



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

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*Memorandum*

TO: Julian Castro, Secretary, S

FROM:   
David A. Montoya, Inspector General, G

SUBJECT: Management and Performance Challenges for Fiscal Year 2015 and Beyond

In accordance with Section 3 of the Reports Consolidation Act of 2000, the Office of Inspector General (OIG) is submitting its annual statement to you summarizing 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 2015. Through our audits, evaluations, and investigations, we work with departmental managers to recommend best practices and actions that help address these challenges. More details on our efforts in relation to these issues are included in our Semiannual Reports to Congress.

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

Achieving HUD's mission continues to be an ambitious challenge for its limited staff, given the agency's diverse programs, the thousands of intermediaries assisting the Department, and the millions of beneficiaries of its housing programs. The attachment discusses nine key challenges facing HUD:

1. Human capital management,
2. Financial management governance of HUD,
3. Financial management systems,
4. Information security,
5. Single-family programs,
6. Office of Community Planning and Development programs,

7. Public and assisted housing program administration,
8. Compliance with the Improper Payments Elimination and Recovery Act of 2010, and
9. Administering programs directed toward victims of natural disasters.

Attachment

**HUD Management and Performance Challenges**  
**Fiscal Year 2015 and Beyond**

**1. Human Capital Management**

For many years, one of the U.S. Department of Housing and Urban Development's (HUD or Department) major challenges has been to effectively manage its limited staff to accomplish its primary mission. HUD lacks a valid basis for assessing its human resource needs and allocating staff within program offices. The Department contracted with the National Academy of Public Administration (NAPA) to study this problem. In 1999, a NAPA report noted that HUD did not conduct short- or long-term planning to determine staffing needs. NAPA specifically noted the absence of a clear workforce planning strategy, which is impeding the Department's efforts to address its workforce needs in a strategic and organized manner.

NAPA recommended that the Department establish an intra-agency team of senior officials from the Offices of the Chief Financial Officer (OCFO) and Chief Human Capital Officer, as well as administrative and budget officials from major program offices, to assess the causes of HUD's erratic resource management practices and develop a more responsive and predictable staffing process. In addition, NAPA recommended that this team create ongoing, agencywide workforce analysis and planning that is tied to HUD's strategic plan and enhances its longer range capability to recruit and sustain a high quality and skilled workforce.

A June 2012 review by the Office of Personnel Management (OPM) found a number of weaknesses in HUD's human capital policies and practices. Specifically, OPM determined that HUD does not meet 41 of 68 expected outcomes across five Human Capital Assessment and Accountability Framework (HCAAF) systems. The five areas of HCAAF are Strategic Alignment, Leadership and Knowledge Management, Results-Oriented Performance Culture, Talent Management, and Accountability. OPM's review traced many of the problems to a lack of human capital accountability and insufficient strategic management of human capital. Since the completion of OPM's review, HUD management has identified corrective actions, developed action plans, taken steps to remediate identified weaknesses, and provided evidence to OPM that HUD has taken the required actions. While this process will continue throughout 2015, HUD expects OPM to issue a report on OPM's conclusions regarding the documentation provided to date. Meanwhile, we will continue monitoring the status of progress made in establishing an effective human capital management program.

In March 2013, the U.S. Government Accountability Office (GAO) issued a report on HUD's strategic human capital and workforce planning, which stated that HUD is reexamining its resource management processes. GAO's review found that HUD has provided central guidance on how work is defined and collected. However, HUD has not created a reliable system to report accurate workload data. GAO found that the data collected are often not used to inform decision makers, making it difficult to adequately assess HUD's resource needs. This is especially important because GAO reported in its February 2013 High Risk Series update that at the end of fiscal year 2012, at least 40 percent of HUD's staff was either already eligible or will become eligible to retire by 2016. In its draft 2016 Annual Performance Plan, HUD estimates that 57 percent of its workforce will be eligible to retire in 2015. The Department stated that it

has developed a succession planning tool to assess high-impact positions and successor candidate readiness to assume these positions. To measure this challenge, HUD will need to track employees in high-impact positions and roles whose departure would have a significant detrimental effect to an office's mission or operations.

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

- (1) Training on the new employee evaluation system framework,
- (2) Deploying performance management training for managers,
- (3) Redefining senior executive service plans,
- (4) Developing an awards policy, and
- (5) Acquiring a new ePerformance system.

