OFFICE OF AUDIT
FINANCIAL AUDIT DIVISION
WASHINGTON, DC

U. S. Department of Housing and Urban Development, Washington, DC

Compliance With the Improper Payments Elimination and Recovery Act of 2010

2013-FO-0005

MARCH 15, 2013

Issue Date: March 15, 2013

Audit Report Number: 2013-FO-0005

TO: David Sidari, Acting Chief Financial Officer, F

/s/

FROM: Thomas R. McEnanly, Director of Financial Audits Division, GAF

SUJECT: HUD's Compliance With the Improper Payments Elimination and Recovery Act of 2010

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of HUD's compliance with the Improper Payments Elimination and Recovery Act of 2010.

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, section 8L, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at http://www.hudoig.gov.

If you have any questions or comments about this report, please do not hesitate to call me at 202-402-8216.

Date of Issuance: March 15, 2013

HUD's Compliance With the Improper Payments Elimination and Recovery Act of 2010

Highlights

Audit Report 2013-F0 -0005

What We Audited and Why

We conducted an audit of the U.S. Department of Housing and Urban Development's (HUD) fiscal year 2012 compliance with the Improper Payments Information Act of 2002 as amended by the Improper Payments Elimination and Recovery Act of 2010 (IPERA). The statute was enacted to prevent the loss of billions in taxpayer dollars due to improper payments by requiring the agency to identify and report on its programs and activities that are susceptible to significant improper payments. IPERA also requires each agency's inspector general to perform an annual review of the agency's compliance with IPERA. Our audit objectives were to (1) determine whether HUD complied with IPERA in accordance with the guidance prescribed by the Office and Management and Budget (OMB) and (2) assess the accuracy, completeness of reporting, and performance of HUD in reducing and recapturing improper payments.

What We Recommend

We recommend that HUD program officials address the deficiencies in the program risk assessment design methodology and strengthen their controls and monitoring efforts to reduce improper payments in rental housing assistance programs.

What We Found

While HUD generally complied with IPERA it did not meet all of the law's objectives. The Office of Chief Financial Officer's (OCFO) and Federal Housing Administration's (FHA) risk assessment processes need significant modifications to improve their performance in identifying and reducing improper payments. Specifically, the design of the OCFO's and FHA's risk assessment methodology had weaknesses that limited their ability to identify programs and activities susceptibility to improper payments.

Additionally, the Office of Multifamily Housing did not meet two supplemental measure target goals. Further, a lack of reliable data in the Enterprise Income Verification system hindered management's ability to accurately measure and reduce improper payments.

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BACKGROUND AND OBJECTIVES

The Improper Payments Information Act of 2002 (IPIA) required the head of each agency to annually review all programs and activities it administered, identify all such programs and activities that might be susceptible to significant improper payments, and report estimated improper payments for each program or activity identified as susceptible. For programs with estimated improper payments exceeding $10 million, IPIA required agencies to report the causes of the improper payments, actions taken to correct the causes, and the results of the actions taken. IPIA was amended in July 2010 by the Improper Payments Elimination and Recovery Act (IPERA). IPERA increased the Federal agencies' responsibilities and reporting requirements to reduce and eliminate improper payments and required each agency inspector general to determine whether the agency complied with IPIA. The Office of Management and Budget (OMB) issued Circular A-123, Appendix C, Requirements for Effective Measurement and Remediation of Improper Payments, to provide implementation guidance for agencies.

The U.S. Department of Housing and Urban Development's (HUD) Secretary designated the Chief Financial Officer as the lead official for overseeing HUD actions to address improper payment issues and bringing HUD into compliance with the requirements of IPERA. The responsibility for conducting an agencywide IPERA program risk assessment is jointly shared by the Federal Housing Administration's (FHA) Office of Finance and Budget and HUD's Office of the Chief Financial Officer (OCFO). FHA's Office of Finance and Budget is responsible for conducting a risk assessment of its loan guarantee programs. OCFO's Financial Management Division is responsible for conducting risk assessments of all other HUD programs. Historically, none of the FHA programs have been determined to be susceptible to improper payments.

OCFO identified and reported in its annual agency financial reports several HUD programs that are susceptible to significant erroneous payments, such as the Community Development Block Grant (CDBG) entitlement and State or small cities programs (CDBG program) and public housing, tenant-based voucher, and project-based assistance programs (collectively referred to as HUD's rental housing assistance programs. Program beneficiaries pay 30 percent of their adjusted income as rent, and HUD payments cover the remainder of the rental cost (or the operating cost in the case of public housing). Except for the CDBG program (excluded from annual improper payment reporting since March 2007[1]), HUD has continued to report improper payments for rental housing assistance programs.

