Memorandum

TO: Julian Castro
   Secretary, S

FROM: David A. Montoya
       Inspector General, G

SUBJECT: Management and Performance Challenges for Fiscal Year 2016 and Beyond

In accordance with Section 3 of the Reports Consolidation Act of 2000, the Office of Inspector General is submitting its annual statement to summarize its current assessment of the most serious management and performance challenges facing the U.S. Department of Housing and Urban Development (HUD or Department) in fiscal year 2016 and beyond. Through our audits, evaluations, and investigations, we work with departmental managers to recommend best practices and actions that help address these challenges. More details of these efforts are included in our Semiannual Reports to Congress.

The Department’s primary mission is to create strong, sustainable, inclusive communities and quality, affordable homes for all. HUD accomplishes 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, oversight of HUD-approved lenders that originate and service FHA-insured loans, and Government National Mortgage Association mortgage-backed security issuers that provide mortgage capital. HUD relies on 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, and other Federal agencies with which HUD coordinates to accomplish its goals. HUD also has a substantial responsibility for administering disaster assistance programs.

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 programs. The attachment discusses our assessment of nine key management and performance challenges facing HUD:
1. Human capital management,
2. Financial management governance of HUD,
3. Financial management systems,
4. Information security,
5. Single-family programs,
6. Office of Community Planning and Development programs,
7. Public and assisted housing program administration,
8. Compliance with the Improper Payments Elimination and Recovery Act of 2010, and

Attachment
HUD Management and Performance Challenges
Fiscal Year 2016 and Beyond

1. Human Capital Management

For many years, one of the U.S. Department of Housing and Urban Development’s (HUD or Department) major challenges has been 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. While the Office of Inspector General (OIG) has done limited work in this area, several studies have been completed on HUD’s use of human capital by the Office of Personnel Management (OPM), and the U.S. Government Accountability Office (GAO).

Human Capital Studies
A June 2012 OPM review found a number of weaknesses in HUD’s human capital policies and practices. Specifically, OPM determined that HUD does not meet 41 of 68 expected outcomes across five Human Capital Assessment and Accountability Framework (HCAAF) systems. The five areas of HCAAF are (1) strategic alignment, (2) leadership and knowledge management, (3) results-oriented performance culture, (4) talent management, and (5) accountability. OPM’s review traced many of the problems to a lack of human capital accountability and insufficient strategic management of human capital. Since the completion of OPM’s review, HUD management has identified corrective actions, developed action plans, taken steps to remediate identified weaknesses, and provided evidence to OPM that HUD has taken the required actions. While this process will continue throughout 2016, HUD expects OPM to issue a report on OPM’s conclusions regarding the documentation provided to date. Meanwhile, we will continue monitoring the status of progress made in establishing an effective human capital management program.

In September 2013, GAO issued a report evaluating the goals-engagement-accountability-results (GEAR) framework, which was developed to help improve performance management in the Federal Government. HUD was one of five Federal agencies participating in this GEAR pilot. The framework was established by Federal agencies, labor unions, and other organizations in response to the longstanding challenge for Federal agencies to develop credible and effective management systems that can serve as a strategic tool to drive internal change and achieve results. In 2013, HUD implemented GEAR agency-wide. GAO found that HUD’s GEAR plan lacked objectives to identify HUD’s purpose for implementing the GEAR framework and did not assign roles and responsibilities to hold individuals and offices accountable for completing the actions. As a result of this review, HUD has taken the following steps:

(1) Training on the new employee evaluation system framework,
(2) Deploying performance management training for managers,
(3) Redefining senior executive service plans,
(4) Developing an awards policy, and
(5) Acquiring a new ePerformance system.
In May 2015, GAO issued a report based on testimony of GAO work issued from January 2014 through February 2015 and ongoing work related to employee engagement. The testimony focused on key human capital areas in which some actions had been taken but attention was still needed by OPM and Federal agencies on issues such as (1) the General Schedule classification system, (2) mission-critical skills gaps, (3) performance management, and (4) employee engagement. The report provides the retirement rate of Federal civilian employees. In HUD, more than 43 percent of career permanent employees onboard as of September 30, 2014, were eligible to retire by 2019. Given this statistic, HUD will need to ensure that it has steps in place to fill the critical skills gap to ensure the continuity of business and that it fulfills its agency missions.

**HUD’s Use of Intergovernmental Personnel**

Since 2009, HUD has entered into 21 temporary assignments of non-Federal personnel to positions within the Department under the Intergovernmental Personnel Act (IPA). HUD faces challenges in executing and managing the assignment agreements because its processes and responsibilities are divided among program areas of the Department and there is no central point of authority over these agreements. We have already reported on an inherent conflict of interest situation and overpayments1 and a potential Antideficiency Act (ADA) violation involving two IPA assignees2. In February 2014, Inspector General Montoya testified at the hearing on “Exploring Alleged Ethical and Legal Violations at the U.S. Department of Housing and Urban Development” before the House Oversight and Investigations Subcommittee regarding one of our multifaceted assignments on IPAs. The Inspector General’s testimony provided examples of serious violations of ethical, lobbying, and hiring violations at HUD in which senior HUD officials had been involved in an effort to mask these embarrassing and questionable activities. Further, investigations revealed the hiring of convicted criminals into key housing positions.

We continue to work in this area due to our findings and continued concerns. In 2014, HUD revised its policy regarding assignment agreements under the IPA, but the policy remains in draft form.

HUD is making sweeping changes to the way it operates. While new process and technology changes always increase operational risk, HUD’s restructuring and reorganization of management and employee roles and responsibilities will further increase that risk. Since a high percentage of employees are nearing retirement eligibility, HUD needs to continue to effectively implement and maintain ongoing and planned human capital management improvements.

