



OFFICE *of*
INSPECTOR GENERAL
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UNITED STATES DEPARTMENT OF
HOUSING AND URBAN DEVELOPMENT

Federal Housing Administration

AUDIT OF FHA'S FISCAL YEARS 2022 and 2021

FINANCIAL STATEMENTS | 2023-FO-0003

November 16, 2022

Date: November 16, 2022

To: Julia R. Gordon
Assistant Secretary for Housing and the Federal Housing Commissioner, H

//signed//

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

Subject: Transmittal of Independent Public Accountant's Audit Report on the Federal Housing Administration's Fiscal Years 2022 and 2021 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 the Federal Housing Administration's (FHA) fiscal years 2022 and 2021 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 FHA as of and for the fiscal years ended September 30, 2022 and 2021, and to provide reports on FHA's 1) internal control over financial reporting; and 2) compliance with laws, regulations, contracts, and grant agreements and other matters. 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 FHA, CLA reported:

- The financial statements as of and for the fiscal year ended September 30, 2022 and 2021, are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles.
- One material weakness¹ for fiscal year 2022 in internal control over financial reporting, based on the limited procedures performed. The material weakness was related to FHA's financial accounting and reporting controls over borrowing authority and loan receivables.
- No reportable noncompliance issues for fiscal year 2022 with provisions of applicable laws, regulations, contracts, and grant agreements or other matters.

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

¹ 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 FHA's financial statements will not be prevented or detected and corrected on a timely basis.

with U.S. generally accepted government auditing standards, was not intended to enable us to express, and we do not express, opinions on FHA's financial statements or conclusions about 1) the effectiveness of FHA's internal control over financial reporting and 2) FHA's compliance with laws, regulations, contracts, grant agreements, or other matters. CLA is responsible for the attached Independent Auditors' Report, dated November 16, 2022, 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 Brittany Wing, Audit Director, at (202) 320-7296.



Independent Auditors' Report

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

Assistant Secretary for Housing – Federal Housing Commissioner
Federal Housing Administration

In our audits of the fiscal years 2022 and 2021 financial statements of the Federal Housing Administration (FHA), we found:

- FHA's financial statements as of and for the fiscal years ended September 30, 2022, and 2021, are presented fairly, in all material respects, in accordance with United States of America (U.S.) generally accepted accounting principles;
- one material weakness for fiscal year 2022 in internal control over financial reporting based on the limited procedures we performed; and
- no reportable noncompliance for fiscal year 2022 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 financial statements, which includes required supplementary information (RSI)¹ and other information² included in the Annual Management Report; (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) FHA's response to our findings and recommendations.

Report on the Audit of the Financial Statements

Opinion

We have audited the accompanying financial statements of FHA, which comprise the balance sheets as of September 30, 2022, and 2021; the related statements of net cost, changes in net position, and budgetary resources for the fiscal years then ended; and the related notes to the financial statements.

In our opinion, FHA's financial statements referred to above present fairly, in all material respects, FHA's financial position as of September 30, 2022, and 2021, and its net cost, changes in net position, and budgetary resources for the fiscal years then ended in accordance with U.S. generally accepted accounting principles.

Basis for Opinion

We conducted our audits in accordance with U.S. generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by

¹ The RSI consists of "Management's Discussion and Analysis" which are included with the financial statements.

² Other information consists of information included with the financial statements, other than the RSI and the auditors' report.

INDEPENDENT AUDITORS' REPORT (Continued)

the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 22-01, *Audit Requirements for Federal Financial Statements* (OMB Bulletin 22-01). Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of FHA and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

FHA management is responsible for (1) the preparation and fair presentation of the 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 the Annual Management Report, and ensuring the consistency of that information with the audited financial statements and the RSI; and (4) designing, implementing, and maintaining effective internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit of financial statements conducted in accordance with *Government Auditing Standards* will always detect a material misstatement or a material weakness when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements, including omissions, are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with *Government Auditing Standards*, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements in order to obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.
- Obtain an understanding of internal control relevant to our audit of the 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 FHA's internal control over financial reporting. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Perform other procedures we consider necessary in the circumstances.

