



**Inspector General’s Statement  
Summarizing the Major Management  
and Performance Challenges Facing  
the U.S. Department of Housing and  
Urban Development for Fiscal Year  
2018 and Beyond**

**October 17, 2017**

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U.S. DEPARTMENT OF  
HOUSING AND URBAN DEVELOPMENT  
OFFICE OF INSPECTOR GENERAL

*Memorandum*

TO: Ben Carson  
Secretary, S

FROM: Helen M. Albert *Helen M. Albert*  
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SUBJECT: Management and Performance Challenges for Fiscal Year 2018 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 2018 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 (Ginnie Mae) 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 financial institutions that have delegated authority to issue FHA-insured mortgages, 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 10 key management and performance challenges facing HUD:

1. Human capital management and financial management governance.
2. Financial management systems.
3. Digital Accountability and Transparency Act compliance.
4. Weaknesses in information technology security control.
5. Single-family programs.
6. Community planning and development programs.
7. Public and assisted housing program administration.
8. Administering programs directed toward victims of natural disasters.
9. Departmental enforcement.
10. Operational and financial reporting challenges affecting Ginnie Mae.

Attachment

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## Introduction and Approach

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### Introduction

The U.S. Department of Housing and Urban Development's (HUD or Department) 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 (Ginnie Mae) 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 financial institutions that have delegated authority to issue FHA-insured mortgages, cities that manage HUD's Community Development Block Grant (CDBG) 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, which have evolved substantially over the years.

### Approach

HUD's Office of Inspector General (OIG) is one of the original 12 Offices of Inspector General established by the Inspector General Act of 1978. While part of HUD, OIG provides independent oversight of HUD's programs and operations. Planning OIG's audits, evaluations, and investigations is a continuing process to focus resources on areas of greatest priority and benefit to the taxpayer and HUD. The broad goal for OIG is to help HUD resolve its major management challenges while maximizing results and providing responsive work.

The process is dynamic in order to address requests and other changes throughout the year. OIG identifies audits, evaluations, and investigations through discussions with program officials, the public, and Congress; assessments of previous audits, evaluations, and investigations; and reviewing proposed legislation, regulations, and other HUD issuances. It also conducts audits, evaluations, and investigations that HUD and Congress request, as well as those identified from OIG's hotline. It works with departmental managers to recommend best practices and actions that help address the management and performance challenges through its audits, evaluations, and investigations.

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

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For many years, one of HUD's 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. Several studies have been completed on HUD's use of human capital by the U.S. Government Accountability Office (GAO) that point to a lack of human capital accountability and insufficient strategic management as pervasive problems at HUD. To some extent, these human capital challenges have contributed to HUD's inability to maintain an effective financial management governance structure, which we have reported on for the last 4 years and which contributed to our issuing disclaimers of opinion as part of our annual financial statement audits of HUD's financial statements.

On March 13, 2017, President Trump signed an executive order on a Comprehensive Plan for Reorganizing the Executive Branch. The order asks agencies to identify where money is being wasted, how services can be improved, and whether the services are benefiting the Nation. The mandate also involves reducing the Federal workforce. To get to a smaller workforce, agencies had to act immediately and submit a plan to the Office of Management and Budget (OMB) by September 2017 as part of their fiscal 2019 budget submission.

In HUD, the effort to restructure itself is not an exercise in workforce reduction. According to its Chief Operating Officer, HUD has spent a lot of time trying to mitigate any concerns around the current or upcoming personnel and process changes by participating in a highly engaged process, which includes obtaining feedback from all levels of the workforce. HUD believes part of the path toward better execution includes Senior Executive Service (SES) reassignments and potential buyouts or early outs across the Department. HUD recognizes the real impact on morale that moving senior executives or offering buyouts could have on the agency. Around 10 to 15 percent of HUD's SES workforce have been reassigned, and HUD expected OMB to approve its reorganization plan by mid-September.

### **Human Capital Studies**

In May 2015, GAO issued a report based on work issued from January 2014 through February 2015 and ongoing work related to employee engagement. The report focused on key human capital areas in which some actions had been taken but attention was still needed by the Office of Personnel Management (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, will be 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 make certain business continues and that it fulfills its missions.



In August 2016, GAO issued a report examining HUD's efforts to (1) meet requirements and implement key practices for management functions, including financial, human capital, acquisition, and information technology (IT) management, and (2) oversee and evaluate programs. GAO found that HUD had made progress in developing new human capital plans and mostly followed key principles and practices for strategic workforce planning, succession planning, and training planning. However, HUD has struggled to maintain other current plans as required by OPM regulations. For example, HUD's previous strategic workforce plan expired in 2009, and HUD did not complete the next plan until 2015. HUD has been unable to maintain current plans in part because it lacks a process to help ensure that it reviews and updates the plans before existing plans expire. Regularly assessing and updating these plans would help ensure that HUD has a strategic vision for managing its workforce and addressing human capital challenges. GAO's report produced eight recommendations, of which five remain open.

In May 2017, the GAO director of strategic issues testified in front of the House of Representatives Committee on Oversight and Government Reform and spoke on the need to carefully consider the Federal compensation system and its modernization to avoid a mission-critical skills gap as more than 34 percent of current governmentwide employees become eligible to retire in 2020. At HUD, around 45 percent of employees are eligible to retire in 2020.

### **Financial Management Governance of HUD and the Impact on HUD's Financial Integrity**

Financial management governance issues have contributed to several of the material weaknesses and significant deficiencies noted in our report on HUD's consolidated financial statements. In mid-September 2017, these issues were further complicated by the unexpected announcement of two Office of the Chief Financial Officer (OCFO) senior management departures. HUD's Deputy Chief Financial Officer (CFO)-Acting CFO departed HUD on September 25. The Assistant Deputy CFO for Budget was then named the Acting Deputy CFO and Acting CFO but has since announced that she also plans to leave HUD in early November 2017. These two senior positions set policy and give direction to HUD's and its components' budgetary and financial reporting processes. HUD has provided no information regarding when replacements for these positions will be announced. The absence of a confirmed CFO, coupled with vacancies in key management positions critical to financial reporting within HUD and Ginnie Mae, creates a lack of leadership going forward to address HUD's current financial integrity issues.

First, HUD's financial management governance weaknesses resulted in many financial statement errors that required frequent restatements. For the fourth consecutive year, HUD will need to restate its financial statements to correct errors. In addition, in fiscal year 2017, HUD had to withdraw and reissue its fiscal year 2016 financial statements. Further, HUD has not received a clean opinion since fiscal year 2014. Frequent restatements to correct errors and disclaimers can undermine public trust and confidence.

Second, we have noted that OCFO management has a high tolerance for risk. Management decided halfway through the fourth quarter of fiscal year 2017 to revamp the financial reporting process and implement a new process to prepare financial statement notes. While process improvements to more effectively prevent or detect the pervasive errors is a worthy goal, delaying such an impactful change presents substantial risks. In addition, we are concerned about the significant risks associated with OCFO's decision to make changes to key financial reporting processes and tools (such as technologies) so close to yearend. We are also concerned

that OCFO's Financial Reporting Division, the group responsible for executing the significantly changed financial reporting processes, have not been included to the extent necessary to address risks. Going forward, HUD should increase the input of responsible personnel and plan time to provide responsible parties the opportunity to perform user acceptance testing and resolve unanticipated or unexpected difficulties. OCFO management has not fully disclosed to us why such a major decision was made so late in the fiscal year instead of immediately after the reissuance of prior-year financial statements. The factors noted above indicate that HUD's financial management maturity contains characteristics associated with "inadequate" or "basic" levels of a financial management maturity model recently published by the Bureau of Fiscal Services (BFS) within the U.S. Department of Treasury.<sup>1</sup>

### **Transition to a Federal Shared Services Provider for Financial Management Services and a Policy and Procedure Framework**

During 2016, GAO and OIG reported on a number of issues related to HUD's transition to a Federal shared services provider (FSSP) for financial management services. During our audit of HUD's fiscal year 2016 financial statements, we noted significant internal control weaknesses in financial processes, information processing, and financial reporting that ultimately contributed to pervasive material errors in the financial statements and notes, causing HUD to withdraw and reissue its fiscal years 2016 and 2015 financial statements and notes. We attributed these weaknesses to the weak financial governance over the transition to the FSSP.

HUD did not identify or address significant risks or implement adequate controls before transitioning to the FSSP for financial management services. As a result, almost 2 years after the shift, several issues remain unaddressed. For example, HUD still cannot produce timely and accurate financial statement notes. Late in the fiscal year, in mid-August 2017, OCFO made the decision to change the way that it prepares the notes; and ultimately decided to not submit third quarter financial statement notes to OMB as required by Circular A-136. As a result, OCFO management will not have the benefit of an established process for yearend that will ensure timely and consistent financial reporting. Further, HUD has not incorporated key elements of internal control into its financial management operations and has yet to implement several important internal controls through policies and procedures or establish the periodic review of policies and procedures to reflect changes to business processes. This condition was identified during fiscal year 2016 and continued during fiscal year 2017 without significant improvement. To improve the continuity of accounting policies and procedures in a changing environment, policies and procedures should be centrally located and easily accessible to staff. The lack of a policy framework has hindered and will continue to hinder efforts to adapt to changes in a timely manner and will continue to hinder the resolution of numerous financial statement audit deficiencies.

### **Information and Communication**

HUD's information and communication among departments and offices has been a consistent challenge. Program office accounting policies and procedures have at times been developed without adequate OCFO input due to broad delegation to program office personnel. For example, HUD's current financial management structure relies on the delegation of several key financial management functions to HUD's program offices, including review and approval of

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<sup>1</sup> Treasury Financial Management Federal Financial Management Self-Assessment Maturity Model



vouchers, reviews of unliquidated obligations, and various budgetary accounting functions. However, we have found that program-related issues, concerns, and decisions cannot be made without adequate consultation with subject-matter experts, including OCFO, and appropriate consideration of accounting standards. We have attributed the root cause of significant deficiencies and material weaknesses identified in our audits to inadequate consideration of key accounting and financial rules and regulations. For example, we have attributed the material weaknesses cited in our financial statement audit reports related to the Office of Community Planning and Development's (CPD) budgetary accounting for grants and HUD's assets and liabilities being misstated or not adequately supported primarily to inadequate collaboration with OCFO.

### **Enterprise Risk Management and Formation of a Senior Management Council**

HUD needs to implement processes and procedures to ensure an effective system of internal control, not only for financial management governance, but also across the Department within all programs. HUD is responsible for implementing enterprise risk management to comply with OMB's updated Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control.<sup>2</sup> These standards provide the criteria for designing, implementing, and operating an effective internal control system with a greater focus on operational risks and controls. To effectively implement enterprise risk management, HUD will need to establish a framework for operational risks and controls.

A 2015 National Academy of Public Administration study<sup>3</sup> of OCFO's governance supported the longstanding OIG recommendations that HUD strengthen the finance workforce, establish a management council to enhance its financial governance, and take action to address risks related to the FSSP transition.

While HUD had resisted recommendations to create a senior management council, the updated OMB Circular No. A-123 changed the establishment of a senior management council from a best practice to a requirement. In response, HUD has formed a senior management council and opted to locate the council and responsibility for enterprise risk management within the Office of Strategic Planning and Management (OSPM). HUD's success will depend on strong coordination between OCFO and OSPM.

