

Management Assurances

FY 2013 ANNUAL ASSURANCE STATEMENT

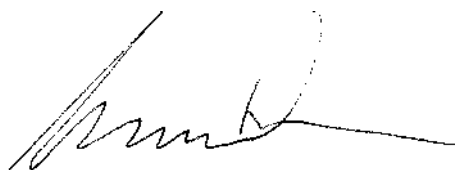
The Department of Housing and Urban Development's management is responsible for establishing and maintaining effective internal control and financial management systems that meet the objectives of the Federal Manager's Financial Integrity Act (FMFIA). HUD is able to provide a qualified assurance of its internal controls over the effectiveness and efficiency of operations as of September 30, 2013, with the exception of three material weaknesses (one for Section 2 and two for Section 4) in the areas of Human Capital Management, Federal Financial Management Improvement Act (FFMIA), and Federal Information Security Management Act (FISMA) noncompliance.

Additionally, HUD conducted its assessment of the effectiveness of internal control over financial reporting in accordance with Appendix A of OMB Circular A-123. The Department provides a qualified assurance that its internal controls over financial reporting were operating effectively as of September 30, 2013, with the exceptions of the three material weaknesses — presentation of Balance Sheet Accounts, implementation of Cash Management Requirements, and the utilization of the First-in, First-out (FIFO) method of accounting. Other than the noted exceptions, the internal controls were operating effectively, and no other material weaknesses were found in the design or operation of the internal control over financial reporting.

In accordance with guidance established by the American Recovery and Reinvestment Act of 2009 (Recovery Act), HUD can provide reasonable assurance that all Recovery Act programs were managed effectively and efficiently, utilized reliable and accurate data to report achievement of program goals, and were in compliance with applicable laws and regulations. All HUD Recovery Act funds were awarded and distributed in a prompt, fair, and reasonable manner for the sole purpose designated in the Recovery Act.

The Department of Housing and Urban Development can provide reasonable assurance that appropriate policies and controls are in place to mitigate the risk of fraud and inappropriate charge card practices.

The Disaster Relief Appropriations Act (Sandy Funds) of 2013 provided the Department with \$16 billion to assist in the Hurricane Sandy recovery. Appropriate policies and controls are in place to mitigate the risk of fraud and inappropriate spending practices and ensure that Sandy Funds are used for their intended purpose.



Shaun Donovan
Secretary

December 16, 2013

Federal Managers' Financial Integrity Act of 1982 (FMFIA)

The Federal Managers' Financial Integrity Act of 1982 (FMFIA) and OMB Circular A-123, Management's Responsibility for Internal Control, requires ongoing evaluations of the adequacy of the systems of internal accounting and administrative controls and the annual reporting of the results of the evaluations. Section 2 of FMFIA requires reporting on the assessment of the effectiveness of the organization's internal controls to support effective and efficient programmatic operations, reliable financial reporting, compliance with applicable laws and regulations, and a summary of material weaknesses. Section 4 of FMFIA requires reporting on whether HUD's financial management systems conform to financial systems requirements.

HUD managers are responsible for ensuring that effective internal controls are implemented and maintained in their daily operations, programs, and financial management systems. Annually, HUD's senior management team provides a Statement of Assurance regarding the effectiveness and efficiency of the internal controls within those operations, programs, and systems. Additionally, they attest to the internal control over financial reporting and compliance with applicable laws and regulations. These assurances statements are the basis for the Secretary's Statement of Assurance.

HUD can provide a qualified statement of assurance that its internal control over operations and internal control over financial reporting (Section 2) and financial management systems (Section 4) meet the objectives of FMFIA, as of September 30, 2013, with the exception of the material weaknesses, which are described further below.