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

## **2. Financial Management Governance of HUD**

HUD faces a significant management challenge to fully establish and implement a successful financial management governance structure and system of internal control over financial reporting as required by the Federal Managers' Financial Integrity Act of 1982 (FMFIA) and the Chief Financial Officers Act of 1990 (CFO Act). In our report on HUD's fiscal years 2013 and 2012 (restated) financial statements, we issued a qualified opinion based on improper budgetary accounting and a lack of accounting for cash management. In addition, in our report on internal control, we reported on 4 material weaknesses, 11 significant deficiencies, and 5 instances of noncompliance with laws and regulations. One of the significant deficiencies directly addressed the weaknesses in HUD's financial management governance, and several of the deficiencies have origins that can be directly related to a weak financial management governance structure.

HUD's current financial management structure, which administered \$32.8 billion in appropriations (not including receipts and collections) during fiscal year 2014, relies on delegations of several key financial management functions to HUD's program offices, including review and approval of vouchers, reviews of unliquidated obligations, and some budgetary functions. However, program-related issues, concerns, and decisions often take a higher priority

than financial management and the requirements for proper financial accounting, thereby limiting the relative importance of program office employees' financial management responsibilities.

HUD still faces several challenges. OCFO continues to lack a position or division to

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

Our audits have indicated that accounting procedures are often determined by program office preference without the guidance and oversight of OCFO and regard for accounting standards. The absence of this function has been the root cause of significant deficiencies identified in our audits and these management challenges.

HUD's ability to monitor and perform routine financial management activities has been hampered by both turnover and reductions in staff. Between 2009 and 2014, there was a 40 percent turnover in OCFO staff and an 11 percent reduction in full-time permanent OCFO employees. Between 2013 and 2014 alone, there was a 13 percent turnover and a 5 percent reduction in OCFO staff. The turnover and reductions have placed additional burdens on OCFO staff and limited its ability to perform its duties in a timely and efficient manner.

Further, HUD lacked a Senior Management Council and Senior Assessment Team or equivalent committees responsible for

- (1) Assessing and monitoring deficiencies in internal control resulting from the FMFIA assessment process,
- (2) Advising the HUD Secretary of the status of corrections to existing material weaknesses, and
- (3) Informing the Secretary of any new material weaknesses that may need to be reported to the President and Congress through the Annual Financial Report.

While establishment of a Senior Management Council and Senior Assessment Team is not required by OMB Circular A-123, Management's Responsibility for Internal Control, it is recommended, and we believe it is a critical step and best practice in establishing effective internal controls.

HUD has taken steps to address the weaknesses in its financial management governance structure. Recently, HUD appointed a new Chief Financial Officer (CFO), and vacancies at the Deputy Chief Financial Officer and three of the four Assistant Chief Financial Officer positions were filled in fiscal year 2014. Additionally, HUD is in the process of hiring staff to fill positions with responsibility for writing accounting policies and procedures. HUD also awarded a contract for a study to determine possible improvements that could be implemented to improve HUD's compliance with the CFO Act, FMFIA, and the Federal Financial Management Information Act and improve internal controls over financial reporting. The study will also

consider the impact of the New Core financial system on HUD's future financial management structure and whether the creation of a Senior Management Council would increase the effectiveness of HUD's financial management.

We are conducting our audit of the Government National Mortgage Association's (Ginnie Mae) fiscal year 2014 financial statements and have identified significant challenges facing Ginnie Mae regarding how Ginnie Mae managed its master servicers' financial reporting risks related to more than \$5 billion in nonpooled loans reported on its balance sheet. Since Ginnie Mae does not have the capacity to service these loans, it relied on its master servicers to perform the servicing, accounting, and reporting of financial transactions and events related to these nonpooled loans. However, significant turnover of key Ginnie Mae financial management personnel in fiscal year 2014 resulted in inadequate monitoring of the master servicers and nonperformance of certain key controls, such as the contract assessment reviews and special reviews.

Overall, the deficiencies in HUD's and Ginnie Mae's financial management governance structure have resulted in a departmentwide imbalance in which financial management requirements are subordinated to program office operational objectives. OCFO could provide better financial information to manage the day-to-day operations of the Department, as well as assist in policy and budget formulation, if HUD's financial management were appropriately structured and the CFO were given the authorities and resources needed. Additionally, Ginnie Mae could provide better financial management and assurance over internal controls if key personnel positions were filled and reviews over master servicers were consistently completed.

Another concern is that HUD's financial management handbooks are either significantly outdated or incomplete. OCFO has attempted to implement accounting policy and procedures through the issuance of memorandums. However, this method does not provide easily accessible guidance and reference for staff, nor does it provide for a permanent source of financial management standard operating policies. Financial management policy in a centralized location that is easily accessible by staff is instrumental for the continuity of accounting policies and procedures during periods of staff turnover. OCFO's significant turnover in the past 5 years, combined with the lack of a basic policy framework necessary to implement a compliant financial management system, has created a significant challenge in ensuring compliance with accounting standards and other regulations. HUD must fully commit to establishing, documenting, and implementing its accounting policies and procedures in a permanent and easily accessible manner.

