

## Independent Auditor's Report



U.S. DEPARTMENT OF  
HOUSING AND URBAN DEVELOPMENT  
OFFICE OF INSPECTOR GENERAL

### INDEPENDENT AUDITOR'S REPORT<sup>1</sup>

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To the Secretary,  
U.S. Department of Housing and Urban Development:

#### Report on the Financial Statements

In accordance with the Chief Financial Officers Act of 1990, the U.S. Department of Housing and Urban Development (HUD) has prepared the accompanying consolidated balance sheets as of September 30, 2013 and 2012 (restated), and the related consolidated statements of net cost, changes in net position, and combined statement of budgetary resources for the fiscal years then ended which have been audited by us as required in accordance with generally accepted auditing standards accepted in the United States of America.

#### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

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<sup>1</sup> This report is supplemented by a separate report issued by the HUD Office of Inspector General (OIG) to provide a more detailed discussion of the internal control and compliance issues and to provide specific recommendations to HUD management. The report is available at the HUD OIG Internet site at [http://www.hudoig.gov/Audit\\_Reports/2014-FO-0003.pdf](http://www.hudoig.gov/Audit_Reports/2014-FO-0003.pdf) and is entitled Additional Details To Supplement Our Report on HUD's Fiscal Years 2013 and 2012 Financial Statements (2014-FO-0003, dated December 16, 2013).

### **Auditor's Responsibility**

We are required by the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994 and implemented by Office of Management and Budget (OMB) Bulletin 14-02, Audit Requirements for Federal Financial Statements, to audit HUD's principal financial statements or select an independent auditor to do so. Our responsibility is to express an opinion on the fair presentation of these principal financial statements in all material respects, in conformity with accounting principles generally accepted in the United States of America based on the audit. The audit was conducted in accordance with auditing standards generally accepted in the United States of America, which require the auditor to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

With respect to the fiscal years 2013 and 2012 (restated) financial statements, we did not audit the financial statements of the Federal Housing Administration (FHA) and the Government National Mortgage Association (Ginnie Mae) for the periods ending September 30, 2013 and 2012, which reflected total assets constituting 58 and 57 percent, respectively, of the related consolidated totals. Another independent auditor, whose reports have been furnished to us, audited those statements, and our opinion on the fiscal years 2013 and 2012 financial statements, related to the amounts included for FHA and Ginnie Mae as of September 30, 2013 and 2012, is based solely on the reports of the other auditors.

In planning and performing our audit, we examined, on a test basis, evidence supporting amounts and disclosures in the financial statements, assessed the appropriateness of the accounting principles used and the reasonableness of significant accounting estimates made by management, and considered HUD's internal controls relevant to the entity's preparation and overall presentation of the financial statements. Additionally, we considered compliance with certain provisions of applicable laws, regulations, and governmentwide policy requirements and certain provisions of contracts and grant agreements that could have a direct and material effect on HUD's principal financial statements. The sufficiency of the audit procedures selected depended on our judgment and we determined to be appropriate, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we considered internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that were appropriate in the circumstances but not for the purpose of expressing an opinion on the

effectiveness of the entity's internal control or compliance with laws and regulations, and accordingly, no such opinion is expressed.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

#### Basis for Qualified Opinion

- *Improper Budgetary Accounting.* HUD's budgetary accounting for Community Planning and Development (CPD) and Ginnie Mae programs were not performed in accordance with Federal GAAP that resulted in a material misstatement in HUD's Combined Statement of Budgetary Resources.