HUD has identified the following three sources of errors and improper payments in rental housing assistance programs:

- Program administrator error – The program administrator's failure to properly apply income exclusions and deductions and correctly determine income, rent, and subsidy levels;

[1] HUD found that in 2 consecutive years, CDBG improper payments were below the $10 million threshold. On March 24, 2007, OMB approved HUD's request for relief from annual improper payment reporting for those programs.

- Tenant income reporting error – The tenant beneficiary's failure to properly disclose all income sources and amounts upon which subsidies are determined; and
- Billing error – Errors in the billing and payment of subsidies due between HUD and third-party program administrators or housing providers.

Before IPIA, HUD established the Rental Housing Improvement Integrity Project (RHIIP)[2] to reduce improper payments estimated to be $3.2 billion in 2000. In 2010, HUD implemented supplemental measures to comply with IPERA and Executive Order 13520. Executive Order 13520 required agencies to provide their inspector general the Accountable Official Report describing (1) the agency's methodology for identifying and measuring improper payments; (2) the agency's plans, together with supporting analysis, for meeting the reduction targets for improper payments in the agency's high-priority programs susceptible to improper payments; and (3) the agency's plans, together with supporting analysis, for ensuring that initiatives undertaken pursuant to the Order do not unduly burden program access and participation by eligible beneficiaries.

In consultation with OMB, HUD developed supplemental measures to track and report on intermediaries' efforts in addressing improper payments. HUD provided the details of these supplemental measures in its Accountable Official Report to the Office of Inspector General (OIG) as required. All of HUD's supplemental measures are reported quarterly on OMB's payment accuracy Web site.

HUD has made substantial progress in reducing erroneous payments, from an estimated $3 billion in fiscal year 2000 to $1.23 billion in fiscal year 2011. HUD calculated its estimated annual improper payment amount using a quality control study, an income match study, and a billing study, conducted by independent contractors. These studies were conducted using data from the prior fiscal year.

Our audit objectives were to (1) determine whether HUD complied with IPERA in accordance with the guidance prescribed by OMB and (2) assess the accuracy, completeness of reporting, and performance of HUD in reducing and recapturing improper payments.

[2] RHIIP was implemented to reduce errors in subsidy calculations of tenant rents by verifying the tenants' income and employment using HUD's Enterprise Income Verification (EIV) system or third-party verification letters. Most importantly, it implemented rental integrity monitoring, consisting of ongoing quality control monitoring reviews, to determine whether and to what extent public housing authorities and administrators accurately, thoroughly, and clearly determined family income and rent for the purpose of reducing subsidy errors. The plan, completed in 2009, resulted in a substantial reduction in improper payments in rental housing assistance programs.

RESULTS OF AUDIT

Finding 1: Weaknesses in HUD's IPERA Risk Assessment Methodologies Were Identified

The departmentwide risk assessment[3] methodology for identifying and reporting on risk-susceptible programs had design flaws so that it did not adequately and identify programs that are risk susceptible. This condition occurred because FHA focused its risk analysis on internal control over disbursements rather than analyzing and measuring the impact of lender compliance risk. The OCFO risk assessment's design did not adequately assess the risk of improper payments in HUD's other programs. Additionally, OCFO had not reevaluated its risk assessment design since it was implemented 10 years ago. Because of these weaknesses, HUD may not have identified all high-risk programs that truly need management's attention and achieved all of IPERA's objectives.

FHA's Risk Assessment Methodology Could Be Strengthened

FHA's risk assessment methodology did not fully consider the impact of certain significant risk factors, such as the other management findings and OIG audit report findings. In accordance with OMB Circular A-123, appendix C, part I, section (A)(7), in conducting a qualitative risk assessment, the agency should consider risk factors[4] such as other relevant management findings or agency inspector general audit report findings that could likely contribute to significant improper payments. FHA relies on thousands of lenders to conduct its business, and the deficiencies cited in FHA's internal management reports and OIG audit reports regarding the issue of lender compliance provide relevant information on the susceptibility of FHA programs to improper payments. OMB Circular A-123, appendix C, part I, section (A)(6), defines an improper payment for the loan guarantee program as any disbursement made to an intermediary or third party for defaults that do not comply with law, program regulations, or agency policy. Under FHA's direct endorsement program, lenders are given the responsibility of ensuring that all loans approved for mortgage insurance meet FHA's applicable

[3] The responsibility for conducting the agencywide IPERA program risk assessment is jointly shared by FHA's Office of Finance and Budget and OCFO. FHA's Office of Finance and Budget performs risk assessments of its programs. OCFO's Financial Management Division performs departmentwide risk assessments of all other HUD programs.

[4] Risk factors or risk conditions are factors that are considered relevant when determining susceptibility of improper payments within a program. An example of a risk condition would be program deficiencies cited in OIG audit reports.

requirements. Loans that do not meet FHA's requirements are ineligible for FHA insurance.

