



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

## Audit of HUD's Fiscal Years 2021 and 2020 Consolidated Financial Statements

**Office of Audit  
Financial Audits Division  
Washington, DC**

**Audit Report Number: 2022-FO-0004  
December 9, 2021**





**To:** George J. Tomchick  
Deputy Chief Financial Officer, F

**//signed//**

**From:** Kilah S. White  
Assistant Inspector General for Audit, GA

**Subject:** Independent Public Accountant's Audit Report on the U.S. Department of Housing and Urban Development's Fiscal Years 2021 and 2020 Consolidated Financial Statements

Attached are the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) results of the audit of HUD's consolidated fiscal years 2021 and 2020 financial statements and reports on internal control over financial reporting and compliance with laws, regulations, contracts, and grant agreements and other matters.

We contracted with the independent public accounting firm of CliftonLarsonAllen LLP (CLA) to audit the financial statements of HUD as of and for the fiscal years ended September 30, 2021 and 2020,<sup>1</sup> and to provide reports on HUD's 1) internal control over financial reporting; and 2) compliance with laws, regulations, contracts, and grant agreements and other matters, including whether financial management systems complied substantially with the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA). Our contract with CLA required that the audit be performed in accordance with U.S. generally accepted government auditing standards, Office of Management and Budget audit requirements, and the Financial Audit Manual of the U.S. Government Accountability Office and the Council of the Inspectors General on Integrity and Efficiency.

In its audit of HUD, CLA reported:

- The consolidated financial statements as of and for the fiscal year ended September 30, 2021, are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles.
- One material weakness<sup>2</sup> and one significant deficiency<sup>3</sup> in internal control over financial

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<sup>1</sup> The accompanying consolidated financial statements as of and for the fiscal year ended September 30, 2020, were audited by other auditors, whose Independent Auditor's Report was issued on December 4, 2020.

<sup>2</sup> A material weakness is a deficiency or a combination of deficiencies in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of HUD's financial statements will not be prevented or detected and corrected on a timely basis.

<sup>3</sup> A significant deficiency is a deficiency or combination of deficiencies in internal control over financial reporting that is less severe than a material weakness yet important enough to merit attention by those charged with governance.

**Office of Audit**

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reporting, based on the limited procedures that it performed.

- A material weakness existed related to HUD and Federal Housing Administration (FHA) controls over financial accounting and reporting.
- A significant deficiency existed related to FHA econometric modeling activities used to estimate the agency's loan guarantee liability.
- Two reportable matters of noncompliance with provisions of applicable laws, regulations, contracts, and grant agreements or other matters.
  - Noncompliance with federal financial management system requirements, federal accounting standards, and the U.S. Standard General Ledger at the transaction level.
  - Noncompliance with the Single Audit Act.

In connection with the contract, we reviewed CLA's reports and related documentation and inquired of its representatives. Our review, as differentiated from an audit of the financial statements in accordance with U.S. generally accepted government auditing standards, was not intended to enable us to express, and we do not express, opinions on HUD's financial statements or conclusions about 1) the effectiveness of HUD's internal control over financial reporting; 2) HUD's compliance with laws, regulations, contracts, and grant agreements; or 3) whether HUD's financial management systems complied substantially with the three FFMIA requirements. CLA is responsible for the attached Independent Auditors' Report, dated December 9, 2021, and the conclusions expressed therein. Our review disclosed no instances in which CLA did not comply, in all material respects, with U.S. generally accepted government auditing standards.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, appendix 8M, requires that OIG post its reports on the OIG website. Accordingly, this report will be posted at <https://www.hudoig.gov>.

If you have any questions or comments about this report, please call Sarah Sequeira, Audit Director, at (202) 402-3949.



## Independent Auditors' Report

Inspector General  
U.S. Department of Housing and Urban Development

Secretary  
U.S. Department of Housing and Urban Development

In our audit of the fiscal year 2021 consolidated financial statements of the U.S. Department of Housing and Urban Development (HUD), we found:

- HUD's consolidated financial statements as of and for the fiscal year ended September 30, 2021, are presented fairly, in all material respects, in accordance with United States of America (U.S.) generally accepted accounting principles (GAAP);
- one material weakness and one significant deficiency for fiscal year 2021 in internal control over financial reporting based on the limited procedures we performed; and
- two reportable noncompliance matters for fiscal year 2021 with provisions of applicable laws, regulations, contracts, and grant agreements we tested and no other matters.

The following sections discuss in more detail (1) our report on the consolidated financial statements, which includes emphasis-of-matter paragraphs related to the loans receivable and related foreclosed property, net, and loan guarantee liability line items and modified federal credit reform accounting, and the required supplementary information (RSI)<sup>1</sup> and other information<sup>2</sup> included with the financial statements; (2) our report on internal control over financial reporting; (3) our report on compliance with laws, regulations, contracts, and grant agreements and other matters; and (4) HUD's response to the audit report.

