



Agency Comments on Disclaimer of Opinion

AGENCY COMMENTS ON DISCLAIMER OF OPINION



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
THE DEPUTY SECRETARY
WASHINGTON, DC 20410-0050

February 29, 2000

MEMORANDUM FOR: Susan Gaffney, Inspector General

FROM: Saul N. Ramirez, Jr.

A handwritten signature in blue ink, appearing to read "Saul N. Ramirez, Jr.", written over the printed name.

SUBJECT: HUD comments on OIG Audit of HUD's Fiscal Year 1999 Financial Statement

These comments are for publication in the OIG's final report on HUD's Fiscal Year 1999 Financial Statement.

The Office of Inspector General (OIG) is declining to issue an audit opinion on HUD's FY 1999 Financial Statements. OIG's failure to issue an audit opinion is wrong on the merits, violates professional standards and audit guidelines, and demonstrates bad faith by the OIG. HUD rejects the OIG audit report.

The OIG asserts that an audit opinion is impossible because of a purported lack of progress in reconciling HUD balances with Treasury's reporting balances. As the OIG is well aware, the reconciliation process was occasioned by HUD's upgrade to a new general ledger system as part of its ongoing modernization of its financial management systems – an action recommended by both OIG and GAO. More importantly, OIG has known since September of last year how HUD proposed to deal with reconciliation process after the upgrade to the new system, but *never* suggested that HUD's plan would necessitate a disclaimer from the OIG, despite weekly meetings between HUD staff and OIG auditors. Instead, in violation of professional audit practice, OIG waited until the eleventh hour to advise HUD that this would be the primary basis for a disclaimer. Then, again in violation of audit procedures and despite the OIG's written assurance to the contrary, repeated efforts by HUD staff and OMB officials to present the necessary information were rejected by the OIG. An OMB official responsible for reviewing the audit process has stated that the Inspector General's actions were a clear departure from the usual practices followed by Inspectors General.

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Following are HUD's general objections to the OIG audit process:

- **OIG was fully advised for months of HUD's plans for handling reconciliations and never objected**

As the OIG is aware, HUD undertook a major financial systems restructuring last year with the creation of HUDCAPS accounting system. Part of this effort contemplated converting data from the old PAS accounting system to the new HUDCAPS general ledger. During this process, HUD prepared cash [SF-224] reports to the Department of the Treasury. The fund balances as reported by Treasury reports were in turn audited successfully by the General Accounting Office. After HUDCAPS went on-line in May of 1999, HUD began converting financial data contained in PAS to HUDCAPS. Based on OIG's participation in weekly Department-wide senior management staff meetings dating back to September of 1999 during which the financial conversion process was discussed in detail, OIG has long known that HUD will complete the necessary reconciliations in the next few months. During all that time, OIG never indicated that this process would prevent the issuance of an unqualified opinion. OIG has now, at the eleventh hour, taken the position that the current state of the HUDCAPS, PAS and Treasury reporting balances reconciliation process precludes OIG from expressing an opinion on HUD's financial statements. OIG's belated position on this issue is unfair to the agency and, as a matter of professional auditing standards, substantively incorrect.

- **OIG can indeed express an unqualified opinion on the financial statements**

Ever since the OIG advised HUD for the first time on February 23, 2000 that it may not be able to express an unqualified opinion on the financial statements, HUD has undertaken substantial efforts to assess its fund balance with Treasury to ensure that agency records agree with those that are officially kept by Treasury and audited by GAO. HUD has assembled documented support for HUDCAPS reconciliation differences to provide OIG with auditable information to further alleviate OIG's concerns. As a result, HUD has the information that will enable the completion of the audit and stands ready to present it to OIG, OMB and GAO.

- **OIG has refused to receive HUD's documentation, or even meet with agency, OMB or GAO officials**

HUD has made repeated efforts to convey the information necessary to complete the audit. As the Secretary's designated CFO representative discussed with OIG auditors James Heist and Kathy Huhl Inclan, HUD stands ready to present OIG with additional documentation her staff has obtained which supports HUD's receipt of an unqualified audit opinion as well as information concerning the fund balance reconciliations which identify and explain our outstanding differences with Treasury. However, these senior OIG audit staffers refused to meet with the agency's Chief Financial Officer representative at all on Friday, February 25, 2000, stating that OIG's work was done, the audit was completed and there was no time to do any further work. The next day, Mr. Heist persisted in his refusal to meet with the Secretary's CFO representative when she again endeavored to explain HUD's reconciliation work.

Even when senior HUD officials spoke directly to OIG officials on Monday, February 28, 2000 – at a meeting arranged but not attended by OMB due to OIG's insistence that OMB and GAO not be present – Ms. Kuhl Inclan and Mr. Heist unequivocally refused to engage in a substantive conversation regarding the fund balance reconciliations. OIG was **not** willing to consider the reconciliations as part of OIG's audit report because in Ms. Kuhl Inclan's words (spoken two days **before** the March 1 deadline) "the audit has already been completed" – belying the written statements in the draft report of February 25th which characterized the OIG's audit work as "ongoing."