**2. Financial Management Governance of HUD**

HUD’s significant management challenge continued in fiscal year 2015 as it struggled to establish and implement a successful financial management governance structure and system of internal control over financial reporting as required by the Federal Managers’ Financial Integrity

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1 Memorandum Number 2015-FW-0801, Intergovernmental Personnel Act Appointment Created an Inherent Conflict of Interest in the Office of Public and Indian Housing, May 30, 2014
Act of 1982 (FMFIA) and the Chief Financial Officers Act of 1990. In our Fiscal Year 2014 and 2013 Financial Statement Audit report, we issued a disclaimer of opinion based on improper budgetary accounting related to Office of Community Planning and Development (CPD) grants and because of a disclaimer of opinion issued on the Government National Mortgage Association’s (Ginnie Mae) stand-alone financial statements. In addition, in our report on internal control, we reported on eight material weaknesses, eight significant deficiencies, and five instances of noncompliance with laws and regulations. One of the material weaknesses directly addressed the weaknesses in HUD’s financial management governance, and several of the other material weaknesses and significant deficiencies have causes that we have attributed, in part, to weaknesses in HUD’s financial management governance structure.

Currently, OCFO lacks a position or division to

(1) Monitor the issuance of accounting policies and standards from entities such as the Federal Accounting Standards Advisory Board and the Office of Management and Budget (OMB) and determine their impact on HUD and
(2) Interpret program office financial reporting policies and determine whether they comply with generally accepted accounting principles and other financial management regulations.

In the fall of 2014, HUD contracted with the National Academy of Public Administration (NAPA) for an organizational assessment of financial management at HUD to identify risks associated with the transition of its accounting functions to a shared service provider and in part to address concerns previously identified by OIG. NAPA issued its report March 19, 2015.

As we have previously recommended, NAPA found that to strengthen its financial governance structure, HUD’s OCFO should establish an internal Chief Financial Officer council and evaluate opportunities to enhance its monitoring of financial activity and controls. HUD lacks a senior management council and senior assessment team or equivalent committees responsible for

(1) Assessing and monitoring deficiencies in internal control resulting from the FMFIA assessment process,
(2) Advising the HUD Secretary of the status of corrections to existing material weaknesses, and
(3) Informing 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

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4 Department of Housing and Urban Development, Office of Chief Financial Officer, Organizational Assessment, March 19, 2015.
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 OCFO staff and an 11 percent reduction in full-time permanent OCFO 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 OCFO staff and limited its ability to perform its duties in a timely and efficient manner.

HUD's current financial management structure relies on delegations of several key financial management functions to HUD's program offices, including review and approval of vouchers, reviews of unliquidated obligations, and some budgetary functions. However, we have found that program-related issues, concerns, and decisions often take a higher priority than financial management and the requirements for proper financial accounting. Previous audits have indicated that accounting procedures are often determined by program office preference without the guidance and oversight of OCFO and regard for accounting standards. The absence of this function has been the root cause of significant deficiencies identified in our audits and these management challenges. For example, the material weakness associated with CPD's budgetary accounting for grants, which contributed to our 2014 disclaimer of opinion, occurred within the environment of substantial delegation and deferral to program office priorities.

While HUD has taken initial steps to address these issues, substantial work remains. HUD's initial efforts have included an effort to develop a memorandum of understanding between OCFO and program offices to improve collaboration with program offices on important accounting issues.

HUD has also made progress regarding the establishment and updating of financial management handbooks and policies and procedures. However, some HUD financial management handbooks remain outdated or incomplete, and further development of policies and procedures is necessary. To improve continuity of accounting policies and procedures in a changing environment, financial management policy should be centrally located and easily accessible by staff. OCFO's significant turnover in the past 5 years, combined with the lack of a policy framework, has contributed to issues related to compliance with accounting standards and other regulations. HUD must continue to establish and implement accounting policies and procedures in a permanent and easily accessible manner.

In addition to the issues associated with OCFO's financial management governance, we have identified significant financial governance issues within Ginnie Mae.

In fiscal year 2015, Ginnie Mae failed to maintain a governance framework that allowed appropriate policies, people, systems, and controls to ensure the reliability and integrity of Ginnie Mae's financial and accounting information. As a result, Ginnie Mae will face significant risks and challenges in fiscal year 2016. 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 the master subservicers, as third-party service providers, on Ginnie Mae's multi-billion-dollar servicing portfolio will challenge Ginnie Mae's inadequate financial management staff. This
issue is a result of Ginnie Mae executive leadership’s failure to backfill a number of critical financial management positions, including the deputy chief financial officer, controller, and economic modeling director. All of these positions have significant financial reporting roles within Ginnie Mae. However, as noted in fiscal year 2014, these positions had been vacant for an extended period, and Ginnie Mae relied heavily on contractors to compensate for the staffing deficiencies in the Office of Finance. For example, we noted that the deputy chief financial officer, controller, and economic modeling director positions had been vacant for 23, 18, and 7 months respectively. Additionally, Ginnie Mae lost its Chief Financial Officer in April 2015 after only a year on the job. Although Ginnie Mae has an acting Chief Financial Officer and the internal controls manager position was filled in April 2015, these individuals have not been fully functioning in their respective roles because of other work priorities.

Overall, Ginnie Mae needs to address its financial management governance deficiencies by filling the gaps in its financial management staff; reviewing its system of internal control for identifying, analyzing, and managing risks; and developing appropriate accounting policies and procedures to properly manage a $1.6 trillion mortgage-backed securities (MBS) portfolio.

HUD needs to implement processes and procedures to ensure an effective system of internal control, not only for financial management governance, but across the Department within all programs. Effective for fiscal year 2016, HUD will be responsible for implementing GAO’s Standards for Internal Control in the Federal Government5 (The Green Book). These standards provide the criteria for designing, implementing, and operating an effective internal control system and define specific principles that are integral to an entity’s internal control system. Based on the ongoing issues noted above, we are concerned about HUD’s ability to successfully implement these new standards in the coming fiscal year and forward.

3. Financial Management Systems

Annually since 1991, OIG has reported on the lack of an integrated financial management system, including the need to enhance the Federal Housing Administration’s (FHA) 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. 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). The project has three phases.

- Phase 1 of the project has been separated into four different releases. Each release defines a particular function that will be transferred to Treasury’s shared services platform.
  - Release 1 transferred the travel and relocation functions to BFS on October 1, 2014.
  - Release 2 transferred the time and attendance functions to BFS on February 8, 2015.