### Report on the Financial Statements

We have audited the accompanying consolidated financial statements of HUD, which comprise the consolidated balance sheet as of September 30, 2021; the related consolidated statements of net cost, changes in net position, and the combined statement of budgetary resources for the fiscal year then ended; and the related notes to the consolidated financial statements.

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<sup>1</sup>The RSI consists of Management's Discussion and Analysis and the Combining Statement of Budgetary Resources, which are included with the financial statements.

<sup>2</sup>Other information consists of the OIG Report on Top Management Challenges Facing HUD in FY2022, Response to OIG Report on Management and Performance Challenges, Summary of Financial Statement Audit and Management Assurances, Payment Integrity Information, Secretary's Audit Resolution Report to Congress, Civil Monetary Penalty Adjustment For Inflation, and Grants Program Information.

## INDEPENDENT AUDITORS' REPORT (Continued)

We conducted our audit in accordance with U.S. generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 21-04, *Audit Requirements for Federal Financial Statements* (OMB Bulletin 21-04). We believe that the audit evidence we obtained is sufficient and appropriate to provide a basis for our audit opinion.

### Management's Responsibility

HUD management is responsible for (1) the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; (2) preparing, measuring, and presenting the RSI in accordance with U.S. generally accepted accounting principles; (3) preparing and presenting other information included in documents containing the audited financial statements and auditors' report, and ensuring the consistency of that information with the audited financial statements and the RSI; and (4) maintaining effective internal control over financial reporting, including the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. *Government Auditing Standards* require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement. We are also responsible for applying certain limited procedures to the RSI and other information included with the consolidated financial statements.

An audit of financial statements involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the auditors' assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit of financial statements also involves evaluating the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit also included performing such other procedures as we considered necessary in the circumstances.

### Opinion on Financial Statements

In our opinion, the U.S. Department of Housing and Urban Development's consolidated financial statements present fairly, in all material respects, HUD's financial position as of September 30, 2021, and its net cost of operations, changes in net position, and budgetary resources for the fiscal year then ended in accordance with U.S. generally accepted accounting principles.

### Emphasis of Matter

As discussed in notes 1 and 7 to the financial statements, HUD discloses certain loans receivable, net, and negative loan guarantees of \$49,072 million and \$17,908 million, respectively, as of September 30, 2021, the majority of which are issued under the *Federal Credit Reform Act of 1990* and attributable to the Federal Housing Administration (FHA), a significant component of

## INDEPENDENT AUDITORS' REPORT (Continued)

HUD. HUD values these Credit Reform direct loans and loan guarantees and related receivables from assigned notes and property inventories at the present value of their estimated future cash flows associated with these assets. Anticipated cash outflows primarily include lender claims arising from borrower defaults, premium refunds, and costs to maintain and sell foreclosed properties. Anticipated cash inflows primarily include insurance premium receipts, proceeds from asset sales and principal and interest collections on Secretary-held notes. The valuation estimates are developed using econometric models that integrate historical loan-level program and economic data with regional house price appreciation forecasts to develop assumptions about future portfolio performance. Subsidy costs are intended to estimate the long-term cost to the U.S. Government of its direct loan and loan guarantee programs. A subsidy re-estimate is performed annually and any adjustment resulting from the re-estimate is recognized as subsidy expense when net cash outflows are expected or subsidy surplus when net cash inflows are expected. Actual results may differ from the estimates. Our opinion on HUD's financial statements is not modified with respect to this matter.

As discussed in notes 1, 8, and 25 to the financial statements, HUD discloses that the Government National Mortgage Association (Ginnie Mae), a significant component of HUD, administers a mortgage-backed securities (MBS) guarantee program that does not follow the Federal Credit Reform Act but uses a program, financing, liquidating and capital reserve accounts to process its cash receipts and disbursements through the U.S. Department of Treasury. Ginnie Mae established this fund structure at the direction of the Office of Management and Budget (OMB) in 2012. Under this structure, OMB also instructed Ginnie Mae to annually record an upward and downward re-estimate and negative subsidy payment, for budgetary purposes only. Based on these estimates, Ginnie Mae transfers funds among its accounts. Ginnie Mae reflects these transfers in the spending authority from offsetting collections and new obligations and upward adjustments financial statement line items on HUD's combined statement of budgetary resources, and these transfers impact the amount held in fund balance with Treasury versus investments on HUD's balance sheet. Therefore, although HUD accounts for Ginnie Mae's MBS guarantee program in accordance with Statement of Federal Financial Accounting Standards (SFFAS) 51 – Insurance Programs<sup>3</sup>, it also performs modified credit reform accounting at the direction of OMB.