HUD used cumulative and First-In First-Out (FIFO) methods to disburse, that were both unacceptable and not in accordance with generally accepted accounting principles for grants in the Federal government, to determine the amount of uncommitted HOME grant funds that would be subject to reallocation/recapture under section 218(g) of the HOME Investment Partnership Act and to process disbursements for CPD formula programs, respectively. Given the dollar risk exposure and volume of CPD grant activities from several thousand grantees (\$5 billion in annual appropriations to support CPD's-related programs including the HOME Investment Partnerships, Community Development Block Grant, Housing for Persons with AIDS, and Emergency Shelter Grant) and the system limitations of HUD's grant management and mixed accounting system to properly account for these grant transactions in accordance with the statutory requirements and generally accepted accounting principles (GAAP), we determined that financial transactions related to these CPD programs that entered HUD's accounting system are being processed incorrectly. Thus, based on the pervasiveness of their effects, in our opinion, the obligated/unobligated balance brought forward and obligated/unobligated balances reported in HUD's Combined Statement of Budgetary Resources for fiscal year 2013 and in prior years were materially misstated. The related amount of material misstatements for these CPD programs in the accompanying Combined Statement of Budgetary Resources cannot be readily determined to reliably support the budgetary balances reported by HUD at year-end, due to inadequacy of evidence available from HUD's mixed accounting and grants management system.

Ginnie Mae's portion of undelivered orders was omitted in HUD's Combined Statement of Budgetary Resources (SBR) in prior years. Ginnie Mae was in compliance with Commercial GAAP, which is appropriate for their stand-alone financial statements; however, their

core financial information system is not configured for Federal GAAP budgetary accounting and subsequent consolidated financial reporting. The lack of automated processes was a contributing factor for the omission of undelivered order balances in the SBR. This omission resulted in a material misstatement of obligated/unobligated balances and unobligated balances brought forward for fiscal year 2013 and 2012. HUD restated its Ginnie Mae portion of the SBR for fiscal year 2012 to correct the material error in the prior year and adjusted the numbers accordingly for fiscal year 2013. However, due to timing of the completion of HUD's restatement analysis we were unable to perform all the appropriate audit procedures that we deem necessary to form an opinion on the reliability of the restated SBR balances as determined by HUD at year-end.

- *Lack of accounting for cash management.* Excess rental subsidy funds held by public housing authorities (PHA) and due back to HUD were not properly recognized and presented in accordance with Federal GAAP. At the direction of Congress in a fiscal year 2012 conference report, HUD implemented U.S. Treasury cash management regulations. Treasury regulations required HUD to perform the following: (1) transfer accumulated funds held by PHAs in net restricted asset accounts outside of HUD back to HUD and hold as program reserves, and (2) complete quarterly reconciliations recognizing amounts due to or by HUD, which HUD began completing in January 2012. These program funding changes should have resulted in the recognition of assets and liabilities in accordance with Statement of Federal Financial Accounting Standards 1 and 5 and Statement of Federal Financial Accounting Concepts 1, 5, and 7. However, HUD failed to recognize these financial events in its accounting records, resulting in their omission in the fiscal year 2012 financial statements. In January 2012, an amount of \$1.7 billion was estimated as funds held by PHAs in excess of their immediate needs for providing rental subsidies and should have been returned to HUD; additional amounts of \$154 million and \$19 million were estimated for accounts receivable and accounts payable, respectively, as of September 30, 2012, based on quarterly reconciliations completed. HUD's Office of the Chief Financial Officer (OCFO) made manual adjustments reflecting advances and expenses in the accounting records to account for fiscal year 2013 activity in the amount of \$934 million and \$534 million, respectively. These adjustments were based on estimates prepared by HUD program officials. We were unable to obtain sufficient, appropriate audit evidence about the reasonableness of these manual adjustments due to the timing of these adjustments and the lack of sufficient documentation to support the estimate. As a result, we could not express an opinion on the accounting and presentation of assets and expenses related to these adjustments.

**Qualified Opinion on the Fiscal  
Years 2013 and 2012 (Restated)  
Financial Statements**

In our opinion, based on our audit and the reports of other auditors, except for the possible effects of the matters described in the Basis for Qualified Opinion section above, the principal financial statements and accompanying notes present fairly, in all material respects, the financial position of HUD as of September 30, 2013 and 2012, and its net costs, changes in net position, and budgetary resources for the fiscal years then ended, in conformity with accounting principles generally accepted in the United States of America.