### ***Summary of OIG Work***

We continue to monitor the status of progress made in establishing an effective human capital management program at HUD. In addition, we continue to report on the need for improved financial governance.

### **Looking Ahead**

We will continue monitoring HUD's progress in establishing an effective human capital management program and improving financial management governance. In addition, we will monitor HUD's efforts to comply with the executive reorganization order. In 2017, the number

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<sup>2</sup> OMB M-16-17, OMB Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control

<sup>3</sup> Department of Housing and Urban Development, Office of Chief Financial Officer, Organizational Assessment, March 19, 2015, [http://napawash.org/images/reports/2015/HUD\\_OCFO\\_Study\\_Final\\_Report.pdf](http://napawash.org/images/reports/2015/HUD_OCFO_Study_Final_Report.pdf)

of material weaknesses, significant deficiencies, and instances of noncompliance is likely to remain elevated, and the 2017 financial statement audit opinion is unlikely to change.

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## Financial Management Systems

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

### New Core Project

In the fall of 2012, the New Core Project was created to move HUD to a new core financial system that would be maintained by a shared service provider, BFS. Through its New Core Project, HUD was the first cabinet-level agency to transition some of its core accounting functions to an FSSP. The transfer of its financial management to an FSSP was widely publicized.

We have completed five audits of HUD's implementation of the New Core Project and issued the reports from June 2015<sup>4</sup> through September 2017. With each audit, we continued to find weaknesses in the planning and implementation of the project. In the first audit, we found that weaknesses in the planned implementation of certain parts of the project were not adequately addressed. HUD also did not follow its own agency policies and procedures, the policies established for the New Core Project, or best practices. These weaknesses related to requirements and schedule and risk management areas that are significant to the project plan and HUD's ability to manage them were critical to the project's success.

Our second audit<sup>5</sup> found that due to missed requirements and ineffective controls, interface processing of travel and relocation transactions resulted in inaccurate financial data in HUD's general ledger and BFS' financial system. Although HUD had taken action to mitigate some of the problems, we were concerned that HUD was moving too fast with its implementation plans and would repeat these weaknesses.

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<sup>4</sup> Audit Report 2015-DP-0006, Weaknesses in the New Core Project Were Not Adequately Addressed, June 12, 2015

<sup>5</sup> Audit Report 2015-DP-0007, New Core Release 1 of Phase 1 Implementation Was Not Completely Successful, September 3, 2015

Our third audit<sup>6</sup> found that HUD had unresolved data conversion errors and inaccurate funds management reports and lacked a fully functional data reconciliation process upon implementing certain parts of the project. In addition, the New Core Interface Solution's performance was not monitored, tracked, or measured, and controls over processing errors within Oracle Financials were routinely bypassed. Oracle Financials provides the ability to establish and manage budgetary authority in accordance with federal appropriations law. These conditions occurred because HUD rushed the implementation of the release. As a result, in June 2016, unresolved data conversion errors were estimated at an absolute value of more than \$9 billion, HUD's funds management reports contained inaccurate data, and the newly completed status of funds reconciliation report indicated that there was an absolute value of \$4.5 billion in differences between the HUD Centralized Accounting and Processing System (HUDCAPS) and Oracle Financials.

Our fourth audit<sup>7</sup> found that HUD's transition to an FSSP did not significantly improve the handling of its financial management transactions. Weaknesses identified with the controls over New Core Interface Solution and the conversion to the shared service provider's procurement application contributed to this issue. A year after the transition, HUD had inaccurate data resulting from the conversions and continued to execute 97 percent of its programmatic transactions using legacy applications. In addition, the interface program that allowed for and translated the financial transactions between HUD and the U.S. Treasury's Administrative Resource Center (ARC) was not covered under HUD's disaster recovery plan. These conditions occurred because of funding shortfalls as well as highly questionable decisions made by HUD. Examples include that the Project Team decided to (1) separate phase 1 of the project into smaller releases, (2) move forward with the implementation despite having unresolved issues, and (3) terminate the project before its completion. While HUD considered its New Core Project implementation successful, it acknowledged that not all of the originally planned capabilities were deployed. In April 2016, HUD ended the New Core Project and the transition to an FSSP after spending \$96.3 million; however, the transition did not allow HUD to decommission all of the applications it wanted to or achieve the planned cost savings.

Our fifth review<sup>8</sup> found that transaction processing had improved but significant challenges and weaknesses remained. Although HUD had improved from what we found during our fiscal year 2016 audit work, HUD continued to experience some weaknesses in transaction processing, could not fully support the balances recorded in its general ledger, and did not fully reconcile data between HUDCAPS and its general ledger.

HUD encountered significant challenges with its transition to ARC's financial management services and Oracle Financials. Funding shortfalls, as well as the impact of HUD's decisions regarding the project, ultimately impaired the effectiveness of HUD's internal controls and the efficiency and effectiveness of its operations instead of improving them. The implementation increased the number of processes required to record programmatic financial transactions, which

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<sup>6</sup> Audit Report 2016-DP-0004, HUD Rushed the Implementation of Phase 1, Release 3, of the New Core Project, September 20, 2016

<sup>7</sup> Audit Report 2017-DP-0001, HUD's Transition to a Federal Shared Service Provider Failed To Meet Expectations, February 1, 2017

<sup>8</sup> Audit Report 2017-DP-0003, New Core Project: Although Transaction Processing Had Improved Weaknesses Remained, September 29, 2017

increased the number of opportunities for data to be modified between HUD's legacy applications' subledgers and the general ledger maintained in Oracle Financials.

### **Outdated Information Technology Systems**

Overall, funding constraints diminished HUD's ability to integrate updated application systems and replace and deactivate legacy systems. Limited progress has been made in modernizing applications and enhancing capabilities to replace 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 challenging 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, high operation and maintenance costs, and increased susceptibility to security breaches. 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. As a result, HUD's financial systems continue to be at risk of compromise.

HUD's voucher and project-based Section 8 and public housing programs accounted for 78 percent of HUD's 2016 enacted discretionary budget authority of \$47.2 billion. In addition, HUD's FHA program has insured more than 33.5 million mortgages valued at more than \$3.8 trillion since 1980. These four program areas alone have 20 major information systems supporting the management of those programs, and those systems contain in excess of 300 million records on program recipients – with data fields that include private, personally identifiable information. In short, the management information systems supporting these four critically important HUD programs contain personally identifiable information for all American citizens who received HUD-sponsored housing assistance, lived in public housing, and obtained an FHA-insured mortgage, including such information on all dependents within those households.

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 relating 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.

### ***Summary of OIG Work***

Annually since 1991, we have reported on the lack of an integrated financial management system, including the need to enhance FHA's management controls over its portfolio of integrated insurance and financial systems. In recent years, we have completed five audits on HUD's implementation of the New Core Project. The results showed that HUD continued to have weaknesses in planning and implementation throughout the project efforts to date. In addition, HUD's transition to an FSSP did not significantly improve the handling of its financial management transactions, even after spending \$96.3 million on the project. Although our most recent testing showed that HUD had improved New Core transaction processing, significant weaknesses and challenges remain. HUD is also challenged by its reliance on outdated information technology systems. The lack of funding to modernize its systems hinders HUD in protecting its system data from being compromised.

### **Looking Ahead**

We will continue evaluating HUD's activities related to the implementation of the New Core Financial Management Solution and FHA's management controls over its portfolio of integrated insurance and financial systems.

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## **Digital Accountability and Transparency Act Compliance**

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One of the Department's emerging major management challenges is compliance with the Digital Accountability and Transparency Act of 2014 (DATA Act).<sup>9</sup> The DATA Act builds on agency transparency reporting requirements established by the Federal Funding Accountability and Transparency Act of 2006 (FFATA) and the implementation date was May 2017. HUD's efforts to comply with the DATA Act have been hindered by management turnover and indecision, resource limitations, and disparate IT systems that reside on different platforms with dissimilar data elements.

### **Noncompliance With DATA Act Reporting Requirements**

As of the statutory reporting deadline, HUD had not submitted all required data for FHA and Ginnie Mae, and loan program data under community planning and development and public and Indian housing for four of the seven required files because it was unable to resolve data quality and file consolidation issues. In addition, HUD was unable to produce, during the second quarter of 2017, two of the seven required files because the data from the awardees were unavailable.

In our August 2016 and March 2017 DATA Act readiness reviews, we found that HUD was not on track to meet the DATA Act's requirements by the statutorily required date of May 2017.<sup>10</sup> Our initial audit of HUD's compliance with the Act has validated those projections, and as of the second quarter of 2017, HUD was noncompliant. Further, the extent of HUD's noncompliance

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<sup>9</sup> Digital Accountability and Transparency Act of 2014, Public Law No. 113-101

<sup>10</sup> 2016-FO-0802, Independent Attestation Review: U.S. Department of Housing and Urban Development, DATA Act Implementation Efforts, dated August 26, 2015, and 2017-FO-0801, Independent Attestation Review: U.S. Department of Housing and Urban Development, DATA Act Implementation Efforts,

increased with an initial third quarter data submission that did not meet governmentwide standards.

### **Lack of Management Governance Over DATA Act Implementation**

HUD's management did not establish an environment for ensuring a successful implementation of DATA Act reporting during fiscal years 2016 and 2017. HUD's DATA Act team has been hindered by management turnover and indecision. HUD had three different senior accountable officials within a 6-month span during the initial phase of implementation. Additionally, the conclusion that the DATA Act applied to FHA and Ginnie Mae was not made until approximately May 2016, or 2 years after the Act requirements became effective and just over 1 year before the reporting deadline. These conditions delayed implementation efforts and precluded the reasonable expectation that the deadline would be met. More recently, we noted that the senior accountable official did not certify key data submissions.

Additionally, HUD's management did not consider establishing proper governance through documented policies and procedures. HUD's management was responsible for taking steps to comply with applicable guidance. In our readiness attestation reviews, we offered eight recommendations to management to ensure an effective implementation of the DATA Act within the agency. However, management disregarded our recommendations, thereby delaying its ability meet the statutory deadline.

In addition, management inaccurately represented HUD's progress toward implementation in a December 8, 2016, testimony<sup>11</sup> before the United States House of Representatives by stating that HUD has developed a plan that follows the eight steps outlined in the DATA Act Playbook and there has been proactive planning and management. Management represented that HUD was on track with completing milestones. However, we concluded in our second attestation review, issued March 2, 2017, that the agency was still unable to show progress in resolving the matters relating to reliance on many legacy and current financial systems with differing technologies and data elements and performing the required data inventory and mapping.

Generally, we have noted a low level of management and executive support for this statutorily required effort. While HUD has taken some steps to implement the DATA Act, the lack of management and executive support will continue to hinder HUD's compliance going forward.

### **Compliance Milestones and Human Resource Limitations**

In addition to management turnover and the delays related to the FHA and Ginnie Mae components, key HUD milestones have been delayed. Specifically, HUD did not complete an inventory of data elements or the mapping of agency data in a timely manner. Throughout the effort, HUD's project plan dates for milestones significantly exceeded Treasury and OMB guidance, and HUD's project plan dates did not position HUD for compliance with the DATA Act by the required implementation date.