We continue to have concern with HUD's ability to summarize and report all transactions and events related to HUD's Office of Community Planning and Development (CPD) programs accurately and in a timely manner in accordance with GAAP until appropriate system changes are implemented in HUD's accounting systems. HUD's accounting system for CPD programs, the Integrated Disbursement and Information System (IDIS Online) was designed to process disbursements using a first-in, first out (FIFO) methodology. Under FIFO, the funds are committed and drawn from the oldest to the newest funds having the same grant program, source of funds, recipient of funds, and type of funds. However, this methodology was not a generally accepted accounting practice for grants in the Federal Government. To properly account for

these transactions in accordance with GAAP, the same source of funding for an obligation should also be used to record disbursements against that obligation. HUD has begun to implement system changes to eliminate the FIFO logic for fiscal year 2015 grant funds and forward. However, prior-year grant funds will continue to be disbursed under the FIFO method, resulting in continued noncompliance with Federal financial management system requirements as well as GAAP. This issue affects all formula programs within CPD and will continue to impact the consolidated financial statements until the prior-year funds are assessed as immaterial.

### **3. Financial Management Systems**

Annually since 1991, the Office of Inspector General (OIG) has reported on the lack of an integrated financial management system, including the need to enhance the Federal Housing Administration's (FHA) management controls over its portfolio of integrated insurance and financial systems. HUD has been working to replace its current core financial management system since fiscal year 2003. The previous project, the HUD Integrated Financial Management Improvement Project (HIFMIP), was based on plans to implement a solution that replaced two of the applications currently used for core processing. In March 2012, work on HIFMIP was stopped, and the project was later canceled. HUD spent more than \$35 million on the failed HIFMIP project. In the fall of 2012, the New Core project was created to move HUD to a new core financial system to be maintained by a shared service provider, the U.S. Department of the Treasury, Bureau of Fiscal Service. The project consists of three phases.

Phase 1 of the project has been separated into four different releases. Each release defines a particular function that will be transferred to Treasury's shared services platform.

- Release 1 transferred the travel and relocation functions to Treasury on October 1, 2014.
- Release 2 will cover time and attendance and is scheduled to start on February 8, 2015.
- Release 3 is scheduled to start in the fourth quarter of fiscal year 2015 or the first quarter of fiscal year 2016 and will cover migration of OCFO core financial services.
- Release 4 will address HUD's grant and loan accounting systems. Details of this release have not been finalized, and there is no scheduled date for implementation.

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

Phase 2 of the project will address managerial cost accounting, budget formulation, and a fixed assets system.

Phase 3 of the project will address the consolidation of FHA and Ginnie Mae as well as the migration of the functionality of HUD's Line of Credit Control System.

The independent verification and validation contractor tasked to assess the project in concert with project activities, listed the project risk as high for 7 of the 16 areas it assessed through July 15, 2014. In addition, several areas of concern noted within the contractor's report indicate that many of the problems that occurred during the failed HIFMIP implementation are also plaguing the New Core project. Consequently, we remain concerned about HUD's ability to successfully complete the project.

We are also concerned about the current state of FHA's information technology (IT) systems and the lack of systems capabilities and automation to respond to changes in business processes and the IT operating environment. To address these challenges, in August 2009, FHA completed the Information Technology Strategy and Improvement Plan, which identified FHA's priorities for IT transformation. The plan identified 25 initiatives to address specific FHA lines of business needs. Initiatives were prioritized, with the top five related to FHA's single-family program. The FHA transformation initiative was intended to improve the Department's management of its mortgage insurance programs through the development and implementation of a modern financial services IT environment. The new modern environment was expected to improve loan endorsement processes, collateral risk capabilities, and fraud prevention. However, to date, FHA has not completed all of the goals because of a lack of funding.

Overall, funding constraints diminished HUD's ability to complete the new application systems and phase out and deactivate the outdated systems. Some progress has been made by creating new systems with modernized capabilities that replaced manual processes. However, many legacy systems remain in use. This situation brings about another concern: the ability to maintain the antiquated infrastructure on which some of the HUD and FHA applications reside. As workloads continue to gain complexity, it becomes more difficult to maintain these legacy systems, which are 15 to 30 years old, and ensure that they can support the current market conditions and volume of activity. The use of aging systems has resulted in poor performance and high maintenance costs. As part of our annual review of information systems controls in support of the financial statements audit, we continue to report weaknesses in internal controls and security regarding HUD's general data processing operations and specific applications. The effect of these weaknesses is that the completeness, accuracy, and security of HUD information is at risk of unauthorized access and modification. For instance, HUD did not

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

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

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

The HUD CIO has primary responsibility over many IT and information management functions; however, he lacks the authority to enforce compliance with Federal law, National Institute of Standards and Technology guidance, or departmental IT policies. The Office of the Chief



Information Officer (OCIO) issues policy and procedures for IT and information security management. For example, OCIO issues guidance for the development and maintenance of system security documentation, including authority to operate statements, systems security plans, annual self-assessments of security controls, risk assessments, contingency plans, and configuration management plans. For the majority of fiscal year 2014, OCIO has been merely a collector of the documents and unable to force compliance with policies and standards.