As noted above, the lender compliance issue has a significant impact on the IPERA risk assessment. Accordingly, FHA's evaluation of improper payment risks should take the following risk conditions into consideration:

FHA's Internal Management Reports

- The FHA Quality Assurance Division's lender monitoring reviews showed that 92 and 95 percent of the lenders targeted for review in fiscal years 2011 and 2012, respectively, had varying levels of underwriting and servicing compliance issues that resulted in a review finding or Mortgagee Review Board referral. The Office of Finance and Budget did not obtain these reports when performing its analysis. The success of FHA's mortgage insurance program assumes substantial lender compliance with FHA requirements from its lenders. However, a vast majority of FHA-approved lenders reviewed by the Quality Assurance Division were found noncompliant in fiscal years 2011 and 2012 based on the results of FHA's monitoring reviews. FHA's approach for monitoring lenders is risk based so that all FHA-approved lenders would not be subject to such reviews; however all lenders selected had indicators of noncompliance.

Table 1. FHA lender compliance review results for fiscal years 2011 and 2012

Lender compliance reviews	2012	%	2011	%
No. of lenders reviewed with findings	252	92%	273	95%
No. of lenders found without findings	23	8%	15	5%
Total number of lenders reviewed	275	100%	288	100%
Source: Office of Single Family Housing, Quality Assurance Division				

OIG Audit Reports and Other Risk Conditions Identified

- We identified a total of 38 audit reports and memorandums[5] issued in fiscal years 2011 and 2012 that specifically addressed the issue of lender compliance. Of the 38 reports issued, 34 determined significant compliance findings related to the lenders' loan origination and underwriting and servicing activities.[6] Overall, the OIG findings supported systemic problems with the lenders, including four of FHA's largest originators or servicers of FHA-insured loans (Wells Fargo, Bank of America, Citi Mortgage, and Flag Star). Most notably, in four of the memorandums identified,[7] OIG determined that the lenders' loan origination and underwriting practices did not fully comply with FHA's

[5] The transaction period covered in these audit reports was from January 2002 to February 2012.
[6] The 34 OIG audit reports are broken down as follows: 27 origination and underwriting and 7 servicing.
[7] The four OIG audit memorandums are 2012-CF-1809, 2012-CF-1810, 2012-CF-1811, and 2012-CF-1814.

requirements, which resulted in HUD's receiving a total of $958.1 million in court settlements from these lenders.[8] Additionally, in fiscal year 2012, OIG conducted a nationwide audit of nine lenders with the highest volume of preforeclosure sales.[9] OIG estimated that FHA had paid $1.06 billion in claims for 11,693 loans out of 16,976 in paid claims (68 percent) that were not eligible for mortgage insurance benefits because they failed to meet the criteria for participation in the program.

- Since 2008, the surge in the volume of seriously delinquent loans[10] in FHA's servicing portfolio and the lack of focus on servicer reviews indicated emerging risks that FHA should have considered in its risk assessment. The volume of seriously delinquent loans in FHA's servicing portfolio had increased more than 200 percent and had been steadily increasing. The Quality Assurance Division completed 60 servicer reviews, representing 14 percent of FHA's servicing portfolio, but this lack of focus on servicer reviews was not factored into the risk assessment methodology.

The risk conditions listed above were not considered in the FHA-wide risk assessment due to a lack of coordination with the Quality Assurance Division and other program offices within FHA that may conduct reviews or address OIG audit reports. The coordination would allow consolidation of various issues with a specific lender to ensure that an appropriate lender risk profile was established for monitoring purposes. A program official from FHA stated that the lender compliance risk had no direct impact on improper payments.

Additionally, the scope of FHA's risk analysis was limited to a review of FHA's internal controls over disbursements, which was not an area posing the highest risk of improper payment to FHA. OMB Circular A-123, appendix C, part I, section (A)(9), requires agencies to focus their sampling and testing on individual components or transaction points of their programs for the areas posing the highest risk of improper payment. The success of FHA's mortgage insurance assumes substantial lender compliance with its requirements, but as noted earlier, given the history of lender noncompliance, ensuring lender compliance is just as important as ensuring effectively designed and implemented internal controls over disbursements.

The continuing identification and participation of noncompliant lenders made FHA programs more susceptible to fraud, waste, and abuse and increased the likelihood of improper payments. Changing FHA's risk assessment methodology

[8] On the basis of OIG's review, the four lenders agreed to settle the Federal Government's complaint out of court. As part of the settlement, three of the four lenders (Deutsche Bank, CitiMortgage, and FlagStar) admitted, acknowledged, and accepted responsibility for certain conduct alleged in the Government's complaint. The fourth lender, Bank of America, settled without admitting to the allegations of the complaint.
[9] Audit report 2012-KC-0004
[10] The volume of seriously delinquent loans increased from 295,068 in 2008 to 738,991 in 2012.

to include the impact of lender compliance risk would provide a better risk assessment of FHA programs overall.

