



Issue Date December 3, 2010

Audit Report Number 2011-DP-0003

TO: Douglas A. Criscitello, Chief Financial Officer, F

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FROM: Hanh Do, Director, Information Systems Audits Division, GAA

SUBJECT: HUD Did Not Fully Comply With the Requirements of OMB Circular A-127

HIGHLIGHTS

What We Audited and Why

We audited the U.S. Department of Housing and Urban Development's (HUD) ability to comply with the requirements of Office of Management and Budget (OMB) Circular A-127, which was revised in January 2009 and became effective on October 1, 2009. We conducted the audit as a component of the audit of HUD's consolidated financial statements for fiscal year 2010 under the Chief Financial Officer's Act of 1990.

What We Found

HUD did not fully comply with the requirements of OMB Circular A-127. Specifically, HUD had not (1) initiated plans to review financial management systems for compliance with computer security and internal control guidelines; and (2) accurately identified HUD's financial management systems within its financial system inventory listing. Additionally, although progress has been made, we continue to have concerns regarding HUD's integrated core financial system.

What We Recommend

We recommend that the Office of the Chief Financial Officer take appropriate steps to move into compliance with the requirements of OMB Circular A-127.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

The draft audit report was issued on October 19, 2010, and written comments were requested by October 26, 2010. We received written comments dated October 28, 2010. The addressee generally agreed with the recommendations in our report.

The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix A of this report.

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BACKGROUND AND OBJECTIVE

Office of Management and Budget (OMB) Circular A-127 prescribes policies and standards for executive departments and agencies to follow concerning their financial management systems. Circular A-127 was issued in 1984 and revised periodically to update policies and procedures, remove outdated information, and provide clarification as needed. The most recent revision to Circular A-127 was issued in January 2009 and became effective October 1, 2009. The revisions were intended to provide greater consistency in determining Federal Financial Management Improvement Act of 1996 (FFMIA) compliance and further strengthen financial management. OMB pointed out that the revised circular should be used for financial reports and audits for fiscal year 2010 and thereafter. Early implementation was encouraged.

The January 2009 revision of Circular A-127 incorporated new requirements for agencies to use financial management shared service providers to implement and maintain their core financial systems. Additionally, agencies were required to use certified configurations for their core financial systems and adopt standard government business processes established by the Financial Systems Integration Office¹ (FSIO). Further, pursuant to FFMIA,² the circular now includes and clarifies the guidance for reporting substantial compliance with FFMIA. While the revised circular introduced these new requirements, it did not eliminate requirements pertaining to computer security,³ internal controls,⁴ and maintaining financial management system plans and an agency wide inventory of financial management systems. Within HUD, the Office of the Chief Financial Officer (OCFO) is responsible for ensuring compliance with OMB Circular A-127.

HUD has three separate program areas with financial information that must be consolidated to produce financial statements that reflect its financial condition. These three areas, (1) the Federal Housing Administration (FHA), (2) the Government National Mortgage Association (Ginnie Mae), and (3) the remaining HUD program areas summarized by the OCFO (i.e., Public and Indian Housing (PIH) and Community Planning and Development (CPD)), each use separate financial applications to accomplish the required financial functions.

For several years, we have reported a significant deficiency in the consolidated financial statement audit report regarding HUD's lack of full compliance with Federal financial management system requirements. To address this deficiency, HUD initiated the HUD

¹ The Financial Systems Integration Office (FSIO), within the General Services Administration, was formerly known as the Joint Financial Management Improvement Program (JFMIP) staff office. FSIO's major areas of responsibility included requirements development, testing and product certification for core financial systems.

² FFMIA is intended to advance Federal financial management by ensuring that Federal financial management systems can routinely provide reliable financial information uniformly across the Federal Government following professionally accepted accounting.

³ Security controls requirements are defined by the Federal Information Security Management Act and Circular A-130 and/or successor documents.

⁴ Internal controls requirements are the internal control objectives of Circular A-123, which ensure that resource use is consistent with laws, regulations, and policies; resources are safeguarded against waste, loss, and misuse; and reliable data are obtained, maintained, and disclosed in reports.

Integrated Financial Management Improvement Project (HIFMIP) to move to an integrated core financial system (ICFS). HIFMIP was initially intended to replace the five financial applications that currently perform the core financial functions (collecting, processing, maintaining, transmitting, and reporting data regarding financial events) with one integrated financial system solution. HUD expected that HIFMIP would:

- Provide direct access to standardized, accurate, timely information;
- Reduce the number of systems;
- Provide efficient reporting and fiscal year end closings; and
- Provide efficient programmatic data for budget formulation.

The base period of performance for the HIFMIP contract was planned to last 18 months. Plans also called for eight 12- month options and one six month option. However, due to multiple protests and changes in requirements by OMB, a contract for HIFMIP was not awarded until September 2010.

This audit was performed as a component of our annual consolidated financial statements audit for fiscal year 2010 under the Chief Financial Officer's Act of 1990⁵. Our overall objective was to evaluate HUD's compliance with the requirements of OMB Circular A-127, which was revised in January 2009 and became effective October 1, 2009.

⁵ The CFO Act requires that annual financial statements be prepared and audited for each CFO Act agency covering all accounts and associated activities of each office, bureau, and activity of the agency. The CFO Act also requires that the financial statements prepared pursuant to the act be audited in accordance with applicable generally accepted government auditing standards.