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

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

#### **4. Information Security**

Our annual evaluation of HUD's IT security program, as mandated by FISMA, revealed continued and extensive noncompliance with Federal IT guidance. HUD has deficiencies in 7 of the 11 program areas on which OIG reports to OMB, including Continuous Monitoring, Incident Response, Security Training, Plans of Actions and Milestones, IT Risk Management, Contractor System Oversight, and Security Capital Planning. Further, our evaluation of HUD's privacy program determined that HUD's executive leadership had not sufficiently prioritized and supported its privacy program. HUD had not established an effective or efficient program, had not mitigated risks associated with the extensive privacy data managed by the agency, and had not complied with many Federal requirements.

HUD does not have a comprehensive plan to address its current IT risks and initiate the critical projects that will be needed to transition and modernize its infrastructure to effectively and securely support HUD's mission. The Department faces many challenges in establishing an effective strategic direction. The challenges are magnified by the complexity of HUD's IT environment, expiration of infrastructure support contracts, excessive number of legacy applications, and abundant holdings of sensitive data and personally identifiable information, all while being faced with emerging IT threats and budget constraints. IT workforce planning will be a vital component to its future success as IT skills are depleted within HUD following years of dependence on contract personnel.

HUD's fiscal year 2014 IT fund of \$343.8 million and fiscal year 2015 request for \$336.8 million will impact HUD's ability to facilitate effective programs and plan for the future. During fiscal year 2014, key IT positions were filled, including both the CIO and Chief Information Security Officer. The leadership has an opportunity to vitalize and instill an IT security culture throughout HUD, assuming it has the support of HUD executives and all offices. OCIO began a major initiative late in fiscal year 2014 to create a cyber security framework to address the current IT security program deficiencies.

### **5. Single-Family Programs**

FHA's single-family mortgage insurance programs enable millions of first-time borrowers and minority, low-income, elderly, and other underserved households to realize the benefits of 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.

For the past 5 years, the FHA fund has failed to meet its legislatively mandated 2 percent capital ratio. Each of these 5 years has seen a further decline in that ratio, and according to the 2013 actuarial study, the fund had a negative economic value of \$1.3 billion. Based on the 2013 projections, the capital ratio will not reach the 2 percent level until 2016, marking 7 consecutive fiscal years below the 2 percent threshold. Due to the continuing stress on the insurance fund's estimated reserves, GAO included FHA concerns in its latest "high risk" update relating to "Modernizing the U.S. Financial Regulatory System and Federal Role in Housing Finance." Restoring the fund's reserves and finances has been a priority for HUD, and it has increased premiums, reduced the amount of equity that may be withdrawn on reverse mortgages, and taken other steps to restore the financial health of the fund. OIG has worked with HUD and the U.S. Department of Justice (DOJ) to pursue civil fraud investigations to recover losses from lenders that fraudulently originated FHA loans. This effort has resulted in more than \$2 billion being recovered. It is incumbent upon the Department to make every effort to prevent or mitigate fraud, waste, and abuse in FHA loan programs.

FHA has a major role in supporting the housing market and has implemented initiatives to strengthen the insurance fund. For example, in May 2014, HUD outlined its initiatives to provide credit access to underserved borrowers. This effort includes several initiatives tying housing counseling with FHA-insured mortgage origination and servicing. A pilot program will provide FHA insurance pricing incentives to first-time home buyers who participate in housing counseling and education. In addition, the initiative enhances FHA's quality assurance efforts to provide transparency to FHA-approved lenders to encourage lending to qualified borrowers across the credit spectrum. Another initiative is the development of a new methodology for evaluating underwriting defects. These new criteria will be more descriptive, identifying a number of specific defects, their related causes, and levels of severity. OIG has reviewed a draft version of the methodology and has provided feedback. Also, FHA plans to expand its evaluation of loans to include random sampling of performing loans closer to the time of endorsement. Further, FHA has begun reconciling more than 900 mortgagee letters and other policy guidance into a single, authoritative document to serve as the definitive guide on all aspects of FHA's single-family programs. The last initiative includes an additional national

lender performance metric to assess lender performance based on the lender's default rate within three credit score bands to compare it to FHA's target rate, rather than to the lender's peers.

