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Housing and Urban Development (HUD) FY2018 Audit Opinion

The Department of Housing and Urban Development (HUD) is the cabinet-level federal agency responsible for national housing and community development policy and programs. As required by the Chief Financial Officers Act of 1990 (CFO Act; 31 U.S.C. §902), as amended, HUD and other federal government agencies annually issue audited financial statements. Under the CFO Act, audits of federal agencies are the responsibility of the agency's inspector general (IG).

HUD's consolidated financial statements include the activities of the Federal Housing Administration (FHA) and Government National Mortgage Administration (Ginnie Mae), both of which are part of HUD. FHA is a mortgage insurer, and Ginnie Mae guarantees mortgage-backed securities backed by federally insured or guaranteed loans. In addition to their inclusion in HUD's consolidated statements, FHA and Ginnie Mae also release standalone financial statements that are separately reviewed by the HUD IG.

For FY2018, the HUD IG was unable to express an opinion on HUD's combined financial statements or Ginnie Mae's standalone statements (*disclaimer of opinion*). FHA received an *unmodified opinion*. (Types of audit opinions are explained later in this In Focus.)

The U.S. government is currently unable to obtain an unmodified opinion on its unitary Financial Report of the United States Government because agencies—such as HUD and the Department of Defense (DOD)—with significant assets and budgetary costs received disclaimers of opinion on their FY2018 financial statements. Although these agencies have significant budgetary costs, their size varies greatly; for example, HUD's annual spending is less than one-tenth that of DOD.

Why an Audit?

Government entities, including the U.S. government as a unitary entity, issue annual reports that present their current financial position and condition, and discuss key financial topics and trends of the reporting entity. An audit of the government's financial information provides accountability to Congress, oversight bodies, and the public about government agencies' use of public resources. Financial audits aim to provide reasonable assurance that the financial statements of an entity are free of material misstatements, whether caused by error or fraud.

Annual audits of federal agencies, including HUD, (1) provide critical insight into the reliability of financial data and the efficiency and effectiveness of internal operations; (2) review compliance with statutes and financial regulations; and (3) uncover potential problems. With such

information, HUD and Congress may be better equipped to improve HUD's performance in these areas.

How Are Audits Done?

For each line item on an entity's financial statement and notes to the financial statement, an auditor will examine a sample of the underlying economic events to determine the accuracy of the information reported. The auditor is expected to give an unbiased professional opinion on whether the financial statements and related disclosures are fairly stated in all material respects for a given period of time in accordance with Generally Accepted Accounting Principles (GAAP). Although the Federal Accounting Standards Advisory Board (FASAB) promulgates financial reporting and accounting standards for federal government entities, GAO is responsible for establishing auditing standards for federal government agencies, including federal grant recipients in state and local governments.

Material misstatement in financial reporting can be defined as information on a financial statement that could potentially affect the reader's decision or the conclusions drawn by a reader about the financial status of an agency.

Audit Standards

GAO issues the Generally Accepted Government Auditing Standards (GAGAS), also commonly known as the "Yellow Book," which provides a framework for conducting federal government audits. The Yellow Book requires auditors to consider the visibility and sensitivity of government programs in determining the materiality threshold. Similar to requirements in the private sector, GAGAS requires federal financial reporting entities to disclose compliance with laws, regulations, contracts, and grant agreements that have a material effect on the entities' financial statements.

Some organizations within the federal government use a hybrid of external and internal auditors. Whether external or internal auditors perform the function, they are required to adhere to the standards established under GAGAS.

In addition to examining financial information, an audit evaluates the agency's management assertion of internal control over financial reporting. Audit of internal control includes the audit of computer systems at the entity-wide, system, and application levels. GAGAS recommends using specific frameworks for internal control policies and procedures, including certain evaluation tools created specifically for federal government entities. An effective internal control framework may help an organization improve its performance and governance.

