



**Inspector General's Statement  
Summarizing the Major Management  
and Performance Challenges Facing  
the U.S. Department of Housing and  
Urban Development for Fiscal Year  
2017 and Beyond**

**October 17, 2016**

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

October 17, 2016

*Memorandum*

TO: Julian Castro  
Secretary, S

FROM:   
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Inspector General, G

SUBJECT: Management and Performance Challenges for Fiscal Year 2017 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 2017 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 ten 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, and
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 has 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. We work with departmental managers to recommend best practices and actions that help address the management and performance challenges through our 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 3 years and which contributed to our issuing disclaimers of opinion as part of our annual financial statement audits of HUD's financial statements.

### **Human Capital Studies**

In May 2015, GAO issued a report based on testimony of GAO work issued from January 2014 through February 2015 and ongoing work related to employee engagement. The testimony focused on key human capital areas in which some actions had been taken but attention was still needed by 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 ensure the continuity of business 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 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.

### **Financial Management Governance of HUD**

HUD's significant management challenge continued in fiscal year 2016 as it struggled to establish and implement effective financial management governance as required by the Federal Managers' Financial Integrity Act of 1982 and the Chief Financial Officers Act of 1990. In our fiscal years 2015 and 2014 financial statement audit report, we issued a disclaimer of opinion

due to unresolved audit matters. In addition, in our report on internal control, we reported nine material weaknesses, eight significant deficiencies in internal controls, and six instances of noncompliance with applicable laws and regulations. One of the material weaknesses directly addressed the shortcomings in HUD's financial management governance, and several of the other material weaknesses and significant deficiencies had causes that were attributed in part to weaknesses in HUD's financial management governance structure.

### **Senior Management Council**

A National Academy of Public Administration (NAPA) study<sup>1</sup> supported the longstanding OIG recommendation that HUD establish a Chief Financial Officer (CFO) council to enhance its financial governance structure. While HUD had historically resisted recommendations to create a senior management council, the updated Office of Management and Budget (OMB) Circular No. A-123 has changed the establishment of a senior management council from a best practice to a requirement. HUD has indicated that plans for the structure of an enterprisewide oversight group are nearing completion. This is an important step toward addressing HUD's significant financial management governance weaknesses.

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

The NAPA study team also identified challenges in a number of areas and recommended that HUD take action to address concerns related to HUD's impending transition to a Federal shared services provider (FSSP) for financial management services. OIG followed up with HUD management to follow HUD's progress in addressing study recommendations and found that HUD had not formally evaluated NAPA recommendations and did not have an adequate tracking mechanism in place for recommendations or planned actions. During 2016, GAO and OIG reported on a number of issues related to HUD's transition to an FSSP for financial management services. Both GAO and OIG have attributed the cause of many of these issues to weaknesses in governance.

The governance weaknesses that HUD experienced during its transition to an FSSP for financial management services were due in part to persistent financial management challenges that included outdated or incomplete policies and procedures and a lack of adequate information and communication among key groups. Program office accounting policies and procedures have at times been developed without adequate Office of the Chief Financial Officer (OCFO) input due to broad delegation to program office personnel. HUD also lacks documented policies to ensure the quality and consistency of program evaluations. 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.

### **Information and Communication**

HUD's information and communication among departments and offices has been a consistent challenge. 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

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<sup>1</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)

approval of 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 the Office of Public and Indian Housing's (PIH) net restricted asset process to inadequate collaboration with OCFO.

While HUD has taken initial steps to address these issues, substantial work remains. HUD's initial remediation efforts have included memorandums of understanding between OCFO and program offices to improve collaboration and a quarterly management review process chaired by the Deputy Secretary. As noted above, to comply with the updated OMB Circular No. A-123, HUD will also need to establish a senior management council and undertake additional governance efforts.

### **Enterprise Risk Management**

HUD needs to implement processes and procedures to ensure an effective system of internal control, not only for financial management governance, but across the Department within all programs. Effective for fiscal year 2016, HUD will be responsible for implementing OMB's updated Circular No. A-123 and GAO's Standards for Internal Control in the Federal Government<sup>2</sup> (The Green Book). These standards provide the criteria for designing, implementing, and operating an effective internal control system and define specific principles that are integral to an entity's internal control system with a greater focus on operational risks and controls. To effectively implement an enterprise risk management framework, HUD will need to identify operational risks and controls and address the financial management governance challenges identified above.

### **HUD's Use of Intergovernmental Personnel**

Since 2009, HUD has entered into 21 temporary assignments of non-Federal personnel to positions within the Department under the Intergovernmental Personnel Act (IPA). HUD faces challenges in executing and managing the assignment agreements because its processes and responsibilities are divided among program areas of the Department and there is no central point of authority over these agreements. We have already reported on an inherent conflict-of-interest situation and overpayments<sup>3</sup> and a potential Antideficiency Act (ADA) violation involving two IPA assignees.<sup>4</sup> In February 2015, Inspector General Montoya testified at the hearing on "Exploring Alleged Ethical and Legal Violations at the U.S. Department of Housing and Urban Development" before the House Oversight and Investigations Subcommittee regarding one of our IPA assignments. The Inspector General's testimony provided examples of serious

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<sup>2</sup> Audit Report GAO-14-704G, Standards for Internal Control in the Federal Government, September 2014

<sup>3</sup> Memorandum number 2015-FW-0801, Intergovernmental Personnel Act Appointment Created an Inherent Conflict of Interest in the Office of Public and Indian Housing, May 30, 2014

<sup>4</sup> Memorandum number 2014-FW-0801, Potential Antideficiency Act Violations Intergovernmental Personnel Act Agreements, May 30, 2014



violations of ethical, lobbying, and hiring violations at HUD in which senior HUD officials had been involved in an effort to mask these embarrassing and questionable activities. Further, investigations revealed the hiring of convicted criminals into key housing positions.

Due to deficiencies identified in the two prior IPA assignments, OIG initiated an audit of HUD's implementation and oversight of the IPA mobility program.<sup>5</sup> We found that HUD failed to ensure that its IPA agreements met the purpose of the Act and were complete and properly reviewed and executed. Also, HUD did not properly manage IPA assignees once they began working at HUD or properly outprocess them when they departed. We are continuing to work with the Department to reach management decisions to resolve all of the recommendations from report 2016-FW-0001. As of July 2016, HUD had issued Handbook 750.1 on its revised policy regarding assignment agreements under the IPA. The policy had been in draft form since 2014.

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

### ***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. We also reported on an inherent conflict-of-interest situation and overpayments<sup>6</sup> and a potential ADA violation involving two IPA assignees.<sup>7</sup> Inspector General Montoya testified before the House Oversight and Investigations Subcommittee regarding one of our IPA assignments. Our investigative activities revealed the hiring of convicted criminals into key housing positions.

### **Looking Ahead**

We will continue monitoring the status of progress made in establishing an effective human capital management program, evaluating HUD's progress in improving financial management governance, and monitoring the resolution of our work regarding IPA agreements. In 2016, the number of material weaknesses, significant deficiencies, and instances of noncompliance is likely to remain elevated, and the 2016 financial statement audit opinion is unlikely to change due to the continuing impact of these issues. There remains room for significant improvement in financial management governance.