The Reverse Mortgage Stabilization Act of 2013 provided FHA with tools to improve the fiscal safety and soundness of the home equity conversion mortgage insurance program in a timelier manner. Using this authority, FHA recently issued a mortgagee letter to limit the insurability of fixed-interest-rate mortgages under the reverse mortgage program to mortgages with the single-disbursement lump-sum payment option. This decision was made to limit the risk that fixed-interest-rate reverse mortgage products pose to the future financial soundness of the program, to the Department's ability to operate the program, and to Ginnie Mae's ability to operate a financially sound securitization program.

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 actions against lenders because of its competing mandate to continue FHA's role in restoring the housing market and ensure the availability of mortgage credit and continued lender participation in the FHA program. For example, FHA has been slow to start a rigorous and timely claims review process. OIG has repeatedly noted in past audits and other types of lender underwriting reviews HUD's financial exposure when paying claims on loans that were not qualified for insurance. Last year, OIG noted HUD's financial exposure when paying claims on loans that were not qualified for insurance. Adding to this concern, HUD increased its financial exposure by not recovering indemnification losses and extending indemnification agreements when appropriate. Based on the results of an August 2014 audit, OIG determined that HUD did not always bill lenders for FHA single-family loans that had an enforceable indemnification agreement and a loss to HUD. The audit identified 486 loans with losses of \$37.1 million from January 2004 to February 2014 that should have been billed and recovered. HUD needs to ensure continued emphasis on indemnification recoveries, especially for newer FHA programs such as Accelerated Claims Disposition or Claims Without Conveyance of Title.

HUD also faces challenges in ensuring that its controls work as intended and provide FHA with the appropriate credit data to properly assess borrowers' eligibility for FHA insurance. In a recent audit of the Department's Credit Alert Verification Reporting System (CAIVRS), OIG found that the system did not contain default, foreclosure, and claim activity information for all borrowers. Further, this system did not contain all information for FHA borrowers with claims older than 3 years. As a result, HUD did not provide other Federal agencies with sufficient information on FHA borrowers with delinquent Federal debt to comply with requirements of the Debt Collection Improvement Act. This Act bars delinquent Federal debtors from obtaining additional Federal loans or loan guarantees until delinquencies are resolved. These conditions occurred because HUD did not adequately design the process for providing data to CAIVRS from its other systems. Also, FHA requirements permit borrowers to be eligible for another FHA loan after 3 years. FHA agreed to update its selection rules for complete reporting of all ineligible borrowers to the extent that the system is used as a credit risk assessment tool. However, FHA does not consider delinquency on an FHA-insured mortgage to be a delinquent Federal debt, nor does it believe that payment of a claim on an FHA-insured mortgage automatically creates a delinquent Federal debt. OIG anticipates challenges with resolving this issue during the audit resolution process.

OIG continues to take steps to help preserve the FHA insurance fund and improve FHA loan underwriting by partnering with HUD, DOJ, and multiple U.S. Attorney's offices nationwide in a number of FHA lender civil investigations. Results to date have shown that a high percentage of loans reviewed should not have been insured because of significant deficiencies in the underwriting. As a result, several of these investigations have led to large settlements. Within the last 3 fiscal years, the Government has reached civil settlements with FHA lenders totaling nearly \$3.2 billion for alleged violations of the False Claims Act and the Financial Institutions Reform, Recovery, and Enforcement Act. More than \$2 billion of the \$3.2 billion is of direct benefit to the FHA insurance fund. Future investigations are expected to lead to additional settlements that will significantly help recover losses to the FHA insurance fund.

Over the past 4 years, Ginnie Mae has seen its outstanding mortgage-backed securities increase by more than 50 percent. As of August 2014, Ginnie Mae's mortgage-backed securities (MBS) portfolio exceeded \$1.52 trillion. We remain concerned that increases in demand on the FHA program are having collateral implications for the integrity of Ginnie Mae's MBS program, including the potential for increases in fraud. Ginnie Mae securities are the only mortgage-backed securities to carry the full faith and credit guaranty of the United States. If an issuer fails to make the required pass-through payment of principal and interest to MBS investors, Ginnie Mae is required to assume responsibility for it. Typically, Ginnie Mae defaults the issuer and assumes control of the issuer's government or agency MBS pools. Historically, Ginnie Mae issuer defaults have been infrequent, involving small to moderate-size issuers. However, major unanticipated issuer defaults beginning in 2009 have led to a multi-billion-dollar rise in Ginnie Mae's nationwide mortgage servicing as well as its repurchase of billions of dollars in defaulted whole loans to meet its guarantee commitments to MBS investors. In the near term, these changes have strained both operating and financial resources.