INDEPENDENT AUDITORS' REPORT (Continued)

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

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 financial statements. Such information is the responsibility of management and, although not a part of the financial statements, is required by FASAB, which considers it to be an essential part of financial reporting for placing the financial statements in an 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 financial statements, and other knowledge we obtained during the audits of the 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

FHA other information contains a wide range of information, some of which is not directly related to the financial statements. This information is presented for purposes of additional analysis and is not a required part of the financial statements or the RSI. FHA management is responsible for the other information included in the Annual Management Report. The other information does not include the financial statements and our auditors' report thereon. Our opinion on the financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the financial statements, or the other information otherwise appears to be materially misstated. If, based on the work performed, we conclude that an uncorrected material misstatement of the other information exists, we are required to describe it in our report.

Report on Internal Control over Financial Reporting

In connection with our audits of FHA's financial statements, we considered FHA's internal control over financial reporting, consistent with our auditors' responsibilities discussed below.

Results of Our Consideration of Internal Control over Financial Reporting

Our consideration of internal control was for the limited purpose described below 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 FHA's internal control over financial reporting and therefore, material weaknesses or significant deficiencies may exist that were not identified. We identified deficiencies in internal control over financial reporting that we consider to be a material weakness, described below and in Exhibit A.

INDEPENDENT AUDITORS' REPORT (Continued)

Weakness in Internal Control Over Financial Accounting and Reporting

Weaknesses in Internal Controls over FHA's Borrowing Authority

Weaknesses in FHA's preventive controls resulted in the erroneous classification of Federal Financing Bank (FFB) borrowings for direct loans as definite borrowing authority instead of indefinite borrowing authority, requiring FHA to make \$22.2 billion in absolute value accounting adjustments after its year-end financial statements were prepared.

Weaknesses in FHA's preventive controls resulted in the erroneous receipt of \$6.9 billion in excess borrowings from the U.S. Department of the Treasury's Bureau of Fiscal Service (BFS) without adequate approvals from OMB leading to the omission of approximately \$110 million in interest expense within the financial statements as of June 30, 2022.

Weaknesses in FHA's detective controls, including key reconciliations, resulted in approximately \$843 million of misstatements in the reported borrowing authority within the Statement of Budgetary Resources as of June 30, 2022.

Weaknesses in Internal Controls over FHA's Loans Receivable

Weaknesses in FHA's detective and monitoring controls over Single Family partial claims resulted in FHA making over \$500 million of reclassifying adjustments within the loans receivable balance after its year-end financial statements were prepared.

Weaknesses in FHA's detective and monitoring controls over loans receivable within the Home Equity Conversion Mortgage (HECM) program resulted in several deficiencies noted with FHA's rights assertion, including whether FHA holds or controls the rights to the collateral property underlying certain HECM loans.

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 deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that even if the control operates as designed the control objective would not be met. A deficiency in operation exists when a properly designed control does not operate as designed or when the person performing the control does not possess the necessary authority or competence to perform the control effectively. 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. 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.

During our 2022 audit, we identified deficiencies in FHA's internal control over financial reporting that we do not consider to be material weaknesses or significant deficiencies. Nonetheless, these deficiencies warrant FHA management's attention. We have communicated these matters to FHA management and, where appropriate, will report on them separately.

INDEPENDENT AUDITORS' REPORT (Continued)

Basis for Results of Our Consideration of Internal Control over Financial Reporting

We performed our procedures related to FHA's internal control over financial reporting in accordance with *Government Auditing Standards*.

Responsibilities of Management for Internal Control over Financial Reporting

FHA management is responsible for (1) designing, implementing, and maintaining effective internal control over financial reporting relevant to the preparation and fair presentation of 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).