Weaknesses in OCFO's Risk Assessment Methodology Were Identified

We reviewed in detail the design and methodology of OCFO's risk assessment process for evaluating the improper payment risk susceptibility of 38 HUD grant and subsidy programs. Overall, OCFO's risk assessment methodology had design flaws that could significantly impact the completeness and accuracy of the risk assessment results. Specifically, the following inherent limitations and weaknesses in the design of HUD's risk assessment methodology precluded OCFO from accurately and adequately identifying high-risk programs. We recommend strengthening the following areas:

- OCFO's risk assessment design did not assess each risk factor separately; instead, it combined the risk weight of all risk factors into one overall risk rating, which could allow low-rated risk factors to mask the impact of high-rated risk factors. If one or more of the internal control risk factors were assessed a high risk while others were rated low, the weighted averaging[11] would reduce the severity of the control risk factors' impact. Specifically, if the quality of monitoring controls and the quality of external payment processing at the grantee level were considered high risk, they could reach the threshold for a high-risk program if considered independently. However, because they were weighted with the other, less significant risk factors, their significance was diminished.

[11] For example, in calculating the overall risk rating assessment for CDBG programs, the weighted sum of the risk factors and program expenditure materiality were assigned an 80 and 20 percent weight of the total score, respectively. To determine the 80 percent risk factor score, a secondary risk weight was assigned to each of the risk factors, and the risk level was assessed based on predetermined criteria. The predetermined criteria were based on a risk matrix tool that was created by a HUD contractor and had not been reevaluated or updated since it was developed 10 years ago The risk assessment methodology requires assigning to each risk factor a score of 1 through 5, with 5 being the highest risk.

Table 2. Example of Risk Assessment Matrix for CDBG Programs

CPD: CDBG Programs Type of Risk	Grants Type Weights %	Frequency Weights %	Entitlement Risk Level 1-5
1. Internal Controls:			
Quality of Monitoring Controls	20%		3
Quality of Internal Payment Processing Controls	15%		2
Quality of External Payment Processing Controls at the Grantee Level	15%		4
2. Human Capital Risk	15%		3
3. Programmatic			
Age of Program	5%		1
Complexity of Program	15%		1
Nature of Program Recipients	15%		3
Subtotal for the frequency of all risk factors. Weight is lowered to 80% to calculate the overall score.	100%	80%	2.6
Severity of the Risk: Materiality of the expenditure.		20%	5
Overall Score *		**100%**	**3.1**

* *An overall risk score greater than 3.5 is required to qualify for statistical sampling.*
Source: FY 2012 Final IPIA Risk Assessment Matrices

- The guidelines and criteria used by OCFO for determining the appropriate level of risk based on a given risk condition were set too high, thus undermining the true impact of the deficiencies. The criteria focused on the number of instances rather than severity of the issues. Also, based on the threshold and weights assigned it would be nearly impossible for a truly high-risk condition to achieve a high-risk rating overall. For example, to achieve the highest risk rating of "5" in the CDBG program for the risk factor entitled Quality of External Payment Processing Controls at Grantee Level, both of the following conditions would have to be met: (1) over a 60 percent average of the single audit clearinghouse statistics[12] from the single audit data and (2) more than five U.S. Government Accountability Office or inspector general reports citing relevant issues.

  With regard to the first requirement, single audit data statistics were averaged together. [13] By averaging them together, the significance of the

[12] The single audit clearinghouse statistics categories include (1) reportable conditions, (2) material weaknesses, (3) material noncompliance, (4) low risk, and (5) questionable costs.
[13] The 60 percent threshold is calculated as an average of the risk categories obtained from the fiscal year 2010 single audit clearinghouse statistics. The average was calculated as follows: (1) reportable conditions – 46 percent,

individual risk categories, particularly reportable conditions and material weaknesses, were masked. In addition, the 60 percent average threshold was too high because the impact of each risk category included in the single audit clearinghouse statistics was not complementary and using the averaging method could obscure the true risk of the program. With regard to the second requirement, the severity of the issues in the audit reports (quality) and not the number of audit reports (quantity) should matter in the risk assessment.

- The risk factor weighting for the two HUD programs marked "Not Applicable" was not redistributed to account for 100 percent of the risk weights. This limitation would make it harder for the applicable programs to achieve a risk rating that is appropriate for its risk condition.