Another key challenge facing Ginnie Mae is the risk posed by the growing number of Ginnie Mae issuers that are institutions other than banks. In June 2011, 7 of the top 10 servicers were banks, but in June 2014, only 4 of the top 10 servicers were banks. Ginnie Mae's potential for losses occurs when an issuer fails to fulfill its responsibilities. With the significant shift of its business going to nonbanks, Ginnie Mae could no longer rely on the Office of the Comptroller of the Currency and other bank regulators to ensure that its servicers can meet their financial obligations. To mitigate the risks, Ginnie Mae will need to be more involved with nonbanks to adequately monitor them, which would require Ginnie Mae to increase its current staffing level.

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 108 at the end of fiscal year 2013. However, Ginnie Mae continues to rely heavily on third-party contractors to perform almost all key operating loan servicing, pool processing, and other functions.

## **6. CPD Programs**

HUD's ability to provide data to monitor compliance with the HOME Investment Partnership Act (HOME statute) requirements for committing and expending funds will remain a concern until appropriate system changes in IDIS Online are implemented and regulatory changes are made. The HOME Investment Partnerships Program is the largest Federal block grant to State

and local governments and is designed to create affordable housing for low-income households. Because HOME is a formula-based grant, funds are awarded to the participating jurisdictions noncompetitively on an annual basis.

In 2009, OIG challenged HUD's cumulative method for determining compliance with section 218(g) of the HOME statute, which requires that any uncommitted funds be reallocated or recaptured after the expiration of the 24-month commitment deadline. After a continuous impasse with HUD, OIG contacted GAO in 2011 and requested a formal legal opinion on this matter. In July 2013, GAO issued its legal opinion, affirming OIG's position and citing HUD for noncompliance. In its decision, GAO reiterated that the language in the statute was unambiguous 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 ramifications of the GAO legal opinion will require extensive reprogramming and modification to IDIS Online in addition to regulatory changes. However, these system and regulatory changes, which are already underway, will be applicable only to new grants awarded in fiscal year 2015 and forward. Funding obligated before the system and regulatory changes will continue to be determined on a cumulative basis, resulting in continued noncompliance with the HOME statute. HUD's plan does not comply with the GAO legal opinion and allows grantees to expend funding that would normally be recaptured if the 24-month commitment timeframe was not met. We believe compliance with GAO's opinion would enable HUD to better monitor grantee performance in a more timely, efficient, and transparent way. It also would strengthen internal controls, bring HUD into compliance with HOME statutory requirements, and accurately and reliably report financial transactions.

Congress created the Neighborhood Stabilization Program (NSP) to help cities, counties, and States deal with community problems that resulted from the Nation's mortgage foreclosure crisis. HUD provided almost \$7 billion in NSP funding to States, local governments, and nonprofits through three rounds of funding. Congress established expenditure deadlines for these three rounds of NSP funding within the appropriations act. HUD continues to be challenged in its monitoring of unexpended funds, not only in this program, but also in its Community Development Block Grant (CDBG) and Disaster Recovery grant programs.

### **7. Public and Assisted Housing Program Administration**

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

HUD has a challenge in monitoring the Housing Choice Voucher program. The program is electronically monitored through PHAs' self-assessments and other self-reported information collected in PIH's systems. Based on recent audits and HUD's onsite confirmatory reviews, the self-assessments are not always accurate, and the reliability of the information contained in PIH systems is questionable. PIH management states that it will address these limitations with the Next Generation Management System, which is under development, and the Portfolio Management Tool, which has recently been implemented. Until both systems are completely implemented, HUD will continue to face challenges in monitoring this program.

During 2012 and 2013, Congress reduced funding to the Housing Choice Voucher program by \$975 million. These reductions are a significant challenge for PIH to provide housing to the same number of families with much less funding. To meet this challenge, PIH needs to ensure optimum use of program funding. PIH developed a spreadsheet tool for PHAs and PIH staff to assist in projecting leasing, spending, and funding over a 2-year period. The purpose is to facilitate decision making by PHAs and guide HUD oversight and technical assistance so that PHAs can fully use their funding. The goal is to avoid large cyclical swings of participant lease-up followed by attrition and to eliminate abrupt funding cutbacks that may cause the canceling of vouchers.