RESULTS OF AUDIT

Finding 1: HUD Did Not Fully Comply With OMB Circular A-127 Requirements

HUD did not fully comply with all requirements specified in OMB Circular A-127. Specifically, HUD had not (1) initiated plans to review financial management systems for compliance with computer security and internal control guidelines; and (2) accurately identified HUD's financial management systems within its financial system inventory listing. Changes in requirements by OMB led HUD to change its position regarding its financial management systems. By not meeting the financial system requirements of OMB Circular A-127, HUD could not be assured that its financial management systems were reasonably secured and met Federal internal control requirements. This increases the risk that the annual financial statements would not be effectively and reliably produced.

HUD Did Not Perform Required Reviews of Its Financial Management Systems

Both the older and revised versions of OMB Circular A-127 require that financial management systems⁶ be reviewed for compliance with Federal computer security and internal control requirements. Before FY 2005, HUD used contractors to perform the Circular A-127 reviews of its financial management systems. During FY 2005, HUD conducted an A-76 streamlined competition⁷ to determine whether it was more cost efficient to perform A-127 compliance reviews with government staff resources. In 2006, HUD won the right to perform the A-127 compliance reviews. Since then, however, HUD had not performed the required number of A-127 compliance reviews. The HUD Office of Inspector General (OIG) reported this condition in its FY 2008 financial statement audit report.⁸ HUD had not taken corrective action to address this weakness and ensure

⁶ A financial management system includes the core financial systems and the financial portions of mixed systems necessary to support financial management, including automated and manual processes, procedures, and controls, data, hardware, software, and support personnel dedicated to the operation and maintenance of system functions. Examples of financial management systems include: core financial systems, procurement systems, loan systems, grants systems, payroll systems, budget formulation systems, billing systems, and travel systems.

⁷ The A-76 streamlined competition allows an agency to perform a cost-based public vs. private competition to determine whether a commercial activity should be performed by government personnel when the number of personnel required to complete the task is fewer than 65. The purpose of the competition is to ensure that the American people receive maximum value for their tax dollars.

⁸ OIG Audit Report number 2009-FO-0003, "Additional Details to Supplement Our Report on HUD's Fiscal Years 2008 and 2007 Financial Statements," issued November 14, 2008.

that A-127 compliance reviews were conducted. HUD’s policy was to complete Circular A-127 compliance reviews of all of its financial systems within a 3-year cycle. The tables below identify the number of Circular A-127 compliance reviews required and completed since FY 2007 and when HUD’s core financial systems were last reviewed.

Fiscal Year	Number of A-127 Reviews Completed by the OCFO Risk Management Division	Total Number of Financial Management Systems in HUD’s Financial System Inventory	Number of A-127 Reviews Required to Meet 3 year Requirement to Review all Systems *
2007	2	42	14
2008	2	42	14
2009	3	40	13
2010 (through March 2010)	1	40	13
Totals	8		54

Table 1 - Number of Circular A-127 compliance reviews completed/required

* Calculated as one-third of the financial management systems inventory

Core Financial Application	Date of Last OMB Circular A-127 Review
HUD’s Centralized Accounting and Program System (HUDCAPS)	October 2003
Line of Credit Control System (LOCCS)	July 2005
Program Accounting System (PAS)	July 2005
Hyperion	October 2003
Financial Data Mart	Not reviewed

Table 2 – Date of last Circular A-127 compliance review for HUD’s core financial systems

As shown in Table 1, only eight A-127 reviews were completed since 2007. Table 2 points out that of the financial applications performing HUD’s core financial functions, two have not been reviewed for compliance with computer security and internal controls within the last seven years, two have not been reviewed within the last five years, and one application was never assessed.

OCFO no longer intends to assess all of HUD’s financial management systems for compliance with computer security and internal control requirements as stated in OMB Circular A-127. Instead, OCFO plans to perform a self-assessment on the HUDCAPS application and rely on the results of the OMB Circular A-123

compliance reviews⁹ and the annual Federal Information Security Management Act (FISMA) review. Circular A-127 points out that agencies can leverage the results of the A-123 and FISMA reviews. However, the circular does not indicate that those reviews alone are sufficient to meet the A-127 review requirement. Neither the annual FISMA review nor the A-123 reviews adequately verify compliance with computer security and internal controls for all of HUD's financial management applications.

OCFO officials stated that the evaluation of internal controls is not just an evaluation through one review; it is based on a series of ongoing actions, activities and events that occur throughout HUD's operations. The OIG agrees with this assessment and believes that this should include HUDCAPS as well as other financial management systems. OIG has reported for the last several years a significant deficiency on HUD's computing environment. OIG consistently identifies weaknesses in computer security controls over HUD's systems, and these weaknesses are typically not identified during A-123 and FISMA reviews.

OMB Circular A-127, section 8, part E, states that agencies should perform an annual review of their financial management systems to verify compliance with computer security and internal controls. The circular suggests that agencies leverage the results of related reviews such as those required by FISMA and Circular A-123. Additionally, the circular states that agencies not using the latest version of a FSIO-certified system¹⁰ may be required to perform self-assessments of their core financial system.

OCFO officials stated that they were unable to find individuals with the necessary knowledge, skills, and abilities to perform the A-127 reviews. However, a contractor was not hired to perform the required reviews. Further, OCFO officials interpreted the term "leverage" in the revised Circular A-127 criteria as permission to rely on the FISMA and Circular A-123 reviews. OMB Circular A-123 reviews do not cover all the financial management systems. The OMB Circular A-127 statement, "Agencies that do not use the latest version of the FSIO certified system may be required to perform self assessments of their core financial system," was interpreted to mean that only the core financial system needed to be reviewed. OCFO referred to HUDCAPS as its core financial system, and stated that it planned to perform a self assessment this system. However, there are five financial management systems (HUDCAPS, LOCCS, PAS, Hyperion, and the Financial Data Mart) that perform the key functions of a core financial management system. Because OCFO did not consider LOCCS, PAS, Hyperion and the Financial Data Mart to be core financial systems, it did not plan to perform self assessments for these systems.