Our previous reported opinion, dated November 15, 2012, which as of September 6, 2013, has been withdrawn, and our original opinion on HUD's fiscal year 2012 consolidated financial statements have been replaced by the opinion in the fiscal year 2013 audit on the basis of the issues outlined in the Basis for Qualified Opinion paragraphs and on the restated financial statements as discussed in Note 30. In addition, there were other material misstatements in the fiscal year 2012 financial statements related to current use of the FIFO method to liquidate obligations under CPD's formula grant programs but no adjustments have been made at the time of issuance of this auditor's report because the specific amount of misstatements and their related effects were unknown. A restatement related to CPD's programs will occur once HUD determines the appropriate adjustments needed to correct the errors.

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Additional details on the other auditors' and our findings regarding HUD's internal controls are summarized below and were provided in separate reports to HUD management. These additional details also augment the discussions of instances in which HUD had not complied with applicable laws and regulations; the information regarding our audit objectives, scope, and methodology; and recommendations to HUD management resulting from our audit.

**Report on Internal Control**

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 significant deficiency is a deficiency or combination of deficiencies in internal control that is less severe than a

material weakness yet important enough to merit attention by those charged with governance. A material weakness is a deficiency or combination of deficiencies in internal control, 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.

Our consideration of internal control was for the limited purpose described above and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, we and the other auditor did note the following 4 material weaknesses and 1 significant deficiencies.

#### **Material Weaknesses**

##### **CPD's Formula Grant Accounting Did Not Comply With GAAP, Resulting in Misstatements on the Financial Statements**

HUD CPD's formula grants program accounting departed from GAAP due to its use of the FIFO method to disburse obligations. The information system used, Integrated Disbursement Information System (IDIS) Online, a grants management system, was not designed to comply with Federal financial management system requirements. As a result of FIFO, budget-year grant obligation balances were misstated and disbursements were made using an incorrect general ledger attribute. Due to the inability of IDIS Online to provide an audit trail of all of the financial events affected by the FIFO method, the financial information within IDIS Online, which was transferred to HUD's core financial system and used to prepare its consolidated financial statements, could not be quantified. Due to the magnitude and pervasiveness of the funds susceptible to the FIFO method and the noncompliant internal control structure in IDIS Online, the combined statement of budgetary resources and the consolidated balance sheet were not prevented from being materially misstated.

##### **The Office of Public and Indian Housing's Housing Choice Voucher Program Cash Management Process Departed From GAAP and Treasury Requirements**

HUD's new cash management process for the Housing Choice Voucher program departed from Federal GAAP and Treasury cash management requirements. When HUD implemented this process, management did not consider its impact on the financial reporting process. HUD also did not establish internal controls to ensure accurate and reliable financial reporting. Consequently, until OIG identified the issue, HUD omitted recognition of material financial events and transactions in the consolidated financial statements in fiscal years 2012 and 2013. Further, under HUD's process, PHAs still held funds in excess of their immediate disbursing needs, which violated Treasury cash management regulations.

**Financial Management Systems Weaknesses Continued To Challenge HUD**

Although HUD had taken steps and efforts were underway in fiscal year 2013 to address some of the Office of Inspector General's (OIG) concerns, weaknesses in HUD's financial management systems remained a serious problem. HUD continued to face these challenges due to shortcomings from its information technology systems and the lack of systems capabilities and automation. As a result of HUD's inherent system limitations and weaknesses, HUD's financial management systems could not be readily accessed and used by financial and program managers without extensive manipulation and excessive manual processing. This situation negatively impacted management's ability to perform required financial management functions and efficiently manage financial operations of the agency, which translated to lost opportunities for achieving mission goals and improving mission performance.