With a focus on the decreasing availability of funds, we are concerned that HUD may not be ensuring that defederalized administrative fees paid to PHAs are reasonable. We recently reported that HUD could not adequately support the reasonableness of operating fund management, book-keeping, and asset management fees and Public Housing Capital Fund management fee limits. In addition, HUD lacked adequate justification for allowing PHAs to charge an asset management fee, resulting in more than \$81 million in operating funds being unnecessarily defederalized annually. HUD also did not adequately monitor PHAs' central office cost center fee charges. Among the five PHAs reviewed, four inappropriately overcharged or transferred \$2.3 million in excessive operating program funds from their asset management projects to their central office cost centers. Two of the PHAs were unable to support \$6.7 million in management, book-keeping, and asset management fees charged. Excess administrative fees, if defederalized, are not required to be used for the program. Ensuring that only the funds that are needed are transferred out will allow more funds to be used directly for the program.

HUD's Housing Choice Voucher program disbursed more than \$17.3 billion to PHAs in fiscal year 2014. However, HUD's new cash management process for the Housing Choice Voucher program, which was implemented to ensure that PHAs received funding only for their immediate disbursement needs, departed from Treasury cash management requirements. In fiscal year 2012, PIH implemented procedures to complete quarterly reconciliations and base disbursements to PHAs on prior quarter expenses, instead of disbursing 1/12 of the total renewal budget authority monthly. This change was implemented to reduce the amount of excess funds accumulating in PHAs' net restricted asset accounts and in accordance with a congressional conference report. However, significant amounts had already accumulated and needed to be transitioned back to HUD. While an OIG audit found that HUD notified the PHAs of its intent to begin the transition, as of the end of fiscal year 2013, HUD had not begun the process. This delay allowed millions of dollars to be held at PHAs and become susceptible to fraud, waste, and

abuse. The transition process began during fiscal year 2014, and significant amounts of funds have been transitioned back to HUD. However, this effort was entirely manual, labor intensive, and required extensive research and analysis to determine how much money needed to be transitioned back to HUD.

Additionally, HUD lacks an automated process to complete the reconciliations required to monitor 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 2,300 PHAs. This process increases the risk of error and causes significant delays in the identification and offset of excess funding. Because of the manual reconciliation and transition process performed this year, reconciliations were not completed during the current year. This delay allowed PHAs to continue holding funding in excess of their immediate disbursement needs, contrary to the congressional intent for HUD to implement sound cash management procedures. In addition, HUD cannot quantify the amount of excess funds, nor is it monitoring the accumulation of excess funds that Moving to Work (MTW) PHAs are holding. HUD has not implemented procedures to identify and return those excess funds and is in violation of applicable regulations.

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 design and test innovative, locally designed strategies that are designed to use Federal dollars more efficiently, help residents become self-sufficient, and increase housing choices for low-income families. In the more than 15 years since the demonstration program began, HUD has not reported on whether the program is meeting its objectives. HUD has requested and Congress is considering expanding the program to include more participants without knowing whether participating PHAs are reducing costs to gain increased housing choices and incentives for families to work. HUD is experiencing challenges in developing programwide performance indicators that will not inhibit the participants' abilities to creatively impact the program.

This conclusion is also supported by a 2012 GAO report, which found that MTW guidance does not specify that PHA MTW plans require that performance be quantifiable and outcome oriented. By not identifying the performance data needed to assess the results of the MTW program, HUD is unable to effectively evaluate this demonstration program. In fiscal year 2013, OIG continued to report that participating PHAs have significantly departed from their MTW agreements. HUD could benefit from formalizing a process for terminating participants from the demonstration program for failure to comply with their agreement. We are looking further into controls over legal and lobbying expenses by participating PHAs.

Based on a 2008 audit report, 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 project-based program. Testing is taking considerably longer than expected. HUD is performing inspections on its voucher units and expects it to be completed by the spring of 2015. However, plans to begin testing a new protocol and related software for a comprehensive monitoring system will not begin until later in 2015. Meanwhile, we continue to identify PHAs with inspection programs, which do not ensure that voucher program units comply with standards.

We also noted that executive directors removed or who left under questionable circumstances are being appointed as executive directors at other agencies in different parts of the country. This matter is concerning because it allows someone with a poor track record to continue poor management practices or possible malfeasance elsewhere. This situation will be a challenge to HUD because it does not track the movement of executive directors between PHAs. In December 2013, we posted an integrity bulletin to our Web site, emphasizing the need to screen applicants to bring this issue to the attention of the PHAs.