Table 3. Example of Risk Assessment Matrix for Administrative Cost Programs

Administrative Cost "Programs" Type of Risk	Grants Type Weights %	Frequency Weights %	HSG: EHLP - Program Acct - Administrative Costs Risk Level 1-5	PIH: Tenant-Based Rental Assistance: Section 8 Contract Administration Fees Risk Level 1-5
1. Internal Controls:				
Quality of Monitoring Controls	15%		2	1
Quality of Internal Payment Processing Controls	20%		2	2
Quality of External Payment Processing Controls at the Grantee Level	10%		**0**	**0**
2. Human Capital Risk	20%		2	4
3. Programmatic				
Age of Program	5%		5	4
Complexity of Program	10%		0	0
Nature of Program Recipients	20%		2	0
4. Subtotal for the frequency of all risk factor. Is lowered to 80% to calculate the overall score.	100%	80%		
5. Severity of the Risk: Materiality of the expenditure. The expenditure materiality represents 20% of the overall total.		20%		
Overall Score		100%	1.6	2.2

Source: FY 2012 Final IPIA Risk Assessment Matrices

(2) material weaknesses – 36 percent, (3) material noncompliance – 7 percent, (4) low risk – 29 percent, and (5) questionable costs – 26 percent; 46+36+7+29+26 = 144/5 categories = 28.8% average.

As a result of the issues described above, OCFO's risk assessment process could better evaluate its programs. This condition occurred because OCFO had not reviewed its risk assessment methodology since its implementation in 2003 to reflect changes to risk factors and operating conditions. Over time and as a result of new guidance, the inherent limitations and weaknesses in the design of OCFO's risk assessment methodology may have put HUD in a situation in which it did not effectively identify and report its high-risk programs.

Conclusion

IPERA requires the agency to conduct a program risk assessment of all programs and activities that the agency administers to identify and report on high-risk programs. FHA's risk assessment methodology could be strengthened by the consideration of lender review results in assessing its programs' susceptibility to improper payments. The OCFO's risk assessment methodology needs significant modifications to improve their performance in identifying and reducing improper payments. HUD's process may not adequately and accurately identify programs that are risk susceptible. To improve its analysis, HUD needs to ensure that necessary steps are taken to address the limitations and weaknesses in its risk assessment design methodologies.

Recommendations

We recommend that the FHA comptroller

1A. Consolidate the results of various monitoring reviews or lender compliance reviews by coordinating with the appropriate program offices within FHA and incorporate the results of these reviews in its risk assessment going forward.

1B. Assess FHA program risk susceptibility for fiscal year 2013 by incorporating the impact of OIG's audit report findings and other management findings related to the issue of lender compliance.

We recommend that the Acting Chief Financial Officer

1C. Review and revise the risk assessment design methodology by assigning the appropriate risk factor weights and grouping some of the risk factors, based on their significance, independently rather than combining them into one overall risk score. Ensure adequate documentation is maintained to support the basis of the revised methodology

1D. Apply the updated risk assessment methodology for fiscal years 2013 and beyond.

Finding 2: Multifamily Housing Did Not Accurately Measure or Enforce Compliance with its Supplemental Measures

The Office of Multifamily Housing Programs did not meet its Enterprise Income Verification (EIV) system access rate or EIV usage rate supplemental measure target goals. EIV system limitations hindered its ability to accurately measure its supplemental target goals. Multifamily Housing spent valuable time verifying the EIV reports, and it could not accurately measure its EIV usage rate. The time spent verifying EIV reports and collecting data for its usage rate calculation could have been better spent enforcing compliance with Multifamily Housing's supplemental measures.

System Limitations Hindered Multifamily Housing's Ability to Measure its Supplemental Target Goals

According to HUD's Accountable Official Report, to reduce improper payments, Multifamily Housing developed four supplemental measures. Multifamily Housing's four supplemental measures and goals for fiscal year 2012 were as follows:

1. EIV access rate - Increase the number of owners and management agents with access to EIV to 97.7 percent.
2. EIV usage rate - Increase the number of owners and management agents using the system to 93.6 percent.
3. Failed identity verification rate - Decrease the number of failed identity verifications to less than 32,958.
4. Deceased single-member households - Decrease payments to the deceased, so that no more than 533 deceased single-member households are paid.

Multifamily Housing did not meet its EIV access rate or EIV usage rate target goals. Further, due to EIV system limitations, Multifamily Housing could not accurately measure its usage rate.

According to Multifamily Housing, the reports from the EIV system were unreliable, and several system enhancements were needed to provide accurate data. Since the EIV system was not initially designed to incorporate Multifamily Housing's data elements, the EIV reports contain duplicates and in some cases, inaccurate data because all fields are not properly defined to allow EIV to pull the correct information from HUD's Tenant Rental Assistance Certification System (TRACS). For the past 2 years, Multifamily Housing had been working with the EIV contractor to resolve these issues. The complexity of the request, previous funding issues, and a change in EIV's management team in May 2012 contributed to the delays in resolving these issues. However, according to the EIV contractor, the upcoming April release will reflect the new structure to address Multifamily Housing's issues. Since Multifamily Housing was not given the opportunity to test this release, it could not be certain that the updated EIV system would address the underlying problems.

Since the EIV system produces unreliable data, Multifamily Housing performed additional manual procedures to verify the EIV reports against TRACS. During the verification process, Multifamily Housing's EIV team identified and removed duplicates and false positives to determine its supplemental measure rates. However, for the EIV usage rate, Multifamily Housing could not rely on the EIV system at all.