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<sup>5</sup> Audit Report 2016-FW-0001, HUD Did Not Effectively Negotiate, Execute, or Manage Its Agreements Under the Intergovernmental Personnel Act, March 30, 2016

<sup>6</sup> Memorandum number 2015-FW-0801, Intergovernmental Personnel Act Appointment Created an Inherent Conflict of Interest in the Office of Public and Indian Housing, January 20, 2015

<sup>7</sup> Memorandum number 2014-FW-0801, Potential Antideficiency Act Violations Intergovernmental Personnel Act Agreements, May 30, 2014

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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. 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. Our review determined that OCFO did not properly plan and manage its implementation of 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, the U.S. Department of the Treasury's Bureau of Fiscal Services (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 three audits of HUD's implementation of the New Core Project. In the first audit, published in June 2015,<sup>8</sup> we found that weaknesses in the planned implementation of release 3 of phase 1 in the New Core Project were not adequately addressed. We determined that HUD did not follow its own agency policies and procedures, the policies established for the New Core Project, or best practices. If HUD was not successful in this implementation, it could reflect negatively on OMB's mandate to use FSSPs. The weaknesses identified in this report related to requirements and schedule and risk management areas that are significant to the project plan. We concluded that the effectiveness with which HUD manages them was critical to the project's success.

Our second audit, published in September 2015,<sup>9</sup> found that HUD's implementation of phase 1, release 1, was not completely successful. Due to missed requirements and ineffective controls, interface processing of travel and relocation transactions resulted in inaccurate financial data in HUD's general ledger and BFS' financial system. As a result, processing continued for more than 6 months with unresolved errors, leaving HUD's general ledger and BFS' financial system with inaccurate financial data and discrepancies in the balances between HUD's general ledger and Treasury's Government Wide Accounting System. We concluded that the implementation of release 1 confirmed the concerns we cited in our initial review of the phase 1, release 3,

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<sup>8</sup> Audit Report 2015-DP-0006, Weaknesses in the New Core Project Were Not Adequately Addressed, June 12, 2015

<sup>9</sup> Audit Report 2015-DP-0007, New Core Release 1 of Phase 1 Implementation Was Not Completely Successful, September 3, 2015

implementation. Although HUD had taken action to mitigate some of the problems that occurred with release 1 and address some of the issues we highlighted, we were concerned that HUD was moving too fast with its implementation plans and would repeat these weaknesses.

Our third audit, published in September 2016,<sup>10</sup> found that HUD had unresolved data conversion errors and inaccurate funds management reports and lacked a fully functional data reconciliation process following the implementation of phase 1, release 3, of the New Core Project on October 1, 2015. 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. These conditions occurred because HUD rushed the implementation of the release. Specifically, HUD did not move the implementation date when issues were identified during system testing to allow time to resolve the issues, development of the custom reports was not far enough along to allow full system testing, development of the reconciliation tool could not be completed before the scheduled implementation date, and time did not permit the establishment of performance metrics. 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 and Oracle Financials.

The New Core Project program charter identified 14 financial management systems capabilities that would have to be delivered with the program to meet its financial management needs, replace the Department's legacy systems, and achieve the expected benefits. HUD accomplished 4 of the 14 items with releases 1, 2, and 3 of the New Core Project. This included transitioning the following functions: travel and relocation, time and attendance, core accounting, and procurement. Since 1991, OIG has reported on system limitations and deficiencies within HUD's legacy financial management systems and the Department's lack of an integrated financial management system. In fiscal year 2015, the issue was a material weakness. Program offices have compensated for the system limitations by using manual processes to meet financial management needs.

These system issues and limitations have inhibited HUD's ability to produce reliable, useful, and timely financial information. Complete and reliable financial information is critical to HUD's ability to accurately report on the results of its operations to both internal and external stakeholders. The implementation of release 3 did not alleviate these issues, as confirmed by GAO in a report issued in July 2016.<sup>11</sup> For fiscal year 2015, 97 percent of the Department's budget was allocated to HUD's program areas (that is, public and Indian housing and community planning and development). Following the implementation of release 3, HUD's core program functions were still being controlled and processed through HUD's legacy applications. In April of 2016, after spending \$96.3 million, HUD ended the New Core Project with the closeout of the release 3 implementation. HUD decided that it would continue to use BFS's systems and services for the capabilities that had already been delivered but would not transition to shared services as a

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<sup>10</sup> Audit Report 2016-DP-0004, HUD Rushed the Implementation of Phase 1, Release 3, of the New Core Project, September 20, 2016

<sup>11</sup> Report GAO-16-656, Financial Management Systems – HUD Needs to Address Management and Governance Weaknesses That Jeopardize Its Modernization Efforts, July 2016

means of achieving the remaining New Core Project capabilities. HUD did not transfer all of the functionality that was originally planned and in some cases, simply shifted the uncompleted segments of the New Core Project to new projects. Additional time and funding will be needed to complete these projects. HUD has not fulfilled its plan to move to an FSSP in order to implement financial management systems capabilities that would have been delivered with the New Core Project to meet its financial management needs, replace the Department's legacy systems, and achieve the expected benefits.

### **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. Also, 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 Social Security numbers; birth dates; address history; income; financial; dependent; and in those cases in which disability and medical status is considered, health-related data. 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, 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. We have completed three audits on HUD's implementation of the New Core Project. In the first audit, published in June 2015, we found that weaknesses in the planned implementation of release 3 of phase 1 of the New Core Project were not adequately addressed. Our second review, published in September 2015, found that HUD's implementation of release 1 of phase 1 was not completely successful. Due to missed requirements and ineffective controls, interface processing of travel and relocation transactions resulted in inaccurate financial data in HUD's general ledger and BFS. Our third review, published in September 2016, found that HUD had unresolved data conversion errors and inaccurate funds management reports and lacked a fully functional data reconciliation process following the implementation of phase 1, release 3, of the New Core Project on October 1, 2015. In addition, the New Core Interface Solution's performance was not monitored, tracked, or measured, and controls over processing errors in Oracle Financials were routinely bypassed.

### **Looking Ahead**

OIG will continue evaluating HUD's activities related to the implementation of the New Core Project and integrating its financial management systems.

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

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One of the Department's major emerging management challenges is compliance with the Digital Accountability and Transparency Act of 2014 (DATA Act).<sup>12</sup> In our August 2016 DATA Act readiness review, we found that HUD was not on track to meet the DATA Act's requirements.<sup>13</sup> The DATA Act builds on agency transparency reporting requirements established by the Federal Funding Accountability and Transparency Act of 2006 (FFATA) and has an implementation date of 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.

### **DATA Act Leadership Turnover and Delayed Decisions**

HUD's DATA Act team has been hindered by management turnover and indecision. HUD has had three different senior accountable officials in a 6-month span, and the conclusion that the DATA Act applied to FHA and Ginnie Mae was not made until approximately May 2016. These

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<sup>12</sup> Digital Accountability and Transparency Act of 2014, Pub. L. No. 113-101

<sup>13</sup> 2016-FO-0802, Independent Attestation Review: U.S. Department of Housing and Urban Development, DATA Act Implementation Efforts, dated August 26, 2015

conditions have delayed implementation efforts and precluded the reasonable expectation that the deadline would be met. While HUD has taken steps to implement the DATA Act, the lack of a constant senior accountable official prevents adequate oversight of the project and workgroups, which would ensure implementation by the statutory date.