### Other Matters

#### Prior Year Financial Statements

HUD's consolidated financial statements as of and for the year ended September 30, 2020, were audited by other auditors, whose Independent Auditor's Report thereon dated December 4, 2020, expressed an unmodified opinion on those financial statements and included an emphasis of matter paragraph on the single-year presentation of HUD's financial statements and Ginnie Mae's Modified Federal Credit Reform Accounting. We were not engaged to audit, review, or apply any procedures to HUD's fiscal year 2020 consolidated financial statements and accordingly, we do not express an opinion or any other form of assurance on the fiscal year 2020 consolidated financial statements.

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<sup>3</sup> The accounting outlined in SFFAS 51 – Insurance Programs does not include the re-estimates and negative subsidy payment transfers described above. The transfers described above are most closely related to the accounting required under SFFAS 2 – Accounting for Direct Loans and Loan Guarantees. However, Ginnie Mae does not follow SFFAS 2 and has only implemented the transfers described for budgetary purposes at the direction of OMB.

## INDEPENDENT AUDITORS' REPORT (Continued)

### Required Supplementary Information

U.S. generally accepted accounting principles issued by the Federal Accounting Standards Advisory Board (FASAB) require that the RSI be presented to supplement the consolidated financial statements. Although the RSI is not a part of the consolidated financial statements, FASAB considers this information to be an essential part of financial reporting for placing the consolidated financial statements in appropriate operational, economic, or historical context. We have applied certain limited procedures to the RSI in accordance with *Government Auditing Standards*, which consisted of inquiries of management about the methods of preparing the RSI and comparing the information for consistency with management's responses to the auditors' inquiries, the consolidated financial statements, and other knowledge we obtained during the audit of the consolidated financial statements, in order to report omissions or material departures from FASAB guidelines, if any, identified by these limited procedures. We did not audit, and we do not express an opinion or provide any assurance on the RSI because the limited procedures we applied do not provide sufficient evidence to express an opinion or provide any assurance.

### Other Information

HUD's other information contains a wide range of information, some of which is not directly related to the consolidated financial statements. This information is presented for purposes of additional analysis and is not a required part of the consolidated financial statements or the RSI. We read the other information included with the consolidated financial statements in order to identify material inconsistencies, if any, with the audited consolidated financial statements. Our audit was conducted for the purpose of forming an opinion on HUD's consolidated financial statements. We did not audit and do not express an opinion or provide any assurance on the other information.

### **Report on Internal Control over Financial Reporting**

In connection with our audit of HUD's consolidated financial statements, we considered HUD's internal control over financial reporting, consistent with our auditors' responsibility discussed below. We performed our procedures related to HUD's internal control over financial reporting in accordance with *Government Auditing Standards*.

### Management's Responsibility

HUD management is responsible for (1) maintaining effective internal control over financial reporting, including the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error; (2) evaluating the effectiveness of internal control over financial reporting based on the criteria established under 31 U.S.C. 3512 (c), (d) (commonly known as the Federal Managers' Financial Integrity Act (FMFIA)); and (3) providing an assurance statement on the overall effectiveness of internal control over financial reporting included in management's discussion and analysis (MD&A) as Systems, Controls and Legal Compliance section.

### Auditors' Responsibility

In planning and performing our audit of HUD's financial statements as of and for the year ended September 30, 2021, in accordance with *Government Auditing Standards*, we considered HUD's internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of

## INDEPENDENT AUDITORS' REPORT (Continued)

HUD's internal control over financial reporting or on management's assurance statement on the overall effectiveness on internal control over financial reporting. Accordingly, we do not express an opinion on HUD's internal control over financial reporting or on management's assurance statement on the overall effectiveness of internal control over financial reporting. We are required to report all deficiencies that are considered to be material weaknesses or significant deficiencies. We did not consider or evaluate all internal controls relevant to operating objectives as broadly established by the FMFIA, such as those controls relevant to preparing performance information and ensuring efficient operations.

### Definition and Inherent Limitations of Internal Control over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of consolidated financial statements in accordance with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition, and (2) transactions are executed in accordance with provisions of applicable laws, including those governing the use of budget authority, regulations, contracts, and grant agreements, noncompliance with which could have a material effect on the consolidated financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements due to fraud or error.

### Results of Our Consideration of Internal Control over Financial Reporting

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 material weaknesses or significant deficiencies or to express an opinion on the effectiveness of HUD's internal control over financial reporting and therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, during our audit, we did identify certain deficiencies in internal control over financial reporting that we consider to be a material weakness and one significant deficiency, described below and in Exhibit A and Exhibit B.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies described below and in Exhibit A to be material weaknesses.

