

CED-76-133

8-25-76

REPORT TO THE CONGRESS

093678



BY THE COMPTROLLER GENERAL
OF THE UNITED STATES

Using Independent Public Accountants To Audit Public Housing Agencies--An Assessment

Department of Housing and Urban Development

Independent public accountants generally performed satisfactorily the financial opinion part of audits of public housing agencies. However, they need training and guidance from the Department of Housing and Urban Development to improve their reviews of housing agencies' compliance with program regulations. At the same time, the Department needs to strengthen its monitoring of public accountants' performance and its use of the audit report as a management tool for the low-rent housing program.

CED-76-133

~~707499~~

093678

AUG. 25, 1976



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-118718

To the President of the Senate and the
Speaker of the House of Representatives

This report describes what the Department of Housing and
Urban Development can do to improve the quality of independent
public accountant audits of public housing agencies. 23

We undertook this review because the Department and other
Federal agencies are increasingly relying on public accountant
audits to assure that statutory and administrative require-
ments of federally funded programs are being carried out by
program recipients.

We made our review pursuant to the Budget and Accounting
Act, 1921 (31 U.S.C. 53 (1970)), and the Accounting and
Auditing Act of 1950 (31 U.S.C. 67 (1970)).

We are sending copies of this report to the Director,
Office of Management and Budget, and to the Secretary of
Housing and Urban Development.

James R. Stacks

Comptroller General
of the United States

2 27

C o n t e n t s

		<u>Page</u>
DIGEST		i
CHAPTER		
1	INTRODUCTION	1
	The low-rent housing program	1
	Use of IPAs to audit PHAs	2
	IPA audit requirements	3
	Scope of review	4
	Other GAO reports concerning use of IPAs	4
2	NEED TO IMPROVE THE QUALITY AND USEFULNESS OF IPA REPORTS	5
	Weaknesses in IPA compliance reviews	5
	Actions needed to improve the quality and usefulness of IPA reports	9
	Need for better guidance	9
	Need to inform IPAs of current HUD handbooks on PHAs	12
	Need to provide training	13
	Conclusions	13
	Recommendations	14
	Agencies' comments and our evaluation	15
	Department of Housing and Urban Development	15
	Office of Management and Budget	15
3	BETTER MONITORING OF IPA PERFORMANCE NEEDED	17
	Need for better reviews of IPA reports	17
	Need for better reviews of IPA workpapers	19
	Conclusions	22
	Recommendations	23
	Agency comments and our evaluation	23
4	MAKING GREATER USE OF IPA REPORTS	24
	Recommendation	25
	Agency comments and our evaluation	25

	<u>Page</u>
CHAPTER	
5	AUDITS NOT MEETING PROFESSIONAL AUDITING STANDARDS
	26
	Case 1
	16
	Case 2
	29
	Conclusions
	30
	Agency comments and our evaluation
	30
	Recommendation
	31
APPENDIX	
I	Letter dated June 24, 1976, from the Assistant Secretary for Housing-Federal Housing Commis- sioner, Department of Housing and Urban Development
	32
II	Letter dated May 7, 1976, from the Deputy Director, Office of Management and Budget
	37
III	Generally accepted auditing standards prescribed by the American Insti- tute of Certified Public Accountants
	38
IV	Principal HUD officials responsible for administering activities discussed in this report
	40

ABBREVIATIONS

GAO	General Accounting Office
HUD	Department of Housing and Urban Development
IPA	independent public accountant
PHA	public housing agency

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

USING INDEPENDENT PUBLIC
ACCOUNTANTS TO AUDIT PUBLIC
HOUSING AGENCIES--AN ASSESSMENT
Department of Housing and
Urban Development

23

D I G E S T

Audits by independent public accountants can provide the Department of Housing and Urban Development with valuable management tools in its low-rent housing program. The accountants can provide financial audits, including an expression of opinion on a public housing agency's financial statements. The accountants can review and report on an agency's compliance with regulations in some 17 areas--rent collection, procurement policies, internal controls over assets and the like. (See pp. 3 and 5.)

In most of the cases GAO reviewed, public accountants performed financial opinion work satisfactorily. However, they often need training and better guidance and assistance from the Department, to improve the quality of their work in the compliance area. (See p. 5.)

The Department spent an estimated \$1.6 billion in fiscal year 1976 to help the Nation's 2,700 public housing agencies pay off construction loans of its low-rent housing program and provide services to an estimated 3.5 million tenants.

In July 1972 the Department first supplemented its own audit staff with independent public accountants to audit all but about the 25 largest housing agencies. Between July 1972 and May 31, 1976, the Department approved 4,173 public accountant audit contracts valued at about \$7.5 million. (See pp. 2 and 3.)

GAO's review of 15 audits showed that none of 11 independent public accountants reviewed adequately all 17 compliance areas called for in their contracts. The public accountants should have made a

total of 215 separate reviews in the compliance areas. However, 170, or 79 percent of the reviews either were not made or were inadequate. (See p. 6.)

Three factors caused this:

- the Department's audit guide does not clearly explain how public accountants should perform compliance reviews. (See pp. 9 to 11.)
- Public accountants cannot always confirm financial information and do not always have access to Department handbooks needed to review a housing agency's compliance with Department regulations. (See pp. 10 and 12.)
- Public accountants are not sufficiently familiar with the Department's audit requirements and accounting and program regulations which differ from those applicable to commercial audit engagements. (See p. 13.)

GAO also found that these deficiencies often were not disclosed by Department monitoring and that audit reports were not analyzed periodically to identify problems common to housing agencies. (See pp. 22 and 24.)

GAO recommends that the Secretary of Housing and Urban Development:

- Revise the audit guide to explain more clearly to public accountants what is expected in compliance reviews. (See p. 14.)
- Assure that public accountants (1) are informed of the Department's list of current Department handbooks governing housing agencies and (2) can confirm financial information applicable to their audits. (See p. 14.)
- Make training courses available to public accountants to familiarize them with Department regulations for auditing housing agencies. (See p. 14.)

--Instruct Department reviewers to improve the quality of their reviews and to reject audit reports not containing required supplemental financial statements. (See p. 23.)

--Identify nationwide problem areas at housing agencies warranting the Department's attention. (See p. 25.)

Some of the work performed by two public accountants in support of their opinions on financial statements may not have always met generally accepted auditing standards of the American Institute of Certified Public Accountants. Department reviews revealed that five audits by a public accountant, whose work GAO did not review, appeared to be below standard. (See p. 26.)

To improve auditing and reporting by its members, the institute has developed a program to handle allegedly substandard accountants' reports.

GAO and other Federal agencies have been invited to report cases of substandard reports to the institute which evaluates each case and decides whether to

--dismiss the case without action,

--urge the accountant to take further training,

--recommend admonishment of the accountant,
or

--submit the case to the institute's trial board.

GAO referred the two audits to the institute to determine if substandard work was performed and recommends that the Department refer the other five audits to the institute. (See pp. 30 and 31.)

POSSIBLE APPLICABILITY TO
OTHER FEDERAL AGENCIES

Increasingly, Federal agencies are relying on audits by independent public accountants to provide accountability over billions of dollars of domestic assistance to help States and local governments. These audits often require a review of the recipient's compliance with program requirements. (See pp. 1 and 14.)

✓ The Office of Management and Budget is responsible for coordinating the use of independent public accountants by Federal agencies. GAO recommends that the Office's Director, as part of his coordinating role, bring to the attention of other Federal agencies the problems experienced by the Department in obtaining adequate compliance reviews from public accountants. (See p. 14.) 27

AGENCIES' COMMENTS

The Department agreed with most GAO recommendations. (See app. I.) It is in the process of

- revising its audit guide to address the findings in the report,
- establishing voluntary training for public accountants,
- improving its monitoring of public accounting audits, and
- evaluating the usefulness of reviewing public accounting audit reports to identify common problems needing management attention.

The Department did not agree that it reject public accountant reports not containing required supplemental financial statements and refer to the institute the five audits performed by a public accountant which appeared to be below standard.

It pointed out that the decision to reject an audit report depends on the nature of the missing statements and that a case-by-case evaluation should be made. Concerning the other recommendation, the Department said that although it is its policy to refer substandard work, it found the working papers prepared by the public accountant involved, on another audit recently made, to be in accordance with generally accepted auditing standards and the Department's audit guide.

Department reviewers should reject reports not containing required supplemental financial statements since these statements are required by contract and the public accountant's fee is based, in part, on fulfilling this requirement. The decision to refer to the institute audits identified as apparently not meeting professional standards should be made on an audit-by-audit basis since each audit report expresses an opinion on a client's financial statements and contains a statement that the audit made complied with generally accepted auditing standards. (See pp. 23 and 31.)

