

Testimony before the U.S. Senate  
Committee on Appropriations  
Subcommittee on Transportation, Housing and Urban Development,  
and Related Agencies

“HUD Office of Inspector General  
Fiscal Year 2017 Budget Request and  
HUD’s Top Management and  
Performance Challenges”



Testimony of  
The Honorable David A. Montoya  
Inspector General  
Office of Inspector General  
U.S. Department of Housing and Urban Development

March 10, 2016, 2:30 PM  
Room SD-192, Dirksen Senate Office Building

Chairman Collins, Ranking Member Reed, and Members of the Subcommittee, I am David Montoya, Inspector General of the U.S. Department of Housing and Urban Development (HUD). Thank you for the opportunity to discuss the Office of Inspector General's (OIG) fiscal year 2017 budget request. The committee also asked that I address the Department's top management and performance challenges and my Office's oversight of HUD's programs and operations.

The Department's primary mission is to create strong, sustainable, inclusive communities and quality, affordable homes for all. HUD seeks to accomplish this mission through a wide variety of housing and community development grant, subsidy, and loan programs. Additionally, HUD assists families in obtaining housing by providing Federal Housing Administration (FHA) mortgage insurance for single-family and multifamily properties. It relies upon many partners for the performance and integrity of a large number of diverse programs. Among these partners are cities that manage HUD's Community Development Block Grant funds, public housing agencies that manage assisted housing funds, HUD-approved lenders that originate and service FHA-insured loans, Government National Mortgage Association (Ginnie Mae) mortgage-backed security issuers that provide mortgage capital, and other Federal agencies with which HUD coordinates to accomplish its goals. HUD also has responsibility for administering disaster assistance programs which has evolved substantially over the years. It also has assumed a prominent role in administering new mortgage assistance and grant programs in response to the Nation's financial crisis, to increases in foreclosures, and to declining home values.

I want to acknowledge that I have continuing open dialogues with Secretary Castro and Deputy Secretary Coloretti on the management and performance challenges that the Department faces and on the work my office does to bring these matters to their attention. I meet regularly with them and their key staff on areas of concern.

I am pleased to highlight the results from our last two Semiannual Reports to the Congress which showcase key results for fiscal year 2015. The Inspector General Act requires each inspector general to report on its results every six months. My office is charged with eliminating and preventing fraud, waste, abuse and mismanagement in HUD programs and operations, and the audits, evaluations and investigations conducted by my office have had a significant impact on safeguarding federal funds. My office takes the approach that early detection and prevention are key to ensuring taxpayer funds are not lost. During the last two 6-month cycles, we issued 148 audits and other reviews, which resulted in nearly \$2.0 billion in recommendations that funds be put to better use, over \$2.1 billion in questioned costs, and nearly \$500 million in collections from audits. Our investigations led to nearly \$670 million in restitution, judgments, recoveries and receivables. Our audits, evaluations and investigations assist HUD in identifying program vulnerabilities and the rest of my testimony will focus on the management and performance challenges faced by HUD as well as the OIG's budget request for the upcoming fiscal year 2017.

## **Overview**

The mission of the Office of Inspector General is not only to prevent and detect fraud, waste, and abuse in the programs and operations of the Department but to promote economy, efficiency and effectiveness as well. We accomplish this by conducting independent audits, evaluations, and investigations. The work performed by our auditors, evaluators, and investigators provides the means to keep the Secretary and the Congress fully and currently informed about the Department's problems and deficiencies while also highlighting best practices. After identifying problems and deficiencies, we make recommendations to improve operations and follow-up with

departmental officials on corrective actions. We are committed to reducing fraud at the outset or at least halting it at the earliest opportunity. Protecting taxpayer dollars is one of the Inspector General's highest priorities in order to account for money going to the right place, doing what it was supposed to do, and having the results it was intended to have. We actively pursue financial and other fraud schemes in all of HUD's programs that can have a significant economic impact often at the expense of the American taxpayer.

### **Fiscal Year 2017 Request**

OIG requests \$129 million and 655 Full Time Equivalents (FTE) in fiscal year 2017. This includes additional funds for the cost of new hires and resources to fund cost-of-living adjustments, promotions, increased benefit costs, and within grade increases. Despite some struggles to replace lost staff previously due in part to budget interruptions, in fiscal year 2015 the OIG was able to make gains in total FTE as part of the overall goal of building the organization back to pre-sequestration levels. The OIG is continuing to build on this success into fiscal year 2016. Utilizing this active workforce management should allow the OIG to maintain a staffing base that is moving closer to historical norms and what is needed based on workload facing the organization. Twelve new FTEs are requested for fiscal year 2017 representing a small increase over fiscal year 2016. Approximately seven FTE will operate within the Office of Audit, where the skill sets needed will mostly concentrate on the increased workload as a result of bringing the HUD consolidated financial statement audits in-house which requires highly specialized skills in federal financial auditing, actuarial modeling, and information technology (IT) skills. The remaining five new FTEs will bolster the Office of Evaluations multi-disciplinary teams that work on overseeing, testing, and improving the information security systems and protocols in place within HUD, which require highly technical skills in IT security and penetration testing, especially in light of breaches to federal IT systems.

### **OIG Program Divisions**

#### *Office of Audit*

The Office of Audit (OA) is responsible for conducting audits to identify, evaluate, and report on the Department's activities and programs so corrective actions can be taken and future problems can be prevented. Auditors assigned to headquarters and to seven regional offices initiate audits based on information obtained from program officials, program research, complaints, congressional requests, and risk assessments.

OA provides oversight across a wide array of responsibilities. The funding requested for the mission of OA allows the organization to expand and concentrate its expert oversight in several areas:

- Financial audits consisting of the HUD Consolidated Financial Statement including the audit of FHA (\$1.2 trillion mortgage insurance program) and Ginnie Mae (\$1.6 trillion in mortgage-backed securities) which determine whether financial statements are fairly presented, internal controls are adequate, and regulations have been followed. Because of the critical impact these agencies have had to the financial stability of the national economy particularly during the last downturn, the OIG began performing FHA's and Ginnie Mae's financial audits in-house in fiscal year 2014. This was done to ensure the highest level of accuracy and due diligence.

- Information system audits determine, among other things, the adequacy of general and application controls, and whether security over information resources is adequate, and in compliance with system development requirements. Ensuring taxpayer and HUD client information is stored with the guarantee that it will be safe and private is something system audits seeks to scrutinize and work to correct when vulnerabilities are found. In addition, OA has been involved with assessing new information system deployments within HUD, an especially large task with HUD's transition to a shared services system with the Department of Treasury.
- The Joint Civil Fraud Division is a multidiscipline team that audits and reviews, working with investigators, attorneys, and other support staff, any suspected financial fraud against HUD and makes referrals for civil actions and administrative sanctions. This group provides case support to the Department of Justice, Civil Division; United States Attorney's Offices nationwide; and HUD's Office of General Counsel to investigate and bring civil fraud cases. As a result, since this initiative began, the Government has reached civil settlements regarding FHA deficient loan underwriting totaling \$3.5 billion for alleged violations of the False Claims Act; the Financial Institutions Reform, Recovery, and Enforcement Act; and the Program Fraud Civil Remedies Act. Nearly \$2.4 billion of the \$3.5 billion in settlements is of direct benefit to the FHA insurance fund and I am proud that the HUD OIG staff from different components played a prominent role in these efforts.

Moreover, the OA has been incredibly successful in rooting out and exposing waste, fraud, abuse of taxpayer funds. In fiscal year 2015, the HUD-wide impact of the audit findings and reports totaled \$4.1 billion. This amount compared with the OIG's appropriated dollars means that for every appropriated dollar received, \$36 are returned to taxpayers or reallocated to other valued mission objectives. When combined with other OIG units (investigations, evaluations, and other support divisions) the overall return on investment rises to even more returned per dollar spent.

### Office of Evaluation

The Office of Evaluation (OE) provides a flexible and effective mechanism for oversight and review of HUD's operations, programs and policies by using a multidisciplinary staff and multiple methods for gathering and analyzing data. OE is comprised of integrative teams, concentrating on areas of risk and multiple methods for analyzing data providing a flexible and effective process to produce impartial and reliable results. In an effort to concentrate resources where they can be most effective, and where the greatest institutional risk is present, several priorities have been identified:

- HUD maintains a tremendous amount of data in many diverse systems and databases. The ability for OE to leverage the information from those systems into products that can be used to identify fraud and wasteful tendencies before they occur, or early on so that they do not have the chance to grow into a larger problem, is a central goal and tenet of the OE mission. Using the data available to recognize patterns from historical events and to learn how those patterns can be used to prevent future incidents is a powerful tool that OE is trying to enhance in strength and deploy in larger scale. In addition to directly identifying weaknesses in the administration of HUD funds and programs, the task of improving data analysis and predictive analytics will provide OIG with the best

information when communicating with constituents, directing enforcement strategies, and allocating limited resources.