• Release 3 was implemented on October 1, 2015, and covers migration of OCFO core financial services.
• Release 4 will address HUD’s grant and loan accounting systems. Details of this release have not been finalized, and there is no scheduled date for implementation.
  ➢ Phase 2 of the project will address managerial cost accounting, budget formulation, and a fixed assets system.
  ➢ Phase 3 of the project will address the consolidation of FHA and Ginnie Mae as well as the migration of the functionality of HUD’s Line of Credit Control System.

Details regarding phases 2 and 3 of the project have not been finalized, and there are no scheduled start dates.

Resources to fund the New Core Project come from various organizations and funding sources. New Core has a three-part budget development that includes the following:

• Modernization and enhancement funds from the Working Capital Fund - information technology (IT) portfolio,
• Full-time employees from many sources, and
• Operations and maintenance – salaries and expenses.

Funding delays and cuts have impacted modernization and enhancement activities. As a result, money appropriated in fiscal year 2014 was not fully available. As of February 2015, HUD had received only about $4.5 million of the $10 million budgeted. In addition, congressional cuts to fiscal years 2015-16 funding resulted in the elimination of all modernization and enhancement funding, including the $15.9 million budgeted for the New Core Project. A significant amount of the operations and maintenance funding requested was also eliminated, resulting in the $16.6 million requested for the New Core Project being transferred to the salaries and expenses budget.

As a result, New Core is pursuing $18 million, the $10 million budgeted and an additional $8 million reallocated from other projects, to cover current agreement and pending activity costs through March 2016.

During this fiscal year, we completed two audits on 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. HUD’s 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 previous project determined that OCFO did not properly plan and manage its implementation of the project. 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

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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' Oracle Financials. As a result, processing continued for more than 6 months with unresolved errors, leaving HUD's general ledger and Oracle Financials 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 when we reviewed release 3. Although HUD had taken action in its plans for release 3 to mitigate some of the problems that occurred with release 1, 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. For instance, HUD did not

(1) Establish proper internal controls to ensure that loan program data were complete and accurate,

(2) Implement effective interface procedures to ensure that FHA and Ginnie Mae data were protected during transmission,
(3) Ensure that procedures were in place to prevent improper transaction error handling or transaction overrides without approval or adequate justification, and
(4) Implement effective access controls to ensure that systems and data were protected from inappropriate exposure.

As a result, HUD’s financial systems continue to be at risk of compromise.

The Clinger-Cohen Act of 1996 has defined the role of Chief Information Officer (CIO) as the focal point for IT management in Federal agencies. The Federal Information Security Management Act of 2002 (FISMA) requires the HUD Secretary to delegate to the Department’s CIO “the authority to ensure compliance with the requirements imposed on the agency under this subchapter.”

The HUD CIO has primary responsibility over many IT and information management functions. However, the CIO continues to lack the authority to enforce compliance with Federal law, National Institute of Standards and Technology guidance, or departmental IT policies. The Office of the Chief Information Officer (OCIO) issues policies and procedures for IT and information security management. For example, OCIO issues guidance for the development and maintenance of system security documentation, including authority to operate statements, systems security plans, annual self-assessments of security controls, risk assessments, contingency plans, and configuration management plans. However, OCIO has been merely a collector of the documents and unable to force compliance with policies and standards.

We continue to identify instances of documents maintained by the program offices that are out of date and do not accurately reflect the current environment. OCIO has indicated that it did not always have the resources available to monitor compliance with standards and ensure that the program offices implemented the policies and procedures to satisfy Federal IT requirements. Instead, OCIO has written policies and procedures that delegate the responsibility and accountability for meeting Federal IT requirements to the program offices. This delegation to less experienced program office personnel could result in inconsistencies and inadequate documentation and limit the CIO’s accountability for HUD’s IT and IT security management.

OCIO was granted authority to reorganize its management and staffing structure in 2012 to improve its IT governance and management. However, many of the new positions remain vacant or have not been permanently filled. Additionally, OCIO experienced several changes in leadership and was without permanent leadership from April 2013 through June 2014. While HUD has a CIO, the absence of permanent division and branch managers may have contributed to OCIO’s continued inability to fully support HUD’s IT operations.

4. Weaknesses in Information Systems Security Controls

While HUD relies heavily on its IT infrastructure to conduct mission essential operations that directly affect millions of citizens, it faces many long- and short-term challenges as it strives to modernize and adequately secure its IT infrastructure and legacy applications. 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. For example, the Department has 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 also 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. However, notable change and implementation from these initiatives are not anticipated to be realized until after the first quarter of fiscal year 2016. Further, successful implementation of these plans will be directly dependent on the agency’s ability to obtain adequate resources, including technical expertise. This issue is complicated because, in the process of outsourcing infrastructure and application maintenance and support, HUD has divested itself of much of its technical expertise. This lack of expertise provides significant challenges to HUD’s ability to conduct technical security reviews of its infrastructure (for example, penetration testing or network assessments) or adequately oversee the technical security provided by vendors.

Meanwhile, our annual evaluation of HUD’s IT security program, as mandated by FISMA, has revealed continued and extensive noncompliance with Federal IT guidance. As depicted in OIG’s fiscal year 2014 FISMA report, HUD has extensive deficiencies in 9 of the 11 program areas on which OIG reports to OMB. HUD is, however, 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&M). However, the agency has failed to adequately address many long-standing security weaknesses identified in prior OIG evaluations:

- According to the OCIO POA&M tracking tool, HUD has 36 open recommendations from the fiscal year 2013 FISMA evaluation which have been open for corrective action for more than 550 days. These recommendations highlight significant vulnerabilities in patching information systems; use of personal identity verification authentication to the HUD network; and the creation, management, and retiring of user network and application access accounts. However, HUD has made considerable progress during the past year by remediating 26 of the 62 other fiscal year 2013 FISMA recommendations, with several in progress.

- HUD has not remediated any of the 23 fiscal year 2014 FISMA recommendations, all of which have been open for more than 240 days. These recommendations address many deficiencies, including failure to implement an effective continuous monitoring program,
inadequate contractor oversight procedures, and weaknesses in agency and IT risk management processes.

