR point estimate from OCFO's preliminary validation of the FY 2023 grant accrual; however, OCFO supplied a point estimate of \$1.35 billion, when the correct point estimate would have been \$1.45 billion.
- b. CPD based its decision to change the third-quarter FY 2024 grant accrual methodologies on an incomplete analysis. Specifically, CPD did not include the CDBG-DR program in the analysis that compared the outcome of the new accrual methodology to the outcome of the old accrual methodology on a program-by-program basis. CDBG-DR represents \$1.2 billion, or 32 percent, of CPD's total third quarter grant accrual, and therefore CPD should have included CDBG-DR in the analysis.
- c. OCFO approved CPD's grant accrual estimate for the CDBG-DR program in the third quarter of FY 2024 without being aware that CPD had changed its grant accrual methodology for CDBG-DR. OCFO also approved the annual CPD grant accrual methodologies on August 1, 2024, without knowing that the CDBG-DR grant accrual methodology had changed.
- d. As part of CPD's year-end FY 2024 grant accrual, OCFO approved an accrual amount of \$76 million for the Economic Development Initiative (EDI) program despite CPD not providing adequate documentation and analysis to justify the basis for this amount.

Grant Accrual Validation

- e. In performing its preliminary validation of CPD's FY 2023 grant accrual, OCFO intended to use proxy data for the last 7 months of the prior two FYs (i.e., 2021 and 2022). However, we noted that OCFO

² The cash-on-hand ratio is calculated by using the grant accrual validation's point estimate from a given fiscal year divided by the cash outlays for that fiscal year.

had inadvertently incorporated three FY's worth of proxy data in its validation, rather than two. The inadvertent inclusion of the FY 2020 proxy data caused errors in the results of the validation.

- f. OCFO and CPD did not use the FY 2022 final grant accrual validation results in developing the methodology for CPD's FY 2024 grant accrual and they did not have a documented rationale or coordinated agreement regarding this decision. Instead of operating together in a collaborative effort to develop a better accrual methodology and to improve future validations, OCFO simply informed CPD that the FY 2022 validation results were not reliable and not to use them. The Accounting, Monitoring and Analysis Division (AMAD) staff within OCFO made the recommendation to the Assistant Chief Financial Officer of Accounting, who made the determination not to use the results without documented joint concurrence with CPD. In turn, CPD did not have the opportunity to determine if any portion of the validation was still useful in assessing the reasonableness of CPD's changes to the grant accrual methodologies.

Criteria: GAO-14-704G, *Standards for Internal Controls in the Federal Government* (September 2014), states:

Component – Control Environment

Principle 3 – Establish Structure, Responsibility, and Authority Attributes –

Organizational Structure

3.02 Management establishes the organizational structure necessary to enable the entity to plan, execute, control, and assess the organization in achieving its objectives. Management develops the overall responsibilities from the entity's objectives that enable the entity to achieve its objectives and address related risks.

3.03 Management develops an organizational structure with an understanding of the overall responsibilities and assigns these responsibilities to discrete units to enable the organization to operate in an efficient and effective manner, comply with applicable laws and regulations, and reliably report quality information.

3.04 As part of establishing an organizational structure, management considers how units interact in order to fulfill their overall responsibilities. Management establishes reporting lines within an organizational structure so that units can communicate the quality information necessary for each unit to fulfill its overall responsibilities. Based on the nature of the assigned responsibility, management chooses the type and number of discrete units, such as divisions, offices, and related subunits. Reporting lines are defined at all levels of the organization and provide methods of communication that can flow down, across, up, and around the structure. Management also considers the entity's overall responsibilities to external stakeholders and establishes reporting lines that allow the entity to both communicate and receive information from external stakeholders.

3.05 Management periodically evaluates the organizational structure so that it meets the entity's objectives and has adapted to any new objectives for the entity, such as a new law or regulation.

Documentation of the Internal Control System

3.10 Effective documentation assists in management's design of internal control by establishing and communicating the who, what, when, where, and why of internal control execution to personnel. Documentation also provides a means to retain organizational knowledge and mitigate the risk of having that knowledge limited to a few personnel, as well as a means to communicate that knowledge as needed to external parties, such as external auditors.

Component – Control Activities
Principle 12 – Implement Control Activities
Attributes –

Documentation of Responsibilities through Policies

12.03 Management documents policies for each unit its responsibility for an operational process's objectives and related risks, and control activity design, implementation, and operating effectiveness. Each unit, with guidance from management, determines the policies necessary to operate the process based on the objectives and related risks for the operational process. Each unit also documents policies in the appropriate level of detail to allow management to effectively monitor the control activity.