- Cybersecurity and insuring the protection of IT systems has become a mission of the utmost importance for the federal government as a whole. HUD is at a critical crossroads with the aging of the Department's IT infrastructure and the need to modernize these systems. In this environment, the opportunities for assessing cybersecurity are heightened. In addition many HUD systems are supported by outside vendors. While this model of IT acquisition and maintenance is sometimes necessary, it also creates additional IT security vulnerabilities or risk. OE contributes to the OIG's IT security mission by conducting necessary oversight and by monitoring these systems.
- OE is responsible for conducting the Federal Information Security Modernization Act of 2014 (FISMA) reviews and other IT operational evaluations. One of the best tools that the OIG has to measure this security effectiveness is technical testing to include "penetration testing." Penetration testing can be conducted in different ways and on multiple levels to technically test mandated IT security controls. Recently we conducted testing which greatly assisted in finding vulnerabilities within the HUD network and provided the OIG with additional key information and recommendations for FISMA reporting. Into the future, follow-up technical testing will be required by the OIG to validate corrective action of previously found vulnerabilities are being implemented by HUD, to assess other areas of the HUD network, FISMA assessment topics, or any future federal cybersecurity guidance.

The Office of Evaluation is maturing and becoming fully staffed and operational with the heightened mission; the key to completing this process is ensuring the timely and consistent availability of budgetary resources and critical technical skills.

### Office of Investigation

The Office of Investigation (OI) is responsible for the development and implementation of the OIG's investigative activities and is comprised of criminal investigators, investigative analysts, and administrative personnel. OI initiates and conducts criminal, civil and administrative investigations of possible violations of laws and regulations relating to the administration of HUD programs and HUD-funded activities as well as employee misconduct.

- The Office of Investigation has recently produced significant criminal and civil findings relating to HUD program fraud, including participation in large-scale settlements that have returned money to the FHA fund. OI has made it a priority to root out fraud involving the origination of FHA mortgages, multifamily equity skimming schemes at housing developments receiving HUD subsidized rental assistance for tenants, and at nursing homes. These efforts have produced noteworthy results in the past and this trend is expected to continue into the future. The OIG is a full-time participant in the Department of Justice's Financial Fraud Enforcement Task Force where the Inspector General is the Co-Chair of the Mortgage Fraud Working Group. This focus on finding and identifying fraudulent activity will continue to protect taxpayers from those who look to defraud the government, negatively impact the financial health of our economy, and undermine the true mission of HUD programs.

- OI also works to reduce fraud, waste, and abuse in the Public and Indian Housing arena, with a focus on Public Housing Authorities (PHAs). Ensuring that public housing dollars are being administered properly and utilized by the intended recipients is a challenge the Office of Investigation emphasizes every day. This work with the PHAs takes on many different forms: identifying public corruption, management and administration deficiencies, contract fraud, embezzlement, bribery, and rental assistance fraud. The fight against corruption also takes place in the management of Community, Planning and Development grant programs.
- OI continues to dedicate time and resources to the work in communities affected by previous disasters, such as the Gulf Coast area after Hurricane Katrina and, more recently, Hurricane Sandy. Designated disaster sites are provided large amounts of grant and emergency funding in the wake of these disasters. OI conducts investigations of fraud and abuse of disaster recovery funds efforts, assists to ensure that these resources are utilized properly, and leads the effort to prevent disaster fraud schemes. It also provides training to those entities tasked at the State and local level on how to detect and deter fraud and abuse.

Over the last 4 years the Office of Investigation has produced over \$4.3 billion in criminal judgments and nearly \$2.2 billion in recoveries. The reach of this office is extended by resources that keep investigators in the field working with the tools they need to root out the waste, fraud, and abuse they are tasked with exposing.

### **HUD's Performance and Management Challenges**

Achieving HUD's mission continues to be an ambitious challenge for its limited staff given the agency's diverse programs, the thousands of intermediaries assisting the Department, and the millions of beneficiaries of its housing and development programs. The national credit and financial crisis continues to have a profound impact on departmental operations. Proposed and new program changes have introduced new risks, oversight and enforcement challenges. HUD is an important spoke to the Nation's housing industry in that FHA-insured mortgages finance approximately one-fourth of all home purchases in the United States and in that it has stepped in to bolster the marketplace during economic challenges.

In October 2016, OIG reported on nine key management and performance challenges facing HUD for fiscal year 2016 and beyond. They are so interrelated and interconnected that our reviews suggest one impacts another to such a degree that, in many cases, the Department will not be able remedy one without first correcting another. This becomes a taxing challenge to determine which needs to come first or whether several be accomplished simultaneously. These challenges are in the following areas:

1. Human capital management,
2. Financial management governance of HUD,
3. Financial management systems,
4. Information security,
5. Single-family programs,
6. Public and assisted housing program administration,
7. Administering programs directed toward victims of natural disasters,
8. Office of Community Planning and Development programs, and
9. Compliance with the Improper Payments Elimination and Recovery Act of 2010.

Since our October 2016 report, my office has completed an additional evaluation relating to HUD's acquisition management and its efforts to address long-standing concerns in this area. I have added a discussion to summarize the results of that review.

### *Human Capital Management and Financial Management Governance*

For many years HUD has struggled and been challenged to effectively manage its limited staff to accomplish its primary mission. HUD continues to lack a valid basis for assessing its human resource needs and allocating staff within program offices. Several studies have been completed in recent years by the Office of Personnel Management and the Government Accountability Office that point to a lack of human capital accountability and insufficient strategic management of human capital as pervasive problems at HUD. To some extent, these human capital challenges have contributed to HUD's inability to maintain an effective financial management governance structure which we have been reporting for the past three years as part of our annual audits of HUD's financial statements.

In our most recent report on HUD's fiscal year 2015 financial statements, we continued to report that HUD's financial management governance remained ineffective. While HUD and its components took steps to address some of the weaknesses in its financial management governance structure and internal controls over financial reporting, deficiencies continued to exist. Specifically, HUD needs to recruit and hire a Chief Financial Officer and Deputy Chief Financial Officer (CFO) with the requisite accounting and technical financial management skills to provide stronger direction to program office accounting so as to improve financial management and governance issues throughout the Department and specifically at Ginnie Mae. Additionally, HUD needs to be more consistent in its control and monitoring activities, including front-end risk assessments, management control reviews and reconciliation activities.

These conditions stemmed from the lack of a senior management council which limits the CFO's ability to stress the importance of financial management and to facilitate internal control over financial reporting throughout HUD. Additionally, as we have reported in prior year audits, HUD did not have reliable financial information for reporting and has been slow in replacing its outdated legacy financial systems. Weaknesses in program and component internal control that impacted financial reporting were caused in part by a lack of financial management governance processes. Entity-level controls could improve HUD's governance and enable the prevention, detection, and mitigation of significant program and component-level internal control weaknesses. As a result, there were multiple deficiencies in HUD's internal controls over financial reporting, resulting in misstatements on the financial statements and noncompliance with laws and regulations.

A 2015 report from the National Academy of Public Administration (NAPA) also recognized the need for an internal management council to strengthen HUD's financial governance structure and enhance its monitoring of financial activity and controls. Such a council would:

- Assess and monitor deficiencies in internal control resulting from HUD's assessment process.
- Advise the HUD Secretary of the status of corrections to existing material weaknesses.
- Inform the Secretary of any new material weaknesses that may need to be reported to the President and Congress through the annual financial report.

We believe that these are critical steps towards establishing effective internal controls. In addition to its concerns and recommendations regarding HUD's impending transition to a shared service provider for financial management functions, NAPA found that HUD should strengthen its finance workforce. As we have previously reported, HUD's ability to monitor and perform routine financial management activities has been hampered by both turnover and reductions in staff. Between 2009 and 2014, there was a 40 percent turnover in CFO staff and an 11 percent reduction in full-time permanent CFO

employees. Between 2014 and 2015 there was a 15 percent turnover and a 9 percent reduction in full-time employees. The turnover and reductions have placed additional burdens on CFO staff and limited its ability to perform its duties in a timely and efficient manner.

In addition to issues at the Departmental level, we have identified significant financial governance issues within Ginnie Mae. In fiscal year 2015, Ginnie Mae failed to maintain a governance framework to ensure the reliability and integrity of Ginnie Mae's financial and accounting information. This failure in governance was the underlying cause of the problems cited in the Ginnie Mae financial statement audit report. Specifically, Ginnie Mae failed to adequately:

- Identify, analyze, and respond to changes in the control environment and risk associated with the acquisition of a multi-billion-dollar servicing portfolio.
- Establish accounting policies, procedures, and systems to manage and control the loan accounting and processing of the activities related to its defaulted issuers' portfolio.
- Oversee the implementation of the budgetary accounting module in its financial system to ensure accurate reporting of budgetary activity.