Section 2 — Internal Control over Operations

In FY 2013, the Section 2 — Internal Control over Operations — Material Weakness over HUD's Human Capital Management still existed. To address this material weakness, HUD continued its partnership with the U.S. Office of Personnel Management (OPM) to strengthen the controls within HUD's Human Capital Management practices in FY 2013. HUD trained its Human Resources staff and developed and implemented new human capital policies and standard operating procedures. HUD's leadership initiated a comprehensive approach to workforce and human capital planning. They created a "Workforce Planning Committee" and a "Human Capital Strategy Working Group." The "Workforce Planning Committee" was established to address concerns related to resource management and

workforce planning and the "Human Capital Strategy Working Group" was established to update the Department's Human Capital Strategic and Workforce Plans.

These plans will prioritize HUD's efforts and facilitate the transformation of HUD's Human Capital programs and services. The Workforce Plan will provide a systematic process for identifying HUD's staffing needs. The Human Capital Strategic Plan will be developed in accordance with Government Performance and Results Act (GPRA) requirements and will be HUD's roadmap for accomplishing the Department's mission and implementing HUD's Strategic Plan goals. HUD plans to continue to make great strides to eliminating this material weakness in FY 2014.

Section 2 — Internal Control over Financial Reporting

Currently, HUD uses the First-in, First-out (FIFO) method to account for disbursement of formula grant funds. By implementation of the FIFO method, HUD's accounting for formula grant funds is not in accordance with Federal Generally Accepted Accounting Principles (GAAP). However, due to the

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magnitude of the funds subjected to the FIFO method, HUD's Combined Statement of Budgetary Resources and the Consolidated Balance Sheet are not being presented in conformance with Federal GAAP. HUD has developed a remediation plan to resolve this noncompliance issue.

The material weakness in Presentation of Balance Sheet Accounts is related to the presentation of balance sheet accounts not being in accordance with the U.S. Government Standard General Ledger (USSGL). This presentation caused HUD to restate its FY 2012 Consolidated Financial Statements. HUD restated its FY 2012 Consolidated Balance Sheet related to one of its government corporations, Government National Mortgage Association (Ginnie Mae), for the corporation's presentation of loans receivables on the balance sheet not being in accordance with the USSGL. Ginnie Mae prepares its financial statements in accordance with Financial Accounting Standards Board (FASB) accounting guidance, and HUD's Consolidated Financial Statements are prepared in accordance with Federal Accounting Standards Advisory Board (FASAB) accounting guidance. HUD restated its FY 2012 Financial Statements in FY 2013 to correct this issue.

The Cash Management material weakness is related to HUD not complying with Department of the Treasury cash management regulations. In FY 2012, HUD was required to comply with Treasury's cash management rules and procedures related to monitoring and recording

public housing authorities' (PHA) cash reserves. The PHAs were required to reduce excess Housing Assistance Payments cash reserves. However, Treasury cash management regulations require the elimination of excess PHA-held cash reserves and conversion to HUD-held reserves. HUD performed cash reconciliations in FY 2013 to determine PHA cash reserve balances, but this process was not completed. In addition, HUD performed only cash reconciliations for non-Moving-to-Work PHAs. HUD is working to complete implementation of Treasury's cash management requirements.

Section 4 and Federal Financial Management Improvement Act of 1996 (FFMIA)

The FMMIA requires Federal agencies to implement and maintain financial systems that comply substantially with: (1) Federal financial management system requirements; (2) applicable Federal accounting standards; and (3) the USSGL at the transaction level. Additionally, Section 4 of FMMIA requires agencies to report on whether their accounting system conforms to the mandated Federal financial management system requirements. In each circumstance, agencies must report instances of material non-conformance, including the preparation of remediation plans that address the non-conformance.

In agreement with the Office of Inspector General's (OIG) assessment, HUD has determined that the Department is not in compliance with FFMIA. HUD's noncompliance with FFMIA is related to the newly declared Material Weaknesses and the Department's noncompliance with FISMA. The FISMA noncompliance changes HUD's risk rating. However, HUD's information technology (IT) infrastructure is safeguarded.