⁹ Circular A-123 compliance reviews ensure that resource use is consistent with laws, regulations, and policies; resources are safeguarded against waste, loss, and misuse; and reliable data are obtained, maintained, and disclosed in reports.

¹⁰ A FSIO-certified system refers to the OMB Circular A-127 requirement that agencies use a core financial system that is a COTS system that has been certified by FSIO as meeting the core financial system requirements.

HUD's financial management systems process billions of dollars in housing transactions. By not performing annual reviews of its financial management systems to verify compliance with computer security and internal controls, HUD increased its risk that monetary resources, such as payments and collections, could be lost or stolen. Since at least 2007, OCFO has not completed a full cycle of A-127 reviews, so the true security and internal control status of HUD's financial systems is not known. As previously mentioned, HUD OIG reported this issue in its FY 2008 financial statement audit report, but corrective action had not been taken. Consequently, we are not including a new recommendation in this report for this ongoing issue.

Financial Data Mart Was Not Classified as a Financial Management System

OCFO did not include the Financial Data Mart in its inventory of financial management systems and did not classify it as a financial management system although it meets OMB Circular A-127's definition of a financial system. The Financial Data Mart is a database application used by HUD for financial reporting and to transfer data between HUDCAPS and Hyperion to produce HUD's consolidated financial statements. Based upon the current data transfer process, HUD's consolidated financial statements cannot be produced without the Financial Data Mart.

OMB Circular A-127, section 9, part a, item 3, requires agencies to develop and maintain an agency wide inventory of their existing and proposed financial management systems and to provide FSIO with an annual inventory of their financial management systems.

Section 5 of the circular defines a financial system as an information system that may perform all of the financial functions, including general ledger management, funds management, payment management, receivable management, and cost management. It is also known as the system of record that maintains all transactions resulting from financial events. It may be integrated through a common database or interfaced electronically to meet defined data and processing requirements. The core financial system is specifically used for collecting, processing, maintaining, transmitting, and reporting data regarding financial events. Other uses include supporting financial planning, budgeting activities, and preparing financial statements. Any data transfers to the core financial system must be traceable to the transaction source, posted to the core financial system in accordance with applicable guidance from the Federal Accounting

Standards Advisory Board¹¹ (FASAB), and configured in the data format of the core financial system.

OCFO did not consider the Financial Data Mart to be a financial management system. After our specific inquiries regarding the rationale for this decision, OCFO reversed its longstanding position and decided that the Financial Data Mart was a financial management system.

Because the Financial Data Mart was not included in HUD's inventory of financial management systems or classified as a financial management system, it was not assessed for compliance with computer security and internal controls as required by OMB Circular A-127, and inaccurate information regarding HUD's financial systems was provided to the Government Accountability Office (GAO), OMB, and FSIO. Further, financial management system inventory listings developed and maintained by OCFO were inaccurate.

Conclusion

HUD did not fully comply with the requirements of OMB Circular A-127. HUD had not conducted all required reviews of its financial management systems, and accurately identified all of its financial management systems. These weaknesses occurred because of changes in requirements by OMB and misinterpretation of those requirements. By not meeting the financial system requirements of OMB Circular A-127, HUD could not be assured that its financial management systems were reasonably secured, met Federal internal control requirements, and effectively and reliably produced its annual financial statements.

Recommendations

We recommend that the Office of the Chief Financial Officer

- 1A. Revise the financial management system inventory listing to include the Financial Data Mart as a financial management system.
- 1B. Review the Financial Data Mart for compliance with computer security and internal controls as required by OMB Circular A-127.

¹¹ The mission of the FASAB is to promulgate federal accounting standards after considering the financial and budgetary information needs of citizens, congressional oversight groups, executive agencies, and the needs of other users of federal financial information.

Finding 2: Concerns Remain Regarding HUD’s Integrated Core Financial System

Although progress has been made, concerns remain regarding HUD’s integrated core financial system. The contract for HIFMIP was awarded on September 23, 2010. However, lack of updated planning documents could impact the 18-month timeframe for completing the initial implementation. Additionally, HUD’s interpretation of its core financial system could impact future option periods for the HIFMIP contract. OCFO officials did not see a need to update the HIFMIP planning documents, and changes in OMB definitions led HUD to conclude that only HUDCAPS should be listed as its core financial system. This interpretation could prevent HUD from achieving its overall vision of completing a fully integrated core financial system.

HIFMIP Planning Documents Were Not Updated to Reflect Current Conditions

In 2003, HUD initiated the HUD Integrated Financial Management Improvement Project (HIFMIP) to move to an integrated core financial system (ICFS) using PeopleSoft.¹² The original scope of the HIFMIP project was identified as a multi-year project to replace HUD’s core financial system with a solution that integrated financial information HUD-wide. The plans affected 34 separate applications within the agency and 73 existing interfaces between computer systems, not including the interfaces that would need to be built for FHA and Ginnie Mae.