Auditors' Responsibilities for the Consideration of Internal Control over Financial Reporting

In planning and performing our audit of FHA's financial statements as of and for the fiscal year ended September 30, 2022, in accordance with *Government Auditing Standards*, we considered FHA's internal control relevant to the financial statement audit 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 FHA'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 FHA'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 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 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.

Purpose of Report on Internal Control over Financial Reporting

The purpose of this report is solely to describe the scope of our consideration of FHA's internal control over financial reporting and the results of our procedures, and not to provide an opinion on the effectiveness of FHA'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.

INDEPENDENT AUDITORS' REPORT (Continued)

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

In connection with our audits of FHA's financial statements, we tested compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements consistent with our auditors' responsibilities discussed below.

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 no instances of noncompliance or other matters for fiscal year 2022 that would be reportable under *Government Auditing Standards*. However, the objective of our tests was not to provide an opinion on compliance with laws, regulations, contracts, and grant agreements applicable to FHA. Accordingly, we do not express such an opinion.

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

We performed our tests of compliance in accordance with *Government Auditing Standards*. Our responsibilities under those standards are further described in the Auditors' Responsibilities for Tests of Compliance section below.

Responsibilities of Management for Compliance with Laws, Regulations, Contracts, and Grant Agreements

FHA management is responsible for complying with laws, regulations, contracts, and grant agreements applicable to FHA, including ensuring FHA's financial management systems are in substantial compliance with the Federal Financial Management Improvement Act (FFMIA) requirements.

Auditors' Responsibilities for Tests for Compliance with Laws, Regulations, Contracts, and Grant Agreements

Our responsibility is to test compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements applicable to FHA that have a direct effect on the determination of material amounts and disclosures in FHA's financial statements and to perform certain other limited procedures. Accordingly, we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to FHA. We caution that noncompliance may occur and not be detected by these tests.

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.

Status of Prior Year's Control Deficiencies and Noncompliance Issues

We have reviewed the status of FHA's corrective actions with respect to the findings and recommendations included in the prior year's Independent Auditors' Report, dated December 6, 2021. The status of prior year findings is presented in Exhibit B.

INDEPENDENT AUDITORS' REPORT (Continued)

FHA's Response to Audit Findings and Recommendations

Government Auditing Standards requires the auditor to perform limited procedures on FHA's response to the findings and recommendation identified in our report and described in Exhibit C. FHA's response was not subjected to the auditing procedures applied in the audits of the financial statements and, accordingly, we express no opinion on the response.

CliftonLarsonAllen LLP

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

Greenbelt, MD
November 16, 2022

EXHIBIT A Material Weakness

1. Weakness in Internal Control over Financial Accounting and Reporting

A. Weaknesses in Internal Controls over FHA's Borrowing Authority

Condition:

FHA management did not sufficiently analyze and respond to significant changes in regulatory guidance impacting accounting and reporting of its borrowing authority from the Federal Financing Bank (FFB) for its direct loans program. In addition, FHA borrowed in excess of its apportioned borrowing authority and failed to record interest expense in the June 30 financial statements. Lastly, FHA did not ensure its borrowing authority was complete and accurately recorded.

Criteria:

GAO-14-704G, *Standards for Internal Control in the Federal Government*:

Principle 9—Identify, Analyze, and Respond to Change 9.01 states, “Management should identify, analyze, and respond to significant changes that could impact the internal control system.”

Principle 12—Periodic Review of Control Activities states, “Management periodically reviews policies, procedures, and related control activities for continued relevance and effectiveness in achieving the entity’s objectives or addressing related risks. If there is a significant change in an entity’s process, management reviews this process in a timely manner after the change to determine that the control activities are designed and implemented appropriately. Changes may occur in personnel, operational processes, or information technology. Regulators; legislators; and in the federal environment, the Office of Management and Budget and the Department of the Treasury may also change either an entity’s objectives or how an entity is to achieve an objective. Management considers these changes in its periodic review.”