Periodic Review of Control Activities

12.05 Management periodically reviews policies, procedures, and related control activities for continued relevance and effectiveness in achieving the entity's objectives or addressing related risks. If there is a significant change in an entity's process, management reviews this process in a timely manner after the change to determine that the control activities are designed and implemented appropriately.

Component – Information and Communication
Principle 14 – Communicate Internally
Attributes –

14.01 Management should internally communicate the necessary quality information to achieve the entity's objectives.

Communication throughout the Entity

14.03 Management communicates quality information down and across reporting lines to enable personnel to perform key roles in achieving objectives, addressing risks, and supporting the internal control system. In these communications, management assigns the internal control responsibilities for key roles.

14.05 The oversight body receives quality information that flows up the reporting lines from management and personnel. Information relating to internal control communicated to the oversight body includes significant matters about adherence to, changes in, or issues arising from the internal control system. This upward communication is necessary for the effective oversight of internal control.

The Federal Accounting Standards Advisory Board's (FASAB's) Federal Financial Accounting Technical Release 12 (TR 12), *Accrual Estimates for Grant Programs* (August 4, 2010), states:

11. *Preparing reliable and timely accrual estimates for grant programs must be a joint effort between the budget, financial, and program offices at each agency. These offices should work together to ensure that the procedures and internal control recommendations outlined in this TR are implemented and operating as designed.*
15. *For existing programs, management should ensure that adequate documentation is available for accrual estimates relating to existing grant programs. Typical support documentation may include:*
 - a. *support for the calculation of the estimate, including the underlying assumptions used*
 - b. *historical data supporting the assumptions*

Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control, Policy*, states:

Risk management practices must be forward-looking and designed to help leaders make better decisions, alleviate threats and to identify previously unknown opportunities to improve the efficiency and effectiveness of government operations. Management is also responsible for establishing and maintaining internal controls to achieve specific internal control objectives related to operations, reporting, and compliance.

Cause:

The conditions occurred because HUD does not have sufficient governance over the CPD grant accrual. HUD's Departmental Grant Accrual Policy, CFO-14-002 REV 1, dated July 31, 2023 (policy), does not effectively establish the organizational structure, assign responsibility, and delegate authority to achieve HUD's objectives. Further, the policy does not sufficiently provide for effective and quality communication to ensure that HUD personnel appropriately document and effectively review changes and decisions in key accrual methodologies and accrual calculations. For example, HUD's policy does not include requirements for documented oversight, collaborative discussion, and decisioning for key areas in the form of committee meeting agendas and committee meeting minutes documenting the decisions, why those decisions were made, and key discussion points held between the stakeholders. Additionally, procedures were not sufficient to identify and correct errors before they affected key decisions, and the amounts recorded in HUD's financial statements.

Because CPD has sole responsibility for developing the quarterly grant accruals, OCFO is not effectively and meaningfully involved in the grant accrual process before posting the accruals. The OCFO and CPD do not have formal, scheduled, and documented discussions to ensure that both parties understand any changes and have an opportunity to provide feedback prior to implementation. HUD could have further mitigated the conditions noted through formal and documented consultation and concurrence regarding whether and how proposed changes to the grant accrual methodologies meet HUD's objective of calculating a reasonable and reliable estimate for CPD grant accruals.

Effect:

The lack of a formal governing process over the grant accrual and validation process—one that includes all stakeholders—increases the risk that HUD's CPD grant accrual liability will be misstated. Those risks are demonstrated as follows:

- CPD understated the CDBG-DR grant accrual by approximately \$35 million in the second quarter of FY 2024 and by approximately \$34 million in the third quarter of FY 2024.
- Since CPD based its decision to change the third-quarter FY 2024 grant accrual methodologies on an incomplete analysis, the third-quarter CPD grant accrual was at risk of being understated³. After we brought this to OCFO and CPD's attention, CPD updated the analysis to include CDBG-DR and OCFO made the decision to have CPD go back to using the old grant accrual methodology for CDBG-DR because it would result in a better grant accrual for the fourth quarter of FY 2024.

³ The flawed analysis, excluding CDBG-DR, showed an increase in the CPD accrual under the new methodologies of \$304 million over the old methodologies in the third quarter of FY 2024. Since the results from OCFO's preliminary validation of the CPD grant accrual for FY 2023 determined the accrual was potentially understated by \$145 million based on the old methodology, the erroneous increase of \$304 million led OCFO to believe the new methodology would result in a better estimate for FY 2024. However, the correct analysis including CDBG-DR, actually decreased the accrual by \$217 million. Consequently, the impact of the changes in methodologies for all CPD programs was reduced to \$87 million (\$304 million - \$217 million), and therefore, no longer resulted in the substantial increase needed to reduce the risk of the accrual being potentially understated.