- The HUD Privacy Program has 30 open recommendations from the fiscal years 2013 and 2014 evaluation periods, reflecting significant deficiencies in this program. Many of these recommendations deal with programmatic and planning issues which, if addressed, will significantly improve HUD’s privacy oversight and reduce risks associated with the extensive amount of personally identifiable information managed by HUD. HUD has recently prioritized the privacy program and realigned it under the Chief Administrative Officer. This renewed support has enabled the program to address and close 14 significant recommendations.

To show improvement in the above areas, all agency components, including OCIO, the Office of Administration, the Office of the Chief Procurement Officer, and HUD program offices, will need to implement cross-agency processes and capabilities to provide effective development and oversight of IT security controls. HUD’s fiscal year 2015 IT funding level of $265 million is well under its request of $336.8 million, which has already impacted agency modernization and IT security efforts. With the constrained budgets, HUD will continue to be dependent on funding to maintain current systems while also initiating projects to upgrade legacy applications and improve technology.

5. Single-Family Programs

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

Preserving the FHA Fund

For the past 6 years, the FHA fund has failed to meet its legislatively mandated 2 percent capital ratio, although it has gradually improved in each of these 6 years. According to the 2014 actuarial study, the fund had an economic value of $35.9 billion. Based on the 2014 projections, the capital ratio will not reach the 2 percent level until 2016, marking 8 consecutive fiscal years below the 2 percent threshold. Due to the continuing stress on the insurance fund’s estimated reserves, GAO included FHA concerns in its latest “high risk” update relating to “Modernizing the U.S. Financial Regulatory System and Federal Role in Housing Finance.” Restoring the fund’s reserves and finances has been a priority for HUD, and it has increased premiums, reduced the amount of equity 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

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7 OIG’s calculation of the capital ratio was based the information we obtained from FHA’s draft actuarial report received in mid-September 2015 and using the unamortized insurance-in-force as the denominator.
insurance fund and improve FHA loan underwriting by partnering with HUD, 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 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, 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 significantly help recover losses to the FHA insurance fund.

**Lender Initiatives**

FHA has a major role in supporting the housing market and has implemented initiatives to strengthen the insurance fund. One initiative is the development of a new methodology to evaluate underwriting defects. These new criteria will be more descriptive, identifying a number of specific defects, their related causes, and levels of severity. OIG has reviewed a draft version of the methodology and has provided feedback. Also, FHA plans to expand its evaluation of loans to include random sampling of performing loans closer to the time of endorsement. FHA posted the methodology on June 18, 2015, but has not provided an implementation date. Further, FHA has begun reconciling more than 900 mortgagee letters and other policy guidance into a single, authoritative document, – Single Family Housing Policy, HUD Handbook 4000.1, to serve as the definitive guide on all aspects of FHA’s single-family programs. Major sections of this handbook became effective September 14, 2015. The last initiative includes an additional national lender performance metric to assess lender performance based on the lender’s default rate within three credit score bands to compare it to FHA’s target rate, rather than to the lender’s peers.

**Claims**

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. Last year, OIG noted HUD’s financial exposure when paying claims on loans that were not qualified for insurance. Adding to this concern, HUD increased its financial exposure by not recovering indemnification losses and extending indemnification agreements when appropriate.
Based on the results of an August 2014 audit, OIG determined that HUD did not always bill lenders for FHA single-family loans that had an enforceable indemnification agreement and a loss to HUD. The audit identified 486 loans with losses of $37.1 million from January 2004 to February 2014 that should have been billed and recovered. HUD needs to ensure continued emphasis on indemnification recoveries, especially for newer FHA programs such as Accelerated Claims Disposition or Claims Without Conveyance of Title (CWCOT). We referred three recommendations to the Assistant Secretary for Housing – FHA Commissioner on January 8, 2015. The three recommendations asked HUD’s Deputy Secretary for the Office of Finance and Budget to initiate the billing process, including determining lender status for loans that (1) were part of the CWCOT program and (2) went into default before the indemnification agreement expired. Further, we recommended initiating the billing process for five refinance loans in which HUD incurred losses. Due to continued disagreements on the appropriate action, we elevated the recommendations to the Deputy Secretary on March 31, 2015. We continue to wait for the Deputy Secretary’s request for further discussions or her decision on the matter.

**Home Equity Conversion Mortgage Challenges**

The Reverse Mortgage Stabilization Act of 2013 gave FHA the tools to improve the fiscal safety and soundness of the Home Equity Conversion Mortgage insurance program (HECM) 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. 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 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 check for this problem. Based on this audit work, OIG expanded work to determine other instances of noncompliance with the principal occupancy requirement by matching address information in FHA’s Single Family Data Warehouse with data in HUD’s Public Housing Information Center (PIC) system to identify borrowers who rented their HECM property to participants in HUD’s Housing Choice Voucher program. OIG has since performed two additional audits in which it matched borrower information in FHA’s Single Family Data Warehouse with data in HUD’s PIC system and Tenant Rental Assistance Certification system. Based on these audits, OIG identified instances of HECM borrowers who may not have been living in the properties associated with their loans because they were concurrently receiving HUD rental assistance through its Housing Choice Voucher and multifamily programs at a different address. This problem exists because HUD did not have policies or procedures to prevent or mitigate instances of borrowers violating principal residency

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requirements by renting out their properties to Housing Choice Voucher participants or by concurrently participating in HUD's rental assistance programs. The Department's response to OIG's audit findings and recommendations has been supportive of the changes needed to ensure compliance with the principal residency requirement.