The Office of Management and Budget agreed to bring to the attention of other Federal agencies the findings disclosed in this report. (See app. II.)

CHAPTER 1

INTRODUCTION

Each year the Federal Government spends billions of dollars on domestic assistance to State and local governments. This assistance, directed at achieving specified national goals, is provided through grants, loans, and contracts. To assure that Federal funds are used and accounted for in accordance with statutory and administrative requirements, Federal administering agencies often provide for periodic audits of the recipients' operations. Increasingly, many Federal agencies are relying on the use of independent public accountants (IPAs) to perform these audits. The Office of Management and Budget is responsible for coordinating the use of the IPAs by Federal agencies.

In 1972 and 1973 the Department of Housing and Urban Development (HUD) began to supplement its own audit staff by using the IPAs, mostly certified public accountants, to audit recipients' records of Federal funds under five housing and community development programs. The most important use of the IPAs, in both number and cost of audits, has been in HUD's low-rent housing program.

THE LOW-RENT HOUSING PROGRAM

The United States Housing Act of 1937 (42 U.S.C. 1437 (Supp. IV, 1974)) authorizes HUD to conduct a low-rent public housing program to provide decent, safe, and sanitary housing to families that cannot afford adequate private housing. Pursuant to State legislation, local governments establish public housing agencies (PHAs) as independent legal entities to develop, own, and operate low-rent public housing projects.

PHAs are primarily responsible for developing and administering federally subsidized low-rent public housing projects, including establishing admission policies and rent schedules subject to HUD approval. PHAs may acquire public housing projects by leasing or purchasing existing structures or by constructing new projects.

HUD financially assists the PHAs by making loans for developing new housing projects and by making annual contributions according to contracts with the PHAs. Annual contributions are for (1) paying the principal and interest (debt (service) on bonds and notes sold by the PHAs to the public or, in some cases, to HUD to obtain funds for developing the projects and (2) paying operating subsidies. There were \$11.9 billion such notes, bonds, and interest outstanding at October 31, 1975.

Annual contributions for debt service have been part of the public housing program since its inception in 1937. Operating subsidies consist primarily of amounts paid to the PHAs in compliance with the 1969, 1970, and 1971 amendments to the housing act enabling the PHAs to maintain adequate operating and maintenance services and to insure their financial solvency.

HUD's annual payments to the PHAs are reduced by residual receipts, if any, derived from operating the housing projects. To encourage efficient operation and to minimize HUD's annual contributions, the annual contribution contracts require the PHAs to administer their housing projects in an efficient and economical manner.

HUD estimates that in fiscal year 1976 it spent about \$1.6 billion in annual contributions on the Nation's 2,700 PHAs which operate about 1.1 million housing units and provide housing for about 3.5 million people.

HUD's Assistant Secretary for Housing-Federal Housing Commissioner administers the low-rent housing program through 10 regional offices and 39 area offices. Before June 14, 1976, the Assistant Secretary for Housing Management administered the low-rent housing program. As of that date the functions of the Assistant Secretaries for Housing Management and for Housing Production and Mortgage Credit were combined under a single Assistant Secretary for Housing.

USE OF IPAS TO AUDIT PHAS

To assure that Federal funds are used and accounted for according to statutory and administrative requirements of the low-rent housing program, the annual contribution contracts provide for HUD, or its representatives, to audit the operations of the PHAs. Those PHAs with over 5,000 housing units--of which there are about 25--are audited by HUD's 10 regional audit staffs.

Beginning in July 1972, HUD directed each PHA with 5,000 housing units or less to contract with an IPA to audit its operations biennially because

- HUD auditors could not handle the considerable number of PHAs due for audit
- HUD had to limit employing additional auditors, and
- HUD pilot programs using IPAs had shown that the IPAs could satisfactorily audit PHAs.

Between July 1972 and May 31, 1976, HUD approved 4,173 IPA contracts valued at about \$7.5 million. Without using IPAs, HUD would not have been able to obtain timely audits of many PHAs.

HUD regulations require PHAs to select the best from at least three IPA proposals, after considering such things as an IPA's price and qualifications, and to submit the proposal to HUD for approval. Upon completing his audit, the selected IPA must submit his report to both HUD and PHA's board of commissioners. After HUD reviews and accepts the report, the PHA is authorized to pay the IPA. Although the PHA pays the IPA, audit fees are an allowable expense under the low-rent housing program. For some PHAs, audit costs reduce the residual receipts due HUD. For those PHAs that do not have residual receipts, HUD generally subsidizes the PHA for the cost of the audit.

IPA reports supplement HUD's own internal activities and can be one of the most important and timely management tools HUD has for monitoring the operations of PHAs. The IPA audit is the only regularly scheduled, independent reporting of a PHA's financial condition and on-site evaluation of its compliance with HUD and self-imposed regulations and procedures.

IPA reports will become increasingly important in view of HUD's performance-funding system--introduced in April 1975--which allocates about \$500 million annually in operating subsidies to PHAs. This system, according to HUD, allocates subsidies on the basis of a formula derived from the operating costs of well-managed PHAs. HUD generally limits PHA's subsidy to the amount it would need if it were a well-managed PHA. Therefore, the PHAs need as much guidance as possible from HUD, or other sources, on how to operate more efficiently to keep their expenditures within Federal assistance limitations. A primary source can be the IPA audit report.

IPA AUDIT REQUIREMENTS

The IPA's contract with the PHA, which is approved by HUD, provides that he follow HUD's audit guide for the low-rent housing program. The guide requires that the IPA perform (1) a traditional financial audit leading to an expression of opinion on the financial statements presented in his report and (2) a compliance review of PHA's operations. In performing the audit, the guide requires the IPA to adhere to generally accepted auditing standards prescribed by the American Institute of Certified Public Accountants. The institute's auditing standards are included as appendix III.

For the compliance review phase of the audit, HUD's audit guide requires the IPA to review, evaluate, and comment on PHA's accounting procedures and system of internal control, including handling funds. Further, the IPA must state in his report whether (1) expenditures examined were for purposes specified in the annual contribution contracts with HUD and (2) the PHA adhered to the terms and conditions of the contract and HUD and the PHA regulations and procedures. In support of these statements, the HUD audit guide specifies 17 special compliance areas which the IPA is required to review during his audit.

SCOPE OF REVIEW

From the inception of the IPA program in July 1972 to December 31, 1974, HUD has accepted reports on 1,667 IPA audits of which 1,150 were of PHAs located in the jurisdiction of the HUD regional offices in Atlanta, Dallas, and Kansas City. From the 1,150 audits, we selected for detailed review 15 audits 11 IPAs had made. The 15 audits we selected were primarily from those HUD accepted in fiscal year 1975 and represented a mix of small and large PHAs. We attempted to select those audits which HUD had previously reviewed, which were by the IPA having the most audits in the region, and which were by the IPA that HUD regional auditors considered among the best.

Our review was directed primarily towards evaluating (1) HUD's guidance given IPAs, (2) HUD's monitoring and use of IPA audits, and (3) the quality of selected IPA audits. We reviewed the IPAs reports and workpapers and tested their work at the PHA. We interviewed PHA and HUD field and headquarters officials and representatives of the IPA firms responsible for the 15 audits.

We also did limited reviews of 21 other reports 18 IPAs prepared. For these reports we did not examine the IPAs workpapers. Furthermore, we randomly selected 75 IPAs from the estimated 596 IPAs who had audited PHAs as of September 1, 1974, and sent them a questionnaire to obtain their views on the adequacy of HUD's audit guide and the assistance HUD gave them.

OTHER GAO REPORTS CONCERNING USE OF IPAs

Of our prior reports, the following two to the Congress dealing with the use of IPAs by Federal agencies may be of interest to readers of this report: (1) Farmers Home Administration Procedures and Policies on the Use of Independent Auditors Should be Strengthened--Department of Agriculture (B-170874, Jan. 22, 1971) and (2) Need for More Effective Audit Activities--Office of Economic Opportunity (B-130515, Apr. 4, 1973).

CHAPTER 2

NEED TO IMPROVE THE QUALITY

AND USEFULNESS OF IPA REPORTS

IPA audits have provided a number of benefits to HUD and the PHA board of commissioners relating to financial and program controls over the PHA operations. The audits have provided assurances of PHAs' fiscal responsibility and accountability, pointed out weaknesses in the PHA operations needing improvement, released HUD audit resources for use in other audit areas, and reduced the number of PHAs due for audit. We found, however, that by improving the quality of the IPA audits, the role of the audit report as a management tool for monitoring the PHA operations could be enhanced.

The IPAs were generally performing that part of the audits relating to traditional financial opinion work in a satisfactory manner. Some exceptions are discussed in chapter 5. The IPAs were not, however, satisfactorily performing the compliance review part of the audits, which differ somewhat from the work required on traditional, commercial audit engagements.