Principle 14—Communicate Internally 14.03 Communication throughout the Entity states, “Management communicates quality information down and across reporting lines to enable personnel to perform key roles in achieving objectives, addressing risks, and supporting the internal control system. In these communications, management assigns the internal control responsibilities for key roles.”

Principle 10—Design Control Activities 10.03 Design of Appropriate Types of Control Activities states, “Management designs appropriate types of control activities for the entity’s internal control system. Control activities help management fulfill responsibilities and address identified risk responses in the internal control system.”

“Proper execution of transactions

Transactions are authorized and executed only by persons acting within the scope of their authority. This is the principal means of assuring that only valid transactions to exchange, transfer, use, or commit resources are initiated or entered into. Management clearly communicates authorizations to personnel.

Accurate and timely recording of transactions

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.”

EXHIBIT A Material Weakness

Principle 16—Perform Monitoring Activities 16.05 Internal Control System Monitoring states, “Management performs ongoing monitoring of the design and operating effectiveness of the internal control system as part of the normal course of operations. Ongoing monitoring includes regular management and supervisory activities, comparisons, reconciliations, and other routine actions. Ongoing monitoring may include automated tools, which can increase objectivity and efficiency by electronically compiling evaluations of controls and transactions.”

OMB Circular No A.11, *Preparation, Submission and Execution of the Budget (8/15/22)*, Part 4 – Instructions on Budget Execution, I. Apportionment, Section 120.64 – Apportionment process states:

“Submit a reapportionment request to OMB when programmatic changes result in a need for an adjustment in the apportionment. In order to allow time for action by OMB, submit such requests well in advance of the time that the revised amounts, to be apportioned, are needed for obligation (an apportionment for a specific time period, such as for a specific quarter of the current fiscal year, may not be changed after the end of that period).”

Cause:

FHA lacked effective preventive and detective controls over the existence, completeness, accuracy, and presentation assertions over its borrowing authority.

Specifically, FHA did not ensure its control activities were adequately designed and implemented after the Department of Treasury, Bureau of the Fiscal Service (Fiscal Service) updated the guidance for the U.S. Standard General Ledger (USSGL) regarding the accounting for definite and indefinite borrowing authority. In addition, lack of communication between the Office of Financial Accounting and Reporting (OFAR) and the Budget Office regarding fiscal year 2022 legislation changes that granted indefinite borrowing authority from FFB, contributed to the inappropriate accounting treatment.

In addition, FHA lacked certain preventive controls to ensure it had adequate authorization prior to executing transactions. Specifically, FHA’s standard operating procedures (SOP) did not require verification that sufficient borrowing authority was obtained from OMB on the standard form (SF) 132, *Apportionment and Reapportionment Schedule*, during any stage of the preparation or approval of the borrowing request nor did its SOPs require authorization for the preparation and request for the funds received from Treasury. Moreover, a lack of communication between the OFAR and the Budget Offices resulted in an updated SF 132 not being requested from OMB to reflect the additional borrowing authority needed to cover the actual borrowing needs and related interest expense prior to the execution of the borrowing transaction with the Fiscal Service.

Furthermore, FHA’s monitoring controls over its budgetary resources, execution, and status of resources were not appropriately designed to help management fulfill their responsibilities in ensuring accurate and timely recording of transactions. Specifically, FHA’s control over key reconciliations between its general ledger, the SF 132, and the SF 133, *Report on Budget Execution*, lacked critical design elements needed to ensure its borrowing authority was complete and accurately recorded.

Effect:

FHA’s weaknesses in its preventive controls over borrowing authority, and specifically, the failure to revise internal control processes in response to significant changes in legislation and regulatory

EXHIBIT A

Material Weakness

guidance as well as weaknesses in communication between the OFAR and the Budget Office, resulted in over \$11 billion (\$22.2 billion in absolute value) of accounting adjustments having to be made to FHA's general ledger after it prepared its year-end financial statements. These adjustments included over \$6 billion effecting various line items within the Statement of Budgetary Resources (SBR) and footnote disclosures, and the amounts reported within the SF 133 to OMB. In addition, these adjustments included approximately \$5 billion of reclassification entries that will impact unobligated balances from prior year budget authority in subsequent years.