### **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 had not completed its inventory of data elements or the mapping of agency data to the DATA Act schema as of July 15, 2016. To assist agencies with implementation, OMB and Treasury issued a playbook with eight key steps to help agencies fulfill the requirements of the DATA Act, and OMB issued a memorandum detailing key guidance.<sup>14</sup> HUD's project plan dates for milestones, including completing an agency data element inventory or mapping agency data to DATA Act schema, significantly exceeded previous Treasury and OMB guidance, and HUD's project plan dates may not have been sufficiently reviewed and approved by OMB and Treasury.<sup>15</sup> HUD submitted updated implementation plans to OMB and Treasury in August 2016.

Competing departmental priorities like HUD's transition to a shared service provider for financial management services have worsened existing resource limitations. Human capital resources are limited compared to the level of effort required to modify systems and perform the required data inventory and mapping. While Treasury may provide resources to supplement HUD's resources and support HUD's compliance efforts, substantial challenges remain.

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

HUD has experienced challenges with 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. As we have previously reported in our annual financial statement audit, 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 (see page 6) 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.

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

While the statutory date for final implementation of the DATA Act is May 2017, we have issued one of two planned preimplementation attestation reports that are designed to determine whether HUD is on track to meet the implementation deadline. In August 2016, we issued a review attestation report on HUD's efforts to comply with OMB and Treasury DATA Act Playbook steps 1-4. While HUD's assertions reasonably represented the status of departmentwide compliance efforts, we reported that HUD was not on track to provide complete, departmentwide

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<sup>14</sup> <https://www.whitehouse.gov/sites/default/files/omb/memoranda/2015/m-15-12.pdf>

<sup>15</sup> GAO-16-698, DATA Act Implementation Plans, <http://gao.gov/assets/680/678765.pdf>

reporting by the May 2017 deadline. Additionally, we provided recommendations to the Department to address compliance impediments.

### **Looking Ahead**

We will continue to perform preimplementation work as HUD works to implement the DATA Act, and we plan to issue our first statutorily required report during fiscal year 2017.

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## **Weaknesses in Information Technology Security Controls**

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HUD conducts hundreds of thousands of transactions with the American public daily and is responsible for safeguarding hundreds of millions of records containing the personal information of private individuals. However, HUD continues to face both long- and short-term challenges as it strives to modernize its legacy systems, adequately secure its IT infrastructure, and properly protect sensitive data. HUD has not adequately planned for its future IT and IT security needs. One of two primary HUD infrastructure services contracts was recently reawarded using a long-term sole-source contract, while the second has been in a period of transition since fiscal year 2014, creating risk for HUD. Further, a significant number of critical HUD applications are legacy systems that are increasingly difficult to maintain and present security risks that HUD will be challenged to mitigate without modernization. More than 400 HUD IT products are running on unsupported platforms, increasing the risk of unknown and unpatchable vulnerabilities. Legacy systems are difficult or unable to migrate to cloud technology, further complicating HUD's long-term efforts to modernize and secure its systems and data while creating efficiencies and cost savings.

HUD has taken some initial steps to address these long-term challenges. HUD filled several key positions, including the CIO, chief information security officer, and chief technology officer. However, we are concerned that turnover in IT leadership roles, including that of the enterprise architect and the conclusion of the CIO's tenure at the end of calendar year 2016, will deflate HUD's momentum. Major HUD initiatives have been negatively impacted by recent turnover in key positions and loss of technical expertise.

HUD has begun key initiatives, such as the development of several long-term plans, including an enterprise architecture roadmap, aimed in part to guide modernization efforts; a Cybersecurity Framework to address IT security program deficiencies; and a recently implemented enterprise incident handling program to improve security incident detection capabilities. However, notable change and implementation of these initiatives are not anticipated to be fully realized until fiscal year 2017 and beyond. Successful implementation of these plans will be directly dependent upon HUD's ability to instill accountability, implement performance measures, and obtain adequate technical expertise and resources. In the process of outsourcing infrastructure and application maintenance and support, HUD has divested itself of much of its own technical expertise and continues to face significant staffing challenges. For example, an organizational chart provided to OIG during its fiscal year 2016 Federal Information Security Modernization Act (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. This condition significantly challenges HUD’s ability to manage and perform vendor oversight of its technology infrastructure and conduct technical assessments. It has also resulted in HUD’s extensive dependence on decentralized IT contracts throughout the HUD IT environment.

Our annual evaluation of HUD’s IT security program for fiscal year 2015, as mandated by FISMA, revealed some IT security improvements, but extensive noncompliance with Federal IT guidance continues. As shown in OIG’s fiscal year 2015 FISMA report, HUD has extensive deficiencies in 5 of the 10 program areas on which OIG reports to OMB, compared to 9 of 10 in fiscal year 2014. HUD is showing some progress in remediating these deficiencies; however, it has 45 open FISMA evaluation recommendations spanning several years that have been open from 300 to 800 days. These recommendations need to be addressed to rectify longstanding security weaknesses. Further, the privacy program has an additional 21 open recommendations for the fiscal years 2013 through 2015 evaluation period.

To ensure improvement in the above areas and reduce vulnerabilities to the IT security environment, all HUD program offices will need to collaborate effectively and establish ownership and oversight of IT security controls. HUD’s fiscal year 2016 IT funding level has decreased 16.3 percent from fiscal year 2015, which continues to impact agency modernization and IT security efforts. With the constrained budgets, HUD will be challenged to fund the operation of current systems while also initiating projects to upgrade legacy applications and improve security.

Further, our evaluations have revealed a lack of enterprise risk management, which directly affects HUD’s ability to manage all IT risks using a holistic framework and hinders HUD’s IT modernization efforts. HUD’s Office of the Chief Information Officer (OCIO) had begun addressing this weakness by developing an IT Risk Management Office, but unless HUD develops an enterprisewide risk management program with one management approach, it will not be able to appropriately prioritize all IT risks.

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

OIG’s work has been focused on assessing mandated requirements and other IT evaluations to assist HUD in identifying IT risks and vulnerabilities in addition to prioritizing efforts to improve the cybersecurity posture and IT infrastructure and secure HUD data. Many areas and deficiencies remain to be reviewed and assessed to independently identify and provide recommendations for improving the cybersecurity posture.

### ***Looking Ahead***

We will continue to evaluate HUD’s IT infrastructure, policy, and processes, while also continuing to provide oversight on the progress of HUD’s IT security program, modernization efforts, and ability to implement IT security long-term plans. We will do this through mandated assessments and targeted evaluations, while instilling a collaborative environment with HUD.



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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 \$1.2 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>16</sup> According to the 2015 actuarial study, the fund had an economic value of \$23.8 billion. Based on the 2015 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. OIG continues to take steps to help preserve the FHA insurance fund and improve FHA loan underwriting by partnering with HUD, the U.S. Department of Justice, and multiple U.S. Attorney's offices nationwide in a number of FHA lender civil investigations. In some instances, these investigations involve, not only the 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 \$14.6 billion in damages and penalties in the last 5 fiscal years.

For the FHA-insured loans, results in the last 5 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 \$4.9 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 \$3.2 billion of the \$4.9 billion is of direct benefit to the FHA insurance fund. Ongoing investigations are expected to lead to additional settlements that will significantly help recover losses to the FHA insurance fund.