This condition occurred because of finance staff turnover and insufficient internal controls to manage the risks associated with business decisions and changes in its business environment. Additionally, Ginnie Mae's executive leadership failed to backfill a number of critical financial management positions, including the deputy chief financial officer, controller, and the economic modeling director, all of which have significant financial reporting roles. These positions had been vacant for an extended period, and Ginnie Mae relied heavily on contractors to compensate for finance staffing deficiencies. As a result, serious financial reporting deficiencies occurred at Ginnie Mae, the most recent of which required \$1.9 billion of restatement adjustments to HUD's fiscal year 2014 consolidated financial statements. Compounding the problem was Ginnie Mae's late notification, inadequate communication, and lack of transparency, resulting in difficulties for HUD's CFO to preparing consolidated financial statements within the required timeframes and ultimately inhibiting our ability to validate the accuracy of the accounting adjustments. Time will tell whether a recent leadership change within Ginnie Mae will ameliorate some of these conditions.

Ginnie Mae's management of risks associated with (1) handling complex and changing financial management operations without the appropriate accounting policies and procedures in place and (2) monitoring the work performed by third-party service providers on Ginnie Mae's multi-billion-dollar servicing portfolio have challenged Ginnie Mae's inadequate financial management staff. These governance weaknesses contributed to Ginnie Mae's inability to produce auditable financial statements.

### Financial Management Systems

Annually since 1991, OIG has reported on the lack of an integrated financial management system, including the need to enhance FHA's management controls over its portfolio of integrated insurance and financial systems. HUD has been working to replace its current core financial management system since fiscal year 2003. The previous project, the HUD Integrated Financial Management Improvement Project (HIFMIP), was based on plans to implement a solution that replaced two of the applications currently used for core processing. In March 2012, work on HIFMIP was stopped and the project was later canceled. This previous attempt to use a commercial shared service provider to start a new financial management system failed after more than \$35 million was spent. Our review of the project determined that OCFO did not properly plan and manage its implementation of the project.



In the fall of 2012, the New Core Project was created to move HUD to a new core financial system that would be maintained by a shared service provider, the U.S. Department of the Treasury's Bureau of Fiscal Services (BFS). We have completed two audits of HUD's implementation of the New Core Project. In the first audit, published in June 2015, we found that weaknesses in the planned implementation of release 3 of phase 1 in the New Core Project were not adequately addressed. We determined that HUD did not follow its own agency policies and procedures, the policies established for the New Core Project, or best practices. HUD will become the first cabinet-level agency to use a Federal shared service provider. The transfer of its financial management to a shared service provider has been widely publicized. If HUD is not successful in this implementation, it could reflect negatively on OMB's mandate to use Federal shared service providers. The weaknesses identified in this report relate to requirements and schedule and risk management. These areas are significant to the project plan, and the effectiveness with which HUD manages them is critical to the project's success.

Our second review, published in September 2015, found that HUD's implementation of release 1 of phase 1 was not completely successful. Due to missed requirements and ineffective controls, interface processing of travel and relocation transactions resulted in inaccurate financial data in HUD's general ledger and BFS' financial system. As a result, processing continued for more than 6 months with unresolved errors, leaving HUD's general ledger and BFS' financial system with inaccurate financial data and discrepancies in the balances between HUD's general ledger and Treasury's Government Wide Accounting System. We concluded that the implementation of release 1 confirmed the concerns we cited in our initial review. Although HUD had taken action to mitigate some of the problems that occurred with release 1 and address some of the issues we highlighted, we are concerned that HUD could be moving too fast with its implementation plans and may repeat these weaknesses.

We are also concerned about the current state of FHA's IT systems and the lack of systems capabilities and automation to respond to changes in business processes and the IT operating environment. In August 2009, FHA completed the Information Technology Strategy and Improvement Plan to address these challenges, which identified FHA's priorities for IT transformation. The plan identified 25 initiatives to address specific FHA lines of business needs. Initiatives were prioritized with the top five related to FHA's Single-family program. The FHA transformation initiative was intended to improve the Department's management of its mortgage insurance programs through the development and implementation of a modern financial services IT environment. The modern environment was expected to improve loan endorsement processes, collateral risk capabilities, and fraud prevention. However, to date, few initiatives have been completed because of a lack of funding. The transformation team is in operations and maintenance mode for the few initiatives that have been implemented, and has limited capability to advance with the project due to the continued lack of funding.

Overall, funding constraints diminished HUD's ability to complete the new application systems and phase out and deactivate the outdated systems. Some progress has been made by creating new systems with modernized capabilities that replaced manual processes. However, many legacy systems remain in use. Another concern is the ability to maintain the antiquated infrastructure on which some of the HUD and FHA applications reside. As workloads continue to gain complexity, it becomes more difficult to maintain these legacy systems, which are 15 to 30 years old, and ensure that they can support the current market conditions and volume of activity. The use of aging systems has resulted in poor performance and high maintenance costs. As part of our annual review of information systems controls in support of the financial statements audit, we continue to report

weaknesses in internal controls and security regarding HUD's general data processing operations and specific applications. The effect of these weaknesses is that the completeness, accuracy, and security of HUD information is at risk of unauthorized access and modification.

### Information Systems Security Controls

HUD information systems have extensive amounts of sensitive data, with thousands of entities in the private sector and program officials directly accessing and using HUD applications daily. However, HUD has not adequately planned for its future IT and IT security needs. The primary HUD infrastructure services contract is in a period of transition and the agency has been forced to issue short-term sole-source contracts with the previous vendors to ensure continuation of service. Further, a significant number of critical HUD applications are legacy systems that are increasingly difficult to maintain and present security risks that HUD will be challenged to mitigate without modernization. Legacy systems are difficult or unable to migrate to cloud technology, further complicating the agency's long-term efforts to modernize and secure its systems and data while creating efficiencies and cost savings.

HUD has taken some initial steps to address these long-term challenges. The agency has finally filled and stabilized several key positions including the Chief Information Officer, Chief Information Security Officer, Chief Technology Officer, and Enterprise Architect. Strategic long-term planning documents have been developed, including an Enterprise Architect Roadmap aimed in part at guiding modernization efforts, and a Cybersecurity Framework to address IT security program deficiencies and prioritize initiatives to correct deficiencies. Notable change and implementation from these initiatives is not anticipated to be realized until later this year. Further, successful implementation of these plans will be directly dependent upon the agency's ability to obtain adequate resources including technical expertise. In the process of outsourcing infrastructure and application maintenance and support, HUD has divested itself of much of its technical expertise and continues to face significant staffing challenges. For example, an organizational chart provided to OIG during its FY 2015 FISMA assessment reflected that 17 of the 35 key managerial/supervisory positions stationed at headquarters were either vacant (13) or filled by temporary "acting" personnel (4) during FY 2015. This presents significant challenges to HUD's ability to conduct technical security reviews of its infrastructure (e.g., penetration testing, network assessments) or adequately oversee the technical security provided by vendors.

Meanwhile, our annual evaluation of HUD's IT security program, as mandated by Federal Information Security Management Act (FISMA), has revealed continued and extensive noncompliance with Federal IT guidance. As depicted in OIG's FY 2015 FISMA report, HUD has extensive deficiencies in five of the ten program areas which OIG reports to OMB. HUD is showing progress in remediating these deficiencies; examples include significant upgrades in its security awareness training program, account access management, and issuance of proper guidance for managing Plans of Action and Milestones (POA&Ms). However, the agency has not adequately addressed many long-standing security weaknesses identified in prior OIG evaluations.

### Procurement and Contract Management

In prior years, we have reported on various concerns relating to HUD's procurement and contract management including HUD's information technology infrastructure contracts and HUD's transition to the third generation of its management and marketing contracts that are used to manage and dispose of its extensive inventory of foreclosed Single-family properties. HUD

continues to be challenged by its over-reliance on contractors in general and its ability to allocate sufficient resources to adequately oversee its contractor work force.

HUD has developed several acquisition improvement initiatives to address the long-standing concerns in this area. We recently completed an evaluation to assess the status of these efforts and whether practices used by other agencies would enhance the quality and effectiveness of HUD acquisitions<sup>1</sup>. HUD had made progress in several areas, including revising and updating its procurement handbook and redesigning its web site. However, some initiatives had not been fully implemented or completed on schedule. HUD officials said that additional resources would be needed to effectively implement ongoing and planned improvement efforts. HUD had not developed a sound, cohesive strategy to address its improvement initiatives, and program offices did not all agree on resource requirements and respective responsibilities for their acquisitions staff.