The recommendations that resulted from the initial phase of the project were summarized within the document “HUD’s Financial Management Vision,” which was issued in July 2005. The original project vision called for the replacement of HUD’s Centralized Accounting and Program System (HUDCAPS)¹³, Program Accounting System (PAS)¹⁴, Hyperion¹⁵, the Financial Data Mart¹⁶ and the

¹² PeopleSoft is an integrated software package that provides a wide variety of business applications to assist in the day-to-day execution and operation of business processes. Each individual application, such as Financials, Customer Relationship Management, and Human Resources, interacts with others to offer an effective and efficient means of working and reporting in an integrated fashion across the enterprise.

¹³ HUDCAPS captures, reports, controls, and summarizes the results of the accounting processes, including budget execution and funds control, accounts receivable and collections, accounts payable and general ledger.

¹⁴ PAS is an integrated subsidiary ledger for HUD’s grant, subsidy, and loan programs. PAS maintains accounting records based on receipt of funding authorizations from HUDCAPS, which generates transaction activity at different levels.

¹⁵ Hyperion is HUD’s consolidated financial statement system. It captures, records, and summarizes HUD’s financial results of operations across all business areas in accordance with the requirements defined by OMB, GAO, Treasury, Congress, and HUD program offices to fulfill HUD’s quarterly and annual Treasury reporting requirements.

portions of the Line of Credit Control System (LOCCS)¹⁷ that related to core financial functions. The document included specific information regarding the justification for each application. It concluded that HUDCAPS, PAS, and LOCCS were not Office of Federal Financial Management¹⁸ (OFFM) compliant applications and that they ran on outdated technology that was costly to maintain. It also included information regarding the fact that the reconciliation of HUDCAPS requires an “extraordinary effort” from HUD staff to accomplish monthly and at year end, and that the batch processing of financial transactions between PAS and HUDCAPS results in untimely financial information. In addition, the results of HUD’s analysis concluded that the functionality provided by both Hyperion and the Financial Data Mart would be accomplished in a more efficient and integrated manner through replacement. The HIFMIP Vision document defined an integrated financial system for HUD as one that “should ensure accountability and control of resources and produce accurate, consistent, timely and useful financial information while linking to program information.” It also stated that the system “should also be able to measure performance and support informed decision making at all levels.”

In addition, vision and requirements documents developed through FY 2005 had not been updated. Since then, a number of significant changes had been made within the HUD financial system environment. The table below provides examples of changes to HUD’s financial system environment:

System/Office Name	Acronym	Description	Type of Change Made
Disaster Recovery and Grants System	DRGR	HUD receives funds from Congress to assist communities and States in recovering from housing and community problems due to Presidentially declared disasters. The DRGR system is used for monitoring and tracking performance under the Disaster Recovery Program.	Added to the HUD financial system environment
Subsidy and Grants Information System	SAGIS	SAGIS automates the competitive and formula-based processes for allocating Public and Indian Housing Office (PIH) program funds.	Added to the HUD financial system environment

¹⁶ The Financial Data Mart was created to provide a consolidated reporting environment of HUD’s financial data to users to create ad hoc queries and reports for analysis and execute canned financial reports.

¹⁷ LOCCS supports OCFO and all HUD program offices in coordinating and controlling grant, loan, and subsidy disbursements. The system is the CFO’s primary vehicle for cash management while monitoring disbursements according to the individual control requirements used by HUD program offices to ensure program compliance. LOCCS is both a payment control tool and a HUD post-award financial grants management system. LOCCS is also the link that connects HUD’s program management information systems to its program accounting data.

¹⁸ The Office of Federal Financial Management (OFFM) within OMB is responsible for the financial management policy of the Federal Government. OFFM responsibilities include implementing the financial management improvement priorities of the President, establishing government-wide financial management policies of executive agencies, and carrying out the financial management functions of the CFO Act.

System/Office Name	Acronym	Description	Type of Change Made
Hyperion	Hyperion	Hyperion is HUD's consolidated financial statement system. It captures, records, and summarizes HUD's financial results of operations across all business areas in accordance with the requirements defined by OMB, the Government Accountability Office, the U.S. Department of the Treasury (Treasury), Congress, and HUD program offices to fulfill HUD's quarterly and annual Treasury reporting requirements.	Application was upgraded
Loan Accounting System/ Northridge Loan System	LAS/NLS	LAS/NLS performs the direct loan servicing activities required to support HUD's Section 202 Housing for the Elderly and Handicapped Loan Program and the Section 201 Flexible Subsidy Programs.	LAS/NLS replaced the Loan Accounting System (LAS)
Fed Traveler	Fed Traveler	FED Traveler is the travel system for government travelers.	Fed Traveler replaced the HUD Travel Management System (HTMS)
Departmental Accounts Receivable Tracking/Collection System	DARTS	DARTS establishes, tracks, and collects account receivables for residual receipts, excess financing, and miscellaneous payments for the Public Housing Agencies/Indian Housing Authorities and Section 236 program receivables for Multifamily Excess Rental Income.	DARTS was retired, and its functionality was integrated into LAS/NLS
Office of Federal Housing Enterprise Oversight	OFHEO	OFHEO required a separate interface with the Financial Information and Management System (FIMS) for reporting.	OFHEO was abolished in 2008.

OCFO officials did not see a need to update the vision and requirements documents developed through FY 2005 because they believed that neither the amount of time elapsed nor detail changes would alter the objectives that the contractor would agree to perform for a fixed price. Further, OCFO officials stated that the contract would include objectives to verify that HUD was current with Federal requirements and to maintain that currency throughout the life of the contract.