#### **8. Compliance With the Improper Payments Elimination and Recovery Act of 2010**

Since the passage of the Improper Payments Information Act of 2002, HUD has made an effort to reduce erroneous payments in its PIH programs. However, departmentwide progress has stalled. In fiscal year 2014, we conducted an audit to determine HUD's compliance with the Improper Payments Information Act of 2002 as amended by the Improper Payments Elimination and Recovery Act of 2010 (IPERA). We determined that, for the first time since being required to conduct this audit, HUD did not comply with IPERA reporting requirements because it did not sufficiently and accurately report on four required areas in its Annual Financial Report. Additionally, we found that HUD's supplemental measures and associated corrective actions did not sufficiently target the root causes of its improper payments as intended by IPERA requirements. Specifically, they did not track and monitor processing entities to ensure the prevention, detection, and recovery of improper payments because of rent component and billing errors, which are root causes identified by HUD's contractor studies.

Last year, we noted that improper subsidy payments in three major rental housing assistance programs resulted from errors made by program administrators as well as from tenants intentionally underreporting income. While HUD had initially made substantial progress in reducing erroneous payments, in 2012, improper payments increased to \$1.32 billion. This amount reflects an overall error rate of 4.3 percent, which is above HUD's 2012 target error rate of 3.8 percent. HUD's error rate in 2011 was 3.9 percent. It was 3.1 percent in 2010.

HUD needs to implement processes to ensure that it accurately reports on its improper payments and the actions it took to reduce and recover them. Additionally, HUD needs to reevaluate its supplemental measures and corrective actions to ensure that they target all root causes of improper payments identified in HUD's rental housing assistance programs. This measure will ensure that HUD is making progress toward reducing its total improper payment rate.

#### **9. Administering Programs Directed Toward Victims of Natural Disasters**

Congress has frequently provided supplemental appropriations through HUD's CDBG program to help communities recover from natural and man-made disasters. The CDBG program is flexible and allows CDBG Disaster Recovery (CDBG-DR) grants to address a wide range of challenges. These grants have been used to help New York recover from the attack on the World Trade Center on September 11, 2001, to help towns in the upper Midwest recover from severe flooding (in 1993, 1997, and 2008), and to help the Gulf Coast in the wake of the hurricanes of 2005. Although HUD has made progress in recent years with assisting communities recovering from disasters, it faces several management challenges in administering these grants.



As a result of the recent high number of disasters, HUD faces difficulties in monitoring disaster program funds because of limited resources to perform the oversight, the broad nature of HUD program requirements, and the lack of understanding of CDBG-DR grants by the recipients. Since HUD disaster assistance may fund a variety of recovery activities, HUD can help communities and neighborhoods that otherwise might not recover. However, HUD must be diligent in its oversight duties to ensure that grantees have completed their projects in a timely manner and that they use the funds for the intended purposes.

Based on our prior audits, we identified some management challenges for the Department regarding the Disaster Recovery program. Some of HUD's greatest challenges in the disaster area include

- (1) Ensuring that expenditure deadlines are met,
- (2) Approving the program waiver process,
- (3) Certifying that grantees are following Federal procurement regulations, and
- (4) Continuing to maintain oversight efforts on disaster grants.

To ensure the expenditure of funds in a timely manner, the Sandy Appropriations Act requires that all funds be spent within 2 years of the date HUD obligates funds to a grantee. The Appropriations Act also requires that HUD obligate all funds not later than September 30, 2017. Grantees must demonstrate in their action plans how funds will be fully spent within 2 years of obligation. For any funds that the grantee believes will not be spent by the deadline, it must submit a letter to HUD justifying why it is necessary to extend the deadline for a specific portion of funds. The letter must detail the compelling legal, policy, or operational challenges for the waiver and must also identify the date by which the specified portion of funds will be spent. Funds remaining in the grantee's line of credit at the time of its expenditure deadline will be returned to the U.S. Treasury. HUD was appropriated \$16 billion in CDBG funds for the Sandy disaster, and a portion of these funds will reach their expenditure deadline in fiscal year 2015.

CDBG-DR appropriations generally grant the HUD Secretary broad authority to issue waivers and alternative requirements. Because HUD is waiving some of the standard CDBG program requirements, it must ensure that each disaster recovery activity includes performance and expenditure schedules as part of its action plan for overall accountability. HUD must be consistent in granting waivers and ensure that they are consistent with the purpose and rules governing the CDBG program.

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

Our audits of disaster programs found CDBG procurement violations and other contracting problems. For example, in a recent audit of the New Jersey tourism program, auditors found that the State did not procure services and products for its tourism marketing program in a manner

that fully met the intent of Federal requirements. In this case, the State awarded a contract with a budget of up to \$25 million for marketing and outreach services without first performing the required independent cost estimate and cost analysis.

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 \$31 billion in obligations and \$26 billion in disbursements. Although many years have passed since some of the specific disasters occurred, significant disaster funds remain unspent. HUD must continue to maintain its oversight efforts to ensure that funds are expended as needed.