**There Were Weaknesses in HUD's Consolidated Financial Statement Preparation and Reporting Processes**

In fiscal year 2013, our audit work identified weaknesses in HUD's financial statement consolidation, preparation, and reporting related to Ginnie Mae. Specifically, we noted the (1) improper valuation and presentation of certain line items related to Ginnie Mae in HUD's consolidated balance sheet, (2) failure to make the appropriate conversion adjustments to account for the differences in the accounting standards applicable to Ginnie Mae's stand-alone financial statements and HUD's consolidated financial statements, and (3) inaccurate accounting and reporting of Ginnie Mae's budgetary resources. We attributed these financial reporting deficiencies to weaknesses in HUD's Federal GAAP basis financial reporting environment and the inadequate oversight of component entities' financial statement preparation and reporting processes. As a result, HUD's previously issued financial statements had to be restated to correct material errors.

**Significant Deficiencies**

**HUD Lacked GAAP-Compliant Policies for Accruals**

HUD's accounting policies and procedures related to the accrual of expenses did not recognize liabilities in accordance with Federal GAAP. Our concern on this departure caused liabilities arising from exchange and nonexchange transactions were not recognized on the financial statements relating to (1) unpaid amounts due from grant and entitlement programs but not reported, (2) goods and services received but not invoiced, and (3) charge card purchases incurred but not billed. The absence of recognition of these financial events existed because OCFO did not allocate resources to ensure that research and identification of new or changing accounting

standards and their applicability to HUD were performed. This deficiency resulted in the lack of policies and procedures to require the preparation and implementation of appropriate methodologies for an accrual estimate for liabilities as of the reporting date. The absence of an accrual estimate for these significant transactions resulted in misstatements on HUD's consolidated financial statements due to the underreporting of liabilities, expenses, and obligations or outlays.

**Weaknesses in the Reporting of HUD's Accounts Receivable Continued**

Weaknesses identified in fiscal year 2012<sup>2</sup> regarding recognition of and proper accounting for accounts receivable remained. Specifically, OIG found (1) HUD did not always record or estimate receivables in the accounting records when a determination was made that funds were owed to HUD and required repayment, and (2) weak oversight of the accounting for accounts receivable derived from Section 8 financing adjustment factor (FAF) bond refunding. These conditions occurred because of a weak financial management governance structure and poor accounting monitoring controls. As a result, we identified \$1.7 million in accounts receivable not included in HUD's consolidated financial statements resulting from program monitoring findings and repayment agreements. Additionally, an estimated \$57.3 million in receivables from OIG audit recommendations was not included in HUD's consolidated financial statements as of September 30, 2013. Lastly, the total receivable balance for FAF bond refunding totaling \$17.1 million was at risk for misstatement due to the lack of oversight of the accounting for the portfolio.

**Weaknesses in HUD's Administrative Control of Funds System Continued**

HUD did not have a fully implemented and complete administrative control of funds system that provided oversight of both obligations and disbursements. Our review noted instances where disbursements were made before the point of obligation documented in the funds control plan, program codes that were not included in funds control plans, and funds control plans that were out of date or did not reflect the controls and procedures in place. These conditions existed because of decisions made by HUD OCFO, failures by HUD's allotment holders to update their funds control plans, a lack of compliance reviews in prior years, and timing issues related to the issuance of obligating documents. As a result, HUD could not ensure that its obligations and disbursements were within authorized budget limits and complied with the Antideficiency Act (ADA). We have reported on HUD's administrative control of funds in our audit reports and management letters since fiscal year 2005, and several prior-year recommendations remained unimplemented.

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<sup>2</sup> Audit Report 2013-FO-0003, Additional Details To Supplement Our Report on HUD's Fiscal Years 2012 and 2011 Financial Statements, issued November 15, 2012

**HUD Continued To Report Significant Amounts of Invalid Obligations**

Deficiencies in HUD's process for monitoring its unliquidated obligations and deobligating balances tied to invalid obligations continued to exist. Specifically, we identified \$168.9 million in invalid obligations that were still on the books as of September 30, 2013. These deficiencies were attributed to ineffective monitoring efforts and the inability to promptly process contract closeouts. As a result, HUD's unpaid obligation balances were potentially overstated by \$168.9 million, which we have recommended for review and deobligation. Additionally, HUD lacked an established process to reconcile the subsidiary and general ledger obligation controlling accounts, causing differences to not be identified on a timely basis, or at all, resulting in balances within the general ledger to be at risk of being unsupported or incomplete.