FHA's weaknesses in its preventive controls cited over management's authorization and execution of borrowing transactions, resulted in the erroneous receipt of \$6.9 billion in excess borrowings in June 2022. Had the additional borrowing authority been appropriately authorized, FHA would have reported an additional \$10 billion in borrowing authority on its June 30 SBR, and an additional \$110 million interest payable and expense on the balance sheet and statement of net cost, respectively. This results in a concern of potential noncompliance with the Antideficiency Act and U.S. Department of Housing and Urban Development (HUD)'s Appropriations Law Division is currently investigating this issue.

FHA's weaknesses in its detective controls cited over management's reconciliation controls for its budget authority, resulted in approximately \$843 million of misstatements in the reported borrowing authority within the June 30 SBR.

Recommendation:

We recommend that the Deputy Assistant Secretary for Finance and Budget:

1A. Establish change management and periodic reviews of control activities to ensure regulatory changes, such as Fiscal Service updates to the USSGL, are identified, analyzed, and assessed for potential needed changes to FHA's established processes.

1B. Establish and ensure appropriate and effective communication protocols between OFAR, FHA, and HUD's Office of Budget to ensure (1) funding type is clearly indicated within the SF 132 and clear communications are made in differentiating between definite and indefinite borrowing authority, (2) legislative changes in FHA's borrowing authority are vetted with OMB to ensure appropriate treatment, and (3) – draft SF-133s are reviewed and vetted with HUD and FHA's budget officers prior to OFAR's finalization with Treasury and OMB.

1C. Establish internal control procedures around the borrowings process to include verifying sufficient borrowing authority exists within the SF 132, prior to executing the borrowing request. Such verification should also be included as part of the borrowing review and approval controls.

1D. Receive a final opinion from HUD's Office of the Chief Financial Officer's Appropriation Law Division on whether FHA was in violation of the Antideficiency Act.

We recommend that the Deputy Assistant Secretary for Finance and Budget work with the Office of Financial Accounting and Reporting Director to:

1E. Implement procedures to enhance the review of all journal entries recorded in the general ledger by requiring a two-level review that includes the review of source documents for the journal entry (for example, the OMB approved SF 132).

EXHIBIT A Material Weakness

1F. Strengthen controls over the preparation of the SF 132 to the SF 133 reconciliation by preparing such reconciliations (1) first, with the unadjusted trial balance and later, with the adjusted trial balance and (2) at the fund level, with detailed documentation of differences, and with sufficient detailed explanations that describe the general ledger impact of the differences.

1G. Perform a thorough review of the SF 132 to SF 133 reconciliations and work with Financial Analysis and Controls Division and other divisions and groups to resolve material reconciling items timely.

B. Weaknesses in Internal Controls over FHA's Receivables

Condition:

FHA's internal reporting on the status of promissory notes for its recorded partial claims receivable balance was inaccurate and was not properly reviewed or monitored. Additionally, key loan functions were not performed, possible default events were not timely identified and captured, and FHA's interest in property collateral securing certain Home Equity Conversion Mortgage (HECM) notes is in question, increasing the likelihood of loss and financial statement misstatement.

Criteria:

GAO-14-704G, *Standards for Internal Control in the Federal Government*:

Principle 15—Communicate Externally 15.02 Communication with External Parties states, "Management communicates with, and obtains quality information from, external parties using established reporting lines. Open two-way external reporting lines allow for this communication. External parties include suppliers, contractors, service organizations, regulators, external auditors, government entities, and the general public."

Principle 17—Evaluate Issues and Remediate Deficiencies:

17.01 states, "Management should remediate identified internal control deficiencies on a timely basis."