- Given that OCFO's preliminary validation of the CPD grant accrual for FY 2023 projected an accrual of \$115 million for EDI and that OCFO believes the program is growing, the FY 2024 EDI grant accrual of \$76 million may be potentially understated.
- Although it is not possible to calculate the direct effect on the FY 2024 grant accrual, the erroneous use of three FY's worth of proxy data caused OCFO's preliminary validation of CPD's FY 2023 grant accrual to fall within OCFO's acceptable range by a margin of more than \$144 million, instead of being \$145 million under OCFO's acceptable range.
- Although it is not possible to calculate the direct effect on the FY 2024 grant accrual, OCFO's final validation of the CPD grant accrual for FY 2022 indicated that CPD's FY 2022 grant accrual was under OCFO's acceptable range by \$1.72 billion. By disregarding this validation, the OCFO may be missing key data points that are needed to produce a reliable estimate, which increases the risk of a potential misstatement in FY 2024 and future years.
- There are also risks that available solutions to challenges in estimating HUD's grant accrual are not identified timely. For example, OCFO performed the grant accrual validation for 3 years before implementing an available solution in the grant accrual validation methodology, known as the partial-pass method, in FY 2024.⁴ Having a partial-pass method earlier would have allowed for additional data to be considered thereby increasing the representation of the various testing strata and thus contributing to an improved precision in the validation for assessing the reasonableness of the CPD grant accrual.

Recommendations:

We recommend that the Chief Financial Officer:

1A. Enhance existing policies to establish a formal grant accrual risk management framework, to help ensure consistent standards across HUD with regard to the development, review, and execution of the grant accrual and validation. This framework should include 1) identifying grant accrual estimation risk, assessing the magnitude of this risk, and managing the risks that arise when using certain quantitative estimation methods, 2) a governance structure that includes estimation ownership, oversight, and framework assessment, 3) the creation of a committee that is responsible for establishing a holistic approach to estimation risk management, including key stakeholders from OCFO and program offices, such as CPD, and 4) a requirement for documentation of committee meeting agendas, minutes, and key decisions and discussion points which impacts the various grant accrual methodologies across the Department.

We recommend that the Deputy Assistant Secretary for Operations of Community Planning and Development:

1B. Enhance CPD's existing Grant Accrual Standard Operating Procedures to strengthen governance within CPD and to effectively work within the framework established by the OCFO in recommendation 1A. The updated procedures should include increased ownership and oversight over the reviews, authorizations, approvals, and changes to the CPD grant accrual estimates and methodology.

⁴ The partial-pass method is a technique that auditors use when performing classical variable sampling to evaluate a sample of items from a population. It involves testing a subset of the sample to determine if the subset meets certain criteria before deciding whether to test the entire sample. If the subset passes the criteria, the auditor can conclude that the entire sample is likely to be acceptable, thus reducing the amount of testing required. This method is thought to have improved the precision of the validation because it allows the calculation to obtain and use a more efficient data set, which improves the representation in each testing strata.

Attachment B



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

OFFICE OF THE CHIEF FINANCIAL OFFICER

HUD OCFO MEMO 25-7

November 7, 2024

MEMORANDUM FOR: Rae Oliver Davis, Inspector General, GAF

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

Vinay Vijay Singh
Digitally signed by: Vinay Vijay Singh
DN: cn = Vinay Vijay Singh
email = vinay.v.singh@hud.gov
c = US, o = HUD, ou = OCFO
Date: 2024.11.07 09:52:44 -0500

SUBJECT: Management's Response to Draft Independent Auditor's Report on HUD's Fiscal Year 2024 Financial Statements

Thank you for the opportunity to comment and review the draft Independent Auditor's Report on HUD's Fiscal Year 2024 Financial Statements. The Department's success is a result of every person at HUD's commitment to the mission, collaborative spirit, and financial integrity. We are excited to have earned an unmodified (clean) audit opinion on our consolidated financial statements for the fifth consecutive year.

Based on our success, HUD will continue exploring innovations to improve financial processes, reduce burden, and enhance operational effectiveness as we carry out HUD's mission "to create strong, sustainable, inclusive communities and quality affordable homes to all". The annual financial statement audit, coupled with our internal validations conducted through the Accountability, Integrity and Risk program, provide HUD with a valuable opportunity to assess our governance structure, analyze the Department's risk management and control environment, and refine our operations for optimal results.

We welcome and appreciate the due diligence of the independent public accounting firm Sikich, and the efforts and partnership provided by your office as we continue making improvements to mission reliability and innovating on how we operate to provide the best value to America. Our cooperative efforts demonstrate to the American taxpayer our commitment to fiscal stewardship.