### 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

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<sup>16</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.

housing market and ensure the availability of mortgage credit and continued lender participation in the FHA program.

For example, FHA has been slow to start a rigorous and timely claims review process. OIG has repeatedly noted in past audits and other types of lender underwriting reviews HUD's financial exposure when paying claims on loans that were not qualified for insurance. Two years ago, OIG noted HUD's financial exposure when paying claims on loans that were not qualified for insurance. Adding to this concern, HUD increased its financial exposure by not recovering indemnification losses and extending indemnification agreements when appropriate.

Based on the results of an August 2014 audit,<sup>17</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. Further, we recommended initiating the billing process for five refinance loans on which HUD incurred losses. Due to continued disagreements on the appropriate action, we elevated the recommendations to the Deputy Secretary on March 31, 2015. We continue to wait for the Deputy Secretary's request for further discussions or her decision on the matter.

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 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 to 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 concern that delayed foreclosures limited its ability to identify current and future risks to the FHA insurance fund.

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<sup>17</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

Based on an audit report issued in October 2016<sup>18</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 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>19</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 last fiscal year. 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. HUD should 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.

### **Loss Mitigation**

FHA requires that its servicers use loss mitigation tools to assist homeowners facing default and as a way to minimize losses to the FHA insurance fund. However, despite the intended purpose, FHA has difficulty ensuring that its program guidance is clearly written for effective implementation. We have conducted two audits<sup>20</sup> of FHA's Home Affordable Modification Program (HAMP). HAMP allows homeowners to modify their FHA-insured mortgages to reduce monthly mortgage payments and avoid foreclosure. The program allows the use of a partial claim of up to 30 percent of the unpaid principal balance as of the date of default, combined with a loan modification. One audit found that HUD did not have an effective postclaim review function and did not have clear program guidance for the FHA-HAMP partial claim option. HUD's policies allowed servicers to determine partial claim amounts in different ways, which resulted in some claims that were higher than necessary. This condition occurred because HUD and its contractors did not produce timely quality postclaim review reports and

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<sup>18</sup> Audit report 2017-KC-0001, FHA Paid Claims for Properties That Servicers Did Not Foreclose Upon or Convey on Time, October 14, 2016

<sup>19</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>20</sup> Audit Report 2015-LA-0003, HUD Did Not Have Effective Controls or Clear Guidance in Place for the FHA-HAMP Partial Claim Loss Mitigation Option, September 18, 2015, and Audit Report 2015-LA-0001, HUD's Claim Payment System Did Not Always Identify Ineligible FHA-HAMP Partial Claims, April 20, 2015

failed to adequately monitor FHA-HAMP. As a result, FHA overpaid at least \$177 million in partial claims due to servicer miscalculations. Management decisions have been reached for recommendations with varying target closeout dates. The other audit found that HUD's claim payment system did not always identify ineligible FHA-HAMP partial claims. The system allowed payment of (1) more than one claim with a previous modification or FHA-HAMP option in a 24-month period, (2) duplicate claims, (3) partial claims in excess of 30 percent of the unpaid principal balance at the time of default, and (4) non-HAMP partial claims after HUD discontinued this claim type. This condition occurred because HUD did not design and implement sufficient claim payment system controls. As a result, HUD spent approximately \$22.5 million on potentially ineligible claims.

### **Departmental Clearance Process**

Departmental clearance is a necessary and important process to ensure required agreement by applicable HUD leadership on the subject matter and content of a directive or policy change. This action requires a review by HUD offices that have expertise, policy or legal, with the subject matter of the change and that there is no conflict with other HUD or administration policies. The originating HUD office places a directive to implement a specific policy change of departmental clearance by completing these four steps: (1) execute an intraoffice agreement, (2) execute a form HUD-22, (3) launch the clearance process, and then (4) manage the clearance. All directives must be cleared, at a minimum, by the following six offices within headquarters: Office of the Chief Human Capital Officer, Office of General Counsel, OIG, OCFO, OCIO, and Office of Policy Development and Research.

At a time when FHA is working to restore confidence in the housing market, we have concerns that when the Department is making program, policy, or procedural changes, it is *not* (1) identifying the significant changes in its notice, (2) following the formal clearance process and instead opting for a more informal method, or (3) avoiding the process altogether and making changes unilaterally. We have noted that HUD failed to follow departmental clearance protocols for FHA programs, policies, and operations by not (1) ensuring that key officials reviewed directives before issuance and (2) following required departmental clearance procedures when issuing directives or Paperwork Reduction Act documents. These actions were contrary to the directives policies in Handbook 000.2, REV-3, HUD Directives System. Below are examples of policies that were not properly vetted through the clearance protocols.

- Loan Quality Assessment Methodology (defect taxonomy) – This methodology discusses significant policy and procedural guidance related to FHA's lender monitoring process and enforcement of FHA loan origination defects. HUD posted this document on its Drafting Table Web site on September 16, 2014, before completing a limited clearance process on May 1, 2015. Posting in draft form for public comment will indicate to the public that, although in draft, the policy and legal positions in the draft form are accurate and reflect the direction that the Department is interested in pursuing. However, the public cannot be assured that draft directives will be pursued unless the draft is approved through departmental clearance. The defect taxonomy remains in draft with no implementation date set.
- Addendum to Uniform Residential Loan Application (form HUD-92900-A) – This document was used for establishing the eligibility of proposed mortgage transactions for

FHA's insurance endorsement. It revised a previously cleared Paperwork Reduction Act document; therefore, departmental clearance was required. Clearance was also required because this document removed certification language that could potentially impact FHA's enforcement efforts. A controversial memorandum issued from Edward Golding, HUD's Principal Deputy Assistant Secretary for Housing, and a U.S. Department of Justice responsive press release highlighted the significance of the document changes.

Excerpt from FHA posting, March 15, 2016

In this final loan-level certification, FHA is clearly identifying what lenders will be held accountable for only those mistakes that would have altered the decision to approve the loan. This important move makes it very clear that minor mistakes that do not affect the decision to approve a loan are not the focus of our compliance efforts.

Excerpt from U.S. Department of Justice press release, March 15, 2016

The department will continue these enforcement efforts by using the False Claims Act, and will continue to be guided by the language of the act that prohibits the submission of knowing and material false claims. In the FHA context, this means that no lender will face False Claims Act enforcement based on an unknowing mistake or an immaterial requirement. But, at the same time, the department will not hesitate to bring an action where a lender – or any other individual or entity who would defraud the federal taxpayer – submits false statements and claims at the expense of the federal fisc.

HUD posted the document on its public Drafting Table Web site on May 1, 2015; however, it did not complete the departmental clearance process until August 11, 2015. In addition, the 60-day Federal Register notice relating to this document was improperly issued before it went through departmental clearance. The Federal Register notice was issued on May 15, 2015.