To determine the usage rate, Multifamily Housing's EIV team sent an email to all hub directors requesting the number of management occupancy reviews conducted and the number of owners and management agents that were found not to be using the EIV system during the reviews. The percentage was based only on these two numbers. Through this method, Multifamily Housing collected data for 4,212 properties; however, according to the support Multifamily Housing provided to determine its EIV access rate, there were approximately 24,000 properties in the Multifamily Housing portfolio. The remaining 19,787 properties were not considered in the usage rate calculation because there was no system in place to verify that users had accessed the system. Additionally, there were no follow-up procedures for hubs that did not respond to the email or verification of the numbers hubs provided.

Multifamily Housing Did Not Adequately Enforce Compliance or Update its Guidance

The time Multifamily Housing spent verifying EIV reports and collecting data for its EIV usage rate could have been better used to enforce owner and contract administrator compliance with its supplemental measures. Multifamily Housing's EIV team did not have follow-up procedures in place to hold noncompliant owners and contract administrators accountable for noncompliance with Multifamily Housing supplemental measures. According to Housing Notice H-2011-21,[14] penalties were imposed only during management occupancy reviews, which we determined were conducted for only approximately 18 percent of properties in fiscal year 2012.

[14] Notice H-2011-21, Enterprise Income Verification (EIV) System, was issued on August 17, 201l, and expired on August30, 2012. The 2013 notice was in the clearance process.

In addition to the lack of follow-up and enforcement, Multifamily Housing's EIV team did not update all of its guidance to require use of the EIV system. The Rent and Income Determination Quality Control Monitoring Guide for Multifamily Programs on Multifamily Housing's RHIIP Initiative Web site was last updated in 2008, and it did not require the use of the EIV system. In the fiscal year 2012 Accountable Official Report, Multifamily Housing noted that the Guide was a tool for HUD staff and contract administrators to use when conducting onsite management occupancy reviews. In the report, Multifamily Housing noted that the Guide had been revised.

Conclusion

The lack of reliable data in the EIV system hindered management's ability to accurately measure its supplemental target goals and reduce improper payments. Without enforcement measures, owners and contract administrators had no incentive to use the EIV system or reduce improper payments. By not adequately measuring and enforcing compliance with its supplemental measures, Multifamily Housing did not sufficiently hold appropriate officials accountable for reducing improper payments.

Recommendations

We recommend that the Director of the Office of Housing Assistance and Grant Administration

2A. Perform user acceptance testing of the modifications made to the EIV system certifying that the release deployed met Multifamily Housing requirements for reducing improper payments.

2B. Develop and implement formal procedures to (1) determine the cause of noncompliant owners and management agents listed on the EIV reports and (2) impose penalties on owners and management agents identified and verified as noncompliant.

2C. Update all guidance on the RHIIP Initiative Web site to clearly indicate the mandatory use of the EIV system by owners and management agents and ensure its implementation.

SCOPE AND METHODOLOGY

We conducted an audit of HUD's fiscal year 2012 compliance with the reporting requirements of IPIA, as amended by IPERA, and Executive Order 13520, Reducing Improper Payments. This review included analyzing the fiscal year 2012 quality control study and income match study of certain fiscal year 2011 payments and fiscal year 2012 improper payment risk assessments. OMB Circular A-123, appendix C, parts I and II, provide guidance on the implementation of IPIA. Part II requires each agency's inspector general to review the agency's improper payment reporting in its annual performance and accountability report or annual financial report and accompanying materials in conjunction with its fiscal year 2012 financial statement audit. OMB Circular A-123, appendix C, part III, requires each agency inspector general to review the accountable official annual report required under section 3(b) of Executive Order 13520.

To complete this work, we interviewed appropriate personnel of OCFO, program representatives, and HUD quality control study and income match study contractors to gather sufficient information to evaluate HUD's plans and the accuracy of the underlying improper payment data. We assessed HUD's design and methodology for reviewing programs' susceptibility to significant improper payments, evaluated HUD's efforts in preventing and reducing improper payments for rental housing assistance programs deemed susceptible to improper payments and HUD's efforts in performing recovery audits, and evaluated the accuracy and completeness of information reported in the agency annual financial report and the accountable official report to the Inspector General.

Additionally, we reviewed HUD's internal controls, policies, procedures, and practices to determine the reasonableness of its plans. Lastly, we reviewed the applicable Federal laws, Executive Order 13520, and the implementing guidance found in OMB Circular A-123, appendix C, that govern actions needed by the agency to address the issue of improper payments. We conducted our review from August 2012 to March 2013 at HUD headquarters in Washington, DC.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objectives:

- HUD's design and implementation of improper payment internal controls, policies, procedures, and practices and
- Compliance with Executive Order 13520 and IPIA as amended by IPERA.

We assessed the relevant controls identified above.