The vendor who won the HIFMIP contract will have to redefine the project plan to detail how it will comply with current laws and regulations and establish the corresponding implementation schedule. We are concerned however, that timelines will slip and contract modifications will be requested since the contract has only an 18-month window for accomplishing the initial implementation. Within the 18-month window for accomplishing the initial implementation, the contractor will have to update project documentation, reevaluate system interfaces due to changes in HUD's computing environment over the years, and assess changes in Federal requirements. Further, the contractor will need to determine how the change of systems to be included in the project will impact this implementation (HIFMIP originally called for the replacement of HUDCAPS, PAS, LOCCS, Hyperion and the Financial Data Mart). Then there is the actual implementation of the new integrated financial system.

**OIG and OCFO Disagree on
How HUD's Core Financial
System Should Be
Characterized**

In the responses to GAO, OMB, and FSIO, OCFO listed the HUDCAPS application as HUD's core financial system. However, we found that OCFO uses five separate financial management systems to accomplish the core financial system functions (collecting, processing, maintaining, transmitting, and reporting data regarding financial events). These five financial management applications are LOCCS, Hyperion, the Financial Data Mart, PAS, and HUDCAPS. LOCCS provides grants management processing and authorized payment transactions to the U.S. Department of the Treasury (Treasury); Hyperion transmits financial information for treasury reporting, including the consolidated financial statements; the Financial Data Mart receives vendor payee information from the Central Contract Registration, which is used for standardized and ad hoc reporting, and is the interface for financial transactions to be recorded in Hyperion; and PAS transmits financial transaction information to HUDCAPS through batch interfaces that occur nightly.

Although information referencing HUDCAPS, LOCCS, PAS, and Hyperion was included within the write-up for HUDCAPS, the responses gave the impression that there was only one financial system to produce the financial statements of the program areas reported on by HUD's OCFO. We also noted that in correspondence between OCFO and HUD OIG, dated January 2010, OCFO identified the core financial applications as HUDCAPS, PAS, LOCCS, and Hyperion. The Financial Data Mart was omitted.

The January 2009 version of OMB Circular A-127 defines a core financial system as an information system that may perform all of the financial functions, including general ledger management, funds management, payment management, receivable management, and cost management. It is also known as the system of record that maintains all transactions resulting from financial events. It may be integrated through a common database or interfaced electronically to meet defined data and processing requirements. The core financial system is specifically used for collecting, processing, maintaining, transmitting, and reporting data regarding financial events. Other uses include supporting financial planning, budgeting activities, and preparing financial statements. Any data transfers to the core financial system must be traceable to the transaction source, posted to the core financial system in accordance with applicable guidance from the FASAB, and configured in the data format of the core financial system.

The FSIO "Core Financial System Requirements Exposure Draft," dated February 22, 2010, defines the capabilities of the core financial system as system

management, reimbursable management, fund balance with treasury management, cost management, receivable management, payment management, funds management, general ledger management, and reporting management. It further states that these capabilities may be tightly integrated as a single system or may be stand-alone systems with information transferred among them.

OIG disagrees with OCFO's interpretation of the revised definition for core financial applications contained in the 2009 version of OMB Circular A-127. OCFO maintained that because HUDCAPS was the official record of all financial transactions at the conclusion of the fiscal yearend processing, it met the definition of core financial system. However, the core financial system requirements relate to functionality. Financial transactions are entered into HUDCAPS nightly through batch processing. As a result, HUDCAPS alone does not contain accurate data regarding HUD's financial transactions on a daily basis. Financial data required on a daily basis must be obtained through multiple applications.

OCFO acknowledged that HUDCAPS relies heavily on PAS, LOCCS, Hyperion and the Financial Data Mart to accomplish the core financial system functions, but disputes OIG's interpretation that all five systems should be considered together as HUD's core financial system. OCFO also expressed concern that if all five systems were classified as core, then once the base period of the HIFMIP contract was completed, HUD would still be non-compliant with requirements to have an integrated core financial system. The base period of the HIFMIP contract will only replace HUDCAPS and PAS; LOCCS, Hyperion and the Financial Data Mart will still exist. OCFO believes that reliance on these three remaining systems will be significantly reduced upon completion of the base performance period of the HIFMIP contract, and that HUD will have a fully compliant integrated core financial system as a result.

The roles that these applications will perform have not yet been officially defined by either HUD or the newly hired contractor. HUD has not conducted any further analysis since it completed the work to identify the original scope of the HIFMIP project and supporting documentation. Modifications to HUD's computing environment and the financial system software being utilized have not been taken into consideration or analyzed. Consequently, the OIG remains concerned regarding the HIFMIP project.

In June 2010, OMB issued memorandum M-10-25, "Reforming the Federal Government's Efforts to Manage Information Technology Projects." This memorandum directed executive departments and agencies to refrain from awarding new task orders or contracts for financial system modernization projects pending review and approval by OMB. OMB reviewed HIFMIP and recommended that HUD give additional consideration to its (1) categorization of risk and mitigation strategies; (2) governance structure to ensure appropriate leadership is in place to support the project; and (3) funding strategy to give more

time to assess whether the current approach is viable. As a result of OMB's recommendations, HUD agreed to re-scope HIFMIP to address only the Department-level portion. Based on HUD's agreement to re-scope the project, OMB approved the 18-month base period. Proposed changes to the scope of the HIFMIP project are subject to OMB review and additional approvals will be needed for the option periods associated with HIFMIP.