Some of HUD's improvement initiatives did not follow successful program management practices or meet the U.S. Government Accountability Office's criteria for achieving an efficient, effective, and accountable acquisition function. We identified several successful practices of other Federal agencies that would improve HUD's acquisition function by using measurable objectives and goals, building partnerships, engaging stakeholders, managing change, streamlining functions, and training staff.

HUD procurement officials and the program offices did not always collaborate or communicate effectively and did not agree on the best way to address acquisition problems. HUD had also not maintained cost and performance metrics to determine where inefficiencies existed. Program offices continued to experience challenges, and some sought alternatives in shared services arrangements with Federal agencies to accomplish their acquisition objectives because the Department could not do it for them. HUD leadership needs to address these issues, or its acquisition function will remain at risk.

### Single-Family Programs

FHA's Single-family mortgage insurance programs enable millions of first-time borrowers and minority, low-income, elderly, or other underserved households to benefit from home ownership. HUD manages a sizable portfolio of Single-family insured mortgages exceeding \$1.2 trillion. Effective management of this portfolio represents a continuing challenge for the Department.

For the 6 years following the financial crisis of 2008, the FHA fund had failed to meet its legislatively mandated 2 percent capital ratio. From a low following the financial crisis, the fund has shown gradual improvement and, at the end of FY 2015, the capital ratio stood at 2.07 percent. Much of this success is heavily dependent on a strong Home Equity Conversion Mortgage insurance program (HECM), a program we have reported on several times. The HECM program is sensitive to a number of factors that can influence its financial stability which then, in turn, can have a significant impact on the achievement of an adequate capital ratio as mandated by statute. While barely above the mandated level, this improvement is a positive development and occurred a year earlier than predicted at the end of 2014. Restoring the fund's reserves and finances has been a priority for HUD, and it has increased premiums, reduced the amount of equity

---

<sup>1</sup> Evaluation Report 2015-OE-0004, Comprehensive Strategy Needed To Address HUD Acquisition Challenges, February 2, 2016

that may be withdrawn on reverse mortgages, and taken other steps to restore the financial health of the fund.

It is incumbent upon the Department to make every effort to prevent or mitigate fraud, waste, and abuse in FHA loan programs. OIG continues to take steps to help preserve the FHA insurance fund and improve FHA loan underwriting by partnering with the Department, the U.S. Department of Justice, and multiple U.S. Attorney's offices nationwide in a number of FHA lender civil investigations. In some instances, these investigations involve not only the loan underwriting of FHA loans but also the underwriting of conventional loans and government-insured loans related to federal programs other than FHA. For those investigations that involved OIG's assistance on the FHA-related part of the cases, the Government has reached overall civil settlements yielding nearly \$13.2 billion in damages and penalties in the last 4 fiscal years.

For the FHA-insured loans, results in the last 4 fiscal years have shown that a high percentage of loans reviewed should not have been insured because of significant deficiencies in the underwriting. As a result and as pointed out in the beginning of the testimony, the Government has reached civil settlements regarding FHA loan underwriting totaling \$3.5 billion for alleged violations of the False Claims Act; the Financial Institutions Reform, Recovery, and Enforcement Act; and Program Fraud Civil Remedies Act. Nearly \$2.4 billion of the \$3.5 billion is of direct benefit to the FHA insurance fund. Ongoing investigations are expected to lead to additional settlements that will further strengthen the health of the fund.

In spite of these positive steps, we remain concerned about HUD's resolve to take the necessary actions going forward to protect the fund. HUD is often hesitant to take strong enforcement actions against lenders because of its competing mandate to continue FHA's role in restoring the housing market and ensure the availability of mortgage credit and continued lender participation in the FHA program. For example, FHA has been slow to start a rigorous and timely claims review process. OIG has repeatedly noted in past audits and other types of lender underwriting reviews HUD's financial exposure when paying claims on loans that were not qualified for insurance, most recently last year. Adding to this concern, HUD increased its financial exposure by not recovering indemnification losses.

The Reverse Mortgage Stabilization Act of 2013 gave FHA the tools to improve the fiscal safety and soundness of the HECM program in a timelier manner. Despite the ability to quickly make needed changes as appropriate to the program, FHA faces challenges in ensuring that homeowners comply with the principal occupancy requirements (though not all dual HECM's are considered improper). For example, borrowers are not required to repay the loan as long as they continue to occupy the insured property as its principal residence. To date, OIG has completed four audits on the HECM program and compliance with principal occupancy requirements. Our initial audit identified borrowers with more than one HECM loan despite the principal occupancy requirement. Borrowers were able to obtain more than one HECM loan because of a lack of controls in place to identify this noncompliance. The Department has been receptive to our findings and has implemented controls to address this problem.

Departmental clearance is a necessary and important process to ensure requisite agreement by applicable HUD leadership on the subject matter and content of a directive or policy change. This action requires a review by HUD offices that have expertise, policy or legal, with the subject matter of the change and that there is no conflict with other HUD or administration policies.

At a time when FHA is working to restore confidence in the housing market, OIG has concerns that when the Department is making program, policy or procedural changes, it is (1) not identifying the significant changes in its notice, (2) not following the formal clearance process and instead opting for a more informal method, or (3) avoiding the process altogether and making changes unilaterally. For example, in May 2015, HUD issued a notice in the Federal Register seeking OMB approval for information collection. However, OIG believes that the notice did not adequately describe the changes to be made. The Notice proposed to make changes to the loan-level certifications that lenders must make to obtain insurance from FHA. As a result, the certification process became ineffective and allowed loan originators, firms, or principals that have been convicted of certain violations to do business with FHA. However, this detail was not provided in the notice. Another example is FHA's Single-Family Housing Loan Quality Assessment Methodology (Defect Taxonomy). The goal of this methodology is to give lenders better clarity on the quality assurance reviews of their FHA loans. Although HUD stated that the draft Taxonomy documents had been published on FHA's Drafting Table web site, FHA did not follow the proper protocol for issuing a new directive. These changes fit the description of a directive change and should have been announced through the proper steps and clearance process as outlined in its own Handbook.

FHA also remains vulnerable to criminal activity and single-family criminal investigations continue to be a priority of my office. We recently concluded an investigation of Great Country Mortgage Bankers, a former FHA mortgage lender in Miami, FL. The owner of the company was sentenced in U.S. District Court to 135 months incarceration and 60 months supervised release and agreed to forfeit \$8 million following his conviction of conspiracy to commit wire fraud affecting a financial institution. From at least 2006 through September 2008, the owner and other conspirators specialized in approving FHA loans primarily for buyers of condominiums at complexes where he had an ownership interest. As part of the scheme, the conspirators provided false information on loan documents to qualify borrowers and in some cases, also paid inducements to borrowers to purchase the condominium units. Many of the loans defaulted, causing losses to FHA and financial institutions. To date, 25 individuals have been charged in this investigation, including the owner, 3 partner developers, and 20 former employees of the mortgage lender. Of those charged, 14 individuals have pled guilty, and 1 has signed a plea agreement. Losses to FHA exceeded \$64 million. This case, and others, highlight why the HUD OIG believes that FHA needs to remain diligent in its efforts, including keeping or enhancing practices that oversee and monitor abusive or wasteful behavior, aimed at those who seek to harm the viability of the program and ultimately the public.

Over the past 5 years, Ginnie Mae has seen its outstanding mortgage-backed securities increase by more than 50 percent and has experienced its fastest growth in the last 6 years. As of August 2015, Ginnie Mae's mortgage-backed securities (MBS) portfolio exceeded \$1.6 trillion and is estimated to reach the \$2 trillion mark in a little over a year and a half. We remain concerned that increases in demand on the FHA program are having collateral implications for the integrity of Ginnie Mae's MBS program, including the potential for increases in fraud. Ginnie Mae securities are the only mortgage-backed securities to carry the full faith and credit guaranty of the United States. If an issuer fails to make the required pass-through payment of principal and interest to MBS investors, Ginnie Mae is required to assume responsibility for it. Typically, Ginnie Mae defaults the issuer and assumes control of the issuer's government or agency MBS pools. Historically, Ginnie Mae issuer defaults have been infrequent, involving small to moderate-size issuers. However, major unanticipated issuer defaults beginning in 2009 have led to a multi-billion-dollar rise in Ginnie Mae's nationwide mortgage servicing as well as its repurchase of billions of dollars in defaulted

whole loans to meet its guarantee commitments to MBS investors. In the near term, these changes have strained both its operating and financial resources.