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, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiencies

Based on our review, we believe that the following items are significant deficiencies:

- Weaknesses in HUD's IPERA risk assessment methodologies were identified (finding 1).
- The Office of Multifamily Housing did not accurately measure or enforce compliance with its supplemental measures (finding 2).

FOLLOW-UP ON PRIOR AUDITS

Audit Report No. 2012-FO-0005

In the audit report entitled Annual Evaluation of HUD's Compliance With the Reporting Requirements of the Improper Payments Information Act of 2002, Executive Order 13520, and Office of Management and Budget Circular A-123 Implementing Guidance, dated March 15, 2012, we recommended that OCFO develop a methodology for estimating the dollar amount of potential improper payments when performing the risk assessment by considering unsupported and ineligible costs in OIG's and independent public accountants' audit reports. OCFO did not agree with our recommendations, and no changes were made to its methodology. In addition, we recommended obtaining clarification from OMB as to what constitutes the expenditures that should be included when testing for improper payments and for calculating the total gross error rate. OCFO agreed and made changes to the calculation of the error rate by excluding certain rental housing assistance program expenditures that were not part of the quality control study on improper payments.

APPENDIX

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation | **Auditee Comments**

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

CHIEF FINANCIAL OFFICER

MAR 1 5 2013

MEMORANDUM FOR: Thomas R. McEnanly, Director, Financial Audits Division, GAF

FROM: David P. Sidari, Deputy Chief Financial Officer, F

SUBJECT: Management Comments on OIG Draft Report on HUD's Compliance With the Improper Payments Elimination and Recovery Act of 2010

Comment 1

Thank you for the opportunity to comment on the subject draft report. We appreciate the work of the Office of Inspector General (OIG) and take very seriously the findings and recommendations contained in their reports. We appreciate OIG's recognition that HUD generally complied with the Improper Payments Elimination and Recovery Act (IPERA). We offer the following summary comments for your consideration when formulating the final audit report. Management disagrees with the Office of Inspector General's statement in the Highlights section of the report that HUD's risk assessment process "needs significant modifications" and "limited the ability to identify programs and activities susceptibility to improper payments." This assertion gives the reader the impression that our risk assessment process did not comply with IPERA.

Comment 2

In the finding, OIG states that our risk assessment's design did not adequately assess the risk of improper payments in HUD's programs and that we have not reevaluated our risk assessment design since it was implemented 10 years ago. We disagree that our risk assessment did not adequately assess the risk of improper payments. While we agree that we have not reevaluated the design of our risk assessment since it was implemented 10 years ago, we see no reason to do so since the design of this assessment was endorsed by OMB and set forth as one of two methodologies for performing risk assessments in their IPERA Implementing Guidance, dated April 14, 2011, as Circular A-123, Appendix C, Parts I and II. HUD assesses all the risk factors in the guidance and has done so since the inception of this requirement. When the Improper Payments Information Act of 2002 (IPIA) was passed, HUD contracted with Pricewaterhouse Coopers (PwC) to assist in implementing the requirements. PwC formulated the methodology used today and endorsed by OMB in its April 2011 implementing guidance for IPERA. HUD takes all risk factors required by OMB and weights them to come up with an overall risk rating for the program being assessed. The weights were assigned by PwC when formulating their original methodology. The finding states that weighting the risk factors into one overall risk rating "could allow low-rated risk factors to mask the impact of high-rated risk factors." OMB's guidance requires that when using this methodology all their listed risk factors should be evaluated. When doing this, the risk assessment would take into consideration all the listed risk factors to come up with an overall risk rating. The guidance does not require grouping certain risk factors and determining a separate risk rating for each grouping and if any one of these groupings is rated high then the overall rating for the program is high. However, this is what the OIG is suggesting we do. If we did this we would not be in compliance with OMB's guidance listing of minimum factors that should be evaluated.

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Comment 3

The other part of the finding states the level of risk on a given risk condition was set too high. They state that the number of occurrences of a condition indicating high risk and the weight assigned make it nearly impossible for a truly high-risk condition to achieve a high-risk rating overall. While we agree that under our current methodology assigning a high rating to one risk factor would not result in an overall high rating unless other factors are also rated high or close to high, OMB did not suggest that each risk factor be assessed individually and a high rating in any one factor result in an overall high rating. In discussions with OIG about this finding, we have agreed to reevaluate the weights assigned to each risk factor and number of occurrences of a condition needed to attain a high rating. However, this cannot be accomplished for our FY 13 risk assessment because it's due for completion on March 31.