### *Weaknesses in Internal Control Over Financial Reporting*

#### Weaknesses in Controls over FHA's Financial Accounting and Reporting

In fiscal year 2021, FHA recorded a series of erroneous loan endorsements and associated negative subsidy for its Home Equity Conversion Mortgage (HECM) program, which led to misstatements of approximately \$3,303 million in its accounting records and borrowing and investment transactions that would otherwise not occur. In addition, FHA management did not adequately review and implement OMB Circular A-136, *Financial Reporting Requirement-Revised*, which resulted in the improper presentation of the loan guarantee liability as a negative



## INDEPENDENT AUDITORS' REPORT (Continued)

liability in the initial version of the financial statements as of September 30, 2021 and 2020.

### HUD's Internal Control Over Financial Reporting Needs to Be Strengthened

Weaknesses continue within the Office of Community Planning and Development's (CPD) grant accrual process and the related validation processes conducted by the Office of the Chief Financial Officer (OCFO) to validate CPD's estimate. Additionally, weaknesses continue with the accuracy and completeness of transactions related to the Office of Public and Indian Housing (PIH) prepayments and PIH's cash management process.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described below and in Exhibit B to be significant deficiencies.

### Weaknesses in Controls over FHA's Econometric Modeling Activities

FHA's econometric modeling activities used to estimate the agency's loan guarantee liability need improvements to minimize the precision risks or the susceptibility to error associated with estimating FHA's largest liability on its balance sheet. Further, we identified areas of needed improvement regarding documentation used to support FHA management's current modeling practices.

During our fiscal year 2021 audit, we identified deficiencies in HUD's internal control over financial reporting that we do not consider to be material weaknesses or significant deficiencies. Nonetheless, these deficiencies warrant HUD management's attention. We have communicated these matters to HUD management and, where appropriate, will report on them separately.

### Purpose of Report on Internal Control over Financial Reporting

The purpose of this report is solely to describe the scope of our consideration of HUD's internal control over financial reporting and the results of our procedures, and not to provide an opinion on the effectiveness of HUD's internal control over financial reporting. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering internal control over financial reporting. Accordingly, this report on internal control over financial reporting is not suitable for any other purpose.

### **Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements and Other Matters**

In connection with our audit of HUD's consolidated financial statements, we tested compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements consistent with our auditors' responsibility discussed below. We caution that noncompliance may occur and not be detected by these tests. We performed our tests of compliance in accordance with *Government Auditing Standards*.

We also performed tests of compliance with certain provisions of the Federal Financial Management Improvement Act (FFMIA). However, providing an opinion on compliance with FFMIA was not an objective of our audit, and accordingly, we do not express such an opinion.

## INDEPENDENT AUDITORS' REPORT (Continued)

### Management's Responsibility

HUD management is responsible for complying with laws, regulations, contracts, and grant agreements applicable to HUD, including ensuring HUD's financial management systems are in substantial compliance with FFMIA requirements.

### Auditors' Responsibility

Our responsibility is to test compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements applicable to HUD that have a direct effect on the determination of material amounts and disclosures in HUD's consolidated financial statements, including whether HUD's financial management systems comply substantially with the FFMIA Section 803(a) requirements, and perform certain other limited procedures. Accordingly, we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to HUD.

### Results of Our Tests for Compliance with Laws, Regulations, Contracts, and Grant Agreements and Other Matters

Our tests for compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements disclosed instances of noncompliance or other matters for fiscal year 2021, described in Exhibit C, that are reportable under *Government Auditing Standards*. In addition, as described in Exhibit C, our tests of compliance with the FFMIA Section 803(a) requirements disclosed instances in which HUD's financial management systems did not comply substantially with (1) federal financial management systems requirements, (2) applicable federal accounting standards, or (3) application of the U.S. Government Standard General Ledger (USSGL) at the transaction level. However, the objective of our tests was not to provide an opinion on compliance with laws, regulations, contracts, and grant agreements applicable to HUD. Accordingly, we do not express such an opinion.

#### Noncompliance with FFMIA

HUD's noncompliance with FFMIA continued in fiscal year 2021 with two systems not complying with federal financial management system requirements, federal accounting standards, and the USSGL at the transaction level.

#### Noncompliance with the Single Audit Act

For the majority of fiscal year 2021, HUD did not comply with key provisions of the Single Audit Act including designating a single audit accountable official or single audit liaison, nor did HUD maintain centralized information regarding its efforts in meeting Single Audit Act responsibilities.

### Purpose of Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements and Other Matters

The purpose of this report is solely to describe the scope of our testing of compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements, and the results of that testing, and not to provide an opinion on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering compliance. Accordingly, this report on compliance with laws, regulations, contracts, and grant agreements is not suitable for any other purpose.