**Loss Mitigation**

FHA requires that its servicers use loss mitigation tools to assist homeowners facing default and as a way to minimize losses to the FHA insurance fund. However, despite the intended purpose, FHA has difficulty ensuring that its program guidance is clearly written for effective implementation. OIG has conducted two audits\(^\text{10}\) of FHA's Home Affordable Modification Program (FHA-HAMP). One audit identified that HUD did not have an effective postclaim review function and did not have clear program guidance for the FHA-HAMP partial claim option. HUD's policies allowed servicers to determine partial claim amounts in different ways, which resulted in some claims that were higher than necessary. This condition occurred because HUD and its contractor did not produce quality postclaim review reports in a timely manner and HUD failed to adequately monitor FHA-HAMP. As an example, we discovered in our audit that the HUD employee responsible for reviewing the contract stated that he was not sure which requirements the contractor reviewed concerning HAMP because he did not have time to review their work thoroughly. In addition, the claim deficiencies identified in the audit report persisted despite reviews that were conducted by HUD's Quality Assurance Division (QAD). Therefore, we believe that corrective action is needed to ensure that future ineligible HAMP claims are prevented. HUD stated that QAD does a more thorough review of FHA-HAMP loans that are selected in their sample. However, the sample selection process for QAD reviews may result in only a very small sample of completed HAMP claims, and additional controls should be designed to ensure that patterns of HAMP claim deficiencies can be identified and addressed. HUD needs to assign the necessary administrative resources and oversight to reduce potential losses of $88.5 million per year for ineligible FHA-HAMP claims that may go undetected. We also recommended that HUD train its staff and contractors on all loss mitigation programs, review a sample of postclaim reviews submitted by the contractor to ensure that the contractor adequately identifies ineligible claims, and update FHA-HAMP policies to ensure that all servicers apply policies consistently.

**Credit Alert Verification Reporting System**

HUD also faces challenges in ensuring that its controls work as intended and providing FHA with the appropriate credit data to properly assess borrowers' eligibility for FHA insurance. In a July 2014 audit report\(^\text{11}\) on the Department's Credit Alert Verification Reporting System (CAIVRS), OIG found that the system did not contain default, foreclosure, and claim activity information for all borrowers. Further, this system did not contain all information for FHA borrowers with claims older than 3 years. As a result, HUD did not provide other Federal agencies with sufficient information on FHA borrowers with delinquent Federal debt to comply with requirements of the Debt Collection Improvement Act. This Act bars delinquent Federal

\(^{10}\) Audit Report 2015-LA-0003, HUD Did Not Have Effective Controls or Clear Guidance in Place for the FHA-HAMP Partial Claim Loss Mitigation Option, September 18, 2015, and Audit Report 2015-LA-0001, HUD's Claim Payment System Did Not Always Identify Ineligible FHA-HAMP Partial Claims, April 20, 2015

\(^{11}\) Audit Report 2014-KC-0002, The Data in CAIVRS Did Not Agree With the Data in FHA's Default and Claims System, July 2, 2014
debtor from obtaining additional Federal loans or loan guarantees until delinquencies are
resolved. These conditions occurred because HUD did not adequately design the process for
providing data to CAIVRS from its other systems. FHA agreed to update its selection rules for
complete reporting of all ineligible borrowers to the extent that the system is used as a credit risk
assessment tool. However, FHA does not consider delinquency on an FHA-insured mortgage to
be a delinquent Federal debt, nor does it believe that payment of a claim on an FHA-insured
mortgage automatically creates a delinquent Federal debt. After review by the Acting Assistant
Secretary for Housing, disagreement remained on the actions necessary to correct the
deficiencies identified in the audit report. On March 23, 2015, OIG referred this matter to the
Deputy Secretary for a decision as the departmental audit resolution official. We continue to
wait for the receipt of the final management decision.

**Departmental Clearance Process**

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. The originating HUD office places a directive to implement a specific policy change of
departmental clearance by completing these four steps: (1) execute an intra-office agreement, (2)
execute a form HUD-22, (3) launch clearance process, and then (4) manage the clearance. All
directives must be cleared, at a minimum, by the following six offices within headquarters:
Office of the Chief Human Capital Officer, Office of General Counsel, OIG, OCFO, OCIO, and
Office of Policy Development and Research.

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 *not* (1)
identifying the significant changes in its notice, (2) 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
outlined in Handbook 000.2 REV-3, HUD Directives System.

**Premium Pricing**

With the update to the consolidated Handbook 4000.1, FHA made changes regarding premium
pricing during the course of several OIG audits that continues to raise concerns for OIG. HUD’s
requirement on premium pricing in Handbook 4155.1, paragraph 5(A)(2)(i), specifically
disallowed the use of funds derived from a premium-priced mortgage to pay any portion of the borrower’s downpayment. However, FHA removed this prohibition from HUD Handbook 4000.1. OIG recognizes that the consolidation of this handbook is a huge and vigorous process. It has received sections to review throughout the departmental clearance process. Some of the sections are hundreds of pages long and often require a short turnaround time. The Department has provided change logs to accompany the review process by highlighting the significant policy changes. However, the removal of the specific language prohibiting the use of premium pricing to pay for any portion of the borrower’s downpayment was not part of the change log. In addition, language was inserted to define premium pricing as a credit from a lender for a chosen interest rate.

OIG believes that the removal of the specific language and the limited definition of premium pricing lessen the controls that were in place when the prohibition was more direct and plainly stated. The Department’s position is that the removal of the specific language is not a policy change and that the prohibition is indirectly covered by the new language, stating that funds derived from a premium-priced mortgage must be used to reduce the principal balance if the credit amount exceeds the actual dollar amount for closing costs and prepaid expenses. OIG does not agree with that position. In addition, OIG believes that the limited definition of premium pricing excludes potential circumstances that could also be defined as premium pricing (for example borrowers receiving a premium interest rate in exchange for downpayment assistance).

Further, OIG has issued three audit reports on lenders’ allowance of ineligible downpayment assistance, highlighting housing finance agencies’ use of a premium pricing structure that does not comply with FHA requirements. Specifically, lenders originated FHA loans that included housing finance agency downpayment assistance gift funds or secondary loans that did not always comply with FHA requirements. The lenders inappropriately allowed premium pricing to be used as a source for the borrowers’ downpayments that did not comply with FHA requirements. As a requirement for program participation, borrowers were given mortgage interest rates (premium rate) that were above the prevailing market rate of interest for mortgages without downpayment assistance. The downpayment assistancegifts were not true gifts as defined by HUD because gifts provided to the borrowers were directly or indirectly repaid. As a result of the premium rates, borrowers were put at a disadvantage due to higher monthly mortgage payments, including the burden of funding the downpayment assistance programs. Going forward, the revised language in Handbook 4000.1 on premium pricing could be interpreted differently among lenders. Lastly, FHA issued a notice on July 20, 2015, reaffirming its support of housing finance agencies’ downpayment assistance programs, which seems in conflict with FHA’s position that it made no changes to requirements concerning the use of premium pricing for a borrower’s downpayment assistance.