Comment 4

We disagree with OIG's conclusion that our risk assessment methodology "needs significant modifications" and their statement that our "process may not adequately and accurately identify programs that are risk susceptible." We also non-concur on OIG's recommendation that we group risk factors and assign independent risk ratings to each grouping rather than combining them into one overall risk score. Our non-concurrence is based on the fact that we're in compliance with OMB's implementing guidance as written. We also strongly disagree with OIG's conclusion that our IPERA risk assessment methodologies are a significant deficiency as stated in their internal controls section of the draft audit report. However, we will reevaluate the weights places on each risk factor and the number of occurrences of a risk condition needed to assign a high risk rating. This would be completed for our FY 14 risk assessment.

Comment 5

In addition, we received the following significant comments from Multifamily Housing (MFH) regarding Finding 2 of the report. MFH disagrees that Enterprise Income Verification (EIV) system limitations hindered their ability to accurately identify improper payments. MFH comments that this is incorrect and reflects a misunderstanding of the use of EIV reporting. EIV system limitations only hindered MFH's ability to measure access rate and usage rate. MFH receives this data from the EIV system through management reports. These reports are not used to identify improper payments. EIV reports used at the owner level (not management reports) provide fairly accurate data for the owner to compare the tenant's reported income against the data in HHS and SSA systems and thereby help owners avoid improper payments.

Comment 6

MFH also disagrees with OIG's conclusion that Finding 2 is a significant deficiency. This disagreement is based on the following facts: 1) EIV usage has increased every year; 2) There has been a greater than 200 percent increase in usage from the initial baseline of 44 percent in 2010 to FYE 2012; 3) The increase in usage was greater from 2011 to 2012 (85.1% vs. 92.7%) than it was the previous year (80.8% vs. 85.1% from 2010 to 2011); and 4) The target of 93.6 percent was missed by less than 1 percent, but still increased 7.6 percent. MFH's detailed comments on Finding 2 of the draft audit report are included in an attachment to this report.

Thank you and your audit team for the opportunity to comment on your draft report. We appreciate your assistance toward improving HUD's efforts to implement IPERA. If you have any questions on our comments, please contact Jerry Vaiana on extension 8106.

Attachment

OIG Evaluation of Auditee Comments

Comment 1 HUD did not concur with our findings; however, generally agreed to implement the recommendation documented in our report. While HUD generally complied with IPERA, the findings show that significant changes are needed to ensure the objectives of IPERA are fully met. As HUD has generally agreed to implement our recommendations, we believe that HUD recognized the need for improvement in its risk assessment process.

Comment 2 HUD did not concur with our finding that its risk assessment did not adequately assess the risk of improper payments. However, OIG believes that HUD's failure to reassess its risk assessment design for over a decade is not negated by OMB's guidance as stated in HUD's response. The methodology formulated by PwC was intended for use by all entities but should be tailored to fit the business operations of its user. Therefore, it is the responsibility of the user agency to ensure that the design is structured in such a way that accurate results are determined and meet the objectives of the purpose for which it is intended. OIG is in no way suggesting that HUD should not adhere to OMB's guidance but rather it should make the utmost effort to meet, if not exceed, the objectives of IPERA.

Comment 3 HUD generally concurred that its current risk assessment methodology of assigning a high rating to one risk factor would not result in an overall high rating unless other factors are also rated high or close to high. However, HUD would not be able to accomplish this task for its fiscal year 2013 assessment. OIG believes the risk assessment methodology should be reassessed for fiscal year 2013 to ensure HUD's ability to meet the objectives of IPERA.

Comment 4 HUD did not concur with our finding but agreed to reevaluate the weights placed on each risk factor for the fiscal year 2014 risk assessment. However, OIG believes the risk assessment methodology should be reassessed for fiscal year 2013 to ensure HUD's ability to meet the objectives of IPERA.

Comment 5 We updated the language in the report to read, "EIV system limitations hindered its ability to accurately measure it supplemental target goals."

Comment 6 While usage rates have increased, the EIV system limitations preclude Multifamily Housing from accurately measuring usage rates. Additionally, measuring all of the supplemental measures requires significant compensating procedures. The usage rate figures presented are not reliable because they are not representative of the entire population, as stated in the report. As mentioned in the report, only 18% of the population of properties were used in developing usage rates.

The Quality Control and Income Study were conducted in FY 2011, and our audit covered FY 2012 Improper Payment reduction efforts. Office of Management and Budget Circular A-123 Appendix C, (p.30) tasks us to "evaluate the accuracy and completeness of agency reporting, and evaluate agency performance in reducing and recapturing improper payments. For example, when reviewing the program improper payment rates, corrective action plans, and improper payment reduction targets, the Inspector General should determine if the corrective action plans are robust and focused on the appropriate root causes of improper payments, effectively implemented, and prioritized within the agency, to allow it to meet its reduction targets." Based on our audit, we determined that the supplemental measure rates that Multifamily Housing reports to OMB are not entirely accurate, and therefore cannot be relied upon without significant compensating efforts to validate the reports. Further, we determined that its corrective actions were not robust because Multifamily Housing did not adequately enforce compliance with its target goals. Consequently, we consider this to be a significant deficiency.