Conclusion

OCFO did not update HIFMIP planning documents, and did not consider core financial system functionality when it interpreted OMB's revised definition of a core financial system. These issues could prevent timely completion of the 18 month base period of the HIFMIP contract and negatively impact future option periods.

Recommendations

We recommend that the Office of the Chief Financial Officer

- 2A. Work with the winning HIFMIP contractor to update the gap analysis to determine which applications should be maintained and update the HIFMIP documentation to detail the changes to HUD's financial system environment.
- 2B. Ensure that the integrated core financial system (ICFS) addresses all core system requirements.

SCOPE AND METHODOLOGY

The review covered the period October 1, 2009 through August 31, 2010. We performed the audit at HUD headquarters in Washington, DC, and from a remote location in Detroit, MI. Audit work was conducted from March through August 2010.

HUD has three separate program areas with financial information that must be consolidated to produce financial statements that reflect its financial condition. These three areas: (1) FHA, (2) Ginnie Mae, and (3) the remaining HUD program areas summarized by OCFO (i.e., PIH and CPD), each use separate financial applications to accomplish the required financial functions. We limited the scope of our review to an assessment of the program areas with financial data summarized by OCFO.

We reviewed the requirements of OMB Circular A-127, issued in January 2009, and compared the requirements to those of the previously issued version, dated July 1993 and updated in 1999 and 2004. We assessed HUD's compliance with the applicable OMB Circular A-127 requirements for the fiscal year ending September 30, 2009, and when possible, HUD's ongoing efforts to address the revised requirements that became effective October 1, 2009.

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

INTERNAL CONTROLS

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

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

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

Relevant Internal Controls

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

- Adherence to policies and procedures
- Managerial oversight and monitoring
- Reporting

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- HUD did not fully comply with OMB Circular A-127 requirements (finding 1).

FOLLOW-UP ON PRIOR AUDITS

**Additional Details to
Supplement Our Report on
HUD's Fiscal Years 2008 and
2007 Financial Statements –
Audit Report 2009-FO-0003**

HUD OIG is required to annually audit HUD's consolidated financial statements in accordance with the Chief Financial Officers Act of 1990, as amended. The OIG audit of HUD's FY 2008 and 2007 financial statements (audit report 2009-FO-0003) concluded that HUD did not comply with FFMIA. It concluded that although it was HUD's policy to complete OMB A-127 reviews of all HUD financial systems within a 3-year cycle, HUD did not complete any of the planned 2007 and 2008 independent reviews of its financial management systems to verify compliance with financial system requirements, identify system and procedural weaknesses, and develop the corrective actions to address identified weaknesses. Additionally, HUD only completed four independent reviews that were planned in 2006. As a result of the issues cited, OIG issued a recommendation that HUD develop a plan to comply with OMB A-127 review requirements, which results in the evaluation of all HUD financial management systems within a 3-year cycle. This recommendation remained unresolved as of August 31, 2010.


APPENDIXES

Appendix A

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

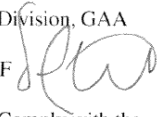
Auditee Comments

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

OFFICE OF THE CHIEF FINANCIAL OFFICER

OCT 28 2010

MEMORANDUM FOR: Hanh Do, Director, Information Systems Audit Division, GAA

FROM: Douglas A. Criscitello, Chief Financial Officer, F 

SUBJECT: Response to Draft Audit Report: HUD Did Not Comply with the Requirements of OMB Circular A-127

This memorandum is in response to your October 19, 2010 request for comments on the Draft Audit Report – HUD Did Not Comply with the Requirements of OMB Circular A-127. We have reviewed the subject report and are providing our response below.


RESPONSE TO OCFO SPECIFIC RECOMMENDATIONS

The Office of the Chief Financial Officer concurs with 2 of the 4 finding recommendations addressed in this Draft Audit Report: Recommendation 1A and Recommendation 1B.

The Office of the Chief Financial Officer non-concurs with 2 of the 4 finding recommendations addressed in this Draft Audit Report: Recommendation 2A and Recommendation 2B.

Presented below is a restatement of each of the applicable findings, your recommendations, and our comment on each recommendation.

Finding 1: HUD Did Not Fully Comply With OMB Circular A-127 Requirements



1st Heading under Finding 1:

OCFO Response: OCFO disagrees with OIG's interpretation that separate A-127 reviews must be performed to assess the internal control and security controls of all HUD's financial management systems. In FY 2010, HUD continued to face challenges in completing the A-127 reviews. Additionally, OMB Circular A-127 was revised significantly. The revised circular introduced a simplified risk based approach to determine FFMI compliance by targeting the agency's most significant financial statement audit risks. It states that agencies should perform an annual review of their financial management systems to verify compliance with internal controls and computer security for FFMI compliance. Additionally, it states that management is allowed to leverage the results of existing reviews, i.e. A-123 and FISMA reviews, to verify compliance with computer security and internal controls.

Under FISMA requirements HUD performs periodic testing and evaluation of the effectiveness of

Comment 1

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Comment 2

information security policies, procedures and practices. Additionally, an independent evaluation of HUD's information security programs and practices is performed by the OIG. This evaluation entails testing the effectiveness of control techniques. Once these reviews are completed, the Secretary submits a report with the results of the reviews to OMB. For any weaknesses noted, the program offices develop a Plan of Action and Milestones (POA&M). This is a plan that outlines the corrective actions that will be taken to correct documented weaknesses. The POA&Ms are monitored on a continuous basis.