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<sup>11</sup> Testimony of Courtney Timberlake, Deputy Chief Financial Officer, U.S. Department of Housing and Urban Development, before the Committee on Oversight and Government Reform Subcommittee on Government Operations, United States House of Representatives, on December 8, 2016



HUD's DATA Act efforts languished, in part due to inadequate resources and unprepared personnel. Competing departmental priorities like HUD's transition to a shared service provider for financial management services added to HUD's resource limitations. While management consistently identified challenges related to limited resources, management did not take action to address these issues in a timely manner. For example, the Acting CFO, who is responsible for DATA Act implementation, decided not to fund contractor resources that were being used toward DATA Act implementation and allowed the existing contract to expire due to a lack of funding.

### **Information System Weaknesses and Data Quality Issues**

HUD has experienced challenges with the DATA Act (and FFATA) implementation due to the Department's reliance on many financial systems with differing technologies and data elements. To provide quality-spending data, agencies will be required to make available financial obligation and outlay data and award-level data based on agency financial systems. However, HUD's legacy systems have hindered efficient and effective financial reporting. As the DATA Act requires the use of agency financial systems, many of the issues reported in the financial systems management challenge also apply.

In addition, HUD has been unable to resolve data quality issues that have impeded the complete and accurate reporting of departmental contract, grant, loan, and other financial assistance awards in USASpending.gov. Data quality issues have limited HUD's ability to map agency data to the established DATA Act schema, including assigning the Federal award identification number.

### **Weak Internal Controls Over DATA Act Reporting**

HUD did not implement internal control policies and procedures for ensuring accurate, reliable, and complete data submissions to USASpending.gov by the statutory May 2017 deadline. HUD was unable to provide a listing and description of the internal controls designed and implemented for reporting for the DATA Act for each source system, including those for FHA and Ginnie Mae components. The data reported in HUD's files submitted to USASpending.gov for the second quarter of 2017 did not have the proper system-level controls over the data consolidated into each required file.<sup>12</sup>

In addition, HUD's management did not consider establishing proper governance through documented policies and procedures. Specifically, the senior accountable official did not document governance policies, including roles and responsibilities of each entity involved in the agency's submission to USASpending.gov. There were no defined policies and procedures established for HUD's internal personnel, including Ginnie Mae and FHA, and ARC for completing file consolidation.

### **Summary of OIG Work**

We issued two preimplementation attestation reports that were designed to determine whether HUD was on track to meet the implementation deadline. Both attestation reports concluded that

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<sup>12</sup> File A, Appropriations Account; File B, Object Class and Program Activity; File C, Award Data for Procurement and Financial Assistance; Files D1 and D2, Award and Awardee Attribute Files; File E, Additional Awardee Attributes; and File F, Sub-award Attributes

HUD was not on track to provide complete, departmentwide reporting by the May 2017 deadline. Additionally, we provided recommendations to the Department to address key issues that would impede timely compliance. However, six of eight recommendations issued remained unimplemented, two of which did not have management decisions at the date of this report.

Further, we assessed the agency's internal controls over DATA Act reporting and conducted a statistical sample of HUD's File C submission. Our draft audit report concluded that HUD's submission of second quarter 2017 data was not compliant with the Act. We recommended that the senior accountable official designate additional HUD personnel and establish an internal reporting structure to complete DATA Act implementation, while sustaining reliable DATA Act reporting for subsequent periods, and ensure that all reportable FHA and Ginnie Mae data are certified and submitted through the DATA Act broker and reported on USAspending.gov. Further, we recommended that HUD establish and implement internal control procedures to ensure that data reported from the agency's source systems are completely and accurately reported in USAspending.gov.

### **Looking Ahead**

We will continue to perform our initial audit as HUD works to implement the DATA Act, and we plan to issue our first statutorily required report by the November 2017 deadline.

Due to the outstanding implementation issues identified during our attestation reviews and compliance audit, HUD continues to be noncompliant with the Act in the third and fourth quarters of 2017. The Department was unable to resolve data quality issues that impeded a complete and accurate submission to USAspending.gov. We will monitor HUD's progress in implementing our recommendations to ensure compliance in fiscal year 2018.

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## **Weaknesses in Information Technology Security Control**

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To accomplish its mission of providing benefits and services to the American public and the nationwide housing market, HUD must efficiently process hundreds of thousands of transactions daily and manage and protect hundreds of millions of records containing the personal information of citizens. HUD systems and web services provide access to these data for HUD personnel, members of the public, and business partners and transmit large amounts of data daily. However, much of these data reside on or are processed on legacy systems, making it essential that HUD modernize its IT infrastructure to ensure the confidentiality, integrity, availability, and overall security of its data and systems.

OIG has conducted annual Federal Information Security Modernization Act of 2014 (FISMA) and other focused evaluations to review HUD's cybersecurity program, initiatives, and ability to secure HUD data and IT systems. Our reviews, evaluations, and audits have consistently found that HUD faces significant long- and short-term challenges in multiple FISMA areas and in its ability to modernize legacy systems. Our most recent FISMA evaluation found that while the Office of the Chief Information Officer (OCIO) is taking positive steps to improve its

cybersecurity program, HUD still needs substantial time, effort, and resources to accomplish significant change. HUD continues to face many of the same IT challenges year after year, making this a challenge in itself. Although HUD is showing some progress in remediating deficiencies, it has 51 open FISMA evaluation recommendations from fiscal years 2013-2016 that have been open from 500 to more than 1,000 days. These recommendations need to be addressed to rectify longstanding security weaknesses. Further, the privacy program has an additional 14 open recommendations for the fiscal years 2013-2015 evaluation period. Additionally, 23 recommendations have been made in fiscal year 2017, and 4 of those have been closed.

As in prior years, we continue to report weaknesses in key areas, such as the IT risk management program, lagging IT system modernization efforts, key IT staffing vacancies, lack of technical contractor oversight, and gaps in the information security continuous monitoring program. HUD is working to develop a comprehensive enterprise risk management (ERM) program, to include IT risks, but this initiative is in its initial stages. Without an ERM, HUD continues to address risk in a decentralized and fragmented fashion and fails to fully incorporate and prioritize IT risks according to enterprise mission and business objectives. In addition, HUD inadequately documents security risks in accordance with National Institute of Standards and Technology guidance.

HUD maintains many legacy systems, resulting in more than 400 IT applications running on unsupported platforms, increasing the risk of unknown and unpatchable vulnerabilities. Legacy systems are difficult or unable to migrate to cloud technology or comply with two-factor authentication requirements, further complicating HUD's long-term efforts to modernize and secure its systems and data while creating efficiencies and cost savings. HUD is striving to increase the use of cloud services but needs to complete and communicate a formal, detailed cloud strategy.

HUD continues to have significant staffing challenges with filling key IT vacancies. HUD recently filled the Chief Information Officer (CIO) position. However, this is a political appointee position and historically has experienced high turnover. The Deputy CIO for IT Operations has been vacant since December 2014, and the Chief Information Security Officer position has been vacant since March 2017. Further, our FISMA evaluation showed that 16 of the 36 key IT managerial and supervisory positions stationed at HUD headquarters were either vacant (11) or filled by temporary "acting" personnel (5) during fiscal year 2016, and the conditions continue to be similar in fiscal year 2017. We are concerned that turnover in IT leadership roles continues to deflate HUD's momentum and reduce its chance of correcting short- and long-term IT security challenges. Because of this, HUD continues to outsource infrastructure and application support, divesting itself of much of its own technical expertise. HUD should also continue to review its cybersecurity cost requirements and be resourced appropriately. According to a draft GAO report,<sup>13</sup> HUD spends 1 percent of its IT budget on IT security, which is the lowest of all 23 Chief Financial Officer Act agencies. The average spending is 8 percent.

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<sup>13</sup> GAO Draft Report, GAO-17-549, Federal Information Security

Further, OIG evaluations examined HUD's web application security posture during fiscal year 2017 and found that multiple publicly accessible web applications were not operated or their existence was unknown by OCIO. These web applications, in several instances, were operated by contractors and in cloud environments that were not vetted by OCIO, resulting in a significant security risk to the Department and its data. This occurrence highlights weaknesses in the CIO's authority and HUD's IT governance, both of which have been cited as longstanding concerns.

Although significant weaknesses still exist, HUD has made improvements to some elements of IT security. For example, HUD has successfully contracted for and implemented a new Computer Incident Response Team, greatly improving HUD's capability to detect and report security incidents. In addition, HUD is participating in the U.S. Department of Homeland Security's Continuous Diagnostics and Mitigation (CDM) program that Congress established to provide adequate, risk-based, and cost-effective cybersecurity and more efficiently allocate cybersecurity resources. HUD is in the early stages of implementing multiple tools and processes through the CDM program. Long-term improvements in HUD's cybersecurity program depend heavily on the successful deployment and integration of these tools and processes.

### ***Summary of OIG Work***

Our work has mainly focused on assessing mandated requirements and web application security to assist HUD in identifying IT risks and vulnerabilities. We continue to work with HUD by making recommendations to prioritize efforts for improving the cybersecurity posture and IT infrastructure and securing HUD data.

### **Looking Ahead**

Numerous program areas need to be reviewed to independently identify and provide recommendations for improving the cybersecurity posture. We have developed a 3-year approach to evaluate HUD's IT infrastructure, policy, processes, and security program capabilities in order to focus on HUD's IT implementation plans and Federal Government IT initiatives. We will provide oversight on the progress of HUD's IT security program and modernization efforts by using the annual FISMA reviews and focused IT evaluations, while ensuring a collaborative effort with HUD and HUD's stakeholders.

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## **Single-Family Programs**

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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 \$1.1 trillion. Effective management of this portfolio represents a continuing challenge for the Department.

### **Preserving the FHA Fund**

Before fiscal year 2015, FHA's fund had been below its legislatively mandated 2 percent capital ratio for the past 6 years. However, beginning in fiscal year 2015, the fund met its threshold target capital ratio once again.<sup>14</sup> According to the 2016 actuarial study, the fund had an estimated economic value of \$35.27 billion. Based on the 2016 projections, the fund is expected to maintain a capital ratio above the threshold limit and will gradually build reserves over time if the forecasted trend continues. 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.

The Department must make every effort to prevent or mitigate fraud, waste, and abuse in FHA loan programs. We continue to take steps to help preserve the FHA insurance fund and improve FHA loan underwriting by collaborating 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 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 more than \$14.8 billion in damages and penalties in the last 6 fiscal years.

For the FHA-insured loans, results in the last 6 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 \$5.1 billion for alleged violations of the False Claims Act; the Financial Institutions Reform, Recovery, and Enforcement Act; and the Program Fraud Civil Remedies Act. Nearly \$3.3 billion of the \$5.1 billion is of direct benefit to the FHA insurance fund.

### **Monitoring Lenders and FHA 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 ensuring 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. Three years ago, we 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.

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<sup>14</sup> Our calculation of the capital ratio was based the information we obtained from FHA's final actuarial report, published in November 2015, and using the amortized insurance-in-force as the denominator.

Based on the results of an August 2014 audit,<sup>15</sup> we 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. 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 a decision on the matter.

