

Message from the Chief Financial Officer

December 29, 2014

The U. S. Department of Housing and Urban Development (HUD) recently became aware of a potential material understatement of assets affecting our comparative financial statements as of and for the fiscal years (FY) ended September 30, 2012 and 2013, which were issued on December 16, 2013 and accompanied by the Office of the Inspector General's report issued on December 16, 2013. Based on preliminary information, it appears that significant amounts of liabilities were not reported in HUD's consolidated financial statements related to its grant programs articulated in the Statement of Federal Accounting Standards Advisory Board's, *Federal Financial Accounting Technical Release 12, Accrual Estimates for Grant Programs*. Therefore, the statements included in the Department's FY 2013 comparative financial statements cannot be relied on as they were presented. The omission of the grant accruals by the Department is also inconsistent with the Statement of Federal Accounting Standards 5, *Accounting for Liabilities of the Federal Government* effective for fiscal years beginning after September 30, 1996 defining a liability as a probable future outflow or other sacrifice of resources as a result of past transactions or events.

Separately, another issue found concerns related to assets due from the establishment of prepayments from our rental assistance programs that were recognized in the Department's FY 2013 financial statements. However, as a result of system impediments and reliance on manual processes, the prepayment recognized in the Department's financial statements was materially understated. A revised estimate was included in the Department's restated financial statements for inclusion in the Department's FY 2014 Annual Financial Report

The Department's restated FY 2013 financial statements resulted in a reduction of \$2.112 billion in the agency's equity based on the adjustments recorded by HUD. The net reduction in the equity reported by HUD was the result of the unrecorded grant accrual liability of \$2.212 billion offset by an increase of \$100 million in the prepayments as a result of revised estimates received by the Department in FY 2014. Prior to the restatement by HUD, the Department had recorded prepayments of \$452 million in its consolidated financial statements as of September 30, 2013.

The Department's program expenses reported on the Statement of Net Cost was also impacted by the grant accrual liability and the prepayments. The Department also established a grant accrual liability of \$2.275 billion as of October 1, 2013 based on prior year estimates requested from the Department's program offices. As a result, the amount of program expenses reported on the restated Statement of Net Cost decreased by \$163 million for the period ending September 30, 2014.

We are required by Office of Management and Budget (OMB) Circular A-136 to promptly inform those persons known to be relying or who are likely to rely on HUD's financial statements and the related audit report should we become aware of potential material misstatements in our previously issued financial statements. Accordingly, this letter serves as notification to you that the Department's FY 2013 comparative financial statements and related audit report should not be relied upon. We are also providing similar notifications to the other external parties to which the Department's FY 2013 comparative financial statements were directly distributed. The Department's restated FY 2013 comparative financial statements and related audit report will be included in the Department's FY 2014 Agency Financial Report.

Based on initial assessments, a substantial level of effort is required to address these issues, including the establishment of operating procedures and the valuation of program data to assess its impact on the Department's financial statements. We are developing a plan to resolve these issues expeditiously, in consultation with the Office of Inspector General and responsible Departmental offices, and expect to be completed in FY 2015.

If you have any questions or require additional information, please contact Nita Nigam, Assistant CFO for Accounting at 202-402-6850. Thank you.