**HUD's Financial Management Governance Structure and Internal Controls Over Financial Reporting Were Ineffective**

HUD did not have a fully implemented and effective financial management governance structure or system of internal control over financial reporting. This condition stemmed from HUD's inadequate implementation of the Chief Financial Officers Act of 1990. Specifically, HUD's financial management structure did not have permanent staff in critical financial management positions and relied on the delegation of key financial management functions without providing adequate policy and oversight. Additionally, as we have reported in prior-year audits, HUD did not have reliable financial information for reporting, did not have integrated financial management systems, and had not implemented a compliant core financial system. As a result, multiple deficiencies existed in HUD's internal controls over financial reporting, resulting in misstatements and instances of noncompliance with laws and regulations.

**Weaknesses in HUD's Rental Housing Assistance Program Monitoring Continued**

HUD needs to improve the monitoring of its more than 2,200 PHAs to ensure that they (1) report accurate financial, compliance, and performance data; (2) comply with statutory objectives; (3) use their funds and leasing capacity; and (4) verify tenant data to reasonably ensure correct housing subsidy payments. Although HUD had improved some aspects of its internal controls from previous years, more improvements are needed to ensure that these objectives are met. Consequently, the accuracy of Voucher Management System self-reported data was questionable, compliance with Moving To Work program statutory requirements could not be determined, PHAs did not fully use their funding, and HUD continued to disburse significant amounts of improper payments.

**Financial and Program Management Controls Over the Emergency Homeowner's Loan Program Were Weak**

HUD did not implement sufficient controls over the Emergency Homeowner's Loan Program to ensure compliance with program, accounting, and financial reporting requirements. This condition was due to a lack of permanent program management structure, causing the administration of the program to be fragmented among three different program offices, resulting in the lack of established policies and procedures to ensure adequate administration, monitoring, and oversight of the program. As a result, (1) \$90.1 million in obligations remained as of September 30, 2013, that potentially no longer had a bona fide need, (2) loans were potentially issued in excess of the maximum loan amount mandated by law, and (3) the portfolio lacked an adequate subsidiary ledger to support the loan receivable balance recognized on the financial statements.

**HUD's Computing Environment Controls Had Weaknesses**

HUD's computing environment, data centers, networks, and servers provide critical support to all facets of its programs, mortgage insurance, financial management, and administrative operations. In prior years, we reported on various weaknesses with general system controls and controls over certain applications, as well as weak security management. These deficiencies increased risks associated with safeguarding funds, property, and assets from waste, loss, unauthorized use, or misappropriation. We audited selected information systems general and application controls of HUD's computer systems on which HUD's financial systems reside and support the preparation of HUD's financial statements. We also followed up on the status of previously reported application control weaknesses. Our review found information systems control weaknesses that could negatively affect HUD's ability to accomplish its assigned mission, protect its data and information technology assets, fulfill its legal responsibilities, and maintain its day-to-day functions.

**FHA Undelivered Orders Should Be Reviewed Annually and Deobligated Promptly**

Review of FHA's undelivered orders revealed (1) inactive obligations, (2) disbursements in excess of obligated amounts, and (3) deobligations of inactive contracts not recognized in the Single Family Asset Management System. While the FHA Comptroller's Office sends a request for follow-up on open obligations to the operation areas, we did not identify any FHA policies and procedures that would implement HUD's annual review of undelivered orders and obligations.

If undelivered orders are not reviewed on a timely basis and de-obligated as needed or contracts are not reviewed on time and closed out properly,

the unobligated balances carried forward could be misstated. In addition, inadequate controls could lead to Anti-Deficiency Act violations and disbursements without proper approval and evidence of payments may lead to waste and abuse of resources.