FHA program regulations at 24 CFR (Code of Federal Regulations) Part 203 do not establish a maximum period for filing a claim, and they do not place limitations on holding costs when servicers do not meet all foreclosure and property conveyance deadlines. In addition, HUD reviews only a small percentage of claims to ensure that servicers meet required deadlines. In July 2015, HUD submitted a proposed rule for public comment in the Federal Register (FR-5742) to establish a maximum period for servicers to file a claim for insurance benefits and curtail servicers’ claims for property preservation and administrative costs occurring after the date on which the servicer should have filed a claim. HUD proposed to allow servicers 12 months from the expiration of the reasonable diligence timeline to convey the property. HUD stated that the proposed rule would improve its ability to protect the FHA insurance fund. However, the proposed rule was not finalized because mortgage servicers expressed concern that such changes were not realistic, citing unavoidable delays in the foreclosure process. HUD needs to continue to pursue changes to FHA program regulations and work with industry leaders to reissue proposed changes that adequately protect the fund from unnecessary and unreasonable costs incurred when servicers do not convey properties in a timely manner. Further, in its 2015 actuarial report, HUD projected that it may incur future losses because of servicers’ delayed foreclosures and conveyances. HUD reported its concern that delayed foreclosures limited its ability to identify current and future risks to the FHA insurance fund.

Based on an audit report issued in October 2016<sup>16</sup> covering FHA’s monitoring and payment of conveyance claims, we found that HUD paid claims for nearly 239,000 properties that servicers did not foreclose upon or convey on time. Servicers missed their foreclosure and conveyance deadlines and did not report the self-curtailment date of their debenture interest. As a result, HUD paid at least \$2.23 billion in unreasonable and unnecessary costs. Without regulatory authority, HUD has few options to compel servicers to convey and file a claim. Program regulations allow HUD to disallow mortgage interest when a servicer misses a foreclosure deadline, but HUD has no further recourse to protect itself from paying holding costs incurred after servicers have missed conveyance deadlines. Therefore, if a servicer missed its deadline to

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<sup>15</sup> Audit Report 2014-LA-0005, HUD Did Not Always Recover FHA Single-Family Indemnification Losses and Ensure That Indemnification Agreements Were Extended, August 8, 2014

<sup>16</sup> Audit report 2017-KC-0001, FHA Paid Claims for Properties That Servicers Did Not Foreclose Upon or Convey on Time, October 14, 2016



initiate foreclosure, it forfeited its mortgage interest and had no further financial or regulatory incentives to meet its remaining deadlines.

Further, in another audit,<sup>17</sup> we found that HUD did not always collect on partial claims due upon termination of the related FHA-insured mortgages. HUD failed to collect an estimated \$21.5 million in FHA partial claims that became due in fiscal year 2015. HUD's contract with its national loan-servicing contractor lacked a performance requirement measuring partial claims collection. In addition, HUD's monitoring reviews of the contractor did not improve the contractor's performance in collecting partial claims. We recommended that HUD require the contractor to identify all partial claims that were due and payable, prepare the paperwork needed for debt collection, and transfer the claims to the Financial Operations Center. The Financial Operations Center should collect the \$21.5 million in uncollected partial claims from fiscal year 2015 from the borrowers, or if it is not possible to collect from the borrowers due to lender error, it should collect those funds from the lender. HUD also needs to strengthen contract and monitoring review procedures to ensure that partial claims are properly collected.

### **Distressed Asset Stabilization Program (Single-Family Note Sales)**

In July 2017,<sup>18</sup> we reported our concerns that HUD did not conduct rulemaking or develop formal procedures for its single-family note sales program. HUD conducts single-family mortgage note sales under section 204(g) of the National Housing Act. In 2012, HUD held three note sales. The first two sales were under the Loan Sales program, and with the third note sale, the name of the program was changed to the Distressed Asset Stabilization Program (DASP). DASP accepts assignment of eligible, defaulted single-family mortgage loans in exchange for claim payment and then sells them in a variety of pooled note sales. The FHA insurance on the mortgages terminates when the pooled notes are sold to investors. HUD has sold more than \$18 billion in distressed notes through its note sales programs.

In 2006, HUD started but did not complete rulemaking for its note sales program. HUD issued an advance notice of proposed rulemaking to solicit comments on its Accelerated Claim and Asset Disposition (ACD) program. This was the first title used by HUD in referring to its single-family note sales program. In that notice, HUD stated, "This notice solicits comments on HUD ACD Demonstration program before HUD issues a proposed rule to codify the requirements for the ACD program." HUD went on in the Background section of the notice to state, "Before implementing the new ACD disposition process on a nationwide basis, HUD has conducted an ACD Demonstration program involving a group of defaulted mortgages. This has allowed HUD to assess the overall effectiveness of this disposition process. HUD believes that improvements can be made to the program to make it more effective. Consequently, before proceeding with the regulatory codification of the ACD program, HUD is soliciting comments from all interested parties, especially those who participated or declined to participate in the Demonstration program, on possible improvements to the program." HUD continued, "When codified, the ACD program will become a permanent part of HUD's single family mortgage insurance programs. The proposed rule would also revise 24 CFR part 291, which governs the disposition

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<sup>17</sup> Audit report 2016-KC-0001, HUD Did Not Collect an Estimated 1,361 Partial Claims Upon Termination of Their Related FHA-Insured Mortgages, August, 17, 2016

<sup>18</sup> Audit Report 2017-KC-0006, HUD Did Not Conduct Rulemaking or Develop Formal Procedures for Its Single-Family Note Sales Program, July 14, 2017

of HUD-acquired single family property, to incorporate the policies and procedures for the sale of loans assigned to HUD under the ACD program.” However, HUD did not finalize the comment process or prepare the program for a final rule.

We concluded that DASP is a substantive rule, which would be subject to rulemaking requirements under 24 CFR Part 10, which extends Administrative Procedure Act rulemaking requirements to HUD programs regarding loans and public property. During the prenote and postnote sale process, there are restrictions on the pooled loans, notification requirements to borrowers, and specific participation requirements of nonprofits and local governments in a direct sales program. These factors strongly suggest that this is more than a simple contractual relationship and may have impacts beyond the actual purchaser of the assigned mortgages. Completing the rulemaking process would allow public officials, citizens, and industry participants the opportunity to provide comments for a more than \$18 billion program and would help HUD develop a consistent standard for administering the program.

### **FHA Safe Water Requirements**

HUD requires that properties insured by FHA meet certain property requirements. One such requirement is that the insured property must have a continuing supply of safe and potable<sup>19</sup> water. We audited HUD’s oversight of safe water requirements for FHA-insured loans nationwide due to news reports that identified elevated levels of lead contamination in water across the country and a prior audit of HUD’s oversight of FHA-insured loans on properties in Flint, MI.<sup>20</sup>

In 2016, we issued a report on elevated levels of lead contamination in the water in Flint, MI. HUD had insured loans on properties in Flint that closed after the city began using the Flint River as its water source. In its response to the audit report, HUD expressed concern that FHA’s duty to enforce the standards for minimum property requirements for homes that are candidates for FHA insurance is conflicted by FHA’s commitment to carry out the Secretary’s goal of promoting access to credit in all communities. It also expressed concern that this commitment was particularly important in communities like Flint that are underserved by the mortgage lending community. HUD further stated that it is essential that FHA’s policy for underwriting mortgage loans be consistent across the entire Nation, including but not limited to the requirement for a safe and potable water supply. As part of the FHA-insured loan process, FHA requires a property appraisal. The appraiser must be an FHA Roster appraiser, licensed, and geographically competent. Geographic competency means that the appraiser is familiar with the local area and understands the local market. Relative to water quality, the requirement for local competency puts the burden on each appraiser to know whether water testing is necessary. It is impractical for FHA to have variations in policy locality by locality.

In response to the January 2016 Presidential Declaration regarding the water crisis in Flint, in February 2016, FHA issued a question and answer document that recognized the water contamination crisis in Flint and reminded lenders and other stakeholders involved with FHA transactions of the requirements for properties to be eligible for insurance. The guidance stated

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<sup>19</sup> Potable water is water that is safe for drinking.

<sup>20</sup> Audit report 2016-PH-0003, HUD Did Not Ensure That Lenders Verified That FHA-Insured Properties in Flint, MI, Had Safe Water, July 29, 2016

that if a property was located in an area serviced by an unacceptable water system with unacceptable levels of contaminants, including lead, a water test must be completed. However, FHA has not incorporated this requirement or any other clarifying language into its single-family housing policy (HUD Handbook 4000.1). We made six recommendations to HUD and have reached management decisions with HUD on all of the recommendations, with final actions to be completed by December 20, 2017.

In September 2017, we further reported that HUD did not provide sufficient guidance and oversight to ensure that properties approved for mortgage insurance had a continuing and sufficient supply of safe and potable water. Of 49 loan files reviewed, from a universe of 1,432 properties connected to a public water supply for which a notice that it had lead contamination was issued to the public, none disclosed the contamination or contained evidence of water testing. We attributed this condition to HUD maintaining that its existing policies and guidance sufficiently ensured that FHA-insured properties had a continuing and sufficient supply of safe and potable water. HUD also lacked adequate controls to determine whether lenders and appraisers performed required testing of properties in areas serviced by a public water system with known issues.

In response to the audit report, HUD stated that it seeks to balance its primary missions of providing access to affordable mortgage credit while protecting the insurance fund and the need to promote safe housing. HUD agreed that its guidance for ensuring that properties meet minimum standards is inadequate regarding water quality. It stated that it will review its current guidelines and consult with appropriate government authorities to develop policies to ensure that lenders and appraisers have clear and consistent guidance for determining when water testing is required. HUD also stated that it will consider our recommendation to require water testing for all properties. It will also consider the cost and ability of the market to execute testing consistently nationwide.

### *Summary of OIG Work*

We continue to report on risks to the FHA insurance fund. In the area of loan underwriting, audits and investigations conducted over the last 6 fiscal years have shown that a high percentage of loans reviewed should not have been insured because of significant deficiencies in the underwriting. In the area of insurance claims against the fund, we have noted HUD's financial exposure when paying claims on loans that were not qualified for insurance. Further, HUD did not always bill lenders for FHA single-family loans that had an enforceable indemnification agreement and a loss to HUD. Our audit of delayed conveyances found that HUD paid claims for an estimated 239,000 properties that servicers did not foreclose upon or convey on time because it did not have adequate controls in place to ensure that servicers complied with Federal regulations.

Regarding other areas of HUD's single-family program, our audit of the rulemaking process for single-family note sales determined that HUD did not conduct rulemaking or develop formal procedures for its more than \$18 billion program. Lastly, our two audits regarding FHA's oversight of insured properties having safe and potable water noted that HUD did not ensure that lenders verified that properties being serviced by a public water system with known levels of lead had the water tested.

## Looking Ahead

We continue to take steps to help preserve the FHA insurance fund and improve FHA loan underwriting by collaborating with HUD, the U.S. Department of Justice, and multiple U.S. Attorney's offices nationwide in a number of FHA lender civil investigations, while continuing to monitor the FHA program.

We will also stay updated on the progress and use of the digital mortgage platform. We will engage with HUD to determine how it is preparing resources in the upcoming fiscal year to move to a digital platform.