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Ginnie Mae

Over the past 5 years, Ginnie Mae has seen its outstanding mortgage-backed securities increase by more than 50 percent. As of August 2015, Ginnie Mae’s mortgage-backed securities (MBS) portfolio exceeded $1.6 trillion. 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.

6. CPD Programs

IDIS Funding

In fiscal year 2014, HUD began work to eliminate first-in, first-out\(^1\) (FIFO) accounting methodology from the Integrated Distribution and Information System (IDIS) prospectively. However, during the spring of fiscal year 2015, IT work on the plan halted because funding to complete the project was no longer available. In August 2015, HUD senior management approved additional funds to continue the project. However, there continues to be a funding

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\(^1\) 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.
shortfall. While the approved funding will pick up where the project left off, completion of the elimination plan will be delayed until December 2016.

Despite the changes made to IDIS thus far, additional modifications are necessary for the system to fully comply with the Federal Financial Management Improvement Act (FFMIA) and to support the U.S. Standard General Ledger at the transaction level. Additionally, we take exception to not removing the FIFO methodology retroactively, which will continue the departures from generally accepted accounting principles and result in material misstatements on the financial statements. Use of the FIFO methodology contributed to the qualified audit opinion and the Disclaimer audit opinion issued on HUD’s financial statements in fiscal years 2013 and 2014, respectively. Therefore, lack of retroactive implementation will have implications on future years’ financial statement audit opinions until the impact is assessed to be immaterial.

Grant Accounting
In fiscal year 2015, HUD’s inability to provide data to monitor compliance with the HOME Investment Partnership Act (HOME statute) requirements for committing and spending funds will continue 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 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. A second letter was sent in 2011 to provide additional details requested by GAO. 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.

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14 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.
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 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 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.

Section 108 Loan Guarantee Program
The Section 108 Loan Guarantee program allows grantees of the CDBG program to borrow federally guaranteed funds for community development purposes. Section 108 borrowers obtain up to five times the amount of their annual CDBG grants by pledging to repay Section 108 loans with future CDBG grants in the event of a default. Section 108 thus enables grantees to undertake substantially larger community development projects than CDBG grants alone would support. In May 2015, HUD conducted a public offering of Section 108 guaranteed participation certificates in the amount of approximately $391 million. The offering consisted of 136 notes from 85 Section 108 borrowers.

HUD considers the program to be a success because there are no reported Section 108 loan defaults. However, this view provides a false sense of success about the Section 108 loan program. There are no reported defaults because borrowers generally use CDBG funds to make loan repayments when funded projects default, when no other source of project income is
available, or when there is a delay in the payment. As a result, the Federal Government bears 100 percent of any losses, regardless of the success of the funded activity.

Audits conducted by OIG for the period 2012 through 2015 identified serious deficiencies in the administration of the Section 108 loan program that affected the effectiveness of the program. We found five Section 108 loans in which loan agreement provisions and HUD requirements were not followed which resulted in more than $35.97 million in questioned funds. Borrowers did not ensure that Section 108-funded activities met a national objective of the CDBG program and fully provided the intended benefits. As a result, projects were incomplete or abandoned, and funds were used for ineligible and unsupported efforts. For example, one borrower transferred more than $6 million in Section 108 loan proceeds to its general fund account as loans for its operations. In addition, loan proceeds were not disbursed within the established timeframe, borrowers did not provide HUD the required loan collateral, borrowers did not establish a financial management system in accordance with HUD requirements, and investments were not fully collateralized. Although HUD was aware of some of these deficiencies, none of the loans were declared in default. In one case, HUD allowed the noncompliance issues to continue for more than 11 years without raising a finding and providing corrective actions or imposing sanctions.

OIG is concerned that the these issues, in which more than $35.97 million was questioned because the loan provisions and HUD requirements were not followed, could have a negative impact on the CDBG program and an adverse effect on the Section 108 Loan Guarantee program objectives. Specifically, the use of HUD funds for efforts not related to the approved activities and projects that did not provide the intended benefits result in a waste of funds.

*Neighborhood Stabilization Program Recapture*

HUD, through its Office of CPD, provided money to local governments, nonprofits, and all 50 States through three rounds of Neighborhood Stabilization Program (NSP) funding, totaling approximately $6.82 billion.

Congress established expenditure deadlines for the three rounds of NSP funding within the appropriations acts for each round. HUD also addressed the expenditure deadlines for NSP1 and NSP3 in Federal Register issuances in which it established provisions for the recapture of any funds not spent by the deadlines.

HUD required grantees to spend an amount equal to their initial allocation of NSP1 funding within 4 years after receiving the funds. It executed NSP1 grant agreements on various dates during the spring of 2009. Therefore, based on HUD's interpretation and application of the statute, all NSP1 grantees should have satisfied this requirement by the date of their grant in the spring of 2013.

Congress required NSP2 and NSP3 grantees to spend 50 percent of their funds within 2 years and 100 percent within 3 years. HUD secured a waiver from OMB to extend the deadline for 100 percent expenditure of NSP2 funds to September 30, 2015. The 100 percent expenditure date for NSP3 grantees was March 8, 2014.
An OIG internal audit\textsuperscript{15} found that HUD failed to take appropriate action regarding more than $22 million in unexpended NSP1 and NSP3 initial funding allocations. The audit found that (1) grantees missed deadlines, (2) HUD did not provide documentation to show remedial actions it took regarding deficient grantees, and (3) expenditures reported in the Disaster Recovery Grant Reporting system were not always correct.

HUD had generally implemented sufficient controls and improvements, including providing guidance and technical assistance, as a result of its own assessments. However, we determined that HUD could improve its administration of NSP and similar programs by effectively using OIG reports on individual grantees to identify trends program wide. HUD management did not effectively use trends identified from OIG reports on individual grantees that highlighted common problems or regulatory gaps on which it could base national policy guidance or other directives. As a result, HUD may not have always recognized recurring issues or provided grantees the most effective guidance for improving overall program performance.

Significant recommendations were that HUD provide support showing that (1) 41 grantees did not miss their expenditure deadlines, which would result in nearly $18.7 million being put to better use, and (2) it took remedial action regarding five NSP3 grantees that missed the expenditure deadline. OIG is working with HUD through the management decision process to resolve these recommendations.