**FHA's New System Reporting and Reconciliation Capabilities Need Improvement**

In fiscal year 2013, FHA transitioned to a new system (Home Equity Reverse Mortgage Information Technology (HERMIT)) for managing insured and assigned home equity conversion mortgage loans. We identified several discrepancies between the reports generated from the new system and reports from the general ledger and other source systems that could not be adequately explained during the reconciliation process. These differences raise concerns about the completeness and accuracy of the data in the HERMIT system and about the movement of data among other FHA systems and the general ledger. Further, they indicate a weakness in internal controls. Due to the unexplainable differences, we were unable to determine whether the discrepancies were caused by timing differences among files or reports, interface issues among systems, conversion problems with HERMIT data, or any combination of these causes. The fact that such questions remained after 9 months of experience with the HERMIT system indicates that there were weaknesses in the reconciliation of data among the related systems.

**Ginnie Mae's Master Subservicer Provided Inaccurate Accounting Reports**

The monthly loan level accounting reports provided by the Master Subservicer to Ginnie Mae were found to contain inaccurate information, beginning in fiscal year 2012 when OCFO observed discrepancies within different elements of the accounting reports. OCFO also noted loans, which were being closed out (transferred to FHA as a claim) but were still being reported to Ginnie Mae as open (awaiting transfer to FHA) on the accounting reports. These reports are used by Ginnie Mae and are an integral part of its financial reporting process. The monthly accounting reports were inaccurate since the Master Subservicer did not have effective integrated systems to accumulate data necessary to generate monthly accounting reports accurately and reliably for Ginnie Mae's purposes and did not establish effective controls to reconcile the data from different systems contained within the reports or ensure that data supporting the reports could be retrieved in a timely manner.

**Report on Compliance With  
Laws and Regulations**

In connection with our audit, we performed tests of HUD's compliance with certain provisions of laws and regulations. The results of our tests disclosed five instances of noncompliance that are required to be reported in accordance with Government Auditing Standards, issued by the Comptroller General of the United States or OMB Bulletin No. 14-02, Audit Requirements for Federal Financial Statements, as amended. However, the objective of our audit was not to provide an opinion on compliance with laws and regulations. Accordingly, we do not express such an opinion.

**HUD Did Not Substantially Comply With the Federal Financial Management Improvement Act**

In fiscal year 2013, we determined that HUD's financial management systems as a whole continued to not substantially meet Federal Financial Management Improvement Act requirements. Due to shortcomings from its information technology systems and lack of systems capabilities, HUD lacked assurance that its systems could support management's need for reliable, useful, and timely information for accountability and day-to-day decision making.

**HUD Did Not Substantially Comply With the Anti-Deficiency Act**

In fiscal year 2013, HUD made demonstrable progress in moving several of the old<sup>3</sup> Anti Deficiency Act (ADA)<sup>4</sup> cases from HUD OCFO<sup>5</sup> to OMB for review and approval. However, for the fifth consecutive year, no ADA violation was reported to the President, Congress, and the Comptroller General at the end of fiscal year 2013 as required. HUD did not make clearing of backlogged ADA cases a priority in fiscal year 2013. Untimely disposition of the ADA cases could delay the implementation of corrective actions, including any needed safeguards to strengthen HUD's fund control system to prevent recurrence of the same ADA violation.

**HUD Did Not Comply With the HOME Investment Partnership Act**

HUD did not comply with the HOME Investment Partnership Act, section 218 (g). HUD's misinterpretation of the plain language in the Act, the

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<sup>3</sup> As of September 30, 2013, a total of 16 cases were open and under review by HUD. The time elapsed since these cases were opened ranged from more than a year to 10 years.

<sup>4</sup> 31 U.S.C. (United States Code) 1341, 342, 1350, 1517, and 1519.

<sup>5</sup> Public Law 108-7, Division K, Title II Department of Housing and Urban Development Appropriations, 2003, granted HUD's Chief Financial Officer, in consultation with the HUD budget officer, the "sole authority" to investigate potential or actual violations under ADA and all other statutes and regulations related to the obligation and expenditure of funds made available in any act. Further, the Appropriations Act provided that the Chief Financial Officer must determine whether violations occurred and submit the final reports required by law.

implementation of the cumulative method and FIFO technique, as well as the current recapture policies have resulted in HUD's noncompliance with the HOME statute requirements. Consequently, HUD incorrectly permitted some jurisdictions to retain and commit HOME program grant funds beyond the statutory deadline.