Types of Audit Opinions

Auditors form audit opinions by first examining the types of risks an organization might face and the types of controls that exist to mitigate those risks. Once the risks and controls to mitigate those risks have been determined, the auditors are to examine the supporting evidence and determine whether management is presenting the financial statements fairly in all material respects. Although many entities usually receive an unmodified opinion in the federal government, the auditor may express other types of opinions based on the circumstances. There are four types of audit opinions an auditor may express:

Unmodified Opinion. An unmodified opinion (clean opinion) states that the financial statements present fairly, in all material respects, the consolidated balance sheets, the related consolidated statements of net cost and changes in net position, the combined statements of budgetary resources, and the related notes to the consolidated financial statements in accordance with GAAP. This is the opinion expressed in the standard report. In certain circumstances, explanatory language might be added to the auditor's standard report, but not affect the auditor's unmodified opinion on the financial statements.

Modified Opinion. A modified opinion states that, except for the effects of the specific matter(s) identified in the opinion, the financial statements present fairly in all material respects in conformity with GAAP.

Adverse Opinion. An adverse opinion states that the financial statement(s) do not present fairly in accordance with GAAP.

Disclaimer of Opinion. A disclaimer of opinion states that the auditor is unable to express an opinion on the financial statements. The auditor's report should give all of the substantive reasons for the disclaimer. Reasons for a disclaimer of opinion include financial statements that do not conform to GAAP and financial management systems that are unable to provide sufficient evidence for the auditor to express an opinion.

Limitations of Audits

Independent audit opinions provide reasonable assurance that financial statements present fairly in all material respects, but for the following reasons do not fully guarantee:

- The auditors use statistical methods for random sampling and look at only a fraction of the economic events or documents during an audit. It is cost—and time—prohibitive to recreate or examine all economic events at an entity;
- Some line items on the financial statements involve subjective decisions or a degree of uncertainty as a result of using estimates; and
- Audit procedures cannot eliminate potential fraud, although it is possible that an auditor may find fraud during the audit process.

Results of FY2018 HUD Audit

For FY2018, the HUD IG issued a disclaimer of opinion on HUD's consolidated financial statements and Ginnie Mae's standalone financial statements, whereas FHA received an unmodified opinion on its standalone financial statements. Although the IG identified a material weakness and significant deficiencies with FHA's internal controls and information technology systems, these issues did not prevent the IG from being able to issue an unmodified opinion on FHA's financial statements.

The IG identified material weaknesses, significant deficiencies, and instances of noncompliance with applicable laws and regulations in its audits of HUD's and Ginnie Mae's financial statements. Some of these issues were specific to certain activities, offices, or accounts, whereas others were related to HUD's and Ginnie Mae's processes and systems more broadly. The specific issues the IG cited as the basis for its disclaimer of opinion on the HUD audit were (1) several issues related to the accounting for certain formula grant and disaster relief grant programs administered by HUD's Office of Community Planning and Development (CPD), as well as for HUD's property, plant, and equipment; and (2) the disclaimer of opinion on Ginnie Mae's standalone financial statements. In regard to Ginnie Mae, the basis for the disclaimer of opinion included questions about its reporting of nonpooled loan assets and FHA reimbursable costs.

Considerations for Congress

Congress may use the findings of the HUD audit to inform or enhance its oversight of HUD's efforts to remediate these identified areas. Possible policy responses could include the implementation of process improvements, investments in information technology systems, changes in accounting practices, and implementing effective internal controls. As noted in the IG's audit report, HUD has taken steps to address some of the issues the IG identified. For example, Ginnie Mae is in the process of implementing a new database project in response to previous IG findings, but it was not fully implemented by the end of FY2018.

CRS Products

CRS Report R44894, *Accounting and Auditing Regulatory Structure: U.S. and International*, by Raj Gnanarajah

CRS In Focus IF10701, *Introduction to Financial Services: Accounting and Auditing Regulatory Structure, U.S. and International*, by Raj Gnanarajah

Other Resource

HUD CFO Reports, *Fiscal Year 2018 (FY2018) Agency Financial Report*, November 2018

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