17.03 Reporting of Issues states, "Personnel may identify internal control issues while performing their assigned internal control responsibilities. Personnel communicate these issues internally to the person in the key role responsible for the internal control or associated process and, when appropriate, to at least one level of management above that individual. Depending on the nature of the issues, personnel may consider reporting certain issues to the oversight body. Such issues may include issues that cut across the organizational structure or extend outside the entity to service organizations, contractors, or suppliers."

Principle 16—Perform Monitoring Activities 16.05 Internal Control System Monitoring states, "Management performs ongoing monitoring of the design and operating effectiveness of the internal control system as part of the normal course of operations. Ongoing monitoring includes regular management and supervisory activities, comparisons, reconciliations, and other routine actions. Ongoing monitoring may include automated tools, which can increase objectivity and efficiency by electronically compiling evaluations of controls and transactions."

EXHIBIT A

Material Weakness

Principle 10—Design Control Activities 10.03 Design of Appropriate Types of Control Activities states, “Management designs appropriate types of control activities for the entity’s internal control system. Control activities help management fulfill responsibilities and address identified risk responses in the internal control system.”

“Accurate and timely recording of transactions

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.”

HUD Handbook 4000.1 III.A.2(H)(8) Failure to Timely Provide Partial Claim Note and Subordinate Mortgage:

- When the Mortgagee fails to provide HUD with the Partial Claim promissory Note and subordinate Mortgage within the required time frames, HUD may require reimbursement of the full amount of the Partial Claim.

Cause:

FHA lacked effective detective and monitoring controls over the existence, completeness, accuracy, rights, and presentation assertions over its loan receivables balances. Specifically, we found 1) ineffective communication between FHA’s National Servicing Center (NSC) and OFAR, 2) a backlog of unprocessed documentation that was not reflected in FHA’s internal report used for financial reporting, and 3) information technology system limitations that contributed to FHA’s inability to appropriately monitor key information relating to its interest on collateral property within the HECM program.

Effect:

Weaknesses in FHA’s detective and monitoring controls over single family partial claims resulted in FHA making over \$500 million of reclassifying adjustments to their loan receivables balance after it prepared its year-end financial statements.

Weaknesses in FHA’s detective and monitoring controls over the HECM loans resulted in several deficiencies noted with FHA’s rights assertion, including whether FHA holds or controls the rights to the collateral property underlying certain loans within the \$44 billion HECM receivable balance.

Recommendation:

We recommend that the Deputy Assistant Secretary for Finance and Budget:

1H. Coordinate with the Deputy Assistant Secretary for Single Family Housing and HUD’s Office of the Chief Procurement Office (OCPO) in developing effective communication channels between FHA’s NSC and OFAR, and in developing effective monitoring controls to ensure the timely identification and remediation of issues, such as unprocessed documentation and inaccurate records, which may impact the balances reported within FHA’s financial statements.

1I. Develop effective detective controls to ensure HECM loan receivables are accurate and complete, exist, and FHA appropriately holds or controls the rights to any collateral property in connection with the receivable.

EXHIBIT A

Material Weakness

1J. Develop and implement procedures to review the reasonableness of the amounts included in the Missing Documents Report before recording the reclassification entry. Include steps to be followed if the amounts in the report do not appear reasonable.

1K. Coordinate with the NSC to take all the actions necessary required by HUD Handbook 4000.1 to ensure that FHA's interests are protected with respect to the partial claims for which FHA has not received the original promissory note and recorded mortgage.

1L. Coordinate with the NSC to conduct a detailed review of the HECM assigned notes portfolio to identify and record all default events that have occurred to date and initiate collection proceedings in accordance with the applicable HUD Handbooks.

1M. Coordinate with the NSC and the OCPO to determine whether the information technology system could be enhanced to track the annual payment of state property taxes for the HECM portfolio.