To improve the quality and usefulness of IPA compliance reviews HUD needs to

- provide better guidance to IPAs on the scope and nature of the compliance work to be performed,
- inform IPAs of the availability of the listing of current HUD program handbooks and other necessary information, and
- provide training for IPAs.

WEAKNESSES IN IPA COMPLIANCE REVIEWS

In auditing the PHA operations, HUD requires the IPA to review 17 special compliance areas. These areas relate to such matters as the adequacy of PHA's rent collection policies, insurance coverage, internal controls over assets, procurement policies, and payroll procedures. HUD audit officials told us that the IPA review of these areas should be based on an extension of the audit procedures beyond those necessary to issue an opinion on the fairness of PHA's financial statements, i.e., financial opinion audit work. However, we found that instead of extending their auditing procedures, 8 of the 11 IPAs in our review generally relied on their financial opinion work to fulfill the audit guide requirement for a review of the 17

compliance areas. As a result, the IPAs audits did not always supply HUD with the type of information it desired about PHAs' compliance with applicable contracts and regulations.

Specifically, we concluded that based on the documentation in IPAs' workpapers none of the IPAs adequately reviewed all applicable compliance areas. For the 15 audits, HUD expected the 11 IPAs to make a total of 215 1/ separate reviews for the compliance areas. However, we found that, for the 15 audits, the IPAs did not review or adequately review 170, or 79 percent of the applicable compliance areas. In this regard IPAs' workpapers contained

--no evidence that the IPAs had reviewed 25 percent, or 54 of the total areas,

--incomplete evidence that the IPAs had adequately reviewed 54 percent, or 116 of the total areas, and

--adequate evidence that the IPAs reviewed 21 percent, or 45 of the total areas.

The table below summarizes the results of our review of the IPAs workpapers regarding the 17 compliance areas.

Evidence in the IPAs Workpapers of Their Review of Applicable Special Compliance Areas

<u>Compliance areas</u>	<u>Total</u>	<u>Evidence of adequate review</u>	<u>No evidence of review</u>	<u>Incomplete evidence of adequate review</u>
1. Cooperation agreement	15	-	-	15
2. Procurement practices	15	4	4	7
3. Professional service contracts	13	2	7	4
4. Real estate purchases	3	-	3	-
5. Relocation payments	4	1	1	2
6. Administrative and personnel policies	15	1	8	6
7. Investments of excess funds	15	3	1	11
8. Rent collection policies	15	3	1	11
9. Fixed assets	15	1	2	12
10. Materials and supplies inventories	15	1	9	5
11. Allocation of jointly shared expenses	7	1	6	-
12. Payroll	15	3	3	9
13. Insurance coverage	15	-	1	14
14. Development costs	15	6	-	9
15. General funds statement	15	14	-	1
16. System of internal control	15	3	4	8
17. Other areas	8	2	4	2
Total	215	45	54	116
Percent of total areas	100	21	25	54

1/ Although the 15 audits would have involved reviews of 255 areas, only 215 reviews were required because 40 were not applicable to the 15 audits.

The following examples show some of the problems we noted in the IPAs reviews of selected compliance areas.

Investment of excess funds by PHAs

PHAs sometimes accumulate cash in excess of short-term needs. To increase their revenues, the annual contribution contract requires PHAs to invest any cash in excess of 90-day needs. Under HUD's procedures, a PHA must follow a prescribed forecasting method or obtain HUD approval on an alternative method to determine how much excess cash, if any, it should invest. The audit guide requires the IPA to (1) review PHA's investment policies and (2) report if excess funds are not being invested according to HUD investment guidelines.

Our review of the 15 audits showed that

--in three audits, the IPAs adequately complied with the audit guide requirements,

--in one audit, the IPA workpapers contained no evidence that audit guide requirements had been met, and

--in 11 audits, the IPAs workpapers showed that only one of the two audit guide requirements had been met.

Regarding the 11 audits, the IPAs usually made some inquiries into PHAs' investment activities. However, the IPAs did not determine whether the PHAs were following a HUD-approved method of forecasting cash requirements. We reviewed the practices 10 of the 11 PHAs followed and found that none were forecasting cash requirements for a 90-day period as HUD's procedures required. None of the IPA reports disclosed the PHAs noncompliance.

Administrative and personnel policies

HUD requires that PHAs establish administrative and personnel policies that are comparable to those of the local government. HUD's audit guide requires the IPA to determine whether comparable policies (1) have been established and (2) are being followed.

Our review of 15 audits showed that

--in one audit, the IPA adequately reviewed PHA's administrative and personnel policies,

--in eight audits, the IPAs workpapers contained no evidence that they made either of the two required determinations concerning administrative and personnel policies, and

--in six audits, the IPAs workpapers did not contain evidence that they made both determinations concerning administrative and personnel policies.

With regard to three of the six audits, one IPA did nothing more than note in his workpapers that PHA's executive director took an annual vacation and that the director's salary was included in PHA's budget. Two other IPAs determined that the PHAs had administrative and personnel policies, however, neither determined that these policies were comparable to local government policies.

Our review of the adequacy of administrative and personnel policies adopted at 14 PHAs disclosed that 5 PHAs did not perform studies to determine that their administrative and personnel policies were comparable to local government policies. The IPAs who performed the audits at these PHAs did not note the absence of such studies in their workpapers or comment on the absence of such studies in their audit reports.

Fixed assets

HUD requires PHAs to establish satisfactory written procedures to inventory fixed assets and to adjust inventory records when necessary. PHAs are also required to follow HUD-prescribed accounting procedures for recording land acquisitions, structures, and equipment. HUD's audit guide requires the IPA to examine PHA's accounting records to determine if (1) property acquisitions were properly recorded, (2) property acquisitions were included in PHA's operating budget HUD approved, (3) PHA's inventory procedures are adequate, and (4) property records were adjusted to agree with physical inventories.

Our review of the 15 audits showed that

--in one audit, the IPA complied with HUD's audit guide concerning fixed assets,

--in two audits, the IPAs workpapers contained no evidence that they made any of the four required determinations relating to fixed assets, and

--in 12 audits, the IPAs workpapers did not contain evidence that they had made all four required determinations related to fixed assets.

With regard to 6 of the 12 audits, the IPAs workpapers contained no evidence that they reviewed PHAs' inventory procedures. Our review showed that the 6 PHAs had not taken an inventory of fixed assets during the audit period and that this weakness was not disclosed in IPAs' workpapers or their audit reports.

ACTIONS NEEDED TO IMPROVE THE QUALITY
AND USEFULNESS OF IPA REPORTS

Based on our findings, the responses received to the questionnaire sent to 75 IPAs, and discussions with HUD field and headquarters officials and with the 11 IPAs, we concluded that HUD could improve the quality and usefulness of IPA reports by (1) providing better guidance to IPAs on the scope and nature of the compliance work to be performed, (2) telling IPAs of the availability at PHAs of the list of current HUD program handbooks governing the PHA operations, and (3) establishing training courses for IPAs.

Need for better guidance

Scope of compliance work
needs to be clarified

HUD regional and headquarters audit officials told us, and we agree, that to adequately review the 17 special compliance areas an IPA should extend his work beyond that necessary to audit PHA's financial statements. However, although HUD's audit guide requires the IPA to review the special compliance areas, the guide does not state whether the IPA can fulfill the review requirement by relying on the audit procedures he uses to determine the fairness of financial statements, or whether he must extend his audit work in the compliance areas.

As previously mentioned, we found that 8 of the 11 IPAs generally relied on their financial opinion work to fulfill the compliance review requirement. The IPAs told us that, if HUD expects them to extend their audit work in compliance areas, HUD should clarify its audit guide.

The institute recognizes both approaches to compliance auditing. In a 1972 report entitled "Suggested Guidelines for Structure and Content of Audit Guides Prepared by Federal Agencies for Use by CPAs," the institute suggested that to achieve consistency and standardization in audit guides prepared by Federal agencies for use in auditing Federal program recipients, the guide should state whether the

"* * * compliance work is to be pursued only incident to the financial audit or whether the financial audit procedures are to be extended to cover some specific compliance matters."

Specific guidance needed for
two compliance areas

In addition to clarifying the audit guide on the required approach to compliance auditing, the guide should explain more clearly how an IPA is to review 2 of the 17 compliance areas. The first compliance area concerns a supplementary financial statement on general funds entitled "analysis of general funds available for reduction of annual contribution" which the IPA must prepare.

The general funds statement is unique to the low-rent housing program and, if prepared correctly, verifies whether the PHA has properly recorded transactions between the PHA, its fiscal agent (usually a local bank), and HUD. According to HUD audit officials, because IPAs often incorrectly prepared or omitted the statement, HUD had to return many reports to IPAs for correction. Four of the IPAs we visited had problems preparing the statement. HUD regional auditors helped two IPAs prepare it, another IPA submitted the statement with errors, and another told HUD that it could not satisfactorily reconcile the statement.