Although HUD lacks an integrated core financial management system, HUD uses both automated and manual processes to perform various financial management functions. These processes enable the Department to carry out its mission in support of its financial management requirements in a safeguarded IT environment. HUD is able to prepare financial statements and other required financial and budgetary reports; provide management reliable and timely financial information; and safeguard HUD's assets from loss, and misappropriation, or destruction. While HUD's financial management systems rely on manual

processes, efforts are underway to integrate HUD's financial management systems. HUD is currently implementing the "New Core" initiative, which aims to implement a consistent, common-enterprise, and compliant financial management system using a Federal Shared Services Provider.

In FY 2013, HUD had 39 financial management systems, of which 5 were identified as noncompliant with FFMIA. The 5 are: the Ginnie Mae Financial and Accounting System (**GFAS**), Facilities Integrated Resources Management System (**FIRMS**), Integrated Disbursement and Information System (**IDIS**), HUD Procurement System (**HPS**), and Small Purchase System (**SPS**).

During the FY 2013 Financial Statement Audit, **GFAS** was identified as not being substantially compliant with 14-MIA. GFAS is not currently configured to support Ginnie Mae's accounting and reporting requirements for its budgetary resources. HUD prepared a remediation plan to bring GFAS into substantial compliance with FFMIA by June 30, 2014. HUD determined the amount of adjustments needed to correct the accounting and reporting errors for FY 2012 and made the adjustments for FY 2013.

FIRMS remains a noncompliant system because HUD had experienced significant problems and delays in making FIRMS operational. HUD's future plans are to implement the functionality of reporting and recording fixed assets in its New Core system, but in the meantime HUD plans to upgrade the FIRMS system.

IDIS does not comply with the internal controls and Federal financial accounting standards, as required by FFMIA, as a result of its use of the FIFO method to account for and disburse formula grant obligations. HUD's implementation of the FIFO method within the IDIS system obstructed HUD from accounting for the formula grant funds in accordance with Federal GAAP. HUD developed a remediation plan to bring IDIS in compliance with FFMIA with a proposed completion date of FY 2015.

The functionality of the **HPS** and **SPS** systems was replaced by the **HUD Integrated Acquisition Management System (HIAMS)** in FY 2012, the Department's end-to-end acquisition solution. The HIAMS system consolidated the prior procurement systems' functionality while simultaneously eliminating most manual and duplicative business processes. HUD originally planned to decommission HPS and SPS in FY 2013. However in FY 2012, OIG identified HIAMS as a 1,1-MIA noncompliant system because of its inability to match obligation balances within the core system, HUD Central Accounting Processing System (HUDCAPS); and HPS and SPS were not decommissioned as planned.

In FY 2013, HUD made great strides and resolved the noncompliance issue with HIAMS. An automated report is generated to reconcile the previous day transactions posted in HUDCAPS back to HIAMS, thereby improving the interface between HIAMS and HUDCAPS. HUD plans to decommission HPS and SPS systems in FY 2014.

Federal Information Security Management Act (FISMA)

During HUD's FY 2013 annual evaluation of the Department's information security program, as required by FISMA, the OIG identified numerous weaknesses in HUD's entity-wide Computer Security program, which resulted in a significant deficiency being declared related to the Department's noncompliance with FISMA. By definition, a significant deficiency identified under FISMA must also be reported by management as a material weakness under FFMIA. The OIG identified several recommendations for HUD to implement. The implementation of these recommendations will strengthen and improve the Department's information security program. HUD began implementing corrective actions in FY 2013.

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In FY 2013, HUD updated its security policies and procedures to ensure compliance with the NIST-800-53 Rev 3 guidance, strengthened the Department's cyber security awareness and training program, developed a comprehensive enterprise-wide Cyber Security continuous monitoring strategy program, implemented a configuration management baseline, and refined the capital planning and investment control process to comply with Federal guidance.

For FY 2014, HUD plans to improve its entity-wide security measures by: (1) updating current policies and procedures to ensure compliance with NIST-800-53 Rev 4 guidance, (2) ensuring that security plans and Certification and Accreditation plans are updated in accordance with NIST guidance, and (3) concentrating the Department's efforts on strengthening our security awareness and training program and activities, as well as the security assessments. The estimated completion date is December 2014.