EXHIBIT B
Status of Prior Year Findings

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

<i>FY 2021 Findings</i>	<i>Type</i>	<i>Fiscal Year 2022 Status</i>
Weaknesses in Controls over Financial Accounting and Reporting a. Erroneous Recording of HECM Subsidy Expense and Underlying Obligations b. Improper Presentation of the Loan Guaranty Liability	Material Weakness	Closed a. Closed b. Closed
Weaknesses in Controls over Econometric Modeling Activities	Significant Deficiency	Closed

EXHIBIT C

FHA's Response to Audit Findings and Recommendations



OFFICE OF HOUSING

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

November 14, 2022

MEMORANDUM FOR: CliftonLarsonAllen, LLP

FROM: **SUSAN BETTS** Digitally signed by SUSAN BETTS
Date: 2022.11.14 09:08:13 -05'00'
Susan A. Betts, Housing, Deputy Assistant Secretary for Finance and Budget, HW

SUBJECT: Response to Draft Audit Report on FHA's Fiscal Years 2022 and 2021 Financial Statements

On behalf of the Federal Housing Administration (FHA), thank you for the opportunity to respond to FHA's Independent Auditors' Report. We are pleased to have obtained an unmodified opinion on our financial statements and appreciate the efforts of the independent auditors in conjunction with the Office of the Inspector General (OIG) to provide us with actionable recommendations. FHA is committed to making the changes necessary to strengthen controls over financial reporting relating to borrowing authority and loans receivable. As you are aware, we have already begun addressing the recommendations. Working collaboratively, we will continue to identify improvements and implement changes needed to address the FY 2022 financial statement findings, as well as to strengthen our overarching system of internal control.

Report on Internal Control – Material Weakness

Weaknesses in Controls over Financial Accounting and Reporting –

Part 1: FHA lacked sufficient controls over borrowing authority to determine completeness and accuracy of general ledger account balances, budget authority, proper usages of USSGL accounts, and timeliness of reconciliations and validations

The Office of Finance and Budget (FAB) agrees with this finding and recommendations. Management has already begun implementing several of the recommendations identified in the finding and will continue to implement the changes necessary to address the remaining recommendations in FY 2023. To address control weaknesses surrounding borrowing authority, FAB's management will:

- Establish a formalized process to review regulatory changes to ensure they are identified, analyzed, and assessed to determine changes to FHA's accounting and reporting processes.

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EXHIBIT C

FHA's Response to Audit Findings and Recommendations

- Improve communication and coordination between FHA's accounting and budget office, OCFO budget office, and OMB regarding the apportionment and reapportionment of funds on the SF-132s, and budget execution activities reported on SF-133s.
- Improve and document processes and procedures surrounding the accounting, analysis, and budgeting for borrowing authority under federal credit reform accounting principles.
- Receive a final opinion from HUD's Appropriation Law Division on whether FHA was in violation of the Antideficiency Act.
- Improve controls and processes surrounding management's review and approval of general ledger journal entries.
- Improve controls and processes surrounding the SF-132 and SF-133 reconciliations and resolution of noted issues.

Part 2: FHA did not have effective controls over loans receivable or adequate oversight of the single-family loan service provider

Management agrees with the findings and associated recommendations. To address control weaknesses surrounding loans receivable and oversight of the single-family loan service provider, FHA's management will:

- Improve communication between the offices of Finance and Budget, Single Family Housing, and the Office of Chief Procurement Officer (OCPO).
- Improve controls to ensure HECM loans receivable are complete, accurate, and exist.
- Improve controls and procedures to review the reasonableness of amounts included in the Missing Documents Report.
- Take actions necessary, as required by the HUD Handbook 4000.1, with respect to partial claims for which FHA has not received the original promissory note and recorded mortgage.
- Review the HECM assigned notes portfolio to identify and record all default events that have occurred and initiate collection proceedings.
- Determine whether the HERMIT system could be enhanced to track the annual payment of state property taxes.