We identified two reasons for the difficulties IPAs experience in preparing the general funds statement: (1) HUD's audit guide does not clearly explain how to prepare the statement and (2) the IPAs have difficulty confirming with HUD headquarters the amount of construction funds HUD had advanced to the PHA. Regarding the audit guide, 34 of the 70 IPAs who responded to our questionnaire felt that the guide did not clearly explain how to prepare the funds statement. The problem of confirming advances, which are often an integral part of the funds statement, was also experienced by HUD auditors when they audited all the PHAs. However, in 1971 HUD auditors developed an arrangement to confirm construction advances by telephone with HUD headquarters. According to a HUD audit official, IPAs have not been included in this arrangement because it was not considered feasible.

The second compliance area needing clarification concerns insurance, such as fire, and public liability, which the PHA must obtain. The audit guide requires the IPA to determine whether the PHA has the required insurance policies and whether the amount of coverages is reasonable. The guide does not include instructions on how to determine the reasonableness of insurance coverage. Although most of the IPAs included in our

review did determine whether the PHAs had the required policies, none evaluated the reasonableness of the insurance coverages. Of the 11 IPAs, 10 told us that they need guidance from HUD on how to evaluate the reasonableness of a PHA's insurance coverages.

We proposed that the Secretary of HUD tell the IPAs how to evaluate the reasonableness of PHA's insurance coverages. HUD told us that it plans to eliminate the audit guide requirement that the IPAs evaluate the reasonableness of PHA's insurance coverages as this is the responsibility of HUD. In addition, HUD plans to revise its audit guide to require the IPAs, among other things, to determine whether evidence of HUD approval of coverages requiring such approval is on file at the PHA.

Additional compliance areas
should be reviewed

In addition to providing better guidance for the compliance areas already required by the audit guide, we believe that HUD could improve the usefulness of the IPA reports by expanding the guide's requirements to include two additional areas where we found common weaknesses in PHA's operations. Our review showed that often the PHA violated the annual contribution contract provisions and HUD regulations by (1) not paying promptly amounts owed to HUD or owed to PHA's fiscal agent and (2) incurring operating budget overruns without obtaining prior approval from HUD. Although the audit guide requires the IPAs to report any material violations of HUD contracts or regulations they uncover, it does not require the IPAs to specifically review these two areas. Generally, the IPAs did not report on these weaknesses.

Of the 36 PHAs, 13 whose audit reports we reviewed,¹ owed HUD a total of about \$897,000 for residual receipts or for interest expense on construction financing. The annual contribution contract requires such obligations to be paid to HUD at the end of the fiscal year in which it occurs. Contrary to this requirement, the 13 PHAs had these obligations outstanding for periods ranging from 21 days to over 3 years, in amounts ranging from \$250 to \$497,000, as of the date of the IPA audit report. Although most of the IPAs reported that the moneys were owed HUD, none reported why the PHAs did not pay HUD or that the PHAs had violated their annual contribution contract.

¹ Includes 15 reports reviewed in detail, including examining the IPAs workpapers, and 21 limited reviews of other reports for which we did not examine the IPAs workpapers. (See p. 4.)

The annual contribution contract and HUD procedures also require the PHA to promptly pay HUD, or in some cases, PHA's fiscal agent, any excess construction funds HUD advanced over PHA's actual construction costs, or overpayments of operating subsidies. Of the 36 PHAs, 5 owed a total of about \$209,000 to HUD or to PHA's fiscal agent for excess construction advances or operating subsidy overpayments. These amounts had been outstanding for periods ranging from about 7 to 48 months, as of the date of the IPAs audit reports. Although most of the IPAs reported the moneys were owed, only one reported the reason; none disclosed how long the moneys were owed or why the PHAs had not paid HUD or the fiscal agent.

The annual contribution contract further provides that the PHAs are not to incur expenses in excess of the amounts HUD approved in PHAs' operating budgets for certain budget categories, such as administrative expenses. We compared PHAs' latest approved budgets in HUD headquarters files to the actual expenses appearing in the IPA reports. Of the 36 PHAs, 20 had budget overruns in these categories for 1 or more years during their audit period which the IPAs had not reported. The overruns ranged from about \$10 to \$44,000 and totaled about \$121,000.

Need to inform IPAs of
current HUD handbooks on PHAs

To issue an opinion on the adequacy of PHA's compliance with the annual contribution contract and HUD's program regulations, an IPA should have access to current HUD low-rent housing handbooks governing PHA's operations. HUD's procedure for accomplishing this was to provide the IPAs, before their first audit, with copies of HUD's audit guide, its handbook on the PHA accounting regulations, and part of the PHA annual contribution contract with HUD. When the IPAs needed HUD handbooks on other aspects of PHA's operations, they were expected to use copies at the PHA.

We found this procedure inadequate. Of the IPAs we visited, 10 had accounting handbooks which were not current; HUD has not sent handbook revisions to the IPAs. Also, 7 of the IPAs told us that the PHAs did not always have current HUD handbooks governing PHA's operations. In these cases HUD had no assurance that the PHA practices were compared to current HUD requirements.

HUD officials told us that HUD sends the PHAs a semiannual listing of the names and effective dates of all its handbooks (and other issuances) governing PHA's operations. We believe that, if HUD would tell the IPAs that such listings are

available at the PHA, the IPAs would be in a better position to determine whether they are comparing the PHA practices with current HUD requirements.

Need to provide training

HUD does not offer the IPAs any training courses. Our review showed that many IPAs need training to fully understand HUD's audit requirements and accounting and program regulations. To issue an opinion on PHA's financial statements and on its compliance with program regulations, an IPA must be familiar with HUD's accounting and program regulations which are unique to the low-rent housing program. Also, compliance opinions are generally not required under commercial audit engagements and present difficulties and challenges to IPAs not fully familiar with HUD requirements.

Of the 70 IPAs, 62 responding to our questionnaire felt that they would benefit greatly from attending a HUD-sponsored training course covering HUD regulations and accounting principles applicable to the PHAs. Also, 9 of the 11 IPAs we visited during our audit favored some type of training.

CONCLUSIONS

IPA audits are the only regularly scheduled, independent evaluations made of the fairness of PHA's financial statements, the extent of PHA's compliance with HUD's program guidelines and regulations, and the adequacy of PHA's system of internal controls. Although the IPA audit services have provided HUD and the PHA administrators with assurances of PHA's fiscal responsibility and accountability and pointed out weaknesses in PHA's operations, generally the IPAs have not reviewed PHA's operations, with respect to special compliance items, to the extent HUD requires.

The shortcomings in the IPA audits can be attributed largely to three factors. First, HUD's audit guide does not state whether an IPA must extend his audit work in order to fulfill HUD's compliance review requirement. Second, the IPAs do not always have access to current HUD handbooks and cannot always confirm with HUD information on construction advances needed in reviewing PHA's performance in the special compliance areas. Third, the IPAs have not been sufficiently familiarized with HUD audit requirements and the PHA accounting and program regulations which differ from those applicable to commercial audit engagements.

These shortcomings can be alleviated, to a large extent, by clarifying the HUD audit guide relating to the special compliance items, telling the IPAs of the listing of current

handbooks HUD provides the PHAs, developing a system to provide the IPAs with information on construction advances, and sponsoring training courses for the IPAs interested in providing audit services to the PHAs.

We believe also that controls over PHA's operations can be strengthened if HUD's audit guide is expanded to require the IPA reviews in two additional areas of PHA's operations-- PHA's obligations to HUD, and to PHA's fiscal agent, and budgetary controls.

RECOMMENDATIONS

To improve the quality of information in the IPA audit reports on PHA's compliance with HUD contracts, regulations, and procedures and to make the IPA reports more useful to both HUD and the PHA administrators, we recommend that the Secretary of HUD require that

1. HUD's audit guide be revised:

- To insure that the IPAs fully understand (1) the scope of the compliance review part of their audit and (2) how to prepare the special funds statement.
- To require the IPAs to review and comment on (1) the nature of any amounts owed to HUD and to PHA's fiscal agent and (2) operating budget overruns.

2. IPAs be:

- Told of the availability of HUD's listing of current PHA handbooks governing PHA's operations and provided a means to quickly confirm PHA's construction advances with HUD headquarters.
- Provided training courses, on a voluntary basis, to familiarize them with HUD's auditing requirements and accounting and program regulations applicable to the PHAs.

As mentioned in chapter 1, increasingly, Federal agencies are using the IPAs to audit Federal program recipients, including the recipients' compliance with program regulations. Accordingly, we recommend that the Director of the Office of Management and Budget, as part of his coordinating role, bring to the attention of other Federal agencies using the IPAs to perform compliance reviews, the problems experienced by HUD in obtaining adequate compliance reviews from the IPAs.