We will remain vigilant in reviewing Ginnie Mae's oversight of its nonbank issuers. In fiscal year 2016, nonbank issuers accounted for 73 percent of Ginnie Mae's single-family mortgage-backed security issuance volume, up from 51 percent in June 2014. It is imperative to evolve and understand the risks imposed by nonbanks and proactively address them.

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## Community Planning and Development Programs

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### Integrated Disbursement and Information System

HUD's continued use of the FIFO (first-in, first-out) method as an accounting methodology for appropriated funds<sup>21</sup> results in a material misstatement of HUD's financial statements. HUD's plan to eliminate FIFO and to remove cumulative commitment accounting<sup>22</sup> from its Integrated Disbursement and Information System (IDIS) Online was applied to fiscal year 2015 and future grants and not to grants for fiscal years 2014 and earlier. Since 2013, we have also reported that IDIS Online, a grants management system, was not designed to comply with Federal financial management system requirements and support the U.S. Standard General Ledger at the transaction level. We continue to take exception to not removing the FIFO methodology retroactively, which will continue the departures from generally accepted accounting principles (GAAP) and result in material misstatements on the financial statements. Use of the FIFO method contributed to the qualified audit opinion on HUD's financial statements in fiscal year 2013 and the disclaimer audit opinion issued in fiscal years 2014 through 2016. HUD's lack of retroactive removal of FIFO will have implications on future years' financial statement audit opinions until the impact is assessed to be immaterial. Despite the changes made to IDIS thus far, modifications are still needed for the system to fully comply with the Federal Financial Management Improvement Act (FFMIA), which were scheduled through September 2017. However, the fiscal year 2017 appropriations act removed the commitment requirement for the

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<sup>21</sup> The FIFO method is a way in which CPD disburses its obligations to grantees. Disbursements are not matched to the original obligation authorizing the disbursement, allowing obligations to be liquidated from the oldest available budget fiscal year appropriation source. This method allows disbursements to be recorded under obligations tied to soon-to-be-canceled appropriations.

<sup>22</sup> HUD implemented a process, called the cumulative method, to determine a grantee's compliance with the requirements of section 218(g) of the statute and determine the amount to be recaptured and reallocated with section 217(d). HUD measured compliance with the commitment requirement cumulatively, disregarding the allocation year used to make the commitments.

HOME Investment Partnerships program for fiscal years 2016 through 2019; therefore, HUD will continue to use the cumulative method for determining compliance with the HOME commitment requirement.

### **Subgrantee Monitoring**

Through August of fiscal year 2017, 5 of our 11 community planning and development-related audits found that in some instances, little or no monitoring occurred, particularly at the subgrantee level. The same deficiency was documented in 15 of our audits issued during fiscal years 2014 through 2016. 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. We have concerns regarding the capacity of subgrantees receiving funding from HUD programs, including grantees receiving Community Development Block Grant 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. In fiscal year 2016, HUD approved \$80.71 million in Section 108 guaranteed loan commitments for a variety of community and economic development projects throughout the United States.

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.

External audits we conducted for the period 2012 through 2016 identified serious deficiencies in the administration of the Section 108 loan program that affected the effectiveness of the program. We found eight Section 108 loans in which loan agreement provisions and HUD requirements were not followed, which resulted in more than \$54 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.

A 1997 report from GAO disclosed similar deficiencies regarding HUD's oversight of the Section 108 Loan Guarantee program. According to the report, some HUD field offices did not routinely include the Section 108 loans in their annual reviews because they (1) did not believe they had guidance on how to monitor the program, (2) did not believe they had a responsibility to monitor the loans, (3) had other priorities, or (4) lacked loan-specific information. The report recommended that HUD direct field offices to include a review of Section 108 activities when they reviewed CDBG communities and States and develop procedures to ensure that the information necessary to monitor the program was promptly provided to field offices. HUD agreed with the recommendations and stated that it would take appropriate corrective measures. However, the deficiencies continued to exist.

In April 2017, an OIG audit found that HUD's oversight of Section 108 loans was not adequate to ensure that funds were effectively used to meet program objectives and that borrowers complied with loan contract provisions. The Section 108 loans were not routinely included in HUD's annual reviews. HUD had not conducted monitoring reviews for 12 of 14 (85 percent, \$102.5 million) loans that we reviewed. Between 327 and 2,533 days had elapsed since the loan contract date, and monitoring reviews had not been conducted for the 12 loans. For two loans, HUD's monitoring review was conducted between 682 and 901 days after the contract date. As a result, HUD had no assurance that more than \$24 million in Section 108 loans fully provided the intended benefits and met program objectives and that borrowers complied with program requirements.

The infrequent monitoring of Section 108 loans was not consistent with section 104(e)(1) of the Housing and Community Development Act of 1974. HUD must conduct performance reviews at least annually to determine whether the grantees have carried out CDBG activities in a timely manner, in accordance with the program requirements, and in compliance with primary and national objectives.

On August 24, 2017, HUD submitted proposed management decisions on the April 2017 audit report, but we have been unable to reach an agreement on the actions necessary to correct some of the deficiencies identified. For example, HUD stated that it was in the process of developing new procedures for the Section 108 program. However, it disagreed with us regarding initiating remedial actions, under paragraph 12 of the loan contract, against borrowers that fail to comply with program requirements. HUD also disagreed with directing field offices to include the review of Section 108-funded activities when performing the annual reviews of CDBG recipients because of alleged resources constraints.

We are concerned that these issues, in which more than \$78 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.

### **Disposition of Real Properties Assisted With CDBG Funds**

HUD faces challenges in its oversight of the disposition of real properties assisted with CDBG program funds. CDBG funds may be used for several activities, including the acquisition, rehabilitation, demolition, remediation, and improvement of private and public real properties. Over the past 3 years, more than \$9.7 billion, or 9.26 percent of the CDBG funds disbursed, went to activities involving real properties that we identified as higher risk based on prior audit work and activity definitions. These activities often involve large amounts of CDBG funds, are subject to several program requirements related to the use of the properties, and can generate program income upon the disposition of the properties, which can be several years after the funds have been used.

In a recent report,<sup>23</sup> we found that HUD could improve its oversight of the disposition of real properties assisted with CDBG funds. Although HUD's drawdown and reporting system allowed grantees to enter identifying information for assisted properties and its field offices performed risk-based monitoring of grantees, HUD's controls were not always sufficient to ensure that grantees (1) entered addresses of assisted properties into its system, (2) adequately protected HUD's interest in the properties, (3) provided proper notice to affected citizens before changing the use of assisted properties, (4) adequately determined the fair market value of assisted properties at the time of disposition, and (5) properly reported program income from the disposition of the properties. We attributed these deficiencies to HUD's lack of emphasis on verifying address information, its field office staff's not being adequately trained to use data to monitor HUD's interest in properties, and one field office that we reviewed incorrectly interpreting program requirements. As a result, HUD could not adequately track and monitor its interest in the properties and did not have assurance that its interest in these properties was protected. Further, HUD did not have assurance that grantees properly handled changes in use and properly reported program income.

### **OIG CPD Collaboration**

An OIG and HUD CPD joint collaboration issued six integrity bulletins to assist grantees and subgrantees in the areas in which OIG reported that grantees and subgrantees were most vulnerable. The bulletins issued addressed the following areas:

- procurement and contracting,
- subrecipient oversight,
- conflicts of interest,
- internal controls,
- documentation and reporting, and
- financial management.

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<sup>23</sup> Audit Report 2017-NY-0002, HUD Could Improve Its Controls Over the Disposition of Real Properties Assisted With Community Development Block Grant Funds, September 29, 2017

In addition, the Inspector General coauthored a joint letter with the Principal Assistant Secretary, CPD, to State and local governments communicating our collaborative effort to encourage efficient operations and effective accountability for the best use of limited resources. The published bulletins are posted on our website at [www.hudoig.gov/fraud-prevention](http://www.hudoig.gov/fraud-prevention). Since publication of the integrity bulletins, the work group has begun developing a guide to provide critical information and insight to CPD grantees to facilitate an efficient OIG audit process. The work group is also discussing other areas in which a joint collaboration may be beneficial.

### ***Summary of OIG Work***

We took exception to HUD's not removing the FIFO methodology retroactively, which continues the departure from GAAP and will result in material misstatements on the financial statements. HUD's use of the FIFO methodology contributed to the qualified audit opinion and consecutive disclaimers of audit opinion issued on HUD's financial statements in fiscal years 2013 through 2016.

In fiscal years 2014 through August 2017, at least 20 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. We have concerns regarding the capacity of subgrantees receiving funding from HUD programs, including grantees receiving CDBG-DR funds.

Audits we conducted for the period 2012 through 2017 identified serious deficiencies in the administration of the Section 108 loan program that affected the effectiveness of the program. Further, HUD lacked assurance that funds were adequately accounted for, safeguarded, and used for authorized purposes and in accordance with HUD requirements.

A recent audit found that HUD could improve its oversight of the disposition of real properties assisted with CDBG funds. We have concerns that HUD does not adequately track and monitor its interest in the properties and, therefore, has no assurance that its interest in these properties is protected.

In an effort to assist grantees and subgrantees in the areas in which our audit reports determined that the grantees and subgrantees were most vulnerable, we have issued several integrity bulletins aimed at providing the grantees and subgrantees with information to help safeguard program funds and ensure that communities get the full benefit of awarded funding. We will continue to work with CPD to encourage efficient operations and effective accountability for the best use of limited resources.

### ***Looking Ahead***

We will continue to monitor these issues and conduct audits as appropriate, related to HUD's community planning and development activities. We are working with HUD through the management decision process to resolve the FIFO methodology and any related recommendations.

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## Public and Assisted Housing Program Administration

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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. Approximately 3,800 PHAs provide affordable housing for 1.1 million households through the low-rent operating subsidy public housing program and for 2.2 million households through the Housing Choice Voucher program. Multifamily project owners provide approximately 28,000 properties that assist more than 1.2 million households. The challenges listed below are the responsibility of PIH. The following challenges relate to PIH's limits on information systems:

- monitoring the Housing Choice Voucher program operations and physical inspections process,
- cash management requirements, and
- monitoring small and very small housing agencies.

Other challenges include

- central office cost centers,
- monitoring Moving to Work (MTW) agencies,
- overincome families in public housing,
- environmental review requirements,
- the Indian Home Loan Guarantee program, and
- the Required Conversion program.

### **Information Technology Challenges in the Office of Public and Indian Housing**

Due to IT funding constraints, PIH has not updated several of its outdated systems. Many of these systems need updates or overhauls to help PIH comply with Federal requirements and its ever-changing environment. In the absence of modern automated systems, PIH is forced to use intensive manual processes that are time consuming, do not fully fulfill Federal requirements, and hamper PIH's monitoring efforts.

### **Monitoring the Housing Choice Voucher Program Operations and Physical Inspections Process**

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. Due to its limited funding for new systems development and staffing constraints, PIH employs a risk-based approach to monitoring using its Utilization Tool and National Risk Assessment Tool. HUD will continue to face challenges in monitoring this

program until it has fully implemented a reliable, real-time, and all-inclusive monitoring tool. This tool would also assist in accumulating actual payments to individual landlords that would address the next challenge.