Comment 3

As part of the A-123, HUD performs an internal control assessment in the areas of general, application and security controls of HUD's financial management systems. Under the course of an A-123 review, systems internal controls, as well as application and security controls are evaluated. This is a documented process which identifies controls objectives and tests these controls, and identifies deficiencies related to the testing. Subsequently, program offices submit corrective action plans and resolve the noted deficiencies.

Comment 4

The evaluation of internal controls and security controls are not just an evaluation through one review; it is based on a series of ongoing actions, activities and events that occur throughout HUD's operations. HUD has internal and security controls implemented throughout its management activities and they are an integral part of the agency's overall operational infrastructure. When deficiencies are noted, follow-up reviews are performed to determine the status of outstanding deficiencies. Furthermore, OCFO tracks HUD's significant deficiencies or material weaknesses identified in the annual Financial Statement audit and we monitor the implemented corrective actions related to HUD's annual FISMA review. In FY 2010, HUD evaluated ten financial management systems, 2 core and 8 mixed financial management systems, under its A-123 annual assessment reviews.

Comment 5

For a typical review, OCFO performs a risk assessment to determine if internal (i.e., A-123, FISMA or A-127) and external (OIG and/or GAO audits) reviews were performed; evaluates the self assessment tool for the related system; and, determines what corrective actions have been implemented. Under the risk based approach, it is not unreasonable for OCFO to rely on the results of these reviews, in addition to ensuring that corrective actions are implemented and accepting management's certification, as a risk indicator in determining if an in-depth A-127 review is warranted for mixed financial management systems. The OCFO intends to perform reviews that are required by OMB Circular A-127 of its financial management systems.

Comment 6

Under this finding, there is not a new audit recommendation issued. However, OIG references Audit Recommendation Number 2009-FO-0003-3a for this finding which was included as part of the FY2008 financial statement audit. For the many changes in the applicable requirements we identify in this response, OCFO requests that the OIG close this audit recommendation and issue a new recommendation.

Financial Data Mart Was Not Classified as a Financial Management System

2nd Heading under Finding 1:

OCFO non-concurs with the designation of Finding 1 as a significant deficiency (on Page 18 - Internal Control Section). It is not clear whether OIG is referring to the first or second heading

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Comment 7

under Finding 1 or the entire finding. The OCFO specifically does not agree with the designation because the OCFO responded to the OIG’s NFR and informed them that FDM Finding Recommendation 1A and 1B have been resolved. The OCFO requests removal of this reference to either aspect of Finding 1 being classified as a significant deficiency.

Recommendation 1A: Revise the financial management system inventory listing to include the Financial Data Mart as a financial management system.

Comment 8

OCFO Response: OCFO agrees with this recommendation. The OCFO has implemented this recommendation; this recommendation should be closed. FDM has been added to HUD’s Financial Management System Inventory and will be reported along with other systems to OMB not FSIO. FSIO was abolished in FY 2010. Additionally, please remove references to FISO reporting on Page 9, 2nd paragraph below the FDM finding header.

Recommendation 1B: Review the Financial Data Mart (FDM) for compliance with computer security and internal controls as required by OMB Circular A-127.

Comment 9

OCFO Response: OCFO agrees with this recommendation and requests that it will be closed. FDM is reviewed annually for compliance with FISMA reviews. Additionally, a self assessment of FDM was prepared during FY 2010.

Finding 2: Concerns Remain Regarding HUD’s Integrated Core Financial System

Comment 10

OCFO Response: HUD does not concur, for the reasons stated in this response, with Finding 2 or either of the two headings under this finding. Any departmental core financial system implementation should raise concerns, but OCFO has put in place the resources and controls to mitigate these concerns. We non-concur and ask that Finding 2 and the associated headings and recommendations be removed.

**HIFMIP Planning Documents
Were Not Updated to Reflect
Current Conditions**

1st Heading under Finding 2:

Comment 11

OCFO Response: OCFO does not agree with Finding 2, but agrees with the recommendation. HIFMIP is proceeding, not with rewriting historical artifacts, but with building upon the work done in the past. As described below we will be incorporating each of the OIG’s recommendations in this area as we proceed. The life cycle of a software implementation requires us to build upon the products of the previous stages and incorporate the new information that has been acquired. Instead of “updating” the artifacts – we create new documents appropriate to the later stages that build upon the former. Note that an architect, engineer, and construction team proceed in the same path – but HIFMIP is like a construction project where a pre-fabricated building is selected (like our acquisition of PeopleSoft) and a services contractor agrees to fixed price statement of objectives contract with a fixed scope and duration (like IBM). “Modifying” previous document when starting construction would not be appropriate just like the cost, time and effort to revisit superseded documents is not appropriate for HIFMIP. With the award of the HIFMIP Systems Integrator / Shared Service Provider contract we are ready to accomplish our objective.

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In the support for this “finding”, OIG is referring to future events that may or may not happen. According to the OIG on Page 13 of the Draft Audit Report, “*The vendor who won the HIFMIP contract will have to redefine the project plan to detail how it will comply with current laws and regulations and establish the corresponding implementation schedule. We are concerned however, that timelines will slip and contract modifications will be requested since the contract has only an 18-month window for accomplishing the initial implementation. Within the 18-month window for accomplishing the initial implementation, the contractor will have to update project documentation, reevaluate system interfaces due to changes in HUD’s computing environment over the years, and assess changes in Federal requirements.*”

We recommend that OIG remove this heading as a finding.