AGENCIES' COMMENTS AND OUR EVALUATION

Department of Housing and Urban Development

In a letter dated June 24, 1976 (see app. I), HUD stated that while the quality of the IPA audits in the low-income housing program has been steadily improving since the inception of the IPA program in 1972, HUD concurs with our recommendations that certain improvements are still needed. HUD stated that it was in the process of revising its audit guide to the IPAs to clarify the compliance review part.

HUD stated that the revised audit guide will (1) highlight the compliance items which it expects the IPA to perform by including each item on a checklist, (2) contain revised instructions on how the IPAs are to prepare the special funds statement as well as a revised format for the statement, (3) require the IPAs to comment on any amounts the PHAs owe to their fiscal agent or HUD that have been due over 3 months and budget overruns in specific controlled categories, and (4) contain instructions on how the IPA can confirm construction advances with either HUD headquarters or its regional accounting divisions.

HUD stated also that it was working with the American Institute of Certified Public Accountants to establish voluntary training courses for the IPAs to familiarize them with its auditing requirements and accounting and program regulations applicable to the PHAs.

We discussed with a HUD audit official our recommendation that HUD provide the IPAs with a means to obtain access to HUD's listing of current PHA handbooks governing PHA's operations. The official agreed with our recommendation and stated that HUD will add a section to its revised audit guide telling the IPA's that HUD semiannually issues a listing of current HUD handbooks governing PHA's operations and that this listing should be available at the PHAs.

We believe that the actions HUD cited in response to our recommendations will, if properly implemented, improve the quality of information in the IPA audit reports and make the reports a more useful management tool for both HUD and the PHA administrators.

Office of Management and Budget

In a letter dated May 7, 1976 (see app. II), the Deputy Director of the Office stated that the Office has actively encouraged departments and agencies to rely on audits made by recipients of Federal assistance or by their independent

process. The Deputy Director stated that for this policy of reliance to succeed, however, it is necessary that such audits be of high quality and meet professional audit standards.

The Deputy Director also stated that the Office plans to bring to the attention of audit officials of other Federal agencies the findings disclosed in our report, and to point out to them the need for adequate followups to see that audits by the IPAs adhere to professional audit standards and conform to the terms of their audit engagements.

CHAPTER 3

BETTER MONITORING OF IPA

PERFORMANCE NEEDED

Our review showed that HUD was not effectively monitoring the performance of the IPAs its own procedures required. As a result, HUD accepted audit reports containing obvious errors or not meeting HUD audit requirements and did not identify deficiencies in the IPA workpapers. We believe HUD needs to

--improve the quality of its reviews of the IPA reports and workpapers and

--instruct HUD reviewers to reject audit reports not containing required supplemental financial statements.

HUD's monitoring of the IPA performance consists of reviewing (1) each audit report before acceptance and (2) the workpapers of selected IPA audits. The reviews are made to determine whether the IPA audit work meets HUD's audit guide and generally accepted auditing standards. When these reviews show that the IPA work did not meet the audit guide requirements or the professional standards, HUD can (1) require the IPA to correct the deficient work before full payment, (2) disapprove future contracts with the IPA, or (3) present the deficient work to the institute, State professional societies, or State regulatory agencies for possible disciplinary actions.

NEED FOR BETTER REVIEWS OF IPA REPORTS

HUD's procedures for reviewing reports require HUD regional auditors to (1) compare the IPA report with the audit guide to determine whether the report contains the required opinions on PHA's financial statements and on PHA's compliance with HUD and self-imposed regulations and (2) determine whether amounts appearing on related financial statements are consistent.

To determine the adequacy of HUD's report reviews, we reviewed 36 IPA reports which HUD regional auditors accepted. We found that of the 36 reports, 10 contained a total of 16 deficiencies as follows:

<u>Type of deficiency</u>	<u>Number of reports containing the deficiency</u>
Required supplemental financial statements not included in audit report:	
Statement of initial operating period income and expenses (note a)	4
Statement of annual contribution earned under leased housing program	1
Statement of development costs incurred to date	3
Failing to report or incorrectly reporting liabilities or receivables (total amount \$162,000)	5
Incorrectly reporting HUD advances to PHAs for development of new projects (total amount \$82,000)	2
Inconsistent and inaccurate reporting of material amounts on related financial statements	1

^a This statement is required for new PHAs, and for existing PHAs upon completion of new projects.

HUD regional auditors responsible for accepting the 10 reports told us that their report reviews did not detect 9 of the 16 deficiencies. The officials stated that they identified the seven remaining deficiencies during their report reviews, but they believe the deficiencies were not significant enough to reject the reports. Of the seven deficiencies, five concerned missing supplemental financial statements.

In this regard it should be noted that HUD's instructions to its regional auditors on reviewing the IPA reports direct the reviewer to determine whether the report contains all the financial statements the audit guide requires. However, the instructions do not indicate whether a report is to be rejected if it excludes a required financial or supplemental financial statement.

The following examples illustrate deficiencies in two IPA reports which were not identified by HUD regional auditors.

IPA report A

The general funds statement in the report indicated that the PHA owed HUD \$51,000 for interest expenses on bonds issued to finance the construction of housing units. The HUD regional auditors should have questioned this item because the IPA did not include it as a liability in PHA's balance sheet or in another supplemental financial statement. We inquired into this matter and found that HUD's records showed that the PHA never owed HUD the \$51,000.

Our review also disclosed another error in the IPA general funds statement involving an understatement, by \$64,000, of the construction funds HUD advanced to the PHA. If HUD relies on the IPA's figure to settle with the PHA on final development financing, the PHA will be overpaid \$64,000. A HUD regional office official told us, however, that HUD will not use the development advance figure appearing in the IPA report at settlement but will rely on records available at HUD.

IPA report B

Various financial statements in the report contained inconsistent and inaccurate amounts of a material nature. Specifically, the IPA

- understated PHA's investments by \$687,000,
- understated PHA's revenues by omitting a \$62,000 operating subsidy provided by HUD,
- overstated PHA's operating expenses by \$21,000, and
- understated PHA's liabilities by omitting \$46,000 of residual receipts owed to HUD.

Our review showed that the IPA understatement of investments resulted in his omission on the balance sheet of a \$497,000 liability owed to HUD. We told HUD officials of this matter, and they billed the authority for the amount. As of June 30, 1976, HUD has collected about \$210,000 from the PHA.

NEED FOR BETTER REVIEWS OF IPA WORKPAPERS

Workpapers are the records kept by an IPA of the procedures he followed, the tests he performed, the information he obtained, and the conclusions he reached during his

audit. An IPA's workpapers should contain the details of the evidence he relied on to support his opinions, judgments, conclusions, and recommendations.

HUD's instructions on the IPA workpaper reviews require HUD regional auditors to keep a file containing notes, copies of pertinent IPA workpapers and other data supporting the reviewer's conclusions as to the adequacy of the IPA's work. The review generally takes place in the IPA's office and lasts from 1 to 2 days. Of the 3,456 audit reports accepted by HUD as of May 31, 1976, HUD auditors performed workpaper reviews on 343 reports, or about 10 percent.

HUD auditors in the Atlanta, Dallas, and Kansas City regional offices had previously reviewed the workpapers for 3 of the 15 audits included in our review. We examined the workpaper review files for the three audits and found that the HUD auditors

- did not adequately document their files to show the basis for their conclusions as to the adequacy of the IPA performance, and
- often did not identify deficiencies which existed in the IPA workpapers.

Workpaper review A

The HUD workpaper review file indicated that the IPA

- adequately performed reviews of the 15 special compliance items applicable to this PHA,
- needed additional knowledge of HUD accounting requirements, and
- agreed to resubmit his audit report to correct errors and format problems on several supplementary financial statements the reviewer previously identified during his review of the report.

The file did not contain adequate documentation explaining how the HUD auditor performed his review or the extent of his testing of the IPA workpapers.

Our review showed that the IPA workpapers contained no evidence that the IPA had performed a review of 2 of the special compliance items and that the evidence available for 11 other compliance items showed that the items had not been adequately reviewed. Also, the IPA workpapers showed that the IPA

- overstated by about \$74,000 the amount of annual contribution earned by the PHA during the last year of the audit period and
- significantly departed from HUD accounting regulations relating to reporting the annual contributions earned by the PHA during the 33-month audit period and did not disclose the effects of the departure in his report.

Workpaper review B

The only comments in the HUD workpaper review file concerning the adequacy of the IPA workpapers were that the papers were not indexed, cross-referenced, signed by the preparer, and showed no sign of supervisory review. The file did not (1) contain any information on actions taken by the reviewer regarding these deficiencies or (2) contain adequate documentation concerning the IPA adherence to generally accepted auditing standards or the IPA review of the 17 special compliance areas.