In response to a 2008 audit report,<sup>24</sup> HUD developed a plan to monitor the physical condition of its Housing Choice Voucher program units. HUD is testing a system of inspections similar to the model used for its public housing units and multifamily projects. However, this testing, with an initial target completion date of September 30, 2014, is taking considerably longer than expected. HUD has performed initial inspections of more than 30,000 voucher units. However, it needs resources to continue developing the new protocol and related software for its comprehensive monitoring system. A 3-year demonstration program is ongoing. The demonstration authority was granted to test and then implement the revised protocol. It covers 241 PHAs and 45 percent of the Housing Choice Voucher program units. Meanwhile, we continue to identify PHAs with inspection programs which do not ensure that voucher program units comply with standards.

Our 2008 audit report also found that HUD did not have adequate controls to ensure that its Section 8 housing stock was in material compliance with housing quality standards. This condition occurred because HUD had not fully implemented its Section 8 Management Assessment Program. As a result, it could not ensure that the primary mission of the Section 8 program, paying rental subsidies so that eligible families can afford decent, safe, and sanitary housing, was met. In addition, HUD's lack of knowledge regarding the condition of its Section 8 housing stock resulted in inflated performance ratings for PHAs administering the program. As a result, HUD routinely rated some agencies as being high performers when a significant percentage of the units they administered were in material noncompliance with housing quality standards. We continue to audit the physical condition of Housing Choice Voucher program units.

#### 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. While PIH has made substantial progress in this area, 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. Complex reconciliations are prepared manually on 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 FFMIA. It also increases the risk of error and fraud 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 was elevated to the Deputy Secretary for a decision on March 31, 2015. HUD has not provided a management decision indicating how it plans to implement this recommendation. However, HUD is in the initial planning stages of developing an automated system, which may take a considerable amount of work to implement.

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<sup>24</sup> Audit Report 2008-AT-0003, HUD Lacked Adequate Controls Over the Physical Condition of Section 8 Voucher Program Housing Stock, May 14, 2008

### Monitoring 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 in low-rent authorized funding, they create oversight burdens and costs for both HUD and PHAs that are disproportionate to the number of families these PHAs serve. In a recent report,<sup>25</sup> we found that a significant cause of the deficiencies identified in small and very small PHAs was that executive directors and boards of commissioners chose to either ignore requirements or lacked sufficient knowledge to properly administer their programs. HUD uses a national risk-based approach to identify PHAs that may have governance issues to provide direct support. In addition, 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, we have 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 website at [www.hudoig.gov/fraud-prevention](http://www.hudoig.gov/fraud-prevention). Several advisories were directly related to PHAs and were emailed to executive directors. In addition, the former Inspector General coauthored a joint letter with the former Principal Deputy Assistant Secretary, PIH, to PHAs 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, the aforementioned training module for board members and executive staff.

### **Central Office Cost Centers**

PIH has a challenge in balancing its responsibility to protect HUD funds and streamlining activities to provide relief for PHAs. PHAs using a fee-for-service model pay a central office cost center for certain costs rather than allocating overhead costs. This practice impacts Housing Choice Voucher, Public Housing Operating Fund, and Public Housing Capital Fund program funds. Once paid to the central office cost center, the funds are defederalized and are no longer required to be spent on these programs. Ensuring that only the funds that are needed are transferred to the central office cost center will allow more funds to be used directly for the programs. HUD is experiencing difficulties with its original plan to develop rulemaking to ensure that Housing Choice Voucher, Public Housing Operating Fund, and Public Housing Capital Fund program funds are not defederalized when paid to the central office cost center. However, HUD will continue to work with OIG to explore options to ensure that only those funds needed to cover costs are defederalized.

HUD has also agreed to establish a process to regularly assess the reasonableness of the asset management fees. However, we continue to be concerned that we have not received justification

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<sup>25</sup> Audit Report 2015-FW-0802, Very Small and Small Public Housing Agencies Reviewed Had Common Violations of Requirements, September 16, 2015

regarding the need for an asset management fee. Our 2014 report<sup>26</sup> found that 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. We maintain concerns as to the fee's necessity, especially since the funds are defederalized.

### **Monitoring MTW 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 20 years since the demonstration program began, HUD has not reported on whether the program is meeting its objectives. HUD missed the opportunity to gather baseline metrics when it began the program with the initial 39 agencies. HUD has experienced challenges in developing programwide performance indicators that will not inhibit the participants' abilities to creatively impact the program. In 2013, HUD management developed new metrics to help measure program performance.

In December 2015, the 2016 Consolidated Appropriations Act authorized HUD to expand the program to include an additional 100 participants over 7 years without knowing whether participating agencies are reducing costs to gain increased housing choices and incentives for families to work. In April 2016, HUD extended its agreements with the 39 MTW PHAs through 2028. In light of the expansion, HUD began looking at new ways to evaluate overall program and agency performance. In the expansion program, HUD will take a more proactive role in controlling the initiatives undertaken and information gathered. Law requires that new agencies be added to the program in cohorts or groups of agencies that target one specific policy change. By narrowing the focus to one policy and trying it at several different agencies, it is possible to gather the needed data to properly analyze the policy being tested. As results become available over the next year or two, it will be clear whether HUD is collecting the data, it needs to adequately monitor the MTW agencies. As the expansion is implemented, we may have an opportunity to reevaluate the program and HUD's efforts to better monitor the outcome of the MTW demonstration program.

### **Overincome Families in Public Housing**

HUD has a challenge in addressing families having excessive income living in public housing units. As result of our 2015 audit<sup>27</sup> and after much public and congressional concern, President Obama signed the Housing Opportunity Through Modernization Act in July 2016. Section 103 of the legislation requires PHAs to either evict overincome families after 2 consecutive years of exceeding the applicable income limitation or raise their rent to the applicable fair market rent for a unit in the same market area of the same size or the amount of the monthly subsidy of operating funds and capital funds used for the unit. It also requires PHAs to submit an annual report that specifies the number of families residing in public housing that had incomes exceeding the applicable income limitation and the number of families on the PHA's waiting lists for admission to public housing. In November 2016, HUD published a Federal Register

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<sup>26</sup> 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

<sup>27</sup> Audit Report 2015-PH-0002, Overincome Families Resided in Public Housing Units, dated July 21, 2015



notice for comment regarding its implementation of Section 103 of the Act. The notice sought comment on HUD's methodology for setting the overcome limit for areas where HUD has discretion to set higher and lower income limits based on local housing market conditions. The comment period expired on January 30, 2017. However, HUD has not yet finalized the rule due to the impact of Presidential Memorandum 1 and Executive Order 13771 on implementation. To issue Section 103 regulations, HUD needs to identify two deregulating actions.

### **Environmental Review Requirements**

HUD has a duty to ensure that its projects are free of environmental hazards. As a result of recent OIG reports,<sup>28</sup> HUD established a memorandum of understanding among the program offices to define roles, responsibilities, and authorities. It also began providing more training to staff and grantees and implemented processes to improve its training program and curriculum to better support all program areas. In addition, 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 has also implemented an internal process within HEROS to track findings, which will allow the program areas to focus training on recurring issues. Risk-based compliance monitoring by HUD's field staff will target the highest risk PHAs and responsible entities based on identified factors and will result in improved compliance with environmental review requirements as well as align PIH with previously OIG-endorsed models within HUD.

While HUD has made improvements, it faces several challenges, including a 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, inadequate environmental reviews may contribute to an increased risk in the health and safety of the public and possible damage to the environment. For the five PIH field offices evaluated, PHAs spent almost \$405 million for activities that either did not have required environmental reviews or had reviews that were not adequately supported.

### **The Indian Home Loan Guarantee Program**

HUD faces challenges in accounting for the Indian Home Loan Guarantee program due to systems limitations and past errors. HUD does not have an interface between the Computerized Homes Underwriting Management System, the system used to track the loan guarantees, and its

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<sup>28</sup> Audit Report 2015-FW-0001, HUD Did Not Adequately Implement or Provide Oversight To Ensure Compliance With Environmental Requirements, June 16, 2015; Audit Report 2014-FW-0005, Improvements Are Needed Over Environmental Reviews of Public Housing and Recovery Act Funds in the Detroit Office, September 24, 2014; Audit Report 2014-FW-0004, Improvements Are Needed Over Environmental Reviews of Public Housing and Recovery Act Funds in the Greensboro Office, July 14, 2014; Audit Report 2014-FW-0003, Improvements Are Needed Over Environmental Reviews of Public Housing and Recovery Act Funds in the Columbia Office, June 19, 2014; Audit Report 2014-FW-0002, Improvements Are Needed Over Environmental Reviews of Public Housing and Recovery Act Funds in the Kansas City Office, May 12, 2014; and Audit Report 2014-FW-0001, The Boston Office of Public Housing Did Not Provide Adequate Oversight of Environmental Reviews of Three Housing Agencies, Including Reviews Involving Recovery Act Funds, February 7, 2014

general ledger. As a result, HUD must transfer files via email to upload daily loan guarantee activity to its general ledger. Additionally, HUD is working to clear discrepancies between its general ledger and subsidiary records, including differences in foreclosed property balances and differences in balances by cohort. HUD and its shared service provider, ARC, are hoping to have the discrepancies resolved in the near future.

### **Required Conversion Program**

HUD faces challenges in implementing its Required Conversion program. The Required Conversion program is included in Section 33 of the United States Housing Act of 1937 as amended and codified at 24 CFR Part 972. The purpose of the program is to ensure that distressed public housing developments are removed from the public housing inventory and tenant-based rental assistance is provided to the residents. The regulations require PHAs to identify distressed public housing developments (or parts of developments). These developments are subject to required conversion if they have vacancy rates of 12 percent or more and (1) it would be more expensive for the PHA to modernize and operate the distressed development as public housing for its remaining useful life than it would be to provide tenant-based rental assistance to all residents of those units or (2) the PHA cannot ensure the long-term viability of the distressed development.

In a recent report,<sup>29</sup> we found that HUD did not properly identify potential projects requiring conversion and did not follow up to ensure that PHAs took action by conducting proper analyses to determine whether projects should be converted to tenant-based rental assistance. Further, HUD did not apply available remedies when PHAs did not properly identify projects or implement required conversions. We attributed this deficiency to a lack of oversight and miscommunication among PIH, the Office of Field Operations, the Special Application Center, regional PIH field offices, and the PHAs. As a result, HUD did not require PHAs to identify and convert distressed projects, and up to \$75 million in operating subsidies and capital funds could continue to be spent on projects that have not been determined to be physically viable or less expensive than tenant-based rental assistance. We recommended that HUD look at each of the nine PHAs noted in the report to determine whether they are subject to required conversion and develop and implement policies and procedures regarding identification of potentially distressed projects and monitoring and enforcement of the required conversion program.

### ***Summary of OIG Work***

In recent audit reports, we demonstrated that PIH faces IT challenges, specifically with (1) monitoring the Housing Choice Voucher program operations and physical inspections process, (2) fully implementing cash management requirements, and (3) monitoring small and very small PHAs. PIH also continues to face challenges in (1) balancing its responsibility to protect HUD funds and streamlining activities to provide relief for PHAs, (2) developing programwide performance indicators that will not inhibit the MTW participants' abilities to creatively impact the program, (3) addressing families having excessive income being allowed to continue to reside in public housing units, (4) ensuring that PHA projects are free of environmental hazards, (5) providing adequate oversight of the Section 184 program, and (6) implementing its required conversion program.

