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MEMORANDUM NO.
2009-AT-0801

September 24, 2009

MEMORANDUM FOR: Anthony P. Scardino, Acting Deputy Chief Financial Officer, F

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FROM: James D. McKay, Regional Inspector General for Audit, Atlanta Region, 4AGA

SUBJECT: Evaluation of the Front-End Risk Assessment for the Neighborhood Stabilization Program 2

INTRODUCTION

We evaluated the U.S. Department of Housing and Urban Development's (HUD) front-end risk assessment (assessment) for the Neighborhood Stabilization Program 2 (NSP2). We wanted to determine whether the assessment complied with the Office of Management and Budget's (OMB) updated guidance for the American Recovery and Reinvestment Act of 2009 (Recovery Act), as well as HUD's streamlined assessment process.

There are no recommendations in this memorandum. Should you or your staff have any questions, please contact David Butcher, Assistant Regional Inspector General for Audit, at 865-474-8218.

METHODOLOGY AND SCOPE

Using OMB's Updated Implementing Guidance for the American Recovery and Reinvestment Act of 2009 and HUD's streamlined assessment process, we evaluated the following factors against the final assessment for NSP2 to ensure that the major objectives were sufficiently emphasized:

- **General control environment** (legislative and program/organization structure);
- **Risk assessment** (program objectives/performance measures and program structure/administration);
- **Control activities** (coverage by written and other procedures, systems, and funding/funds control and organizational checks and balances);

- **Information/communication** (management attitude and reporting and documentation); and
- **Monitoring** (monitoring and special concerns or impacts).

We also determined whether the final assessment for NSP2 sufficiently and properly emphasized the major program objectives of timeliness, clear and measurable objectives, transparency, monitoring, and reporting.

We performed our work from July through August 2009 at our office in Knoxville, Tennessee. For this memorandum, our work was not conducted in accordance with generally accepted government auditing standards. Under the Recovery Act, inspectors general are expected to be proactive and focus on prevention; thus, this report is significantly reduced in scope.

BACKGROUND

The Recovery Act includes a \$2 billion appropriation for the Neighborhood Stabilization Program (NSP). NSP provides assistance to states and local governments for the redevelopment of abandoned and foreclosed homes and residential properties in order that such properties be returned to productive use or made available for redevelopment purposes. NSP has five eligible uses of funds: (1) establishment of financing mechanisms for purchase of foreclosed homes, (2) purchase and rehabilitation of abandoned or foreclosed homes, (3) land banking of foreclosed homes, (4) demolition of blighted structures, and (5) redevelopment of vacant or demolished property.

NSP was initially established by the Housing and Economic Recovery Act of 2008 (HERA). The HERA version of NSP (NSP1) provided \$3.92 billion in funding for emergency assistance to states and local governments. The Recovery Act provides an additional \$2 billion in NSP funding (NSP2) but makes several fundamental alterations to the program. First, the Recovery Act establishes NSP2 as a competitive program as opposed to the formula distribution for NSP1. Second, NSP2 funding is available to nonprofit organizations, as well as states and local governments. NSP is considered to be a component of the Community Development Block Grant (CDBG) program, and basic CDBG requirements govern NSP. Recovery Act funding will also provide \$50 million of the \$2 billion for NSP technical assistance to improve the capacity of NSP1 and NSP2 communities to carry out neighborhood stabilization programs.

The expected benefits of NSP are to stabilize property values and prevent neighborhood blight. NSP2 will provide funding for the purchase and/or redevelopment of thousands of foreclosed and abandoned homes and properties across the nation. These actions will help to stabilize neighborhoods by limiting the downward pull that vacant properties exert on surrounding properties and will provide the opportunity for thousands of households to realize or regain the ability to own their own home. It will also aid communities by providing a ready source of funding to demolish and clear blighted structures or to land bank real property until such time as demand can be reestablished. Further, the inclusion of nonprofit organizations as eligible grantees in NSP2 will foster greater innovation in support of the goals of the program and offers the opportunity to increase coordination and cooperation between the public and private sectors.

The new funding provided under the Recovery Act will require an ongoing evaluation and analysis of risk and continued monitoring to work toward achieving the goals of the legislation. In applying the Recovery Act implementing guidance regarding risk management, HUD will incorporate elements of its process for assessments. The streamlined assessments process will build upon the analysis and work underway to implement the Recovery Act provisions, maximizing the use of documents and materials available and supplementing as needed to ensure that internal controls are in place.