7. 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 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 onsite 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 onsite 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

\textsuperscript{15} Audit Report 2015-AT-0001, HUD’s Office of Community Planning and Development Did Not Always Pursue Remedial Actions but Generally Implemented Sufficient Controls for Administering Its Neighborhood Stabilization Program, March 31, 2015
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 still have not reached management decisions on all recommendations in a recent report. 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. HUD continues its desire to maintain the fee for service model, which is similar to the model used by the Office of Multifamily Housing Programs. 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.

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 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 and labor intensive, and does not allow for accurate financial reporting at the transaction level, as required by FFMI. 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.

16 Audit Report 2014-LA-0004, HUD Could Not Support the Reasonableness of the Operating and Capital Fund Programs’ Fees and did not Adequately Monitor Central Office Cost Centers, June 30, 2014
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. 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 HUD could benefit from a formalized process for terminating participants from the demonstration program for failure to comply with their agreement. We are also looking further into controls over legal expenses by participating PHAs.

Overincome Families in Public Housing
HUD also has a challenge in addressing overincome families living in public housing units. 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 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, HUD initially disagreed and issued a press release stating as much. After much public and congressional outcry, 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. We are also concerned that a nationwide policy may not allow flexibility to protect tenants. To ensure that tenant rights are protected and communities remain strong, tenants are encouraged to strive for self-sufficiency. PIH will need to find a way to encourage PHA participation and ensure the effectiveness of its policies.

Environmental Review Requirements
In recent reports, we demonstrated that PIH did not adequately implement environmental requirements or provide adequate oversight to ensure compliance with these requirements. The

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17 Audit Report 2015-PH-0002, Overincome Families Resided in Public Housing Units, July 21, 2015
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, 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 in the health and safety of the public and 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.

**Indian Home Loan Guarantee Program**

With annual increases in funding and the number of loans guaranteed, the Section 184 Indian Home Loan Guarantee program continues to be an area of concern. The Section 184 program is a great resource for the Native American community. However, the lack of controls, oversight, and enforcement increases the risk to the program. OIG recently completed an audit19 detailing

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19 Audit Report 2015-LA-0002, HUD Did Not Provide Adequate Oversight of the Section 184 Indian Home Loan Guarantee Program, July 6, 2015
how the Office of Loan Guarantee did not provide adequate oversight of the Section 184 program, resulting in an increased overall risk to the program, including guaranteeing 3,845 loans totaling more than $705 million that were not underwritten in accordance with program guidelines. Given the lack of enforcement and the Office of Native American Programs’ acknowledgement that there is significant room for improvement, there is continued risk for fraud, waste, and abuse within the Office of Loan Guarantee and at the lender level.

Small and Very Small Housing Agencies
HUD faces challenges in monitoring PHAs when more than 2,000 of its 3,000 PHAs are small or very small. Since these PHAs receive approximately 12 percent (or an estimated $732 million) of HUD’s $6.1 billion low-rent authorized funding, it creates oversight burdens and costs for both HUD and PHAs that are disproportionate to the number of families these PHAs serve. In a recent report,20 we identified that a significant cause of the deficiencies identified in small and very small PHAs was that executive directors and boards of commissioners either chose to ignore requirements or lacked sufficient knowledge to properly administer their programs. In 2015, HUD launched an online training course, Lead the Way, which is designed to help PHAs’ boards and staff fulfill their responsibilities in providing effective governance and oversight. However, we remain concerned that the administrators, board members, and local officials do not have the resources or information available to them to properly administer their programs. Further, we are concerned that without additional oversight or outreach, there is increased risk of fraud, waste, and abuse going undetected at these entities.

In an effort to promote awareness, HUD OIG has issued several industry advisories that highlight areas of risky and illegal activities that jeopardize the integrity of otherwise legitimate housing programs. The advisories are posted on our Web site at www.hudoig.gov/fraud-prevention. Several advisories were directly related to PHAs and were emailed to executive directors. In addition, the Inspector General co-authored a joint letter with Lourdes M. Castro Ramirez, Principal Deputy Assistant Secretary, PIH, to public housing agencies communicating our collaborative effort to encourage efficient operations and effective accountability for the best use of limited resources. The letter also introduced Lead the Way, a training module for board members and executive staff.

Physical Condition of the Housing Choice Voucher Units
In response to a 2008 audit report,21 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.

21 Audit Report 2008-AT-0003, HUD Lacked Adequate Controls Over the Physical Condition of Section 8 Voucher Program Housing Stock, May 14, 2008
8. 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\(^\text{22}\) 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 recommendations from our fiscal year 2014 audit report\(^\text{23}\) 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.

9. Administering Programs Directed Toward Victims of Natural Disasters

Congress has frequently provided supplemental appropriations through HUD’s CDBG program to help communities recover from natural and man-made disasters. The CDBG program is flexible and allows CDBG-DR grants to address a wide range of challenges. Congress has appropriated more than $47 billion in supplemental funding to HUD since 1993 to address long-term recovery in the wake of the attacks of September 11, 2001; Hurricanes Katrina, Rita, and Wilma in 2005; Hurricanes Ike and Gustav and Midwest flooding in 2008; and Hurricane Sandy in 2012. Most CDBG-DR funding is available until spent, with the exception of the Hurricane Sandy funding, which must be obligated by the end of fiscal year 2017.

Although HUD has made progress in recent years with assisting communities recovering from disasters, it faces several management challenges in administering these grants. Based on our prior and current audits, we identified the following challenges for the Department regarding the disaster recovery program:


\(^{23}\) Audit Report 2014-FO-0004, Compliance With the Improper Payments Elimination and Recovery Act of 2010, issued April 15, 2014
(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.

Ensuring That Expenditures Are Eligible and Supported
HUD faces a significant management challenge to ensure that funds disbursed for disaster recovery programs are used for eligible and supported items. HUD OIG has completed 16 Hurricane Sandy related audits to date, and as a result, we have identified $3.5 million in ineligible costs, $458 million in unsupported costs, and $360 million in funds put to better use. We have highlighted three audit reports that demonstrate these challenges for HUD in administering disaster recovery programs:

- In our review of New York City’s Health and Hospitals Corporation, 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 York State’s buyout program, 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, 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

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awarded, was unsupported. Also, State officials need to ensure that receipts are 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**

HUD has a major management challenge in properly administering waivers of disaster program requirements and retroactively amending State action plans.