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<sup>29</sup> Audit Report 2017-NY-0001, HUD PIH's Required Conversion Program Was Not Adequately Implemented, May 18, 2017

## Looking Ahead

We will continue to work with and monitor HUD's actions to address challenges in these areas. We have started an audit to look at lead-based paint in public housing and Housing Choice Voucher program units. We will continue to audit PHAs to identify other areas of concern that may arise.

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## Administering Programs Directed Toward Victims of Natural Disasters

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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 \$49.6 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; Hurricane Sandy in 2012; and the Louisiana flooding event and Hurricane Mathew in 2016. 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.

Of the active disaster grants, HUD has more than \$37.9 billion in obligations and \$34.5 billion in disbursements. 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, compliance with procurement requirements, and timely oversight efforts.

In addition to recovery efforts from prior-year disasters such as Sandy, HUD will have tremendous future challenges resulting from disaster relief efforts in response to the extraordinary destructive hurricanes that recently hit the United States in 2017. The United States has never been hit by three hurricanes as strong as Harvey in Texas, Irma in Florida, and Maria in Puerto Rico in the same season in modern times. As just one example, an estimated 213,000 FHA-insured single-family homes in the area affected by Hurricane Harvey lacked flood insurance. A media report puts the number of homes damaged or destroyed by Hurricane Harvey at 185,149, with at least 80 percent of those lacking flood insurance. The entire island of Puerto Rico and the States of Florida and Texas are in the process of fully assessing the massive destruction and recovery efforts that will be needed there. The amount of HUD funding ultimately needed to assist with recovery for these most recent disasters will be enormous. HUD's efforts to provide assistance to affected families and communities immediately after the storm and in the initial rebuilding stages will be essential to the recovery. HUD will also continue to have challenges for years to come when helping communities in their long-term recovery process.

Although HUD has made progress in recent years in 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:

- ensuring that expenditures are eligible and supported,
- ensuring that disaster grantees are following Federal procurement regulations,
- citizens encounter challenges when seeking disaster assistance, and
- conducting consistent and sufficient oversight efforts on disaster grants.

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

The Department faces significant challenges in monitoring disaster program funds provided to various States, cities, and local governments under its authority. This challenge is particularly pressing for HUD because of the limited resources to directly perform oversight, the broad nature of HUD projects, the length of time needed to complete some of these projects, the ability of the Department to waive certain HUD program requirements, and the lack of understanding of disaster assistance grants by the recipients. HUD must ensure that the grantees complete their projects in a timely manner and use the funds for their intended purposes. Since HUD disaster assistance may fund a variety of recovery activities, HUD can help communities and neighborhoods that otherwise might not recover due to limited resources. However, oversight of these projects is made more difficult due to the diverse nature of HUD projects and the fact that some construction projects may take between 5 and 10 years to complete. HUD must be diligent in its oversight to ensure that grantees have identified project timelines and are keeping up with them. HUD also must ensure that grantee goals are being met and that expectations are achieved.

We have completed 38 audits and 4 evaluations as well as investigation-related actions relating to CDBG-DR funding for Hurricane Sandy and other eligible events occurring in calendar years 2011, 2012, and 2013. We have identified \$119.6 million in ineligible or unnecessary costs, \$465 million in unsupported costs, and \$5.3 billion in funds put to better use. There are a number of other audits and evaluations as well as investigative work, which are underway. Before Hurricane Sandy, we had extensive audit and investigative experience with HUD's CDBG-DR program, most notably with grants relating to recovery after Hurricane Katrina and the terrorist attacks of September 11, 2001. While over the years, HUD has gained more experience and has made progress in assisting communities recovering from disasters, it continues to face challenges in administering these grants.

HUD faces a significant management challenge to ensure that funds disbursed for disaster recovery programs are used for eligible and supported items. We have highlighted four audit reports that illustrate these challenges for HUD in administering disaster recovery programs.

- In our review of St. Tammany Parish's Disaster Recovery grant program,<sup>30</sup> we determined that Parish officials did not (1) support that they performed an independent cost estimate and adequate cost analyses or maintained complete procurement files; (2) maintain a complete monitoring policy and finalize and fully implement their policy to aid in detecting fraud, waste, and abuse or have an internal audit function; or (3) include

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<sup>30</sup> Audit Report 2017-FW-1004, St. Tammany Parish, Mandeville LA, Did Not Always Administer Its CDBG Disaster Recovery Grant in Accordance With HUD Requirements or as Certified, April 6, 2017

all required information on their public website. As a result of these systemic deficiencies, the Parish could not provide reasonable assurance to HUD that it would properly administer, adequately safeguard, and spend its remaining \$8.67 million in allocated CDBG-DR funds in accordance with requirements and paid more than \$400,000 in questioned costs.

- In our report of the City of Springfield, MA’s management of its CDBG-DR grants,<sup>31</sup> we found that the City did not always properly procure vendors in accordance with Federal requirements and some payments to vendors were not adequately supported. The City also did not always properly document the duplication of benefits review in accordance with Federal requirements and City policies. As a result, HUD lacked assurance that \$1.9 million in CDBG-DR funds was provided for supported, necessary, and reasonable costs.
- In our review of the City of New York’s Build it Back Single Family program,<sup>32</sup> we determined that City officials did not establish adequate controls to ensure that CDBG-DR funds were disbursed in accordance with the HUD-approved action plan and to ensure compliance with HUD’s Lead Safe Housing Rule requirements. As a result, the City could not ensure that all eligible homeowners received fair and equitable treatment, and it did not show that more than \$1 million disbursed was for lead-safe homes.
- In our review of the State of Connecticut’s management of its Sandy CDBG-DR grants,<sup>33</sup> we found that the State did not always comply with the requirements for its owner-occupied rehabilitation and reimbursement programs. Specific issues included that procurements were not always executed in accordance with HUD requirements, environmental reviews were not completed in accordance with requirements, and the State did not always support the low- and moderate-income national objective. As a result, more than \$2.4 million in CDBG-DR funds was ineligible, and more than \$13.5 million was unsupported.

We attributed these conditions to the grantees’ weaknesses in maintaining file and supporting documentation, unfamiliarity with HUD rules and regulations, inadequate controls over its rehabilitation and reimbursement program, noncompliance with existing policies and procedures, and failure to follow State and Federal procurement regulations.

### **Ensuring That Disaster 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. Under Public Law 113-2, 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

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<sup>31</sup> Audit Report 2017-BO-1002, The City of Springfield, MA, Needs To Improve Its Compliance With Federal Regulations for Its Community Development Block Grant Disaster Recovery Assistance Grant, October 17, 2016

<sup>32</sup> Audit Report 2017-NY-1001, The City of New York, NY, Implemented Policies That Did Not Always Ensure That Community Development Block Grant Disaster Recovery Funds Were Disbursed in Accordance With Its Action Plan and Federal Requirements, November 2, 2016

<sup>33</sup> Audit report 2017-BO-1001, The State of Connecticut, Community Development Block Grant Disaster Recovery Assistance Funds, October 12, 2016

follow their own State and local laws, so long as their standards are equivalent to the applicable Federal law and standards. Further, a State is required to 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, so long as the procurements conform to applicable Federal law and standards.

Our audits of disaster programs funded under Public Law 113-2 found CDBG procurement violations and other contracting problems. We issued 15 external audit reports on disaster grantees with questioned costs totaling more than \$391.6 million related to procurement. Ten of the fifteen reports and more than \$371 million of the more than \$391.6 million involved State grantees. For example, in our audit of the State of New Jersey's CDBG-DR-funded Sandy Integrated Recovery Operations and Management System,<sup>34</sup> we found that the State did not procure services and products for its disaster management system in accordance with the Federal procurement requirements in 24 CFR 85.36(b) through (i). Specifically, the State (1) had not prepared an independent cost estimate and analysis before awarding the system contract to the only responsive bidder, (2) did not ensure that option years were awarded competitively and included provisions in its request for quotation that restricted competition, and (3) did not ensure that software was purchased competitively. The State did not adopt the Federal procurement standards but certified that its standards were equivalent to the Federal procurement standards. We concluded that the State's certification to HUD that it had proficient procurement processes was inaccurate. HUD disagreed. To resolve the recommendations from this audit, on January 10, 2017, HUD's former Deputy Secretary issued a memorandum stating that a State grantee that followed its procurement policy was not required to follow the Federal requirements.

In our audit of HUD's controls over its certifications of State disaster recovery grantee procurement processes,<sup>35</sup> we found that HUD did not always provide accurate and supported certifications of State disaster grantee procurement processes. Specifically, HUD (1) allowed conflicting information on its certification checklists, (2) did not ensure that required supporting documentation was included with the certification checklists, and (3) did not adequately evaluate the supporting documentation submitted by the grantees. As a result, HUD did not have assurance that State grantees had sufficient procurement processes in place, and the Secretary's certifications did not meet the intent of the Disaster Relief Appropriations Act of 2013. The report included five recommendations. HUD stated that our disagreement regarding the definition of a proficient procurement process as it related to State disaster grantees and the meaning of "equivalent" as it related to a State's procurement policies and procedures being "equivalent to" or "aligned with" the Federal procurement standards was closed by the former Deputy Secretary in her January 10, 2017, decision regarding the New Jersey audit. Based on that decision, HUD believed it was appropriate to close all of the recommendations. We disagreed and referred these recommendations to the Acting Deputy Secretary on March 31, 2017.

Although our audit reports have repeatedly identified procurement issues, HUD has continued to

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<sup>34</sup> Audit report 2015-PH-1003, The State of New Jersey, Trenton, NJ, Community Development Block Grant Disaster Recovery-Funded Sandy Integrated Recovery Operations and Management System, June 4, 2015

<sup>35</sup> Audit Report 2016-PH-0005, HUD Certifications of State Disaster Grantee Procurement Processes, September 29, 2016



revise the procurement requirements for State grantees, by lowering the procurement standards. For example, under Public Law 113-2, HUD considered that State grantees had a proficient procurement process in place if the State's procurement standards were equivalent to the Federal procurement standards. However, in June 2016, under Public Law 114-113, HUD considered that State grantees had a proficient procurement process in place if the effect of the State's procurement standards was equivalent to the effect of the Federal procurement standards, meaning that the standards operate in a manner providing fair and open competition. Later, in November 2016 and January 2017, under Public Laws 114-223 and 114-245, respectively, HUD considered that State grantees had a proficient procurement process in place if the effect of the State's procurement standards was equivalent to the effect of the Federal procurement standards, meaning that the standards, while not identical, operate in a manner that provides for full and open competition. We disagree with the lower procurement standards and will continue to perform audits in this area. We believe that Federal procurement is more than ensuring full and open competition. It also involves the acquisition of products and services at fair and reasonable prices.

### **Citizens Encounter Challenges When Seeking Disaster Assistance**

In response to a request from HUD, we identified the path and process citizens, homeowners, and businesses navigate to obtain disaster recovery assistance and the challenges and barriers they may encounter. Citizens may encounter a variety of challenges throughout the disaster navigation process. These challenges include potential duplication of benefits, slow disbursement of disaster-related funding, and delays in funding for low- and moderate-income citizens.