### **Downpayment Assistance and Premium Pricing**

Through the course of three audits,<sup>21</sup> we learned about and continue to be concerned with a funding arrangement for downpayment assistance to FHA borrowers, which we believe violates the National Housing Act regarding prohibited sources for downpayment assistance. Specifically, we learned that NOVA and LoanDepot had entered into triparty agreements among the FHA lender, a housing finance agency (HFA), and U.S. Bank, a Ginnie Mae issuer. These agreements were part of a program in which the HFA would provide downpayment assistance in a grant or loan to the borrower. The FHA lender would provide the primary financing to the borrower in the form of an FHA-insured loan. Upon origination, the FHA loan would be sold to U.S. Bank, which would securitize the mortgage loan through Ginnie Mae security and service

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<sup>21</sup> Audit Report 2015-LA-1010, loanDepot's FHA-Insured Loans With Golden State Finance Authority Downpayment Assistance Gifts Did Not Always Meet HUD Requirements, September 30, 2015; Audit Report 2015-LA-1009, loanDepot's FHA-Insured Loans With Downpayment Assistance Funds Did Not Always Meet HUD Requirements, September 30, 2015; and Audit Report 2015-LA-1005, NOVA Financial & Investment Corporation's FHA-Insured Loans With Downpayment Assistance Gifts Did Not Always Meet HUD Requirements, July 9, 2015

the mortgage. Although not parties to the FHA loan, the HFA and U.S. Bank required the FHA lender to inflate the interest rate on the loan. The HFA providing the downpayment assistance and U.S. Bank had previously determined what interest rate above the market interest rate would be necessary on the FHA loan to net a premium payment from the investor when the loan was securitized. The HFA, U.S. Bank, and the FHA lender agreed that the premium payment would reimburse the HFA for the downpayment and pay other program-related fees. The increased rate was up to 1.5 percent above the market rate for FHA loans (for example, 4.5 percent for HFA downpayment assistance versus 3 percent for nonassisted FHA loans). The HFA, U.S. Bank, and the FHA lender also agreed to charge the borrower additional securitization, administration, and tax fees as part of the origination totaling \$300-\$600, which would not have otherwise been paid on the lower interest rate mortgage. We determined that U.S. Bank had similar agreements with FHA lenders and HFAs around the country.

Since the issuance of the first and later similar audits, we have attempted to resolve the findings and recommendations with the Department to no avail. HUD has failed to recognize disturbing parallels to the seller-funded downpayment assistance arrangements practiced from the late 1990s to 2008, which caused wide-scale problems for the program that continue to be felt today. On May 25, 2016, the Department issued its decision regarding our disagreement over the HFA's downpayment assistance and premium pricing in the NOVA audit. The decision relied heavily on a HUD, Office of General Counsel, legal opinion that did not review the specific details or funding structure of borrower-financed downpayment assistance programs. Instead, the legal opinion was meant to opine on HFAs as permissible sources of downpayment assistance since they are government entities. We strongly disagree with this position because downpayment assistance provided or reimbursed indirectly by a party that benefits financially from the transaction is prohibited under statute and negatively affects the borrower.

HUD's actions enabled questionable downpayment assistance programs. HUD's requirements, guidelines, and interpretations on downpayment assistance from government entities allow for increased risk to the FHA Single Family Mortgage Insurance program and have enabled the creation and growth of questionable borrower-financed downpayment assistance programs. Current requirements and guidelines provide little oversight and give HFAs broad access to the FHA program that other entities do not have. For example, a comparison of Handbook 4155.1 provisions in effect at the time of the OIG audits to the provisions in Handbook 4000.1 reveals major changes in policy. Handbook 4000.1 was modified to strictly define premium pricing and eliminated the prohibition on premium pricing as a source of funds for the borrower's minimum required investment that was in Handbook 4155.1.

### *Summary of OIG Work*

Audits conducted over the last 5 fiscal years related to FHA-insured loans have shown that a high percentage of loans reviewed should not have been insured because of significant deficiencies in the underwriting. OIG has noted HUD's financial exposure when paying claims on loans that were not qualified for insurance. Based on the results of an August 2014 audit, OIG determined that HUD did not always bill lenders for FHA single-family loans that had an enforceable indemnification agreement and a loss to HUD. In addition, OIG conducted two

audits<sup>22</sup> of FHA-HAMP. One audit determined that HUD did not have an effective postclaim review function and did not have clear program guidance for the FHA-HAMP partial claim option. The second audit reported that HUD's claim payment system did not always identify ineligible FHA-HAMP partial claims. OIG's audit of delayed conveyances<sup>23</sup> 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. As a participant in the departmental clearance process, OIG noted that FHA did not always follow required departmental clearance procedures when issuing directives. In addition, with the update to the consolidated Handbook 4000.1, FHA made changes regarding premium pricing during the course of several OIG audits, which continues to raise concerns for OIG. Further, OIG issued three audit reports<sup>24</sup> on lenders' allowance of ineligible downpayment assistance, highlighting HFAs' use of a premium pricing structure that does not comply with FHA requirements and negatively impacts borrowers.

### **Looking Ahead**

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

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## **Community Planning and Development Programs**

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### **Integrated Disbursement and Information System**

Due to HUD's continued use of the FIFO (first-in, first-out) method as an accounting methodology for appropriated funds<sup>25</sup> for committing and disbursing obligations for community planning and development formula grant programs for fiscal year 2014 and earlier grants, which does not comply with accounting standards, resulted in a material misstatement of HUD's financial statements. HUD's plan to eliminate FIFO 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

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<sup>22</sup> Audit Report 2015-LA-0003, HUD Did Not Have Effective Controls or Clear Guidance in Place for the FHA-HAMP Partial Claim Loss Mitigation Option, September 18, 2015, and Audit Report 2015-LA-0001, HUD's Claim Payment System Did Not Always Identify Ineligible FHA-HAMP Partial Claims, April 20, 2015

<sup>23</sup> Audit Report 2017-KC-0001, FHA Paid Claims for Properties That Servicers Did Not Foreclose Upon or Convey on Time, October 14, 2016

<sup>24</sup> Audit Report 2015-LA-1010, loanDepot's FHA-Insured Loans With Golden State Finance Authority Downpayment Assistance Gifts Did Not Always Meet HUD Requirements, September 30, 2015; Audit Report 2015-LA-1009, loanDepot's FHA-Insured Loans With Downpayment Assistance Funds Did Not Always Meet HUD Requirements, September 30, 2015; and Audit Report 2015-LA-1005, NOVA Financial & Investment Corporation's FHA-Insured Loans With Downpayment Assistance Gifts Did Not Always Meet HUD Requirements, July 9, 2015

<sup>25</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.

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 and result in material misstatements on the financial statements. Use of the FIFO methodology 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 and 2015, respectively. Therefore, lack of retroactive implementation will have implications on future years' financial statement audit opinions until the impact is assessed to be immaterial. Due to funding problems, completion of the elimination plan will be delayed until May 2017. Despite the changes made to IDIS thus far, additional modifications are necessary for the system to fully comply with the Federal Financial Management Improvement Act (FFMIA).

### **Grant Accounting**

In fiscal year 2016, HUD's inability to provide data to monitor compliance with the HOME Investment Partnership Act (HOME statute) requirements for committing and spending funds will remain a concern until appropriate system changes in IDIS Online are implemented and regulatory changes are fully implemented. The HOME Investment Partnerships Program is the largest Federal block grant to State and local governments designed to create affordable housing for low-income households. Because HOME is a formula-based grant, funds are awarded to the participating jurisdictions noncompetitively on an annual basis.