Our review showed that the IPA workpapers contained no evidence that the IPA had reviewed four of the special compliance items and that the evidence available for eight other compliance items showed that the items had not been adequately reviewed. Our review also showed that the IPA did not always adequately document the financial attest work which he said he performed, especially that relating to a study and evaluation of the PHA internal controls.

HUD auditors are not required to test financial records or management practices at the PHAs as part of their review of the IPA workpapers. However, we performed tests at this PHA and found that the IPA should have detected and reported the following items if he had adequately reviewed the special compliance items. We found that the PHA did not

- pay the local government about \$600 it owed for 2 years for payments instead of taxes,
- have an investment policy, make forecasts of excess cash, or adequately invest excess cash as required by HUD,
- have an insurance policy for workmen's compensation as required by HUD,
- take an inventory of equipment during the 52-month period covered by the audit, and

--follow good internal control practices because it was not promptly depositing rental receipts.

Workpaper review C

Although the HUD auditor concluded in his file that the IPA workpapers were well prepared, the file contained no documentation to support the conclusion or to indicate the extent of his testing of the IPA workpapers.

Our review showed that the IPA workpapers contained no evidence that the IPA reviewed three of the special compliance items and that the evidence available for eight other compliance items showed that the items had not been adequately reviewed. Also, the IPA report did not include a required supplemental financial statement of initial operating period income and expenses.

Our testing at the PHA revealed that the IPA should have detected and disclosed in his audit report that the PHA

--had underinsured its building and equipment,

--was not preparing required quarterly forecasts on excess funds available for investment, and

--did not obtain, as required by HUD, assurance from the local government that it would eliminate an equal amount of substandard housing for each low-rent housing unit provided by HUD.

CONCLUSIONS

Monitoring of the IPA performance, through reviews of audit reports and workpapers, is necessary to provide confidence in and insure the quality of the IPA audit reports. We found that often HUD's regional auditors are not identifying deficiencies in audit reports and workpapers of the IPAs they review.

We also found some cases where HUD reviewers accepted reports which they knew contained deficiencies, most of which involved missing supplemental financial statements. Because HUD's audit guide requires these financial statements, we believe HUD reviewers should reject the IPA reports not containing them.

RECOMMENDATIONS

We recommend that the Secretary of HUD direct the Inspector General to

- emphasize to HUD reviewers the need to (1) exercise greater care in reviewing the IPA reports and workpapers and (2) document the basis for their conclusions on the adequacy of an IPA's workpapers and
- instruct HUD reviewers to reject audit reports not containing required supplemental financial statements.

AGENCY COMMENTS AND OUR EVALUATION

With regard to the recommendation aimed at improving the quality of HUD reviews of the IPA reports and workpapers, HUD stated it was currently field testing a questionnaire to be used by its auditors in reviewing the IPA reports and workpapers. HUD believes the questionnaire will assure that most deficiencies are disclosed and that adequate documentation will exist to support its auditors' findings.

HUD did not agree, however, that its reviewers should be instructed to reject audit reports not containing required supplemental financial statements. HUD stated that the IPA reports must be evaluated on a case-by-case basis. HUD added that it accepted the IPA reports which might omit supplemental financial statements rather than rejected an IPA's audit report depending on the nature of the missing statements. In some cases, the IPA is requested to provide supplemental data. Such data can be obtained from other sources. In a number of cases, reports are rejected because of failure to submit statements.

We continue to believe that HUD reviewers should reject the IPA reports not containing required supplemental financial statements. IPA's fee is based on his fulfilling all of the requirements stipulated in his audit contract. One such requirement is that the IPAs prepare and submit certain specified supplemental financial statements as part of their audit report.

CHAPTER 4

MAKING GREATER USE OF IPA REPORTS

IPA reports are intended to inform HUD and the PHA administrators whether Federal and local funds are being used and accounted for in accordance with statutory and administrative requirements, and to some extent, whether the PHAs are operating efficiently. HUD considers the financial and management information in the reports on an individual basis. However, HUD could collectively analyze the financial and management information in the reports to identify nationwide problem areas in the low-rent housing program. To achieve the maximum benefits of audits performed by the IPAs, we believe that HUD should perform such analyses to identify problem areas warranting HUD management's attention.

Our analysis of 36 IPA reports showed that there were two common deficiencies in the financial and management practices at the PHAs. Because of their frequent occurrence these deficiencies represent potential nationwide problem areas warranting HUD attention.

<u>Nature of deficiency</u>	<u>Number of PHAs</u>
Excess funds not invested	7
Amounts owed to HUD or the PHA's fiscal agent not promptly paid	17

As discussed in chapter 2, the annual contribution contracts require the PHAs to invest funds in excess of their estimated needs for the next 90 days. Of the 36 IPA reports, 7 disclosed that the PHAs were not adequately investing excess cash and, thus, were not maximizing their revenues. Although not required by the audit guide, in five of the reports the IPAs estimated that the interest the PHAs lost totaled about \$10,000.

Similarly, chapter 2 explains that the annual contribution contracts and HUD regulations require the PHAs to promptly pay HUD residual receipts or other amounts owed. Our analysis of the 36 reports showed that 17 of the PHAs had not promptly paid such liabilities totaling about \$1.1 million to HUD or PHA's fiscal agent. According to HUD records, the amounts were outstanding from 21 days to about 4 years as of the date of the IPA report.

RECOMMENDATION

To promote greater operating efficiency in the low-rent housing program and to encourage greater compliance by the PHAs with HUD's regulations and contracts, we recommend that the Secretary of HUD implement a program requiring periodic reviews of the IPA reports to identify nationwide problem areas needing management attention in the low-rent housing program.

AGENCY COMMENTS AND OUR EVALUATION

HUD stated that reviews of the type we proposed have actually been carried out intermittently during recent years. At the present time, however, they are not being done because of limited staff resources and because, after having done them for a time, their value was no longer commensurate with the effort involved.

Commenting on our proposal, HUD stated that it would now reinstate reviews of the type we proposed on the basis of a sampling adequate to determine if there are general problem areas which may need special management attention. If such problem areas are identified, HUD stated it would initiate procedural changes or strengthen the existing procedures to remedy the situation.

We believe these actions, if properly implemented, can promote greater operating efficiency in the low-rent housing program and encourage greater compliance by the PHAs with HUD's regulations and contracts.

CHAPTER 5

AUDITS NOT MEETING

PROFESSIONAL AUDITING STANDARDS

In addition to the difficulties IPAs experienced in performing compliance reviews, some of the financial opinion work performed by 2 IPAs on 2 of the 15 audits we reviewed, in our opinion, may not have always met generally accepted auditing standards. One of the two IPAs is a member of the American Institute of Certified Public Accountants. Also, HUD auditors identified another institute member who, in their opinion, did not fully comply with generally accepted auditing standards in auditing five PHAs. The lack of adherence by the three IPAs concerned one or more of the following standards: (1) obtaining sufficient evidential matter to support opinions on PHA's financial statements, (2) performing a proper study and evaluation of PHA's internal control system, (3) exercising due professional care, and (4) maintaining independence.

In an effort to improve the auditing and reporting by its members, in 1972 the institute initiated a program asking Federal agencies to refer to them cases of alleged substandard audits by institute members. The institute evaluates the referrals to determine if the audit work was substandard and what action it should take including (1) dismissing the referral without action, (2) urging the member to undertake an educational program, (3) recommending admonishing the member, or (4) submitting the referral to the institute's trial board for further action. Institute officials told us that they would also welcome referrals of deficient work performed by certified public accountants who are not institute members.

HUD regional auditors are required to determine the type of corrective action that should be initiated when an IPA's performance does not appear to meet professional standards or HUD auditing requirements. Such action may include referring cases which HUD considers to involve deficient audit work to the institute if the IPA is an institute member.

Presented below is one of two cases where, we believe, an IPA may not have always met generally accepted auditing standards, and the case of the IPA who, according to HUD reviewers, did not always comply with these standards.

CASE 1

The IPA's report contained unqualified opinions of the fairness of the presentation of PHA's financial and

supplemental financial statements. The report stated that the audit was made in accordance with generally accepted auditing standards and the HUD audit guide. In our opinion, IPA's work did not fully comply with the following generally accepted auditing standards.

Sufficient evidence standard

This standard requires an accountant to obtain sufficient, competent evidential matter to support his opinion regarding the financial statements. According to the institute, an accountant's workpapers provide important support for his opinion, including his representation that he followed generally accepted auditing standards. As mentioned in chapter 3, workpapers are the records kept by an accountant of the procedures he followed, the tests he performed, the information he obtained, and the conclusions he reached pertinent to his examination.