HUD's Financial Management Systems Framework

HUD's current financial application portfolio is comprised of compartmentalized legacy systems that combine both program and traditional accounting functionality. In order to improve the stability and efficiency of financial management operations and reduce the risks posed by legacy financial systems that are no longer supported by the vendor, HUD's

financial management systems are in need of an enterprise consolidation and modernization. In accordance with OMB Memorandum M-10-26, Immediate Review of Financial Systems IT Projects, HUD initiated the feasibility of utilizing a Federal Shared Service Provider (FSSP) as part of a formal alternatives analysis. In FY 2013, HUD entered into an Interagency Agreement (IAA) with the Bureau of Fiscal Service's Administrative Resource Center to conduct a Discovery Phase.

The purpose of the Discovery Phase was to analyze HUD's high-level processes and requirements to determine if it was feasible to utilize the Administrative Resource Center's shared service offering. The alternatives analysis considered approaches for HUD to enhance its legacy environment, to utilize a federally maintained or commercially hosted shared service provider, or pursue a third-party vendor for a traditional integration of a comprehensive financial enterprise solution.

Based on the Discovery Phase results, HUD decided to enter into another IAA with the Administrative Resource Center as the Department's FSSP. HUD determined that an FSSP provides the most value to HUD by leveraging modern technologies while reducing implementation risks. HUD currently plans to implement a shared service accounting solution in FY 2015. The migration of HUD's Core Financial Services includes the administrative and accounting system services associated with budgeting, accounting, finance, and reporting to a federal shared service provider. The replacement of both of HUD's legacy financial management systems, HUDCAPS and the Program Accounting System (PAS), is called the "New Core" project. As a result, all program offices that previously utilized legacy financial systems will instead interface with FSSP core financials. Additionally, all program users who work with HUD's current procurement, time and attendance, and travel systems will also be served by FSSP functionality.

The goal of HUD's New Core project is to transform HUD's core financial management processes and systems by improving the accuracy of its financial information to support better decisions. In addition, New Core's objective is to modernize the Department's financial management systems to allow HUD to: (1) achieve HUD's Strategic Goal 5—to transform the way HUD does business by automating processes or modernizing obsolete IT systems, (2) achieve substantial compliance with 1,1-MIA, (3) provide

financial information and analytical capabilities to complete analyses to measure the effectiveness and efficiency

of its program outputs and outcomes, and (4) implement system improvements to resolve audit findings, major management challenges, and program deficiencies.

The New Core project will directly benefit HUD's internal stakeholders by consolidating and modernizing the Department's financial management systems and processes. The production of timely and accurate financial information, as well as increased analytical and customized reporting capabilities, will benefit HUD's users throughout the department.

Completed Actions

- HUD terminated the HIFMIP project and created the New Core Project. HUD evaluated system modernization options, which met HUD's strategic goals and Federal guidelines.
- HUD followed OMB guidance and evaluated the feasibility of utilizing a FSSP. The Department performed a Discovery phase with the Bureau of Fiscal Services' Administrative Resource Center. The Center and HUD reviewed HUD's needs against the Center's standard approach and feasible business solutions were identified for all gaps discovered. During this same time frame, a structured analysis was performed, which considered factors including HUD's functional and technical requirements, costs, risks, and organizational impacts.
- HUD determined that an FSSP provides the most value by leveraging modern technologies while reducing implementation risks.
- HUD negotiated an IAA for the activities required to implement the Center's shared service model.
- HUD completed the planning phase of the Shared Service Project.
- HUD and the Center began to hold requirements sessions with HUD's Subject Matter Experts.

Planned Activities

- Complete requirements validation sessions with HUD and Administrative Resource Center subject matter expert teams and update requirements and design activity time frames.
- In Phase 1 of the project, HUD will include activities for an interface solution, as well as modernization of financial reporting included in HUD's data warehouse.