Another key challenge facing Ginnie Mae is the risk posed by the growing number of Ginnie Mae issuers that are institutions other than banks. In June 2011, 7 of the top 10 servicers were banks, but by September 2015, only 4 of the top 10 servicers were banks. Ginnie Mae's potential for losses occurs when an issuer fails to fulfill its responsibilities. With the significant shift of its business going to nonbanks, Ginnie Mae can no longer rely on the Office of the Comptroller of the Currency and other bank regulators to ensure that its servicers can meet their financial obligations. To mitigate the risks, Ginnie Mae will need to be more involved with nonbanks to adequately monitor them, which would require Ginnie Mae to increase its current staffing level and expertise.

With the approval of OMB and Congress, Ginnie Mae has significantly increased its management capacity. The total number of Ginnie Mae full-time employees increased from 89 in fiscal year 2012 to 130 at the end of fiscal year 2015. However, Ginnie Mae continues to rely heavily on third-party contractors to perform almost all key operating loan servicing, pool processing, and other functions. It is imperative to the country's larger financial health that Ginnie Mae be able to increase staffing with the needed skills, knowledge, and abilities to manage a \$1.6 trillion program.

Ginnie Mae could benefit from an estimated 30 positions with a higher salary level than what the general schedule allows in order to attract the needed and specialized skill sets to operate in the U.S. financial market. HUD's lack of human capital management support and a weak procurement process have contributed to Ginnie Mae's inability to promptly recruit and hire needed skills as well as hampered its ability to operate swiftly and timely in the marketplace.

#### Public and Assisted Housing Program Administration

HUD provides housing assistance funds under various grant and subsidy programs to public housing agencies (PHA) and multifamily project owners. These intermediaries, in turn, provide housing assistance to benefit primarily low-income households. The Office of Public and Indian Housing (PIH) and the Office of Multifamily Housing Programs provide funding for rent subsidies through public housing operating subsidies and the tenant-based Section 8 Housing Choice Voucher and Section 8 multifamily project-based programs. More than 4,000 intermediaries provide affordable housing for 1.2 million households through the low-rent operating subsidy public housing program and for 2.2 million households through the Housing Choice Voucher program. Multifamily project owners assist more than 1.5 million households.

#### Housing Choice Voucher Monitoring

HUD has a challenge in monitoring the Housing Choice Voucher program. The program is electronically monitored through PHAs' self-assessments and other self-reported information collected in PIH's systems. Based on recent audits and HUD's on-site confirmatory reviews, the self-assessments are not always accurate and the reliability of the information contained in PIH systems is questionable. PIH targets PHAs for various types of on-site reviews using its Utilization Tool and National Risk Assessment Tool. It also states that it will further address limitations with the Next Generation Management System, which continues to be delayed due to a shortage in IT funding. HUD will continue to face challenges in monitoring this program until it has fully implemented a reliable, real-time, and all-inclusive monitoring tool.

### Central Office Cost Centers

We are concerned that HUD may not be ensuring that defederalized administrative fees paid to PHAs for their public housing program are reasonable. We found that HUD could not adequately support the reasonableness of operating fund management, book-keeping, and asset management fees and Public Housing Capital Fund management fee limits. In addition, HUD lacked adequate justification for allowing PHAs to charge an asset management fee, resulting in more than \$81 million in operating funds being unnecessarily defederalized annually. Our concern continues to be that the fee amounts implemented are not supported and may not be reasonable. Excess administrative fees, if defederalized, are not required to be used for the public housing program. Ensuring that only the funds that are needed are transferred to the COCC will allow more funds to be used directly for the public housing program. After input from OMB, HUD and OIG have reached an agreement to implement the recommendations as stated in our audit report. HUD has agreed to refederalize the fees and will be reevaluating the fee amounts. HUD will need to go through the rulemaking process to fully implement the changes, so it may take some time.

### Cash Management Requirements

In fiscal year 2012, PIH implemented procedures to reduce the amount of excess funds accumulating in PHAs' net restricted asset accounts in accordance with Treasury's cash management requirements as directed by a congressional conference report. By that point, a significant amount of reserves had accumulated with the PHAs. As of 2015, most of the funds had been transitioned back to HUD. However, PIH has not transitioned any of the excess funding from its Moving to Work (MTW) program PHAs. Through PIH's confirmation process, MTW PHAs reported holding \$556 million and \$514 million, as of September 30, 2014, and March 31, 2015, respectively. PIH must now validate these balances before it transitions the funds back. This process may take some time because the composition of these balances is complex and HUD was not tracking the funds for these agencies. Until HUD validates and collects the funds, MTW PHAs will continue to hold hundreds of millions of dollars in excess of their immediate disbursement needs, making the funds susceptible to fraud, waste, and abuse. Further, this is a continued departure from Treasury's cash management requirements.

Adding to this challenge, HUD continues to lack an automated process to complete the reconciliations required to monitor all of its PHAs and to ensure that Federal cash is not maintained in excess of immediate need. Reconciliations are prepared manually on unprotected Excel spreadsheets for more than 2,200 PHAs receiving approximately \$17 billion annually. This process is time consuming, antiquated and labor intensive, and does not allow for accurate financial reporting at the transaction level as required by FFMIA. This process also increases the risk of error and causes significant delays in the identification and offset of excess funding. We recommended that HUD automate this process during our 2013 financial statement audit, and the matter has been elevated to the Deputy Secretary for a decision.

### Monitoring of Moving to Work Agencies

HUD's monitoring and oversight of the 39 PHAs participating in the MTW demonstration program is particularly challenging. The MTW program provides PHAs the opportunity to develop and test innovative, locally-designed strategies that use Federal dollars more efficiently, help residents become self-sufficient, and increase housing choices for low-income families. However, in the

more than 15 years since the demonstration program began, HUD has not reported on whether the program is meeting its objectives which such a long-standing demonstration should assert. This is particularly important as under the MTW program participants receive less oversight from the Department. HUD has requested and Congress is considering expanding the program to include more participants without knowing whether participating PHAs are reducing costs to gain increased housing choices and incentives for families to work. HUD is experiencing challenges in developing program-wide performance indicators that will not inhibit the participants' abilities to creatively impact the program. It is developing renewal contracts to replace contracts expiring in 2018. HUD management developed new metrics to help measure program performance and states that the new contracts will allow it to better evaluate each PHA's performance. We continue to believe that this is essential before new agencies are allowed into the program. Moreover, HUD could benefit from a formalized process for terminating participants from the demonstration program for failure to comply with their agreement.

### Overincome Families in Public Housing

HUD's challenge in addressing overincome families living in public housing units is exacerbated by public housing agencies' lack of desire to address these issues themselves. HUD's December 2004 final rule gave public housing authorities discretion to establish and implement policies that would require families with incomes above the eligibility income limits to find housing in the unassisted market. HUD regulations require families to meet eligibility income limits only when they are admitted to the public housing program. Neither public law nor regulations limit the length of time that families may reside in public housing. Our recent audit<sup>2</sup> showed that as many as 25,226 families, whose income exceeded HUD's 2014 eligibility income limits, lived in public housing. The PHAs that we contacted during the audit chose not to impose limits based on the notice. In response to our audit, PIH initially disagreed. After some public discourse, HUD issued a letter to PHA executive directors, strongly encouraging them to use the discretion available to them to remove extremely overincome families from public housing. However, HUD does not have the authority to require PHAs to implement limits. Consequently, to comply with our recommendation, HUD initiated the rulemaking process through an advanced notice of proposed rulemaking. Through this process, HUD will collect public comments from stakeholders and determine how to proceed with rulemaking. We will be part of this process. Our concern is that a nationwide policy may limit flexibility to protect tenants. Until a new final rule is established, PIH will need to find a way to encourage PHA participation and ensure the effectiveness of its policies.