We believe that IPA's workpapers did not contain sufficient evidence to support his opinion on PHA's financial statements. His workpapers did not contain evidence of auditing tests made on accounts of a material nature and included in PHA's financial statements. For example, the IPA had no workpapers showing what audit tests were made of the PHA's rental income or operating expenses included in PHA's income statement which totaled about \$222,000 and \$306,000, respectively.

Similarly, IPA's workpapers showed no evidence of audit tests made on \$645,000 in long-term bonds, which represented about 30 percent of the liabilities reported on PHA's balance sheet. Auditing procedures appropriate in this area include verifying that \$645,000 was the correct amount of long-term bonds outstanding as of the balance sheet date, and determining whether the bonds were bona fide obligations of the PHA.

Internal controls standard

This standard requires an accountant to study and evaluate the client's internal controls, including the client's organizational plan and the procedures and records concerned with safeguarding assets and assuring the reliability of financial records. The accountant's study of the client's internal control system should include obtaining an understanding of the system and determining, with a reasonable degree of assurance, whether the system is being followed as planned.

We found no evidence in IPA's workpapers that he studied or evaluated PHA's internal control system. According to the institute, an accountant's workpapers should show (1) that he studied and evaluated the client's internal control system and (2) how he relied on this work to determine the extent of the tests to which auditing procedures were restricted.

Independence standard

Generally accepted auditing standards require an auditor to maintain independence in mental attitude in all matters relating to his audit. When an auditor is not independent, he should not render an opinion of the financial statements and should indicate in his report that he is not independent.

The IPA stated in his audit report that he performed bookkeeping services for the PHA during the audit period. For an independent auditor who performs bookkeeping services to retain the appearance that he is not virtually an employee of the client, and therefore lacking independence, the institute requires that a certified public accountant

"* * * in making an examination of financial statements prepared from books and records which he has maintained completely or in part, must conform to generally accepted auditing standards. The fact that he has processed or maintained certain records does not eliminate the need to make sufficient audit tests."

As discussed earlier, we believe that the IPA workpapers did not contain sufficient evidential matter to support his opinion of the financial statements. Because it appears that he relied on work performed in providing his bookkeeping services to support the opinions of his audit report, we believe that he may not have been independent and therefore should not have rendered an opinion on PHA's financial statements.

- - - -

In discussing these matters with the IPA, he told us that he may have taken too many shortcuts in performing his audit and that he could have done a better job documenting the work he performed. He also stated that because he was familiar with the recording of transactions through the bookkeeping services he performed for the PHA, he did verify during his audit various transactions affecting accounts included in PHA's financial statements.

CASE 2

HUD regional auditors reviewed five audit reports and related workpapers prepared by an IPA. In their opinion, the IPA did not appear to adhere to generally accepted auditing standards because, among other things, IPA's workpapers

--often contained no evidence of audit work to substantiate his opinion that PHAs' income statements were fairly presented and

--contained no evidence that he reviewed and evaluated PHAs' internal control systems.

The IPA told the HUD regional auditors that he had performed all necessary work but had failed to document in his workpapers the nature and extent of his audit work. To substantiate the audit work performed, the IPA later prepared additional workpapers. A HUD regional auditor reviewed these workpapers and performed a limited review at the PHAs regarding those areas covered in the additional workpapers. However, the regional auditor found inconsistencies between the information presented in the additional workpapers and the actual operating procedures followed by the PHAs.

For example, for one audit the IPA added the statement that the PHA

"* * * maintains a card file on equipment. Physical inventory is taken and checked against the card file at the end of the fiscal year. Additions appear to be adequately capitalized."

The regional auditor determined that the PHA had not made an inventory of equipment during the audit period nor had the PHA made any adjustments to the general ledger account to bring it in balance with their physical inventory.

For another audit, the IPA added to his workpapers that his tests of payroll included

"* * * (1) comparison of employees on the payroll and rates paid with personnel records, (2) comparison of time charges with time records."

The regional auditor found that the PHA did not have any employee time records or personnel files.

HUD regional auditors recommended, in a February 1974 report to the applicable HUD area office director, that he

disapprove pending proposals and contracts between the PHAs and the IPA and tell the PHAs involved to solicit other proposals for audit services.

Although HUD's policy includes referring cases involving what it considers to be deficient audit work to the institute, HUD had not taken action to refer the five audits as of June 24, 1976.

In October 1974, we discussed HUD's implementation of its referral policy with the former HUD Inspector General. He told us at that time that HUD had made no referrals of deficient audit work to the institute. Subsequently, in an October 3, 1975, letter, the present Inspector General told us that in the future HUD would refer cases of substandard audit work it identified to the institute.

CONCLUSIONS

Our reviews disclosed examples where some work by two IPAs on two audits appeared to be below expected professional standards. Also, HUD reviews revealed that five audits performed by an IPA whose work we did not review, appeared to be below standard.

We believe it is in the interest of the Federal Government and the public accounting profession that Federal agencies refer to the institute IPA audits which do not meet expected professional performance for determination as to whether the audit work performed was substandard and, if so, the action which should be taken. On April 7, 1976, we referred to the institute the two audits which, according to our reviews, did not appear to meet expected professional standards.

AGENCY COMMENTS AND OUR EVALUATION

HUD stated that its policy is to refer substandard work of IPAs to either the institute or the State Board of Accountancy. HUD disagreed, however, with our proposal that it refer to the institute the five audits performed by the IPA which it identified in 1974 as apparently not meeting professional standards. HUD stated that the work performed by the IPA was done in 1973 and reported in February 1974. The IPA has recently made another audit of a housing agency. HUD stated that it reviewed the applicable workpapers and found they were prepared in accordance with generally accepted auditing standards and the work was done as prescribed by the HUD audit guide, except for three minor items which were brought to the IPA's attention.

We believe that the decision to refer to the institute audits identified as apparently not meeting professional standards should be made on an audit-by-audit basis since each audit report contains an opinion of a client's financial statements and a statement that the audit was made in accordance with generally accepted auditing standards. When Federal agency reviewers determine that an IPA who is an institute member performed an audit which does not appear to have met these standards, we believe it is in the interest of the Federal Government and the public accounting profession to refer the audit to the institute for a determination as to whether substandard work was performed, and if so, the action which should be taken. The fact that an IPA later performs another audit which conforms to generally accepted auditing standards does not, in our opinion, mitigate the need to refer the previous audit to the institute.

RECOMMENDATION

In addition to referring to the institute future deficient audit work by IPAs, we recommend that the Secretary of HUD direct the Inspector General to refer to the institute the five audits which his staff identified in 1974 as apparently not meeting professional standards.



DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D. C. 20413

JUN 24 1976

OFFICE OF THE ASSISTANT SECRETARY
FOR HOUSING MANAGEMENT

IN REPLY REFER TO:

Mr. Henry Eschwege
Director
Resources and Economic Development
Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Eschwege:

Secretary Hills has asked me to respond to your letter of March 31, 1976, transmitting a proposed report to the Congress entitled, "Using Independent Public Accountants to Audit Housing Authorities -- an Assessment." In the letter you asked that we review and comment on the material contained in the report. We have reviewed the report and are of the opinion that while the quality of the IPA audits in the low-income housing program has been steadily improving since the inception of the program in 1972, we concur with the recommendations that certain improvements are still needed.

We will respond to each of the recommendations in the order that they were presented in the report. Please note that the recommendations are numbered for convenience in responding to the individual items. In addition, while the recommendations refer to LHAs, our responses reflect the term PHA (Public Housing Agency) in accordance with a recent procedural change.

Recommendation No. 1:

To improve the quality of information in the IPA audit reports on LHA compliance with HUD contracts, regulations and procedures, and to make IPA reports more useful to both HUD and LHA administrators, the Secretary of HUD should require that:

- a. HUD's audit guide be revised to ensure that IPAs fully understand (1) the scope of the compliance review portion of their audit, and (2) how to prepare the special funds statement.

[GAO note: material has been deleted because of changes to final report.]

Reply:

The audit guide is presently being revised to clarify the compliance review portion. To highlight the compliance items which we expect the IPA to perform, we will include each item on a checklist. It will be made an appendix to the guide. The revised audit guide will also inform the IPA that it will be necessary to expand the scope of the audit to meet the compliance requirements.

The new guide will have a revised special funds statement format. We will also revise the instructions on preparation of the form included in the guide.

We will eliminate the requirement that the IPA evaluate the reasonableness of the PHA insurance coverage as this is the responsibility of HUD. As a part of our revised compliance requirements, we plan to have the IPA determine whether the PHA has in force all required insurance and bonding coverages and whether evidence of HUD approval of those coverages requiring such approval is on file.