In 2009, OIG challenged HUD's cumulative method<sup>26</sup> for determining compliance with section 218(g) of the HOME statute, which requires that any uncommitted funds be reallocated or recaptured after the expiration of the 24-month commitment deadline. After a continuous impasse with HUD, OIG contacted GAO in 2011 and requested a formal legal opinion on this matter. In July 2013, GAO issued its legal opinion, affirming OIG's position and citing HUD for noncompliance. In its decision, GAO repeated that the language in the statute was clear and that HUD's cumulative method did not comply with the statute. Accordingly, GAO told HUD to stop using the cumulative method and identify and recapture funds that remain uncommitted after the statutory commitment deadline.

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

Compliance with GAO's opinion would enable HUD to better monitor grantee performance in a more timely, efficient, and transparent way. It also would strengthen internal controls, bring

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<sup>26</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.



HUD into compliance with HOME statutory requirements, and accurately and reliably report financial transactions.

On June 16, 2015, we issued a memorandum to HUD regarding potential ADA violations due to the noncompliance issues noted above. In the memorandum, we requested that the Chief Financial Officer (1) open an investigation and determine the impact of FIFO and the cumulative method for commitments for the HOME program on HUD's risk of an ADA violation; (2) as part of the violation, obtain a legal opinion from GAO and OMB to determine whether maintaining the cumulative method for determining compliance with the HOME statute results in noncompliance with the statute and potential ADA violations; and (3) if HUD incurred an ADA violation, comply with the reporting requirements at 31 U.S.C. (United States Code) 1351 and 1517(b) and OMB Circular No. A-11, Preparation, Submission, and Execution of the Budget, section 145 (June 21, 2005). HUD opened an ADA investigation in response to our memorandum with a target completion date of September 1, 2016, which was later revised to October 24, 2016.

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

### **Subgrantee Monitoring**

In fiscal years 2014 through 2016, at least 15 of our audits have found that in some instances, little or no monitoring occurred, particularly at the subgrantee level. HUD focuses its monitoring activities at the grantee level through its field offices. Grantees, in turn, are responsible for monitoring their subgrantees. HUD should continue to stress the importance of subgrantee monitoring to its grantees. OIG has concerns regarding the capacity of subgrantees receiving funding from HUD programs, including grantees receiving 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.

HUD considers the program to be a success because there are no reported Section 108 loan defaults. However, this view provides a false sense of success about the Section 108 loan program. There are no reported defaults because borrowers generally use CDBG funds to make loan repayments when funded projects default, when no other source of project income is

available, or when there is a delay in the payment. As a result, the Federal Government bears 100 percent of any losses, regardless of the success of the funded activity.

Audits conducted by OIG for the period 2012 through 2016 identified serious deficiencies in the administration of the Section 108 loan program that affected the effectiveness of the program. We found five Section 108 loans in which loan agreement provisions and HUD requirements were not followed, which resulted in more than \$35.97 million in questioned funds. Borrowers did not ensure that Section 108-funded activities met a national objective of the CDBG program and fully provided the intended benefits. As a result, projects were incomplete or abandoned, and funds were used for ineligible and unsupported efforts. For example, one borrower transferred more than \$6 million in Section 108 loan proceeds to its general fund account as loans for its operations. In addition, loan proceeds were not disbursed within the established timeframe, borrowers did not provide HUD the required loan collateral, borrowers did not establish a financial management system in accordance with HUD requirements, and investments were not fully collateralized. Although HUD was aware of some of these deficiencies, none of the loans were declared in default. In one case, HUD allowed the noncompliance issues to continue for more than 11 years without raising a finding and providing corrective actions or imposing sanctions.

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

### **OIG-CPD Collaboration**

Recently, OIG and HUD CPD began a joint collaboration to assist grantees and subgrantees in the areas in which OIG reported that grantees and subgrantees were most vulnerable. The work group determined that assistance should be provided in the following areas:

- Procurement and contracting,
- Subrecipient oversight,
- Conflicts of interest,
- Internal controls,
- Documentation and reporting, and
- Financial management.

In addition, the Inspector General coauthored a joint letter with Harriet Tregoning, 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 work group began meeting to develop a series of “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. The bulletins on procurement and contracting, conflicts of interest, and subrecipient monitoring and oversight have been sent to grantees and subgrantees during fiscal year 2016, and the work group continues to draft the

remaining bulletins. In addition, the published bulletins are posted on our Web site at [www.hudoig.gov/fraud-prevention](http://www.hudoig.gov/fraud-prevention).

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

OIG took exception to HUD's not removing the FIFO methodology retroactively, which will continue the departures from generally accepted accounting principles and result in material misstatements on the financial statements. 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, 2014, and 2015, respectively.

In fiscal years 2014 through 2016, at least 15 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 conducted by OIG 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. Further, HUD lacked assurance that funds were adequately accounted for, safeguarded, and used for authorized purposes and in accordance with HUD requirements.

In an effort to assist grantees and subgrantees in the areas in which OIG audit reports determined the grantees and subgrantees were most vulnerable, HUD OIG has 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. OIG will continue to work with Harriet Tregoning, Principal Deputy Assistant Secretary, 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 cumulative method 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. PIH and the Office of Multifamily Housing Programs provide funding for rent subsidies through public housing operating subsidies and the tenant-based Section 8 Housing Choice Voucher and Section 8 multifamily project-based programs. More than 3,300 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 assist more than 1.2 million households. The following challenges highlight the various issues faced by the Department:

- Monitoring the Housing Choice Voucher program,
- Central office cost centers,
- Cash management requirements,
- Monitoring Moving to Work (MTW) agencies,
- Overincome families in public housing,
- Environmental review requirements,
- The Indian Home Loan Guarantee program,
- Monitoring small and very small housing agencies, and
- The physical condition of Housing Choice Voucher program units.

### **Monitoring the Housing Choice Voucher Program**

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.

### **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 will 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. This measure will ensure that excess fees paid into the account will remain available to the program. 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 regarding the need for an asset management fee.

Our 2014 report<sup>27</sup> found that HUD could not adequately support the reasonableness of operating fund management, book-keeping, and asset management fees and Public Housing Capital Fund management fee limits. In addition, HUD lacked adequate justification for allowing PHAs to

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<sup>27</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

charge an asset management fee, resulting in more than \$81 million in operating funds being unnecessarily defederalized annually. HUD continues its desire to maintain the fee-for-service model, which is similar to the model used by the Office of Multifamily Housing Programs.

### **Cash Management Requirements**

In fiscal year 2012, PIH implemented procedures to reduce the amount of excess funds accumulating in PHAs' net restricted asset accounts in accordance with Treasury's cash management requirements as directed by a congressional conference report. By that point, a significant amount of reserves had accumulated with the PHAs. As of 2015, most of the traditional PHA funds had been transitioned back to HUD, but HUD faced an additional challenge of quantifying and transitioning excess funds from its MTW program PHAs. This process was complex and time consuming because the composition of these balances included funding from other HUD programs and was not being tracked separately by HUD or the PHAs. During fiscal years 2015 and 2016, PIH worked with MTW PHAs to determine their accumulated balances. Through PIH's confirmation and validation process, MTW PHAs reported holding \$466.5 million and \$425.6 million, as of September 30, 2015, and March 31, 2016, respectively. However, several PHAs reported that the amount they confirmed should not be transitioned for a variety of reasons, such as that the PHA used the accumulations as collateral, owed funds to other programs under the MTW program, or had upcoming commitments before the planned August transition. HUD evaluated each reason provided by the PHA to determine the proper amount available for transition and had transitioned \$218 million back to HUD as of September 1, 2016. We are in the process of evaluating the amount transitioned to determine whether it is adequate to satisfy cash management requirements.