OMB's publication, "Updated Implementing Guidance for the American Recovery and Reinvestment Act of 2009," provides an accountability risk framework that shows objectives under phases of the funding lifecycle. It lists the following "accountability objectives" that apply to all agencies and programs:

- Funds are awarded and distributed in a prompt, fair, and reasonable manner;
- The recipients and uses of all funds are transparent to the public, and the public benefits of these funds are reported clearly, accurately, and in a timely manner;
- Funds are used for authorized purposes, and potential for fraud, waste, error, and abuse are mitigated;
- Projects funded under the Recovery Act avoid unnecessary delays and cost overruns; and
- Program goals are achieved, including specific program outcomes and improved results on broader economic indicators.

OMB's guidance also discusses how program-specific risks should be identified through the assessment process. Given the nature and purpose of the Recovery Act, the following objectives require emphasis:

- **Timeliness**--For every step of every program, it is critical to consider timing and whether the actions can be taken within the required timeframe.
- **Clear and measurable objectives**--All funds will be tracked to show results. It is critical to have clear and measurable outputs and outcomes and to have tracking mechanisms in place.
- **Transparency**--Information about how all funds are awarded, distributed, and used and what results are achieved must be available for the public.
- **Monitoring**--Workable plans for monitoring programs and related funds must be in place and must be carried out.
- **Reporting**--Identifying and tracking all funding under the Recovery Act is critical and must be reported on regularly.

RESULTS OF REVIEW

With one exception cited below, HUD's final assessment for NSP2 discloses that for each of the 11 factors, the program risk was identified, in-place and planned risk mitigation techniques were identified, and the rationale for the final risk ratings was adequately described. Our review determined that the factors of general control environment, risk assessment, control activities, information/communication, and monitoring were adequately addressed and the major program

objectives of timeliness, clear and measurable objectives, transparency, monitoring, and reporting were adequately emphasized in the assessment.

Timeliness: HUD was directed to implement the NSP2 expeditiously, and the final NSP2 assessment details the specific timeframes associated with NSP2 funding. Competition criteria were due to be published within 75 days of enactment, applications were due within 150 days of enactment, and all funds were due to be obligated within one year of enactment. Upon receiving allocated funds, grantees must expend at least 50 percent of funds within two years and 100 percent of funds within three years.

Clear and measurable objectives: Mechanisms were in place to measure and track outputs and outcomes. HUD had identified the risk measures and how these measures will be evaluated. Outputs and outcomes will be tracked through quarterly grantee reporting. The grantees will provide baseline information, which will be measured against quarterly reports to track program outputs and outcomes. These outputs and outcomes include short-term and long-term program objectives. Short-term program objectives are to arrest the decline in home values based on average sales price and to reduce or eliminate vacant and abandoned residential property in targeted neighborhoods. Long-term program objectives are to increase sales of residential property and increase market values of real estate in targeted neighborhoods.

In addition to the short- and long-term measures above, HUD defined six additional measures to analyze the effectiveness of NSP2, including

- The total number of housing units acquired,
- Jobs created or retained as a result of the NSP2 assistance, and
- Total number of housing units assisted with NSP2 funds and affordable at 50 percent of average median income.

Transparency: HUD was acutely aware of the Administration's expectation with respect to the program's transparency. The assessment quotes a portion of the Recovery Act, which reads in part, "The President has made it clear that every tax dollar spent on our economic recovery must be subject to unprecedented levels of transparency and accountability." Factor 11: Special Concerns or Impacts, deals in depth with the transparency issue. The assessment reads in part, "As mentioned in prior sections, the Department is carefully analyzing its performance measurements to address the special accountability mandate for the Recovery Act. Given additional attention from the Department, added risks involving accountability and transparency are being addressed." As detailed above, HUD had identified outputs and performance measures for accountable and transparent management. HUD will use the Disaster Recovery Grant Reporting system to track the measureable objectives cited above, and grantees will be required to enter actual performance achieved for each selected measure.

Monitoring: Historically, monitoring has been a problem for HUD's Office of Community Planning and Development (CPD) staff. As the assessment states, "Field office staffs are currently overextended by their workload, as indicated by the fact that only 20% of existing grantees can be monitored annually by field offices." In addition, Office of Inspector General (OIG) report number 2008-NY0001 reads in part, "...while HUD monitoring of CDBG

entitlement communities identified numerous grantee deficiencies and offered meaningful recommendations for corrective actions, grantee performance had often not improved over time. We attribute this deficiency to the fact that HUD monitoring was geared to the resolution of compliance issues while placing little emphasis on performance outcomes.”