## INDEPENDENT AUDITORS' REPORT (Continued)

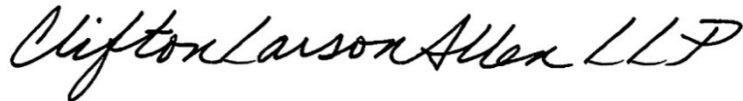
### Status of Prior Year's Control Deficiencies and Noncompliance Issues

We have reviewed the status of HUD's corrective actions with respect to the findings and recommendations included in the prior year's Independent Auditor's Report, dated December 4, 2020. The status of prior year findings is presented in Exhibit D.

### HUD's Response to Audit Findings and Recommendations

HUD's response to the findings and recommendations identified in our report is described in Exhibit E. HUD's response was not subjected to the auditing procedures applied in the audit of the financial statements and accordingly, we express no opinion on it.

### CliftonLarsonAllen LLP

A handwritten signature in black ink that reads "CliftonLarsonAllen LLP". The signature is written in a cursive, flowing style.

Greenbelt, MD  
December 9, 2021

## EXHIBIT A Material Weakness

### 1. Weakness in Internal Control Over Financial Reporting

#### a. Weaknesses in Controls over FHA's Financial Accounting and Reporting

Certain weaknesses were identified within FHA's internal control over financial reporting. For details, see FHA financial statement audit report dated December 6, 2021, issued in OIG audit report 2022-FO-0003.

#### b. HUD's Internal Control Over Financial Reporting Needs to Be Strengthened - Controls over Accrued Grant Liabilities

**Background:**

HUD must recognize and report balances due to or advanced to grantees at the end of the reporting period. Adjustments are needed to provide for eligible expenses that grantees have incurred as of the reporting date but have not yet reported to the agencies. Since these adjustments are based upon estimates, they are referred to as "accrual estimates."

**Condition:**

Weaknesses remain in CPD's processes to estimate accrued grant liabilities and with OCFO's processes to validate CPD's estimate.

**Criteria:**

The Government Accountability Office's (GAO), *Standards for Internal Control in the Federal Government*, state the five components of internal control must be effectively designed, implemented, and operating together in an integrated manner, for an internal control system to be effective. The five components are control environment, risk assessment, control activities, information and communication, and monitoring.

OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, provides guidance to federal managers on improving accountability and effectiveness of federal programs and operations by establishing, assessing, correcting, and reporting on internal controls. Management is responsible for establishing and maintaining internal control to achieve the objectives of effective and efficient operations, and reliable financial reporting.

FASAB's Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government*, states "A liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events. General purpose federal financial reports should recognize probable and measurable future outflows or other sacrifices of resources arising from (1) past exchange transactions, (2) government-related events, (3) government-acknowledged events, or (4) nonexchange transactions that, according to current law and applicable policy, are unpaid amounts due as of the reporting date."

FASAB's Federal Financial Accounting and Auditing Technical Release 12: *Accrual Estimates for Grant Programs* provides specific guidance and framework for developing and documenting reasonable estimates of accrued grant liabilities.

## **EXHIBIT A**

### **Material Weakness**

**Cause:**

CPD's accrual process does not use actual grantee reported expenditure data<sup>4</sup>, which is the most accurate data. Instead, CPD continues to base the accrual estimation on each program's historical disbursement or cash-on-hand activity with an unsubstantiated percentage multiplier. This estimation methodology is flawed because disbursement or cash-on-hand activity does not typically represent true grantee expenditures. Further, the accrual methodology is unreliable as it fails to provide an adequate documented justification for the establishment of the percentage multiplier used to derive the accrual amount for each program.

Weaknesses in the validation process were due to OCFO's inability to (1) obtain accurate and sufficient responses and supporting documentation from the grantees, and (2) identify errors in the grant expenditure amounts certified by the grantees.

**Effect:**

These conditions increase the risk of material misstatement to HUD's accrued grant liabilities and inaccurate financial reporting. CPD's fiscal year 2020 accrued grant liabilities is estimated to be understated by \$230 million.

**Recommendations:**

We are recommending OCFO:

1A. As part of the validation process for CPD's accrued liabilities, improve its validation process to ensure that it is based on verifiable grantees responses and supporting documentation.

We are recommending OCFO reopen the following recommendation reported in audit report 2021-FO-0003-0001-D:

1B. As part of the validation process for CPD's accrued grant liabilities, review CPD's accrued grant liabilities estimation methodology to ensure that it is based on verifiable grantee supporting documentation and all assumptions and variables used for the grant accrual estimate were properly established, supported, and documented.

We are recommunicating the following open recommendation reported in audit report 2021-FO-0003:

2020-FO-0003-001-H: We recommend the Deputy Assistant Secretary for CPD re-evaluate and adequately document justification for the establishment of the percentages and other key assumptions used to determine the accrual amount for each program in CPD's accrued grant liabilities estimate.