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The OIG's refusal to cooperate has left the agency in a tenuous position – with only days to go before an audit deadline, the OIG has again violated the fundamental professional practice of timely communication and cooperation with a client. Entreaties from the General Accounting Office and the Office of Management and Budget to urge the OIG to participate in the audit process in a professional manner have not persuaded OIG staff to properly consider the information that OIG itself has requested.

- **OIG has clearly violated Generally Accepted Auditing Standards**

Despite HUD's good faith efforts at reconciling our differences, the OIG has persisted in refusing to comport with the generally accepted auditing standards. For example, the Statement on Auditing Standards Section 325, entitled "Communication of Internal Control Related Matters Noted in an Audit," states at paragraph 18: "Because timely communication may be important, the auditor may choose to communicate **significant matters during the course of the audit** rather than after the audit is concluded. The decision on whether an interim communication should be issued would be influenced by the relative **significance of the matters noted and the urgency of corrective follow-up action.**" (emphasis added)

There can be no more "significant matters" than those which might lead to a disclaimer regarding a client's financial statement. OIG and HUD had conducted audit meetings since September of 1999 during which time all matters were discussed – including HUD's efforts to reconcile accounts information submitted monthly to Treasury as audited by GAO to HUDCAPS. At no time during this process did OIG suggest that this issue could preclude an unqualified opinion. Indeed on February 28, 2000, Ms. Kuhl Inclan conceded as much in her conversations with senior HUD officials.

Notwithstanding the significance of this matter and the professional obligation of timely communication, OIG did not inform HUD until February 23, 2000 – one week before the March 1, 2000 deadline – that OIG would refuse to express an opinion regarding HUD's financial statements due to the fund balance reconciliation issue. Once HUD was belatedly advised that its reconciliation process – which OIG has been aware of for several months – was being cited as the basis for a threatened disclaimer only a week before the audit deadline, HUD aggressively pursued a solution. Recognizing the urgency of taking corrective action, HUD has done so. Yet OIG officials refuse to audit this work.

- **The OIG's refusal to issue an audit opinion will impose significant additional costs on taxpayers**

The OIG's failure to comply with audit requirements will force HUD to incur more costs, as taxpayer fund will have to be directed toward a re-audit of HUD's financial statement in order to establish a beginning balance for FY 2000. In order to alleviate further problems, HUD intends to pursue a process which is genuinely independent, and free from bias and political influences. Until this documentation is audited, the audit of HUD's financial statements is not complete and OIG has improperly refused to issue an audit opinion. When HUD's financial statements are in fact completely audited and a draft audit report is provided to the agency, HUD will provide comprehensive comments in response to that report. In the meantime, HUD will seek an objective, independent review of the agency's financial statements.

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- **The conduct of OIG reflects bad faith**

Had OIG expressed its inability to render an opinion sooner than a week before the audit deadline and two days before its draft report, HUD would have been able to provide the OIG with the information necessary to complete the audit well before now. Yet despite an auditor's duty to communicate significant matters to a client so that, as here, corrective actions may result; despite OIG's eleventh-hour insistence that review of this information is a condition precedent to auditing HUD's financial statements; despite HUD's timely provision of support for reconciliation differences to further alleviate OIG's concerns; despite the fact that the audit period has yet to expire; despite several efforts by HUD, OMB and GAO to urge OIG to continue – not foreclose – the audit process, OIG continues to insist that the audit process is over, the report published, that matter concluded. There appears to be no rational basis for OIG's refusals, leading to the obvious inference that the OIG has no intention of discharging its responsibilities in accordance with the professional practices as referenced above and further outlined in OMB Bulletin No. 98-08: Audit Requirements for Federal Financial Statements.

These actions by the OIG renew questions about the Inspector General's impartiality and objectivity. Just two weeks ago, the Inspector General testified before a Congressional committee regarding OIG's most recent audit of the agency. One member of Congress found the Inspector General's written testimony to be "unprofessional" and "overly personalized". The Congressman went on to say, "I believe we can make more progress if all concerned can regard your assessments as objective, balanced and fair." Another member criticized the tone of the Inspector General's testimony as "snide". This is not the first time that OIG actions have come under Congressional scrutiny. Many members of Congress have raised questions about the Inspector General's ability to render fair assessments of HUD management actions, and the apparent politicization of the audit process. Indeed, the Inspector General and OIG senior audit staff are currently subject to several Congressional reviews and an investigation by the President's Council on Integrity and Efficiency regarding the OIG's injection of politics into the audit process. By discarding professional audit guidelines and departing from generally accepted audit practices, the OIG only further raises doubt about the credibility of its audit process.