**HUD Did Not Comply With the Federal Information Security Management Act**

The fiscal year 2013 independent evaluation of the HUD information technology security program found significant deficiencies in most of the practices and component parts of the program. We found that the program did not comply with the Federal Information Security Management Act and information assets were at risk.

**FHA Did Not Comply With the Cranston-Gonzalez National Affordable Housing Act of 1990**

The Cranston-Gonzales National Affordable Housing Act of 1990 required that FHA's Mutual Mortgage Insurance (MMI) Fund maintain a minimum level of capital sufficient to withstand a moderate recession. This capital requirement, termed the "capital ratio," is defined as capital resources (assets minus current liabilities), less the liability for future claim costs (net of future premiums and recoveries), divided by the value of amortized insurance-in-force. The Act requires FHA to maintain a minimum capital ratio of 2 percent and conduct an annual independent actuarial study to, among other things, calculate this ratio. The Housing and Economic Recovery Act of 2008 requires that the HUD Secretary submit a report annually to Congress describing the results of the study, assess the financial status of the MMI Fund, recommend program adjustments, and evaluate the quality control procedures and accuracy of information used in the process of underwriting loans guaranteed by the MMI Fund. As of the date of our audit, this report for fiscal year 2013 had not been submitted to Congress, but preliminary FHA data indicated that this ratio remained below the required 2 percent throughout fiscal year 2013.

**Required Supplementary Information**

U.S. GAAP requires that certain information be presented to supplement the basic general-purpose financial statements. Such information, although not a part of the basic general-purpose financial statements, is required by the Federal Accounting Standards Advisory Board, which considers it to be an essential part of financial reporting for placing the basic general-purpose financial statements into an appropriate operational, economic, or historical context.

In its Fiscal Year 2013 Agency Financial Report, HUD presents “required supplemental stewardship information” and “required supplementary information.” The required supplemental stewardship information presents information on investments in non-Federal physical property and human capital and investments in research and development. In the required supplementary information, HUD presents a “management discussion and analysis of operations” and combining statements of budgetary resources. HUD also elected to present consolidating balance sheets and related consolidating statements of changes in net position as required supplementary information. The consolidating information is presented for purposes of additional analysis of the financial statements rather than to present the financial position and changes in net position of HUD’s major activities. This information is not a required part of the basic financial statements but is supplementary information required by the Federal Accounting Standards Advisory Board and OMB Circular A-136.

We did not audit and do not express an opinion or provide any assurance on this information; however, we applied certain limited procedures, in accordance with auditing standards generally accepted in the United States of America, which consisted principally of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management’s responses to the auditor’s inquiries, the basic financial statements, and other knowledge the auditor obtained during the audit of the basic financial statements. These limited procedures do not provide sufficient evidence to express an opinion or provide any assurance.

#### **Results of the Audit of FHA’s Financial Statements**

The independent certified public accounting firm of CliftonLarsonAllen LLP performed a separate audit of FHA’s fiscal years 2013 and 2012 financial statements. Its report on FHA’s financial statements, dated December 13, 2013,<sup>6</sup> includes an unqualified opinion on FHA’s financial statements, along with discussion of two significant deficiencies in internal controls and one instance of noncompliance with laws and regulations.

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<sup>6</sup> CliftonLarsonAllen LLP’s report on FHA, Audit of Federal Housing Administration Financial Statements for Fiscal Years 2013 and 2012 (2014-FO-0002, dated December 13, 2013) was incorporated into this report.