Based on a review of the State of Louisiana’s Road Home Elevation Incentive Program\(^{27}\) regarding homeowner compliance in elevating their homes, it appears that CPD has established a pattern and practice to either waive the program requirements or approve retroactively the State’s amended action plan, when deficiencies are identified with this program. Our follow-up review\(^{28}\) 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, CPD approved the State’s Amendment 60 on July 26, 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, CPD again unilaterally waived the Road Home program requirements. Specifically, CPD changed its 2013 documentation requirement for rehabilitation expenses, as described above, 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 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 failed to properly enforce the intent of the Road Home, instead opting to change the rules so that violations can be excused. If HUD wishes to implement proper risk management in its programs, this defeats the purpose as this most recent action announces to all recipients of HUD funds that noncompliance is excused because HUD will allow it in the end with no consequences.

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\(^{27}\) Inspections Report IED-09-002, Inspection of the State of Louisiana’s Road Home Elevation Incentive Program Homeowner Compliance, March 2010

\(^{28}\) 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
CPD’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 and the affected homeowners’ trust and confidence that HUD maintains the highest standards of integrity, efficiency, and fairness in its grant award process.

**Certifying That Grantees Are Following Federal Procurement Regulations**

We continue to have concerns about HUD’s ability to ensure that disaster grantees are following Federal procurement regulations. Grant recipients of HUD CDBG-DR funds must provide a copy of their procurement standards and indicate the sections of their procurement standards that incorporate the Federal standards. The State and its subgrantees may follow their own State and local laws, so long as the procurements conform to applicable Federal law and standards. Further, a State must establish requirements for procurement policies and procedures based on full and open competition. In addition, all subgrantees of a State are subject to the procurement policies and procedures required by the State.

Our audits\(^{29}\) of disaster programs found CDBG procurement violations and other contracting problems. For example, in a recent audit of New Jersey’s recovery management system, auditors found that the State did not procure services and products for its system in accordance with Federal procurement and cost principle requirements. In this case, the State did not demonstrate that the overall contract price of $38.5 million and option years totaling another $21.7 million were fair and reasonable and that the $1.5 million it disbursed was adequately supported.

**Conducting Consistent and Sufficient Oversight Efforts on Disaster Grants**

Another area of concern is HUD’s ability to properly monitor all disaster grant recipients. Based on our Fiscal Year 2014 financial statement audit, we communicated to HUD that it did not always monitor disaster grants in accordance with its policies and procedures. Specifically, monitoring reports were not issued in a timely manner, and follow-up on monitoring findings was not performed consistently or in a timely manner. As a result of the recent high number of disasters, HUD faces difficulties in monitoring disaster program funds because of limited resources to perform the oversight, the broad nature of HUD program requirements, and the lack of understanding of CDBG-DR grants by the recipients. Since HUD disaster assistance may fund a variety of recovery activities, HUD can help communities and neighborhoods that otherwise might not recover. However, HUD must be diligent in its oversight duties to ensure that grantees have completed their projects in a timely manner and that they use the funds for their intended purposes.

**Promoting Disaster Resiliency Within Communities Trying To Recover**

Another major challenge for HUD will be to reduce the risk of substantial recovery costs from future disasters by promoting resilient investments. When rebuilding disaster-stricken communities, innovative techniques can be implemented so future disasters will have less impact

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through better building and community planning. We have already started reviewing some of these programs that protect the environment and reduce future disaster damage. We reported that the State of Maryland\(^{30}\) could not show that replacement homes were designed and constructed to increase energy efficiency and minimize their environmental footprint as required. Specifically, the State's subgrantee could not provide documentation to show that it constructed replacement homes that complied with the Green Building Standard as defined by HUD. This condition occurred because the subgrantee lacked procedures to ensure that replacement homes complied with the Green Building Standard. The State also lacked monitoring procedures to ensure that its subgrantee complied with the standard. As a result, HUD had no assurance that $1.9 million in program funds reimbursed to the subgrantee and $293,000 in program funds not yet reimbursed to the subgrantee were spent to design and build 13 replacement homes in a manner that increased energy efficiency and minimized their environmental footprint.

HUD is challenged in promoting community resilience, developing State and local capacity, and ensuring a coordinated Federal response that reduces risk and produces a more resiliently built environment. Under the National Response Framework developed since Hurricane Katrina, HUD has a major role in helping implement disaster recovery. Further, executive orders require Federal agencies to plan for climate-change-related risk and modernize programs to support climate-resilient investment. Over the longer term, new disasters and emerging national needs have the potential to create new needs and require significant changes in the Department’s program operations.

**Keeping Up With Communities in the Recovery Process**

Keeping up with communities in the recovery process is challenging for HUD. Congress has appropriated $47 billion to HUD since fiscal year 1993 for disaster assistance. Of the active disaster grants, HUD has more than $34 billion in obligations, $30 billion in disbursements, and $14 billion yet to be disbursed. Although in some cases many years have passed since the specific disaster occurred, significant disaster funds remain unspent. Thus, HUD must ensure the timely expenditure of funds, consistency in waiver approvals, compliance with procurement requirements, timely oversight efforts, and reduction in the risk of damage from future disaster events.

**Conclusion**

HUD will continue to face the challenges we have described until it puts controls and adequate resources in place to provide the necessary oversight and enforcement of HUD’s programs and operations. HUD OIG remains committed to working collaboratively with HUD. We will continue to strive to provide best practices and reasonable recommendations that support HUD’s mission and responsibilities. We also wish to note that within the first several weeks of the Secretary’s arrival, he issued a joint letter with the Inspector General to all personnel in which he not only encouraged but required staff to work with HUD OIG to advance HUD’s mission. HUD OIG also wants to acknowledge the active and detailed involvement by the Deputy Secretary to understand HUD’s long standing challenges and work with HUD OIG to find solutions and close outstanding audit recommendations.

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