**c. HUD's Internal Control Over Financial Reporting Needs to Be Strengthened - Controls over PIH's Cash Management Process**

**Background:**

HUD's prepayment balances include estimates for certain disbursements made to public housing agencies (PHAs) that are in excess of their expenses. These estimates are required as HUD does

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<sup>4</sup> The current accrual methodology in use by CPD cannot reliably capture grantee expenditures in a timely manner due to grantees having approximately 45 days after the month end to report incurred expenditures. Such delay between when grantee expenditures were incurred and when they are recognized contribute to the estimation weakness.

## EXHIBIT A Material Weakness

not have a system in place to provide real-time information on PHA expenditures or automatically reconcile PHA expenditures with HUD's disbursements.

### **Condition:**

HUD's financial reporting process does not recognize PIH prepayments when funds are disbursed to PHAs as advances or timely recognize expenses at the transaction level when funds are spent by PHAs. Instead, OCFO records an expense for the total HUD prepayment to PHAs upon disbursement. Quarterly, OCFO then records manual journal entries to adjust the PHA expense and prepayment balances in its general ledger to agree to its quarterly PIH prepayment estimate<sup>5</sup>.

In addition, for fiscal year 2021, PIH completed semiannual cash reconciliations, which identified that it had overpaid and underpaid PHAs \$220 million and \$122 million, respectively, as of June 30, 2021. However, no corresponding receivables and payables were recorded by HUD to recognize its cash claim from PHAs for overpayment and underpayment liability owed to PHAs.

### **Criteria:**

GAO-14-704G, *Standards for Internal Control in the Federal Government, Principle 10 - Design Control Activities* 10.03 Accurate and timely recording of transactions states, "Transactions are promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from its initiation and authorization through its final classification in summary records. In addition, management designs control activities so that all transactions are completely and accurately recorded."

FASAB's SFFAS 1, *Accounting for Selected Assets and Liabilities*, states:

"Accounts receivable arise from claims to cash or other assets. A receivable should be recognized when a federal entity establishes a claim to cash or other assets against other entities, either based on legal provisions, such as a payment due date (e.g., taxes not received by the date they are due), or goods or services provided."

"Advances and prepayments should be recorded as assets. Advances and prepayments are reduced when goods or services are received, contract terms are met, progress is made under a contract, or prepaid expenses expire."

"Accounts payable are amounts owed by a federal entity for goods and services received from, progress in contract performance made by, and rents due to other entities."

### **Cause:**

PIH relied on untimely expenditure data submitted by PHAs through the Voucher Management System (VMS) and manual cash reconciliations. In addition, PIH did not have a system capable of capturing PHA expenses in real time or performing reconciliations between HUD's disbursements and PHA expenses at the PHA level.

### **Effect:**

HUD's accounts payable and accounts receivable were understated and HUD's PIH prepayment was overstated by the amount that should have been recognized as a receivable.

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<sup>5</sup> Quarterly, OCFO utilizes PHA disbursement data from its general ledger and PHA expense information provided by PIH to estimate PIH's prepayment balance.

## **EXHIBIT A**

### **Material Weakness**

In addition, because prepayments, accounts receivable, and accounts payable transactions were not recorded by HUD at the point of the transaction date, the HUD recording process did not comply with FFMIA.

#### ***Recommendations:***

We are recommunicating the following open recommendations reported in audit reports 2014-FO-0003 and 2014-FO-0003:

We recommend OCFO:

- 2014-FO-0003-002-C: Implement a cost-effective method for automating the cash management process to include an electronic interface of transactions to the standard general ledger.
- 2014-FO-0003-002-E: Review the cash management process to identify all financial events to be recognized in accordance with GAAP. Establish procedures to account for the cash management activity in a timely manner in compliance with GAAP.
- 2014-FO-0003-002-G: Ensure that PIH's automation of its cash management process complies with Federal financial management requirements.
- 2016-FO-0003-002-D: Establish a process to track the amount HUD owes to PHAs to cover prepayment shortages and provide the information to OCFO so that it can be properly recognized as accounts payable.

**EXHIBIT B**  
**Significant Deficiencies**

**2. FHA Controls over Modeling Activities**

Certain weaknesses were identified within FHA's internal control over modeling activities. For details, see FHA financial statement audit report dated December 6, 2021, issued in OIG audit report 2022-FO-0003.



## **EXHIBIT C**

### **Noncompliance Findings**

#### **3. Noncompliance with FFMIA**

HUD's noncompliance with FFMIA continued in fiscal year 2021 with two systems not complying with federal financial management system requirements, federal accounting standards, and the USSGL at the transaction level.