Based on our evaluation, Navigating the Disaster Assistance Process, 2017-OE-0002S, we identified the following challenges citizens may encounter while obtaining disaster recovery assistance:

- Duplication of benefits is an inherent risk to disaster recovery funding across the government. Benefits from multiple sources of Federal aid can result in citizens receiving funds that exceed the need for a particular recovery purpose. In these cases, citizens are responsible for repaying any duplicate benefits, which can be a burden to the citizen. A 2016 Congressional Research Service report noted duplication between the Small Business Administration (SBA) Disaster Loan Program and the CDBG-DR grant program. Another issue is that SBA disaster loans are dispersed more quickly than financial assistance from a CDBG-DR grant. As a result, it is possible for some homeowners to receive an SBA disaster loan, which would make them ineligible for a CDBG-DR grant. Therefore, homeowners who sought assistance early on are, in effect, disadvantaged because SBA loans must be repaid, while CDBG-DR grants do not have a repayment requirement.
- In some cases, the slow disbursement of funding created significant problems for citizens navigating the disaster recovery process. For example, in October 2016, the State of New Jersey's legislative committee held a hearing in which several citizens identified problems they encountered navigating the application process at both the Federal and State levels. Almost 4 years after Hurricane Sandy, citizens complained of difficulties in rebuilding their homes while fighting foreclosure actions, being short-changed by

contractors, and receiving little or no help from the State or Federal agencies disbursing funds to help them recover from the storm.

- CDBG-DR spending rates as well as how funds were disbursed varied significantly from State to State, creating inconsistencies in recovery efforts. In general, at least half of CDBG-DR funding must benefit low- and moderate-income (LMI) individuals and areas. Based on our review of reports from HUD OIG, we found instances in which a significant portion of CDBG-DR funding was not provided to LMI individuals and areas. For example, in 2016, HUD OIG issued a report on the State of Connecticut's CDBG-DR funding for Hurricane Sandy, which found that the State did not always support the LMI national objective. The 2008 Steps Coalition report stated that only 23 percent of Mississippi CDBG-DR funding was devoted to LMI individuals. Lastly, the Mississippi Center for Justice report identified Mississippi's failure to rebuild homes and pressure placed on the State to redirect unused Federal hurricane resources to more recent disasters. Unfortunately, these shortcomings put low-income citizens at risk of not being able to return to a permanent home.

### **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 2015 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 followup on monitoring findings was not performed consistently or in a timely manner. As reported in prior years, HUD faces difficulties in timely report issuance and monitoring of disaster program funds because of limited resources to perform the oversight and an aggressive monitoring schedule for Hurricane Sandy grantees. The inconsistent nature of the disaster recovery programs and HUD's intense workload continued to surpass its efforts to mitigate its challenges and conduct its work in a timely manner. 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. Untimely resolution of grantee performance and financial management issues increase the programs' susceptibility to instances of fraud, waste, abuse, and mismanagement of funds. Monitoring of disaster grant recipients will continue to be of great importance, as multiple disasters have occurred in recent months.

### ***Summary of OIG Work***

Our audit reports exposed the challenges for HUD in administering disaster recovery programs. They highlighted CDBG procurement violations and other contracting problems and identified challenges citizens may encounter as they attempt to recover from disaster-related occurrences. In addition, the reports illustrated grantee control problems with ineligible and unsupported cost items. As reported in prior years, HUD faces difficulties in timely report issuance and monitoring of disaster program funds because of limited resources to perform the oversight and an aggressive monitoring schedule for Hurricane Sandy grantees.

### **Looking Ahead**

We will continue our audit, investigative, and evaluation work regarding HUD's disaster recovery activities, including (1) the timely expenditure of funds, (2) compliance with

procurement requirements, (3) timely oversight efforts, and (4) systematically documenting challenges citizens encounter during the disaster assistance process to reduce the likelihood of similar challenges recurring over time.

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## Departmental Enforcement

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A common thread underlying several of the issues discussed earlier is the lack of a cohesive departmental approach to monitoring, risk management, and followthrough for OIG findings and recommendations. In an evaluation,<sup>36</sup> we conducted on the effectiveness of the Departmental Enforcement Center (DEC), we found that the Department does not have an enterprise risk management approach to monitoring. Its monitoring is, for the most part, contained in each program office, and the approaches and results differ greatly.

While there were some successes, a much greater task lies ahead. DEC, working with the Office of Multifamily Housing Programs and the Real Estate Assessment Center, had improved housing physical conditions and financial management of troubled multifamily properties. Although some other program offices had taken steps toward risk-based enforcement, they had not taken full advantage of the benefits demonstrated when programs allow DEC to assess compliance and enforce program requirements. DEC proved that it can remedy poor performance and noncompliance when programs are willing to participate in enforcing program requirements.

DEC was established in part to overcome a built-in conflict of roles. The HUD management reform plan stated that program offices had a conflicting role in getting funds to and spent by participants versus holding them accountable when fraud or mismanagement of the funds occurs. However, memorandums of understanding between DEC and the program offices, for the most part, limit DEC's ability to monitor, report, and take action to end noncompliance. While the Office of General Counsel disagreed with much of our report, it is working with the program offices to strengthen the memorandums of understanding. However, we emphasize that new agreements need to give DEC clear and increased enforcement authority for it to be effective as a separate entity.

### *Summary of OIG Work*

We conducted an evaluation of the effectiveness of DEC and found that the Department does not have an enterprise risk management approach to monitoring. Its monitoring is, for the most part, contained in each program office, and the approaches and results differ greatly.

### **Looking Ahead**

We will continue to evaluate the Department's approach to monitoring, risk management, and followthrough for OIG findings and recommendations.

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<sup>36</sup> Evaluation Report 2015-OE-0004, Comprehensive Strategy Needed To Address HUD Acquisition Challenges, February 2, 2016

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## Operational and Financial Reporting Challenges Affecting Ginnie Mae

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Managing counterparty risks and strengthening Ginnie Mae's financial management accountability have been major challenges affecting Ginnie Mae in fiscal year 2017 and will continue in the coming years. Key factors that contributed to these challenges include the rise of nonbanks, lack of resources, inadequate financial systems, and lack of a fully functioning financial management governance framework.

### Managing Counterparty Risks

Ginnie Mae mortgage-backed securities (MBS) are the only securities to carry the full faith and credit guaranty of the United States Government. 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. At times, Ginnie Mae assumes the servicing rights and obligations of the issuer's entire Ginnie Mae guaranteed, pooled loan portfolio. Ginnie Mae uses master servicers (MSS) to service these portfolios. Ginnie Mae has two MSS for single-family defaulted issuers that service defaulted issuer portfolios (of pooled and nonpooled loans). In the aftermath of the 2008 financial crisis, a number of regulated banks have retreated from securitizing mortgages, and in this vacuum, the ranks of nonbank institutions have increased and continue to dominate Ginnie Mae's MBS program in terms of issuance. In fiscal year 2016, nonbanks were 73 percent of issuance volume, compared to 18 percent in fiscal year 2010.

Unlike regulated banks, these entities lack a primary prudential regulator to ensure their safety and soundness. In addition, these entities are not as well capitalized as regulated banks. Thus, Ginnie Mae has to mitigate these risks with greater oversight and resources dedicated to nonbank compliance, resources Ginnie Mae does not have. In the near term, these changes have strained its operating resources.

### Financial Reporting Challenges

Although Ginnie Mae has made progress in financial management governance issues in fiscal year 2017, there remain significant issues that warrant the attention of Ginnie Mae's stakeholders.

As in the previous 3 years, Ginnie Mae is not yet ready for OIG to audit all of the financial statements line items related to its nonpooled loan assets. In preparation for our full scope fiscal year 2017 audit of Ginnie Mae, we asked Ginnie Mae to provide progress updates and its work plan for its nonpooled loan assets and associated accounts (NPA) subledger database project. This was to include a schedule of when GAAP balances for all in-scope financial statements line items would be available for our review. In Ginnie Mae's response, it told us that while progress is being made to obtain operational balance on various NPA accounts, it was not possible for Ginnie Mae to produce GAAP balances on various NPA accounts in time for us to audit them in fiscal year 2017. Therefore, we excluded these Ginnie Mae financial statements line items in our audit scope for our fiscal year 2017 audit. Since the NPA accounts represent material balances

in Ginnie Mae's financial statements as well as the HUD consolidated financial statements, their exclusion in our audit scope in 2017 because of their inauditability would likely lead to a disclaimer of opinion on Ginnie Mae and HUD consolidated financial statements fiscal year 2017 financial statements audit.

In fiscal year 2016, we identified shortcomings in Ginnie Mae's issuer default governance framework. This framework includes the identification, monitoring, analysis, evaluation, and response to potential issuer defaults. This process includes an assessment to maximize defaulted issuer assets and minimize losses to Ginnie Mae. Moreover, this process gap can lead to Ginnie Mae's failing to properly capture the loss contingencies measured under the MBS program guaranty (reserve for loss) financial statements line item. In accordance with GAAP, Ginnie Mae is required to book a reserve for loss related to potential issuer defaults that are probable and estimable and to disclose in the notes to the financial statements any reasonably possible issuer defaults.

Ginnie Mae continues to have staffing issues. Of 11 positions backfilled in fiscal year 2016, 5 employees resigned in fiscal year 2017, including 2 employees in executive management positions.<sup>37</sup> Although the executive vice president position was subsequently backfilled in July 2017, the vice president of accounting policy and financial reporting position had remained vacant since March 2017. The impact of not backfilling an important position such as the vice president of accounting policy and financial reporting, who left the agency after having been on the job for less than a year, has created a huge void in Ginnie Mae's financial management operations and was a significant setback for Ginnie Mae. As Ginnie Mae's chief accountant, we recognize the importance of the vice president of policy and financial reporting's role in shaping and managing Ginnie Mae's financial management operations. For example, given his recent departure, we now have concerns that this situation will put Ginnie Mae more behind in finalizing and implementing many of its accounting policies and procedures. Ginnie Mae has finalized only 8 of 21 critical accounting policies to date. To assist Ginnie Mae with its day-to-day activities, it continues to rely heavily on third-party contractors to perform almost all key operating functions, such as loan servicing, pool processing, financial reporting, and audit readiness and remediation.

### ***Summary of OIG Work***

We identified significant financial governance issues within Ginnie Mae. While progress was made in fiscal year 2017, more work is needed to maintain a governance framework that allows appropriate policies, people, systems, and controls working together to ensure the reliability and integrity of Ginnie Mae's financial and accounting information.

### **Looking Ahead**

Ginnie Mae will continue to face challenges in this dynamic environment due to the shift in its business model. HUD and Ginnie Mae have yet to adequately respond to this new concept and properly mitigate these risks by implementing a sound infrastructure and control environment. Ginnie Mae has stated that it would require a significant investment in technology, infrastructure, and people spanning multiple years to make its significant financial assets auditable. HUD and

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<sup>37</sup> The two executive management positions are the executive vice president and vice president of accounting policy and financial reporting.

Ginnie Mae need to engage with Congress to lay out priorities, accelerate needed human capital and infrastructure improvements, and mitigate risks faced by the entity.

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## **Conclusion**

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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. We remain committed to working collaboratively with HUD and will continue to strive to provide best practices and reasonable recommendations that support HUD's mission and responsibilities.