Adding to this challenge, HUD continues to lack an automated process to complete the reconciliations required to monitor all of its PHAs and ensure that Federal cash is not maintained in excess of immediate need. Reconciliations are prepared manually on unprotected Excel spreadsheets for more than 2,200 PHAs receiving approximately \$17 billion annually. This process is time consuming and labor intensive and does not allow for accurate financial reporting at the transaction level as required by 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. We are still awaiting a response.

### **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 is experiencing 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 and stated that new contracts would allow it to better evaluate each agency's performance. According to HUD, it has extensively engaged with the 39 MTW

PHAs to extend their agreements through 2028. 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. We continue to believe that HUD could benefit from a formalized process for terminating participants from the demonstration program for failure to comply with their agreement.

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

HUD is challenged in addressing families having excessive income being allowed to continue to reside in public housing units, since HUD regulations require families to meet eligibility income limits only when they are admitted to the public housing program. Neither public law nor regulations limited the length of time that families could continue to reside in public housing regardless of their income. In December 2004, HUD issued a final rule giving PHAs discretion to establish and implement policies that would require families with incomes above the eligibility income limits to find housing in the unassisted market. Our 2015 audit found that as many as 25,226 families, whose income exceeded HUD's 2014 eligibility income limits, lived in public housing. The PHAs that we contacted during the audit chose not to impose limits based on the notice.

As result of our work and after much public and congressional concern, legislation passed unanimously in both the U.S. House and Senate to address the issue, and the legislation was signed into law by President Obama in July 2016. 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. HUD's Office of General Counsel is developing a plan for implementation that will include the creation of regulations through public involvement in the rulemaking process.

### **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 began providing more training to staff and grantees and implemented processes to improve its training program and curriculum to better support all program areas. Also, HUD was piloting a recently developed electronic data system, HUD's Environmental Review Online System (HEROS), which is part of HUD's transformation of IT systems.

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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

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 Office of Public Housing field offices we visited, PHAs spent almost \$405 million for activities that either did not have required environmental reviews or had reviews that were not adequately supported.

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

With annual increases in funding and the number of loans guaranteed, the Section 184 Indian Home Loan Guarantee program continues to be an area of concern. The Section 184 program is a great resource for the Native American community. However, the lack of controls, oversight, and enforcement increases the risk to the program. OIG recently completed an audit<sup>29</sup> detailing how the Office of Loan Guarantee did not provide adequate oversight of the Section 184 program, resulting in an increased overall risk to the program. We found that HUD did not identify underwriting deficiencies in 3,845 guaranteed loans totaling more than \$705 million. Given the lack of enforcement and the Office of Native American Programs' acknowledgement that there is significant room for improvement, there is continued risk for fraud, waste, and abuse within the Office of Loan Guarantee and at the lender level. This lack of oversight and high incidence of poorly underwritten loans has the potential to negatively impact the financial standing of Native American communities. HUD agrees that new or revised policies for its program would allow it to better track and monitor the loan guarantees. PIH is working to find an automated solution.

### **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, it creates oversight burdens and costs for both HUD and PHAs that are disproportionate to the number of families these PHAs serve. In a recent report,<sup>30</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 either chose to ignore requirements or lacked sufficient knowledge to properly administer their programs. HUD uses a

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<sup>29</sup> Audit Report 2015-LA-0002, HUD Did Not Provide Adequate Oversight of the Section 184 Indian Home Loan Guarantee Program, July 6, 2015

<sup>30</sup> Audit Report 2015-FW-0802, Very Small and Small Public Housing Agencies Reviewed Had Common Violations of Requirements, September 16, 2015

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, HUD OIG has issued several industry advisories that highlight areas of risky and illegal activities that jeopardize the integrity of otherwise legitimate housing programs. The advisories are posted on our Web site at [www.hudoig.gov/fraud-prevention](http://www.hudoig.gov/fraud-prevention). Several advisories were directly related to PHAs and were emailed to executive directors. In addition, the Inspector General coauthored a joint letter with Lourdes M. Castro Ramirez, 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, a training module for board members and executive staff.

### **The Physical Condition of Housing Choice Voucher Program Units**

In response to a 2008 audit report,<sup>31</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 demonstration program has been developed to implement the revised protocol. Meanwhile, we continue to identify PHAs with inspection programs, which do not ensure that voucher program units comply with standards.

Our 2008 audit report 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 also continue to audit the physical condition of Housing Choice Voucher program units.

### **Summary of OIG Work**

In recent audit reports, we demonstrated that PIH continues to face challenges in (1) monitoring the Housing Choice Voucher program, (2) balancing its responsibility to protect HUD funds and streamlining activities to provide relief for PHAs, (3) fully implementing cash management

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<sup>31</sup> Audit Report 2008-AT-0003, HUD Lacked Adequate Controls Over the Physical Condition of Section 8 Voucher Program Housing Stock, May 14, 2008



requirements, (4) developing programwide performance indicators that will not inhibit the MTW participants' abilities to creatively impact the program, (5) addressing families having excessive income being allowed to continue to reside in public housing units, (6) ensuring that PHA projects are free of environmental hazards, (7) providing adequate oversight of the Section 184 program, (8) monitoring small and very small PHAs, and (9) ensuring that its Section 8 housing stock was in material compliance with housing quality standards.

In an effort to promote awareness, HUD OIG has issued several industry advisories that highlight areas of risky and illegal activities that jeopardize the integrity of otherwise legitimate housing programs and will continue to work with Lourdes M. Castro Ramirez, Principal Deputy Assistant Secretary, PIH, to encourage efficient operations and effective accountability for the best use of limited resources.

### **Looking Ahead**

We will continue to work with and monitor HUD's actions to address challenges in these areas. 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 \$47 billion in supplemental funding to HUD since 1993 to address long-term recovery in the wake of the attacks of September 11, 2001; Hurricanes Katrina, Rita, and Wilma in 2005; Hurricanes Ike and Gustav and Midwest flooding in 2008; and Hurricane Sandy in 2012. Most CDBG-DR funding is available until spent, with the exception of the Hurricane Sandy funding, which must be obligated by the end of fiscal year 2017.

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

- Ensuring that expenditures are eligible and supported,
- Certifying that grantees are following Federal procurement regulations,
- Conducting consistent and sufficient monitoring efforts on disaster grants, and
- Keeping up with communities in the recovery process.

### **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.

OIG has completed 23 audits and 1 evaluation 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 \$3.8 million in ineligible costs, \$482 million in unsupported costs, and \$5.2 billion in funds put to better use. There are a number of other audits and evaluations as well as investigative work, which are currently underway. Before Hurricane Sandy, OIG had extensive audit and investigative experience with HUD's CDBG-DR program, most notably with grants relating to recovery after Hurricane Katrina and the terrorist attacks of September 11, 2001. 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 three audit reports that illustrate these challenges for HUD in administering disaster recovery programs.