OIG and OCFO Disagree on How HUD's Core Financial System Should Be Characterized

2st Heading under Finding 2:

Comment 12

OCFO Response: OCFO does not agree with this finding but agrees with the recommendation below. We believe that the time and effort on both sides has led to agreement between OIG and OCFO on both the current characterization and the anticipated impact of the successful implementation of A100 HUD ICFS. We appreciate the changes to this document that have been incorporated based on the productive discussions that we have had. Based on the information provided below we non-concur with this finding and ask that it be removed because of resolution from our joint efforts.

Recommendation 2A: Work with the winning HIFMIP contractor to update the gap analysis to determine which applications should be maintained and update the HIFMIP documentation to detail the changes to HUD’s financial system environment.

Comment 13

OCFO Response: It is reasonable for OIG to have concerns as we begin the Base Period of this critical project. It is also reasonable for OIG to express these concerns to HUD OCFO. We actually concur with the recommendation because these activities are (and have been) incorporated into the HIFMIP solicitation, contract and performance work statement.

Comment 14

We do not concur that 2.1 constitutes a “finding” and ask that it be removed. The HIFMIP methodology and project approach are clearly documented and consistent with the applicable standards. We welcome the opportunity to continue to inform OIG throughout the project so that their concerns are addressed, and we are confident that HIFMIP’s approach will accomplish our mutual goals.

Recommendation 2B: Ensure that the integrated core financial system (ICFS) addresses all core system requirements.

Comment 15

OCFO Response: Based on the certification of Oracle’s PeopleSoft Enterprise Financial software by JFMIP/FSIO/OMB and the HIFMIP Systems Integrator’s fixed price contract, HIFMIP is prepared to achieve this recommendation. Recommendation 2B is already consistent with our

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approach.

We look forward to working with you and your staff to resolve and close-out the recommendations. If you have any questions or need additional information please contact Gail B. Dise at 202-402-3749 or Simin Narins at 202-402-3719.

OIG Evaluation of Auditee Comments

- Comment 1** We agree that OMB Circular A-127 allows agencies to leverage the results of the OMB Circular A-123 and FISMA reviews. However, the circular does not indicate that those reviews alone are sufficient to meet the A-127 review requirement. OIG consistently identifies weaknesses in computer security controls over HUD's systems, and these weaknesses are typically not identified during A-123 and FISMA reviews.
- Comment 2** The OIG's independent evaluation of HUD's overall information security program is performed annually as part of its responsibility to address OMB's FISMA questions.
- Comment 3** OMB Circular A-127 requires that financial management systems be reviewed for compliance with Federal computer security and internal control requirements. While Circular A-123 reviews do assess internal controls, they are not performed annually for each financial system. The OCFO stated in its response to this report that HUD evaluated ten financial management systems in FY 2010 under its A-123 annual assessment reviews. However, HUD has 43 financial management systems. And as noted in the audit report, only eight A-127 reviews were completed since 2007.
- Comment 4** The OIG agrees with OCFO's assessment that the evaluation of internal controls and security controls are not just an evaluation through one review, but a series of ongoing actions, activities and events. The OIG believes that this should include HUDCAPS as well as other financial management systems. OIG has reported for the last several years a significant deficiency on HUD's computing environment. OIG consistently identifies weaknesses in computer security controls over HUD's systems, and these weaknesses are typically not identified during A-123 and FISMA reviews.
- Comment 5** Since at least 2007, OCFO has not completed a full cycle of A-127 reviews, so the true security and internal control status of HUD's financial systems is not known. As previously mentioned, HUD OIG reported this issue in its FY 2008 financial statement audit report, but corrective action had not been taken. We hope that the OCFO will assess all of its financial management systems to comply with the requirements of OMB Circular A-127.
- Comment 6** The Director of OIG's Financial Audit Division advised OCFO on September 24, 2010 that HUD OIG does not consider the actions taken by the Department to be sufficient. Consequently, he did not agree with closing the original recommendation. Thus, there is no need to issue a new recommendation.
- Comment 7** Although the OCFO has already taken action for these recommendations, the findings were valid during the audit, and contributed to our determination of a significant deficiency on HUD's computing environment. However, because

OCFO has already taken corrective action, and supporting documentation has already been provided, the recommendation can be closed concurrently with the management decision.

- Comment 8** We commend the OCFO for taking corrective action once the deficiency was brought to its attention. Supporting documentation can be submitted as part of the management decision process, and if the documentation is sufficient, we can close the recommendation concurrently.
- Comment 9** Again, we commend the OCFO for taking corrective action once the deficiency was brought to its attention.
- Comment 10** Although the OCFO states that it does not concur with Finding 2, the concerns raised by the OIG are legitimate concerns. OCFO acknowledges this in its response and further states that any “core financial system implementation should raise concerns.” Finding 2 is appropriately titled “Concerns Remain Regarding HUD’s Integrated Core Financial System” because it expresses the OIG concerns pertaining to HIFMIP. Therefore, we will not remove the finding and its associated headings.
- Comment 11** The OIG is pleased that OCFO will be incorporating each of the OIG’s recommendations.
- Comment 12** It would be inappropriate to not present the full discussion of the concerns and disagreements regarding the characterization of HUD’s core financial system. Therefore, as stated in OIG comment 10, we will not remove finding 2 or any of its associated headings. We are pleased that OCFO agrees with our recommendation.
- Comment 13** See comment 12.
- Comment 14** See comment 12.
- Comment 15** As stated in OIG comment 10, we will not remove finding 2 or any of its associated headings. We are pleased that OCFO agrees with our recommendation.