- b. HUD's audit guide be revised to require IPAs to review and comment on (1) the nature of any amounts owed to HUD and to the LHA's fiscal agent, and (2) operating budget overruns:

Reply:

We plan to include a compliance requirement in the checklist of our revised guide for the IPA to comment on any amounts owed to HUD and the PHA's fiscal agent that have been due over three months.

We will include as an item in the compliance appendix, a requirement that the IPA comment on any budget overruns in specific controlled categories.

- c. IPAs be provided a means to quickly
[See GAO note, p. 32.] confirm an LHA's
construction advances with HUD headquarters.

Reply:

[See GAO note, p. 32.]

We plan to include instructions in the revised IPA guide on how the IPA can confirm construction advances with either Headquarters or the Regional Accounting Divisions.

- d. IPAs be provided training courses, on a voluntary basis, to familiarize them with HUD's auditing requirements and accounting and program regulations applicable to LHAs.

Reply:

We are currently working with the American Institute of Certified Public Accountants (AICPA) to establish such courses as a part of its continuing education program. We plan to schedule the courses to coincide with the issuance of our revised audit guide.

Recommendation No. 2:

The Secretary of HUD should direct the Inspector General to:

- a. Emphasize to HUD reviewers the need to (1) exercise greater care in reviewing IPA reports and workpapers, and (2) document the basis for their conclusions on the adequacy of an IPA's workpapers.

Reply:

We are in process of field testing a questionnaire which is to be used by HUD auditors when reviewing audit reports and working papers of IPAs. We believe that this will assure that most deficiencies are disclosed and that adequate documentation will exist to support the HUD auditors' findings.

- b. Instruct HUD reviewers to reject audit reports not containing required financial statements.

Reply:

We accept IPA reports which may omit supplemental financial schedules rather than reject an IPA's audit report depending on the nature of the missing schedules. In some cases, the IPA is requested to provide supplemental data; such data can be obtained from other sources, and in a number of cases, reports are rejected because of the failure to submit schedules.

Each case requires review, and a judgment is made on what to do depending on the particular case.

[See GAO note, p. 32.]

Recommendation No. 3:

To promote greater operating efficiency in the low-rent housing program and to encourage greater compliance by LHAs with HUD's regulations and contracts, the Secretary of HUD should implement a program requiring periodic reviews of IPA reports to identify nationwide problem areas needing management attention in the low-rent housing program.

Reply:

Reviews of the type recommended in this finding have actually been carried out intermittently during recent years. At the present time, however, they are not being done because of limited staff resources and because, after having done them for a time, their value was no longer commensurate with the effort involved. We will now reinstate them on the basis of a sampling adequate to determine if there are general problem areas which may need special management attention. If such problem areas are identified, we will initiate procedural changes or strengthen the existing procedures to remedy the situation.

Recommendation No. 4:

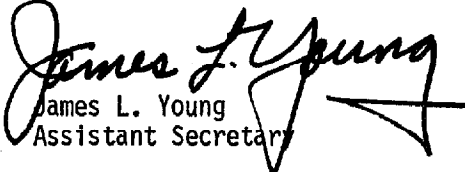
In addition to referring to the Institute future deficient audit work by IPAs, the Secretary of HUD should direct the Inspector General, to refer to the Institute the five audits which his staff identified in 1974, as apparently not meeting professional standards.

Reply:

It is the Inspector General's policy to refer substandard work of IPAs to either the AICPA or the State Board of Accountancy as appropriate, as well as to discuss the subject with the IPA.

We disagree with the recommendation to refer the substandard work of the cited IPA to the AICPA. The work referred to was done in 1973 and reported in February 1974. The IPA has recently made another audit of a housing agency. Our audit supervisor in Little Rock, Arkansas reviewed the applicable working papers. The IPA's working papers were prepared in accordance with generally accepted auditing standards and the work was done as prescribed by the HUD audit guide, except for three minor items. These were brought to the IPA's attention in a letter dated April 8, 1976.

Sincerely,


James L. Young
Assistant Secretary



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

Honorable Elmer B. Staats
Comptroller General of the United States
General Accounting Office
Washington, D. C. 20548

MAY 17 1976

Dear Mr. Staats:

This is in reply to the draft report, "Using Independent Public Accountants to Audit Housing Authorities--An Assessment."

The report recommends that we bring to the attention of other Federal agencies the problems experienced by the Department of Housing and Urban Development in obtaining adequate audits from public accountants.

As you know, we have actively encouraged departments and agencies to rely on audits made by recipients of Federal assistance or by their independent public accountants. In this way we have sought to reduce overlap and duplication in the audit process. For this policy of reliance to succeed, however, it is necessary that such audits be of high quality, and meet professional audit standards.

Your report serves a useful purpose in disclosing examples of substandard audit work by independent public accountants. In order to deal with situations of this kind, OMB participated in the development of a working procedure with the American Institute of Certified Public Accountants, whereby Federal agencies would bring to its attention substandard audit work by certified public accountants. We are pleased to note that you are referring two cases to the Institute under that procedure for consideration and appropriate action.

We plan to bring to the attention of the audit officials of other Federal agencies the findings disclosed in your report, and to point out to them the need for adequate followup to see that audits by independent public accountants are made in accordance with professional audit standards and conform to the terms of the engagements.

We appreciate the opportunity to review and comment on the draft report.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "Paul H. O'Neill".

Paul H. O'Neill
Deputy Director

GENERALLY ACCEPTED AUDITING STANDARDS
PRESCRIBED BY THE AMERICAN INSTITUTE OF
CERTIFIED PUBLIC ACCOUNTANTS

GENERAL STANDARDS

1. The examination is to be performed by a person or persons having adequate technical training and proficiency as an auditor.
2. In all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors.
3. Due professional care is to be exercised in the performance of the examination and the preparation of the report.

STANDARDS OF FIELD WORK

1. The work is to be adequately planned and assistants, if any, are to be properly supervised.
2. There is to be a proper study and evaluation of the existing internal control as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted.
3. Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under examination.

STANDARDS OF REPORTING

1. The report shall state whether the financial statements are presented in accordance with generally accepted accounting principles.
2. The report shall state whether such principles have been consistently observed in the current period in relation to the preceding period.
3. Informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report.

4. The report shall either contain an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons should be stated. In all cases where an auditor's name is associated with financial statements, the report should contain a clear-cut indication of the character of the auditor's examination, if any, and the degree of responsibility he is taking.

PRINCIPAL OFFICIALS OF THE
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
RESPONSIBLE FOR ADMINISTERING
ACTIVITIES DISCUSSED IN THIS REPORT

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
SECRETARY OF HOUSING AND URBAN DEVELOPMENT:		
Carla A. Hills	Mar. 1975	Present
James T. Lynn	Feb. 1973	Feb. 1975
George W. Romney	Jan. 1969	Feb. 1973
ASSISTANT SECRETARY FOR HOUSING-FEDERAL HOUSING COMMISSIONER (note a):		
James L. Young	June 1976	Present
ASSISTANT SECRETARY FOR HOUSING MANAGEMENT:		
James L. Young	Mar. 1976	June 1976
Robert C. Odle, Jr. (acting)	Jan. 1976	Mar. 1976
H. R. Crawford	Apr. 1973	Jan. 1976
Abner D. Silverman (acting)	Jan. 1973	Mar. 1973
Norman V. Watson	July 1970	Jan. 1973
INSPECTOR GENERAL:		
James B. Thomas, Jr.	Sept. 1975	Present
Charles L. Dempsey (acting)	May 1975	Sept. 1975
Charles G. Haynes	Jan. 1972	May 1975

^aOn June 14, 1976, HUD combined the functions of the Assistant Secretaries for Housing Management and for Housing Production and Mortgage Credit under a single Assistant Secretary for Housing-Federal Housing Commissioner.

Copies of GAO reports are available to the general public at a cost of \$1.00 a copy. There is no charge for reports furnished to Members of Congress and congressional committee staff members. Officials of Federal, State, and local governments may receive up to 10 copies free of charge. Members of the press; college libraries, faculty members, and students; and non-profit organizations may receive up to 2 copies free of charge. Requests for larger quantities should be accompanied by payment.

Requesters entitled to reports without charge should address their requests to:

U.S. General Accounting Office
Distribution Section, Room 4522
441 G Street, NW.
Washington, D.C. 20548

Requesters who are required to pay for reports should send their requests with checks or money orders to:

U.S. General Accounting Office
Distribution Section
P.O. Box 1020
Washington, D.C. 20013

Checks or money orders should be made payable to the U.S. General Accounting Office. Stamps or Superintendent of Documents coupons will not be accepted. Please do not send cash.

To expedite filling your order, use the report number in the lower left corner and the date in the lower right corner of the front cover.

GAO reports are now available on microfiche. If such copies will meet your needs, be sure to specify that you want microfiche copies.