- In our review of New York State's Small Business Grants and Loans program,<sup>32</sup> we determined that State officials did not establish adequate controls to ensure that CDBG-DR funds were disbursed for eligible costs. As a result, the State disbursed \$272,459 in CDBG-DR funds for ineligible costs and \$152,703 for unsupported costs. In addition, State officials did not adequately ensure that \$300,000 was disbursed to eligible businesses and that ineligible costs could be promptly recaptured.
- In our review of Luzerne County's Disaster Recovery grant program,<sup>33</sup> we determined that County officials did not ensure that subrecipients followed procurement requirements and lacked documentation to support funds disbursed for a building rehabilitation project. As a result, HUD and County officials did not have assurance that \$227,243 disbursed for contracts related to street improvements and flood drainage facilities was spent for costs that were fair and reasonable and that \$109,423 disbursed for a building rehabilitation project was used in accordance with HUD and Federal requirements.

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<sup>32</sup> Audit Report 2016-NY-1006, New York State Did Not Always Disburse Community Development Block Grant Disaster Recovery Funds in Accordance With Federal and State Regulations, March 29, 2016

<sup>33</sup> Audit Report 2016-PH-1004, Luzerne County, PA, Did Not Always Use Disaster Funds in Accordance With HUD and Federal Requirements, June 18, 2016

- In our review of Rhode Island’s Disaster Recovery grant program,<sup>34</sup> we found that State officials generally obligated and disbursed Sandy funds in a timely manner in accordance with HUD rules and regulations. However, State officials obligated \$127,750 for one project without performing an adequate duplication of benefits analysis and cost analysis before procuring rehabilitation services.

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

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

We continue to have concerns about HUD’s ability to ensure that disaster grantees are following Federal procurement regulations. Grant recipients of HUD CDBG-DR funds must provide a copy of their procurement standards and indicate the sections of their procurement standards that incorporate the Federal standards. The State and its subgrantees may follow their own State and local laws, so long as the procurements conform to applicable Federal law and standards. Further, a State must establish requirements for procurement policies and procedures based on full and open competition. In addition, all subgrantees of a State are subject to the procurement policies and procedures required by the State, so long as the procurements conform to applicable Federal law and standards. In our recent audit of the State of New Jersey’s CDBG-DR Superstorm Sandy Housing Incentive Program,<sup>35</sup> auditors found that the State did not prepare an independent cost estimate and cost analysis before receiving bids or proposals and awarding the contract. These conditions occurred because the State did not have adequate controls in place to administer its contract and monitor contract performance. Further, it was not fully aware of applicable Federal procurement and cost principle requirements. As a result, HUD did not have assurance that the \$43.1 million disbursed under the contract was for costs that were reasonable and necessary.

Our audits of disaster programs found CDBG procurement violations and other contracting problems. For example, in a recent internal audit of HUD’s controls over its certifications of State disaster recovery grantee procurement processes,<sup>36</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.

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<sup>34</sup> Audit Report 2016-BO-1001, The State of Rhode Island Generally Administered Its Community Development Block Grant Disaster Recovery Assistance Grant in Accordance With Federal Regulations, March 09, 2016

<sup>35</sup> Audit Report 2016-PH-1009, State of NJ’s CDBG DR “Superstorm Sandy Housing Incentive Program,” September 30, 2016

<sup>36</sup> Audit Report 2016-PH-0005, HUD Certifications of Disaster Procurement Processes, September 29, 2016

### **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.

### **Challenges in Administering Disaster Programs**

Keeping up with communities in the recovery process is challenging for HUD. Congress has appropriated \$47 billion to HUD since fiscal year 1993 for disaster assistance. Of the active disaster grants, HUD has more than \$36 billion in obligations and \$33 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.

### ***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. Also, 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, and (3) timely oversight efforts.

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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 follow-through for OIG findings

and recommendations. In an evaluation<sup>37</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 follow-through for OIG findings and recommendations.

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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 and continue to be the major challenges affecting Ginnie Mae in fiscal year 2016 and in the coming years. Key factors that contributed to these challenges include the

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<sup>37</sup> Evaluation Report 2015-OE-0004, Comprehensive Strategy Needed To Address HUD Acquisition Challenges, February 2, 2016

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. 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. As of today, 7 of 10 Ginnie Mae issuers are nonbanks. Unlike regulated banks, these entities lack a primary prudential regulator to ensure their safety and soundness. Also, 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 both its operating and financial resources.

Historically, Ginnie Mae issuer defaults have been infrequent, involving small- to medium-size issuers. However, major unanticipated nonbank issuer defaults, like Taylor, Bean & Whitaker Mortgage Corporation in 2009, have led to a multi-billion-dollar rise in Ginnie Mae's mortgage servicing as well as its repurchase of billions of dollars in defaulted loans to meet its guarantee to the MBS investors. In 2016, Ginnie Mae was exposed to a 5-year, \$7.5 million mortgage fraud scheme executed by a small long-term issuer. The issuer exploited a flaw in the issuer buyout program by defaulting loans it serviced, buying the delinquent loans out of the pool, and resecuritizing them.

### **Financial Reporting Challenges**

Although Ginnie Mae has made progress in financial management governance issues in fiscal year 2016, there remain significant issues that warrant the attention of Ginnie Mae's stakeholders.

For the third year in a row, our annual financial statement audit of Ginnie Mae received a disclaimer of opinion due to its nonpooled loans assets (NPA) being unauditible. This year, Ginnie Mae acknowledged that the NPA balances are not supportable and not in accordance with generally accepted accounting principles. Ginnie Mae has reengaged its financial reporting and audit readiness contractor to assist in the development of its loan-level accounting system and related infrastructure.

With the approval of OMB and Congress, Ginnie Mae has significantly increased its management capacity. The total number of Ginnie Mae full-time employees increased from 89 in fiscal year 2012 to 130 at the end of fiscal year 2015. However, Ginnie Mae continues to have issues with staffing. Some personnel were hired in 2016 on a rolling basis. Of the 17 positions identified during the fiscal year, 7 were still unfilled as of mid-August. Ginnie Mae continues to rely heavily on third-party contractors to perform almost all key operating loan servicing, pool processing, and other functions. It is vital to the country's larger financial health that Ginnie Mae be able to significantly increase staffing and benefit from a pay structure that will allow it to

attract and hire individuals with the needed skills, knowledge, and abilities to manage a \$1.6 trillion program.

In fiscal year 2016, Ginnie Mae revamped a majority of its existing accounting policies and procedures, which have not been updated for many years, to comply with changes in generally accepted accounting principles among other things. Ginnie Mae has not finalized all of its accounting policies, and the accounting procedures are still in process. Currently, 5 of the 20 policies have been finalized. The remaining guidelines are in various stages of development. Therefore, the underlying accounting problems that are preventing Ginnie Mae from obtaining a clean audit opinion will continue until the accounting policies and procedures have been finalized and fully implemented and Ginnie Mae is appropriately staffed with the needed skills to manage its accounting requirements.

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

We identified significant financial governance issues within Ginnie Mae. In fiscal year 2015, Ginnie Mae failed to maintain a governance framework that allowed appropriate policies, people, systems, and controls to ensure the reliability and integrity of Ginnie Mae's financial and accounting information.

### **Looking Ahead**

Ginnie Mae will continue to face challenges in this dynamic environment due to the shift in its business model. Ginnie Mae and HUD 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 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.