##### A. Disaster Recovery Grant Reporting System

CPD is responsible for the Disaster Recovery Grant Reporting (DRGR) system, an internet-based system supporting the Community Development Block Grant Disaster Recovery (CDBG-DR) program and other special appropriations. DRGR did not comply with federal financial management system requirements, federal accounting standards, and the USSGL at the transaction level due to system weaknesses and insufficient monitoring of invalid and expired obligations that may have resulted in potential Anti-Deficiency Act (ADA) violations.

##### B. Tenant Rental Assistance Certification System

The Office of Housing is responsible for the Tenant Rental Assistance Certification System (TRACS) application. TRACS is the official contract management repository for the Office of Multifamily Housing Programs' rental assistance project-based contracts, including budget projections and funding for contracts. TRACS is designed to process subsidy contracts, tenant rental assistance information, and owner requests for payment (vouchers) for project-based programs. TRACS did not comply with federal financial management system requirements, federal accounting standards, and the USSGL at the transaction level due to weaknesses in monitoring executed repayment agreements between HUD and multifamily property owners.

A. We are recomunicating the following open recommendations reported in audit report 2018-FW-0802:

- i. 2018-FW-0802-0001-A: We recommend that the CFO determine whether the summary expenditures totaling \$160,360,714, which exceeded the grant round obligations for the two grantees, were ADA violations. If the transactions were violations, action should be taken as required by the ADA.
- ii. 2018-FW-0802-0001-B: We recommend that the CFO determine whether the revised and completed detail transactions totaling \$435,263,268, which occurred before and after grant rounds obligation and expenditure dates, were ADA violations. If the transactions were violations, actions should be taken as required by the ADA.

B. We are recomunicating the following open recommendations reported in audit report 2021-FO-0003:

- i. 2021-FO-0003-002-1J: We recommend that the Assistant Secretary for Housing – Federal Housing Commissioner review all executed repayment agreements in TRACS to determine which repayment agreements have not been fully repaid and represent an amount owed to HUD and work with OCFO to record these receivables.
- ii. 2021-FO-0003-002-1K: We recommend that the Assistant Secretary for Housing – Federal Housing Commissioner include a field in TRACS to identify which repayment agreements represent an amount owed to HUD and implement controls to ensure the accuracy of the listing in TRACS.

#### **4. Noncompliance with the Single Audit Act**

For most of fiscal year 2021, HUD did not have a designated single audit accountable official or a single audit liaison in accordance with 2 CFR § 200.513(c), which establishes agency responsibility to provide OMB with the name of a single audit accountable official among the senior

## EXHIBIT C Noncompliance Findings

policy officials of the federal awarding agency. In addition, HUD did not maintain centralized information with regard to HUD's efforts in meeting the single audit responsibilities.

HUD management indicated that these positions were in place over three years ago, but the office that held those positions was disbanded and those employees are no longer with HUD. HUD management did not reassign those positions due to an oversight.

The lack of an accountable official and centralized process for ensuring single audit act requirements are met increases the risk for delays in grantees having single audits conducted, HUD issuing management decisions, and any resulting corrective actions and the potential recovery of questioned federal costs.

We recommend that the Deputy CFO:

- 4A. Implement a policy to ensure the federal regulation responsibilities for outgoing HUD employees are reassigned to appropriate HUD personnel to enable HUD to continue to address those federal regulation requirements.
- 4B. Establish controls to determine if single audits for HUD grantees are being completed and reported in a timely manner in accordance with 2 CFR §200.512.
- 4C. Provide a means for which HUD grantees and their auditors can request technical advice and counsel.
- 4D. Establish controls to determine if follow-up is being conducted to determine if the grant recipients have taken appropriate and timely corrective action. That follow-up must include the following:
  - a. Issuing a management decision letter as prescribed in 2 CFR §200.521;
  - b. Monitoring recipients to ensure they are taking appropriate and timely corrective action;
  - c. Using cooperative audit resolution mechanisms (see 2 CFR §200.25) to improve federal program outcomes through better audit resolution, follow-up, and corrective action; and
  - d. Developing a baseline, metrics, and targets to track, over time, the effectiveness of HUD's process to follow-up on audit findings and on the effectiveness of single audits in improving recipient accountability and their use by HUD in making award decisions.
- 4E. Establish controls to ensure that HUD provides Office of Management Budget (OMB) annual updates to the compliance supplement<sup>6</sup> and works with OMB to ensure that the supplement focuses the auditor to test compliance requirements most likely to cause improper payments, fraud, waste, abuse or generate audit findings for which HUD will take sanctions.
- 4F. Establish a control to hold HUD's Single Audit Accountable Official responsible for improving the effectiveness of the single audit process based on single audit metrics that HUD will establish in response to recommendation 4D above.