### Results of the Audit of Ginnie Mae's Financial Statements

The independent certified public accounting firm of CliftonLarsonAllen LLP performed a separate audit of Ginnie Mae's fiscal years 2013 and 2012 financial statements. Its report on Ginnie Mae's financial statements, dated December 6, 2013,<sup>7</sup> includes an unqualified opinion on these financial statements, along with discussion of one significant deficiency in internal control.

### Objectives, Scope, and Methodology

As part of our audit, we considered HUD's internal controls over financial reporting by obtaining an understanding of the design effectiveness of internal controls, determined whether they had been placed into operation, assessed control risks, and performed tests of the reporting entity's internal controls to determine our audit procedures for the purpose of expressing our opinion on the principal financial statements. We are not providing assurance on those internal controls. Consequently, we do not provide an opinion on internal controls. We conducted our audit in accordance with Government Auditing Standards and the requirements of OMB Bulletin 14-02. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion on the financial statements.

We also tested HUD's compliance with laws, regulations, governmentwide policies, and provisions of contract and grant agreements that could have a direct and material effect on the financial statements. However, our consideration of HUD's internal controls and our testing of its compliance with laws, regulations, governmentwide policies, and provisions of contract and grant agreements were not designed to and did not provide sufficient evidence to allow us to express an opinion on such matters and would not necessarily disclose all matters that might be material weaknesses; significant deficiencies; or noncompliance with

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<sup>7</sup> CliftonLarson Allen LLP's report on Ginnie Mae, Audit of Government National Mortgage Association Financial Statements for Fiscal Years 2013 and 2012 (2014-FO-0001, dated December 6, 2013) was incorporated into this report.

laws, regulations, governmentwide policies, and provisions of contract and grant agreements. Accordingly, we do not express an opinion on HUD's internal controls or its compliance with laws, regulations, governmentwide policies, and provisions of contract and grant agreements.

With respect to internal controls related to performance measures to be reported in management's discussion and analysis and HUD's Fiscal Year 2013 Agency Financial Report, we performed limited testing procedures as required by AU-C Section 730, Required Supplementary Information. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

#### **Agency Comments and Our Evaluation**

On November 27, 2013, we provided a draft of the internal control and compliance sections of our report to the OCFO, appropriate assistant secretaries, and other departmental officials and requested that the OCFO coordinate a departmentwide response. The OCFO responded in a memorandum dated December 12, 2013, which is included in its entirety in our separate report, along with our complete evaluation of the response. The Department's response was considered in preparing the final version of this report. While HUD did not provide formal comments to all reported control deficiencies and compliance with laws and regulations, management indicated agreement with most of OIG's findings and conclusions. However, HUD continues to disagree regarding the finding that the Office of Community Planning and Development's formula grant accounting does not comply with Generally Accepted Accounting Principles. However, a high level plan has been developed to address the finding and eliminate the use of the First-In First-Out method of disbursing and cumulative method of determining program compliance. OIG will evaluate and report on HUD's progress on implementing these corrections in the next fiscal year. HUD also disagrees with a part of the finding stating HUD's financial management systems weaknesses continued to be a challenge. Specifically, HUD disagrees that its procurement applications do not meet FFMA's system requirements because it was not intended nor designed to perform any of the core financial system functions. OIG respectfully disagrees with HUD's position. HUD generally agrees with the finding related to PIH's Housing Choice Voucher Program Cash Management Process departing from GAAP and Treasury requirements in addition to the finding related to the consolidated financial reporting issues with Ginnie Mae. In regards to (1) Ginnie Mae's implementation of a budgetary accounting module for its core financial system, and (2) HUD's implementation of a new core

financial system, OIG will evaluate and monitor progress in implementing both of these noncompliant core financial management system.

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This report is intended for the information and use of the management of HUD, OMB, the U.S. Government Accountability Office, and Congress and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record, and its distribution is not limited. In addition to a separate report detailing the internal control and compliance issues included in this report and providing specific recommendations to HUD management, we noted other matters involving internal control over financial reporting and HUD's operation that we are reporting to HUD management in a separate "management letter."



Randy W. McGinnis  
Assistant Inspector General for Audit

December 16, 2013