### Environmental Review Requirements

In recent reports,<sup>3</sup> we demonstrated that PIH did not adequately implement environmental requirements or provide adequate oversight to ensure compliance with these requirements. The

---

<sup>2</sup> Audit Report 2015-PH-0002, Overincome Families Resided in Public Housing Units, July 21, 2015

<sup>3</sup> Audit Report 2015-FW-0001, HUD Did Not Adequately Implement or Provide Oversight To Ensure Compliance With Environmental Requirements, June 16, 2015; Audit Report 2014-FW-0005, Improvements Are Needed Over Environmental Reviews of Public Housing and Recovery Act Funds in the Detroit Office, September 24, 2014; Audit Report 2014-FW-0004, Improvements Are Needed Over Environmental Reviews of Public Housing and Recovery Act Funds in the Greensboro Office, July 14, 2014; Audit Report 2014-FW-0003, Improvements Are Needed Over Environmental Reviews of Public Housing and Recovery Act Funds in the Columbia Office, June 19, 2014; Audit Report 2014-FW-0002, Improvements Are needed Over Environmental Reviews of Public Housing and Recovery Act Funds in the Kansas City Office, May 12, 2014; and Audit Report 2014-FW-0001, The Boston Office of Public Housing Did Not Provide Adequate Oversight of Environmental Reviews of Three Housing Agencies, Including Reviews Involving Recovery Act Funds, February 7, 2014



Offices of Housing and Public Housing did not adequately monitor or provide training to their staff, grantees, or responsible entities on how to comply with environmental requirements. Also, HUD did not have an adequate reporting process for the program areas to ensure that the appropriate headquarters programs were informed of field offices' environmental concerns. Further, our review of five Office of Public Housing field offices found that none of them followed environmental compliance requirements. HUD relied heavily on its Office of Environment and Energy to ensure compliance with environmental requirements. HUD stated that cross-office collaboration should be encouraged as a sensible and efficient way to achieve oversight and compliance objectives. While HUD shares OIG's concerns regarding responsible entities' compliance with environmental requirements and agreed with our recommendations, HUD believes that the program offices do not always have the authority to impose corrective actions or sanctions. We provided several examples in which environmental issues, if not detected, can severely impact the residents and communities as well as consume significant resources.

As a result, HUD began providing more training to staff and grantees and implemented processes to improve its training program and curriculum to better support all program areas. Also, HUD was piloting a recently developed electronic data system, HUD's Environmental Review Online System (HEROS), which is part of HUD's transformation of IT systems. HEROS will convert HUD's paper-based environmental review process to a comprehensive online system that shows the user the entire environmental process, including compliance with related laws and authorities. It will allow HUD to collect data on environmental reviews performed by all program areas for compliance. HUD's Office of Environment and Energy had also implemented an internal process within HEROS to track findings, which will allow the program areas to focus training on recurring issues.

While HUD has made improvements, it faces several challenges, including lack of resources, unclear guidance, and a perceived lack of authority to impose corrective actions or sanctions on responsible entities. Until HUD fully addresses these needed improvements, it faces an increased risk of creating a potential human health and safety concern as well as possible damage to the environment. For the five Office of Public Housing field offices we visited, PHAs spent almost \$405 million for activities that either did not have required environmental reviews or had reviews that were not adequately supported.

#### Physical Condition of the Housing Choice Voucher Units

In response to a 2008 audit report,<sup>4</sup> HUD developed a plan to monitor the physical condition of its Housing Choice Voucher program units. HUD is testing a system of inspections similar to the model used for its public housing units and multifamily projects. However, this testing with an initial target completion date of September 30, 2014, is taking considerably longer than expected. HUD has performed initial inspections of a sample of its voucher units. However, it needs resources to continue developing the new protocol and related software for its comprehensive monitoring system. Meanwhile, we continue to identify PHAs with inspection programs which do not ensure that voucher program units comply with standards.

---

<sup>4</sup> Audit Report 2008-AT-0003, HUD Lacked Adequate Controls Over the Physical Condition of Section 8 Voucher Program Housing Stock, May 14, 2008

## OIG's Fraud Prevention Program

To assist the department in addressing these various issues, my office has initiated a fraud prevention program. A key component of this is a series of Integrity Bulletins to aid commissioners and public housing executives to identify red flags of fraud and mismanagement. The series includes topics such as Procurement and Contracting, Embezzlement, Charge Cards, Fraud Policy, Hiring, and a Primer for Commissioners. These bulletins are available on the OIG public web site. To further alert public housing boards and directors of these bulletins, a direct emailing went out July 2015 that was signed jointly by Principal Deputy Assistant Secretary Lourdes M. Castro Ramírez and me. The letter emphasized that public trust and integrity is a collective responsibility, and encourages recipients to read and share the Integrity Bulletins.

The fiscal year 2014 appropriation language required HUD to work jointly with the OIG "...to determine the critical skills that PHA boards should have to effectively oversee PHA operations, as well as the actions HUD will take to ensure that PHAs possess them..." HUD has since developed a web-based training program for boards of commissioners. The training, named "Lead the Way" includes the basic skills and knowledge commissioners need to understand their roles and responsibilities. HUD is now in a second phase working with our office to update the training to add skills and knowledge for identifying risks and responding to them. The training will also cover identifying common fraud and mismanagement issues and how to report cases to OIG. The target for completion of the training is mid-summer 2016.

One challenge that has not been resolved is how to get commissioners to complete this training. HUD has no authority to require completion of the training of the boards (or PHA executive staff either). HUD reports that about 500 commissioners have completed the training. Industry group training for commissioners appears to have the same problem in getting commissioners to attend training with 300 commissioners being certified by the National Association of Housing and Redevelopment Officials, and a similar number being certified through the Public Housing Authority Directors Association. All these together have trained and certified about seven percent of commissioners.

Professional certification for public housing commissioners and executive directors exists in a conflicting array of certificates offered by public housing industry groups. While these certification programs are available, completion of the training is not a requirement to serve as a commissioner or executive director.

We believe it would take congressional action to require boards and key executive staff to be certified. A certification body needs to be designated, with HUD approval of a curriculum, and timeframes established for phasing in the requirement. A requirement would also be useful that would establish a deadline for successfully completing the training. Certification of executive directors should likewise be mandated for at least medium and larger size agencies.

## **Administering Programs Directed Toward Victims of Disasters**

The Department faces significant challenges in monitoring disaster program funds provided to various States, cities, and local governments under its purview. This challenge is particularly pressing for HUD because of the limited resources to directly perform oversight, the broad nature of HUD projects, the length of time needed to complete some of these projects, the ability of the Department to waive certain HUD program requirements, and the lack of understanding of disaster assistance grants by the recipients. HUD must ensure that the grantees complete their projects in a

timely manner and that they use the funds for intended purposes. Since HUD disaster assistance may fund a variety of recovery activities, HUD can help communities and neighborhoods that otherwise might not recover due to limited resources. However, oversight of these projects is made more difficult due to the diverse nature of HUD projects and the fact that some construction projects may take between five and ten years to complete. HUD must be diligent in its oversight to ensure that grantees have identified project timelines and are keeping up with them. HUD also must ensure that grantee goals are being met and that expectations are achieved.

My office has completed 16 audits and 1 evaluation relating to CDBG-DR funding for Hurricane Sandy and other eligible events occurring in calendar years 2011, 2012, and 2013. There are a number of other audits and evaluations, as well as investigative work, that are currently underway. Prior to Hurricane Sandy, HUD-OIG had extensive audit and investigative experience with HUD's CDBG-DR program, most notably, with grants relating to recovery after Hurricane Katrina and the terrorist attacks of September 11, 2001. Over the years, HUD has gained more experience and has made progress with assisting communities recovering from disasters, but it continues to face the following challenges in administering these grants:

- 1) Ensuring that expenditures are eligible and supported;
- 2) Approving the program waiver process;
- 3) Certifying that grantees are following Federal procurement regulations;
- 4) Conducting consistent and sufficient monitoring efforts on disaster grants;
- 5) Promoting disaster resiliency within communities trying to recover; and
- 6) Keeping up with communities in the recovery process.

I will elaborate on the first two areas above as they represent the most serious challenges faced by HUD.

#### *Ensuring That Expenditures Are Eligible and Supported*

In overseeing the CDBG-DR program, HUD must ensure that funds disbursed for disaster recovery programs are used for eligible and supported items. Our audits relating to Hurricane Sandy funding have identified \$3.5 million in ineligible costs, \$458 million in unsupported costs, and \$360 million relating to recommendations that funds be put to better use. We have highlighted three audit reports that demonstrate these challenges for HUD in administering grants made under this program:

- In our review of New York City's Health and Hospitals Corporation,<sup>5</sup> we determined that City officials disbursed \$183 million to the City's subrecipient for unsupported salary and fringe benefits and unreasonable and unnecessary expenses and did not adequately monitor its subrecipient and sufficiently document national objectives. As a result, City officials could not assure HUD that (1) \$183 million in CDBG-DR funds was disbursed for eligible, reasonable, and necessary program expenses and (2) going forward the City will have adequate accounting and financial controls in place to ensure the remaining allocation of \$40 million will be properly spent for the purposes intended.
- In our review of New Jersey's Sandy Integrated Recovery Operations and Management

---

<sup>5</sup> Audit Report 2015-NY-1001, The City of New York, NY, Did Not Always Disburse Community Development Block Grant Disaster Recovery Assistance Funds to Its Subrecipient in Accordance With Federal Regulations, November 24, 2014

System, we found that the State did not procure services and products for its system in accordance with Federal procurement and cost principle requirements. The State's procurement process was not equivalent to Federal procurement standards. As a result, it disbursed \$38.5 million for unsupported costs. It was also planning to disburse another \$21.7 million to extend the initial period of the related contract for 3 additional options years including \$9.1 million for costs that it had not shown were fair and reasonable.