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<sup>6</sup> Compliance supplement means an annually updated authoritative source for auditors that serves to identify existing important compliance requirements that the Federal Government expects to be considered as part of an audit. Auditors use it to understand the Federal program's objectives, procedures, and compliance requirements, as well as audit objectives and suggested audit procedures for determining compliance with the relevant Federal program.

**EXHIBIT D**  
**Status of Prior Year Findings**

Our assessment of the current status of the findings related to the prior year audits is presented below:

<i><b>Fiscal Year 2020 Findings</b></i>	<i><b>Type</b></i>	<i><b>Fiscal Year 2021 Status</b></i>
<p>HUD Had Weaknesses in Its Controls Over Financial Reporting and Did Not Always in Comply With Federal Generally Accepted Accounting Principles</p> <ol style="list-style-type: none"> <li>1) HUD Did Not Follow Generally Accepted Accounting Principles When Accounting for HCVP CARES Act Administrative Funds</li> <li>2) HUD Did Not Sufficiently Document Estimation Model Assumptions Used in CPD's Accrued Grant Liabilities Estimate or Adequately Validate the Estimate</li> <li>3) HUD Did Not Record All Reductions in the Guaranteed Loan Principal Outstanding Balance for Loans in the Section 184 Indian Home Loan Guarantee Program</li> <li>4) HUD Did Not Recognize All Financial Events Resulting From PIH's Cash Management Process</li> <li>5) HUD Did Not Ensure That Its Accounts Receivables Were Complete or That It Had Adequate Support for the Net Realizable Value of Its Accounts Receivable</li> </ol>	Material Weakness	<ol style="list-style-type: none"> <li>1) Closed</li> <li>2) Repeat – see fiscal year 2021 Material Weakness 1.b.</li> <li>3) Closed</li> <li>4) Repeat - see fiscal year 2021 Material Weakness 1.c.</li> <li>5) Closed</li> </ol>
<p>HUD's Financial Management System Did Not Comply with the Federal Financial Management Improvement Act</p>	Compliance Finding	Modified Repeat

In addition to the findings listed above, the audit of HUD's fiscal year 2020 financial statements listed 41 prior year audit recommendations associated with past findings that remained open at the beginning of fiscal year 2021. Our assessment of the current status of these recommendations, at the conclusion of our audit, is that 21 are considered closed and 20 remain open<sup>7</sup>.

<sup>7</sup> These assessments are based on CLA's review of audit evidence provided by the Department. These assessments may not necessarily reconcile with the recommendation status in HUD's Audit Resolution Corrective Action Tracking System.

# EXHIBIT E

## HUD's Response to the Audit Report



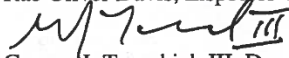
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
WASHINGTON, DC 20410-3000

OFFICE OF THE CHIEF FINANCIAL OFFICER

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### HUD OCFO MEMO 22-17

MEMORANDUM FOR: Rae Oliver Davis, Inspector General, HUD, GAF

FROM:   
George J. Tomchick III, Deputy Chief Financial Officer, F

SUBJECT: Response to Draft Independent Auditor's Report on HUD's Fiscal Year 2021 Financial Statements

DATE: December 6, 2021

I appreciate the professionalism and leadership exhibited by HUD, the OIG, and the independent public accounting firm (IPA) throughout the audit of HUD's consolidated financial statements. Our combined efforts and teamwork made the difference in successfully meeting the objectives of the financial audit process.

I take pride of the resiliency and adaptability of our workforce during the COVID-19 pandemic to sustain a strong and vigilant financial management environment, which resulted in an unmodified audit opinion. Our employees demonstrated continued dedication and reliability by seamlessly meeting mission requirements during challenging times. Our programs surged in capacity to help millions of our nation's most vulnerable people through the American Rescue Plan. The transition of the financial audit from the OIG to an IPA came with some complexities and new demands on resources to support the IPA's integration into the HUD environment. When it matters most, our workforce delivers for the public.

The audit is an opportunity for ongoing improvement as we promote equity, effectiveness, and accountability in the delivery of the HUD mission. As part of our approach to drive strong accountability and performance across HUD, we are committed to identifying and addressing areas requiring corrective action. Leveraging what we have learned in the last year, we will strive to build long-lasting efforts to enhance controls, build capacity, refine governance, and meet the changing needs of our stakeholders as we focus to resolve our one material weakness, one significant deficiency, and two instances of noncompliance with laws and regulations. While we have work ahead to resolve these issues, we are building on a solid foundation with high standards of effectiveness and accountability that will deliver results.

We are committed to consistently acting in a manner deserving of the public's trust, with utmost integrity and stewardship in everything that we do as public servants as we deliver on the HUD mission.