To address these concerns, HUD planned to hire 32 additional staff dedicated to NSP2. The staff will be responsible for overseeing hundreds of new grant applications and up to 100 grants during the three-year life cycle of NSP2. Although HUD monitoring of grantee performance will be conducted pursuant to monitoring guidelines and practices for the regular CDBG program, monitoring resources will be determined after headquarters and field offices perform individual grantee risk analyses through the grants management process. HUD was also developing new guidance to cover unique risk analysis and monitoring checklist items.

Reporting: HUD’s NSP2 assessment details the reporting requirement for its grantees. The assessment cites requirements for the grantee to report the following to HUD 10 days after the end of each calendar quarter (starting July 10, 2009), including but not limited to

- The total amount of recovery funds received from HUD.
- The amount of recovery funds received that were expended or obligated to projects or activities. This reporting must also include unobligated balances to facilitate reconciliations.
- Detailed information on any subcontracts or subgrants awarded by the grantee.
- A detailed list of all projects or activities for which recovery funds were expended or obligated, including but not limited to
 - The name of the project activity,
 - A description of the project or activity,
 - An evaluation of the completion status of the project or activity, and
 - An estimate of the number of jobs created and the number of jobs retained by the project or activity.

Compliance Exception - HUD Failed to Comment on Open Audit Recommendations as Required

HUD failed to comply with section 3.10 of OMB’s Updated Implementing Guidance for the American Recovery and Reinvestment Act of 2009. The guidance provides the following instructions to agencies developing such a plan:

Agencies should also begin their planning by determining whether final action has been taken regarding weaknesses or deficiencies disclosed by prior audits and investigations in program areas under which Recovery Act funds are authorized. If final action has not been completed, agencies should: (1) expedite such action to preclude the continuance of such weaknesses or deficiencies in the administration of Recovery Act funded programs; or (2) provide an explanation of why such corrective actions

cannot or should not be taken in the administration of Recovery Act funded programs.

During 2006 and 2007, OIG performed an audit (Report Number 2008-NY-0001) of HUD's CDBG program and issued a report on December 31, 2007, that contained several recommendations. We found that four of the recommendations that could have affected our review objectives remained open and overdue. Although HUD made general references to previous audits in its assessment, it failed to specifically address the open recommendations cited below as required by the guidance. The open recommendations, listed by original recommendation number, that could have affected our review objectives include

- 1B. Design a performance measurement system that allows HUD to report, not just outputs, but also meaningful outcomes, such as the extent to which grantees meet their own goals and the objectives of the CDBG program.
- 1C. Design a ranking and rating scoring system for the individual CDBG grantees so that HUD and stakeholders can identify and address both good and poor program performers.
- 2A. Establish controls to ensure that CPD monitoring efforts are consistently applied, streamlined to emphasize high-impact activities, and focus on promoting improvements in program participant performance.
- 2B. Establish controls that will assess the impact of CPD monitoring on grantee performance so as to ensure that grantee compliance with recommendations relates to overall performance.

The assessment states that NSP2 will be administered as the CDBG program is administered. Therefore, the recommendations above should have been considered in the context of the assessment, and an explanation as to why corrective action had not been taken should have been given. With respect to the open recommendations, HUD is required to either expedite such action to preclude the continuance of such weaknesses or deficiencies in the administration of Recovery Act-funded programs or provide an explanation of why such corrective actions cannot or should not be taken in the administration of Recovery Act-funded programs.

CONCLUSION

With the single exception cited above, HUD's final assessment for NSP2 disclosed that for each of the 11 factors, the program risk was identified, in-place and planned risk mitigation techniques were identified, and the rationale for the final risk ratings was adequately described. Our review determined that the factors of general control environment, risk assessment, control activities, information/communication, and monitoring were adequately addressed and the major program objectives of timeliness, clear and measurable objectives, transparency, monitoring, and reporting were adequately emphasized.

RECOMMENDATIONS

Based on the results of this review, the memorandum contains no recommendations.

AUDITEE'S RESPONSE

We provided our discussion draft audit memorandum to HUD's Acting Deputy Chief Financial Officer on September 8, 2009, and held an exit conference on September 15, 2009. HUD declined our offer to provide comments on the memorandum.