- In our review of New York State's buyout program,<sup>6</sup> we determined that officials did not always administer the program in accordance with program procedures. As a result, officials disbursed \$6.6 million for properties that did not conform to published requirements. This amount included \$672,000 and \$598,300 for ineligible incentives and purchase prices in excess of authorized limits, respectively. In addition, documentation was inadequate to support that \$1.7 million was disbursed for eligible purchases and that \$8.7 million spent for contracts complied with Federal or State requirements.
- In our review of the New York Rising Housing Recovery Program,<sup>7</sup> we found that officials did not establish adequate controls to ensure that CDBG-DR funds were awarded and disbursed for eligible costs. As a result, more than \$2.2 million in CDBG-DR funds was disbursed for ineligible costs and \$119,124 for unsupported costs. Additionally, the use of a statewide cost figure, by which more than \$87.5 million was awarded, was unsupported. Also, State officials needed to ensure that receipts were available to support work completed, or request that more than \$241.2 million be repaid.

We attributed these conditions to the grantees' weaknesses in maintaining file documentation, unfamiliarity with HUD rules and regulations, and failure to follow State and Federal procurement regulations.

### Approving the Program Waiver Process

We performed two reviews of the State of Louisiana's Road Home Elevation Incentive (RHEI) Program, in 2010<sup>8</sup> and a follow-up review in 2012<sup>9</sup>. Based on these reviews, it appears that HUD has established a pattern and practice to either waive the program requirements, or retroactively approve the State's amended action plan after the fact, when deficiencies are identified with this program. The initial review's objective was to determine whether homeowners used funds to elevate their homes as set out in their grant agreements. The review found that 79 percent of the homes we inspected had not been elevated, strongly suggesting that the grant program was at risk and could fail to achieve its intended goal of reducing homeowner flood risks from future hurricanes. Our follow-up review found that as of August 31, 2012, the State did not have conclusive evidence that approximately \$698.5 million in CDBG-DR funds provided to 24,000 homeowners had been used to elevate homes. As an example of HUD's practice to minimize or eliminate original program requirements, HUD approved the State's Amendment 60 on July 26,

---

<sup>6</sup> Audit Report 2015-NY-1010, New York State Did Not Always Administer Its Rising Home Enhanced Buyout Program in Accordance with Federal and State Regulations, September 17, 2015

<sup>7</sup> Audit Report 2015-NY-1011, Program Control Weaknesses Lessened Assurance That New York Rising Housing Recovery Program Funds Were Always Disbursed for Eligible Costs, September 17, 2015

<sup>8</sup> Inspections and Evaluations Report IED-09-002, Inspection of the State of Louisiana's Road Home Elevation Incentive Program Homeowner Compliance, March 2010

<sup>9</sup> Audit Report 2013-IE-0803, Follow-up of the Inspections and Evaluations Division on Its Inspection of the State of Louisiana's Road Home Elevation Incentive Program Homeowner Compliance (IED-09-002 March 2010), March 29, 2013

2013, which retroactively allowed homeowners who received a grant under Road Home to prove that they used those funds to either elevate or rehabilitate their home, although the grant was specifically intended for elevation only. The amendment is contrary to the elevation incentive agreement which stated that the funds were intended to assist homeowners to only elevate their homes. If the funds were not used for this sole purpose, they were to be repaid to the State.

In August 2015, HUD again unilaterally waived the Road Home program requirements. Specifically, HUD changed its 2013 documentation requirement for rehabilitation expenses to permit an affidavit by the homeowner and a “valuation inspection” by the State to determine the value of home repairs that were previously performed. This waiver of requirements was due to the fact that it was still having difficulty acquiring documentation from homeowners as proof of repair. This new approach does not consider whether recipients previously received grants or insurance funds for rehabilitation and could result in a duplication of benefits. While Congress provided considerable flexibility in the use of CDBG-DR funds, it specifically required HUD to establish procedures that prevent duplication of benefits.

HUD has not properly enforced the intent of the Road Home program, instead opting to change the rules ex post facto so that violations can potentially be excused. If HUD wishes to implement proper risk management in its programs, this most recent action seems to defeat the purpose as it announces to all recipients of HUD funds that noncompliance may be pardoned because the Department will allow it in the end with no consequences for divergent actions.

HUD’s actions, and retreat from its position and the original intent of the approved State action plans, diminishes HUD’s ability to properly administer grant agreements, provide proper oversight and enforcement when needed, and lessens the affected homeowners’ trust and confidence that HUD maintains the highest standards of efficiency and fairness in its grant award process.

### Government-wide Concerns

In view of the significance of funding to multiple agencies to address Hurricane Sandy, my office is leading a joint cross-cutting review with seven other OIGs<sup>10</sup> to assess participating Federal entities’ funding, expenditures, and monitoring. Our objective is to identify common concerns and make recommendations to improve oversight, enhance collaboration, and report on best practices.

As noted earlier, Congress imposed time limits with respect to the funding it provided to HUD in the Disaster Relief Appropriations Act, 2013. Funding for other agencies either included varying time limits or, in some cases, imposed no time limit and will remain available until spent. Based upon our audits of funds relating to prior disasters, we believe that imposing statutory deadlines will help to ensure that funds are promptly spent. HUD is not alone in facing challenges with timely expenditure of funding. A representative from the Department of Homeland Security’s OIG told us that FEMA disaster funds remained unspent for extended periods and FEMA still had unspent funding relating to the Northridge earthquake (more than 21 years ago) and Hurricane Katrina (more than 10 years ago).

---

<sup>10</sup> In addition to HUD-OIG, OIGs from the following agencies are participating: Department of Homeland Security, Department of Health and Human Services, Department of Defense, Department of the Interior, Department of Transportation, Small Business Administration, and Environmental Protection Agency.

Funding for oversight activities also varied. Separate funding was provided to both HUD and HUD-OIG for oversight. The Department of Health and Human Services, which received more than \$500 million in funding, also received funding for its OIG but not for the agency to conduct administrative oversight. OIGs from the Department of the Interior, Environmental Protection Agency and the Department of Defense did not receive separate funding to provide for oversight of their respective agencies' funding that ranged from \$577 million to more than \$5 billion.

Our collaboration with other OIGs has noted a common concern with respect to time limits being placed on oversight funding relating to Hurricane Sandy. As is the case with HUD CDBG-DR funds, HUD-OIG's funding must be obligated by the end of fiscal year 2017. This presents a challenge for HUD-OIG because much of the expenditure activity under the CDBG-DR program will occur well after that date, as late as the end of fiscal year 2022. In addition, a waiver was obtained that allows the Department to extend program funds beyond the original deadline. It is unclear from the current statutory language whether HUD-OIG will be able to use its Sandy funding beyond the obligation deadline. HUD-OIG is planning to seek an opinion on the specific appropriation issue from the GAO.

As of the end of fiscal year 2015, over 70 percent of HUD's Hurricane Sandy funding remains unspent and until the bulk of that funding is spent, our ability to conduct effective oversight is limited. This is a concern with at least two other OIGs who have expressed similar concerns with the slow rate at which their respective agencies are using their disaster assistance funding. I urge the Congress to recognize that oversight activities conducted by the various agencies and their OIGs need to occur well beyond the obligation deadline and to consider providing relief to the affected organizations to extend the date at which these oversight funds will expire.

### **Community Planning and Development Programs**

Due to the use of what the Department calls the FIFO method (first-in, first-out as an accounting methodology of appropriated funds)<sup>11</sup> for committing and disbursing obligations, HUD's accounting for its Community Planning and Development formula grant programs' accounting does not comply with accounting standards resulting in material misstatement of HUD's financial statements. Since 2013, we have also reported that the information system used, the Integrated Disbursement Information System (IDIS) Online, a grants management system, was not designed to comply with Federal financial management system requirements. Further, HUD's plan to eliminate FIFO from IDIS Online was applied to fiscal year 2015 and future grants and not to fiscal years 2014 and earlier. Moreover, because of funding problems, completion of the elimination plan will be delayed until December 2016.

As a result, budget year grant obligation balances continued to be misstated and disbursements made using an incorrect U.S. Standard General Ledger (USSGL) attribute resulted in additional misstatements. Although FIFO has been removed from fiscal year 2015 and forward grants, modifications to IDIS were necessary for the system to comply with the Federal Financial Management Improvement Act (FFMIA) and USSGL transaction records.

---

<sup>11</sup> The FIFO method is a way in which CPD disburses its obligations to grantees. Disbursements are not matched to the original obligation authorizing the disbursement, allowing obligations to be liquidated from the oldest available budget fiscal year appropriation source. This method allows disbursements to be recorded under obligations tied to soon-to-be-canceled appropriations.

The inability of IDIS Online to provide an audit trail of all financial events affected by the FIFO method made it impossible to quantify the financial effects of FIFO on HUD's consolidated financial statements. Further, because of the amount and pervasiveness of the funds susceptible to the FIFO method and the noncompliant internal control structure in IDIS Online, the obligated and unobligated balance brought forward and obligated and unobligated balances reported in HUD's combined statement of budgetary resources for fiscal year 2015 and in prior years were materially misstated. The effects of not removing the FIFO method retroactively will continue to have implications on future years' financial statement audit opinions until the impact is assessed to be immaterial.

HUD's continued inability to provide data to monitor compliance with the HOME Investment Partnership Act (HOME statute) requirements for committing and spending funds continues to remain a concern until appropriate system changes in IDIS Online are implemented and regulatory changes are fully implemented. The HOME Investment Partnerships Program is the largest Federal block grant to State and local governments designed to create affordable housing for low-income households. Because HOME is a formula-based grant, funds are awarded to the participating jurisdictions noncompetitively on an annual basis.

In 2009, OIG challenged HUD's cumulative method<sup>12</sup> for determining compliance with section 218(g) of the HOME statute, which requires that any uncommitted funds be reallocated or recaptured after the expiration of the 24-month commitment deadline. After a continuous impasse with HUD, OIG contacted GAO in 2011 and requested a formal legal opinion on this matter. In July 2013, GAO issued its legal opinion affirming OIG's position and citing HUD for noncompliance. In its decision, GAO repeated that the language in the statute was clear and that HUD's cumulative method did not comply with the statute. Accordingly, GAO told HUD to stop using the cumulative method and identify and recapture funds that remain uncommitted after the statutory commitment deadline.

The effects of the GAO legal opinion require extensive reprogramming and modification to IDIS Online in addition to regulatory changes. However, these system and regulatory changes, which are already underway, will apply only to new grants awarded going forward and will not be changed retrospectively. Therefore, HUD's plan does not comply with the GAO legal opinion and allows grantees to spend HOME program funding that would normally be recaptured if the 24-month commitment timeframe was not met.

Compliance with GAO's opinion would enable HUD to better monitor grantee performance in a more timely, efficient, and transparent way. It also would strengthen internal controls, bring HUD into compliance with HOME statutory requirements, and accurately and reliably report financial transactions.

On June 16, 2015, we issued a memorandum to HUD regarding potential Anti-Deficiency Act (ADA) violations due to the noncompliance issues noted above. In the memorandum, we requested that the Chief Financial Officer (1) open an investigation and determine the impact of FIFO and the cumulative method for commitments for the HOME program on HUD's risk of an ADA violation; (2) as part of the violation, obtain a legal opinion from GAO and OMB to

---

<sup>12</sup> HUD implemented a process, called the cumulative method, to determine a grantee's compliance with the requirements of section 218(g) of the Statute and determine the amount to be recaptured and reallocated with section 217(d). HUD measured compliance with the commitment requirement cumulatively, disregarding the allocation year used to make the commitments.

determine whether maintaining the cumulative method for determining compliance with the HOME statute results in noncompliance with the Statute and potential ADA violations; and (3) if HUD incurred an ADA violation, comply with the reporting requirements at 31 U.S.C. (United States Code) 1351 and 1517(b) and OMB Circular No. A-11, Preparation, Submission, and Execution of the Budget, section 145, (June 21, 2005). We determined that HUD has opened an ADA investigation in response to our memorandum.

We will continue to report that HUD is not in compliance with laws and regulations until the cumulative method is no longer used to determine whether commitment deadlines required by the HOME Investment Partnership Act are met by the grantees.

### Subgrantee Monitoring

In fiscal years 2014 and 2015, at least seven of our audits have found that in some instances, little or no monitoring occurred, particularly at the subgrantee level. HUD focuses its monitoring activities at the grantee level through its field offices. Grantees, in turn, are responsible for monitoring their subgrantees. HUD should continue to stress the importance of subgrantee monitoring to its grantees. OIG has concerns regarding the capacity of subgrantees receiving funding from HUD programs, including grantees receiving CDBG Disaster Recovery (CDBG-DR) funds. Therefore, audits of grantees and their subgrantee activities will continue to be given emphasis this fiscal year as this continues to be a challenge for HUD and its grantees.

### OIG Prevention Activities

To assist the Department with these and other Community Planning and Development Program concerns, we are currently working with HUD staff to issue a series of bulletins similar to the topics we have issued for public housing but adapting them to Community Planning and Development program grantees. The first of the series is scheduled for issuance in May. These will also be announced through a joint communique, signed by Principal Deputy Assistant Secretary Harriet Tregoning and me, to encourage public official to read and share the bulletins.

### **Compliance with the Improper Payments Elimination and Recovery Act of 2010**

For the second year in a row, we determined that HUD did not comply with the Improper Payments Elimination and Recovery Act of 2010 (IPERA). Specifically, our fiscal year 2015 audit<sup>13</sup> found that HUD did not adequately report on its supplemental measures and its risk assessment did not include a review of all relevant audit reports. Additionally, we found that HUD's estimate of improper payments due to billing errors was based on out-of-date information, a finding that was repeated from the prior-year audit.

After exceeding the targeted improper payment rate of 3.8 percent in fiscal year 2012, HUD's goal for the targeted improper payment rate was increased to 4.2 percent for fiscal year 2013. While HUD met its fiscal year 2013 goal with an improper payment rate of 3.2 percent, with estimated improper payments of \$1.03 billion, it continues to face significant challenges to comply with the requirements of IPERA and further reduce its improper payments.

For example, without sufficient funding, it will be difficult for HUD to perform the studies needed to update its estimates of improper payments due to billing errors. Additionally, there were several

---

<sup>13</sup> Audit Report 2015-FO-0005, Compliance With the Improper Payments Elimination and Recovery Act of 2010, issued May 15, 2015



recommendations from our fiscal year 2014 audit report<sup>14</sup> without agreed-upon management decisions that had to be referred to the Deputy Secretary. During fiscal year 2015, HUD increased its efforts to address these recommendations, as well as current-year recommendations, and develop corrective action plans. HUD needs to continue its efforts to address our recommendations and improve its processes for reporting on its improper payments to become compliant with IPERA in the future.

### **Departmental Enforcement**

A common thread underlying several of the issues discussed earlier is the lack of a cohesive departmental approach on monitoring and follow-through on findings. In an evaluation we conducted on the effectiveness of the Departmental Enforcement Center (DEC), we found that the Department does not have an enterprise risk management approach to monitoring. Its monitoring is for the most part siloed in each program office and the approaches and results differ greatly. While there were some successes, there is a much greater task that lies ahead. The DEC, working with the Office of Multifamily Housing Programs and the Real Estate Assessment Center, improved housing physical conditions and financial management of troubled multifamily properties. Although some other program offices had taken steps toward risk-based enforcement, they had not taken full advantage of the benefits demonstrated when programs allow the DEC to assess compliance and enforce program requirements. The DEC proved that it can remedy poor performance and noncompliance when programs are willing to participate in enforcing program requirements.

The DEC was established in part to overcome a built in conflict of roles. The HUD management reform plan stated that program offices had a conflicting role in getting funds to and spent by participants versus holding them accountable when fraud or mismanagement of the funds occurs. However, memoranda of understanding between the DEC and the program offices, for the most part, limit the DEC's ability to monitor, report, and take action to end noncompliance.

HUD is starting to make some changes. Recent attention has emphasized the point that improvements are necessary for the DEC, REAC and Office of Multifamily Housing to effectively oversee its aging portfolio. PIH is working with the DEC to identify risk-based triggers to target monitoring, and the Chief Financial Officer is leading a Departmental task force looking at enterprise risk management. The Department should strive for a Department-wide risk monitoring approach that is data driven and supports taking actions that will end noncompliance or will seek the return of funds or other enforcement steps when corrective actions are ignored.

### **Conclusion**

The Department's role has greatly increased over the last decade as it has had to deal with unanticipated disasters and intervening economic crises, in addition to its other missions, that have increased its visibility and reaffirmed its vital role in providing services that impact the lives of our citizens. My office is strongly committed to working with the Department and the Congress to ensure that these important programs operate efficiently and effectively and as intended for the benefit of the American taxpayers now and into the future.

---

<sup>14</sup> Audit Report 2014-FO-0004, Compliance With the Improper Payments Elimination and Recovery Act of 2010, issued April 15, 2014