

Testimony before the U.S. House of Representatives
Committee on Financial Services

“Oversight of HUD’s HOME Program”



Testimony of
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Good morning Chairman Bachus, Ranking Member Frank, and distinguished Members of the Committee. I am James Heist, Assistant Inspector General for Audit at the U.S. Department of Housing and Urban Development's (HUD) Office of Inspector General (OIG). I thank you for the opportunity to discuss oversight of HUD's HOME program. Today, I will discuss this issue from the perspective of an audit manager with 35 years of audit experience, including over ten years as HUD OIG's Assistant Inspector General for Audit.

Background

OIG's mission is independent and objective reporting to the Secretary and the Congress for the purpose of bringing about positive change in the integrity, efficiency, and effectiveness of HUD programs. HOME is the largest federal block grant dispersed to state and local governments designed to create affordable housing for low-income households. Each year it allocates approximately \$2 billion among the states and hundreds of localities nationwide based on formula grants. The program was designed to reinforce several important held values and principles of community development:

- HOME's flexibility enables people and communities to design and implement strategies tailored to their own needs and priorities.
- HOME's emphasis on consolidated planning expands and strengthens partnerships among all levels of government and the private sector in the development of affordable housing.
- HOME's technical assistance activities and set-aside for qualified community-based nonprofit housing groups builds the capacity of these partners.

The HOME program is authorized under Title II of the Cranston-Gonzalez National Affordable Housing Act, as amended. Program regulations are found at 24 CFR Part 92. HOME provides formula grants to states and localities that communities often use, in partnership with local nonprofit groups, to fund a wide range of projects that build, buy, and rehabilitate affordable housing for rent or homeownership, or to provide direct rental assistance to low-income people. HOME funds are allocated by formula to Participating Jurisdictions ("PJ"). PJs are state and local governments (including consortia) that receive funds to operate the program. After set-asides for technical assistance and insular areas are subtracted from the total appropriation from Congress, 40 percent of each annual appropriation is allocated by formula to states and 60 percent to local governments. The formula is based, in part, on factors including age of units, substandard occupied units, number of families below the poverty rate, and population in accordance with the most recent Census data.

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The HOME program statute states that the PJs lose rights to HOME funds that are not committed¹ within 24 months or reserved to community housing development organizations (CHDOs) within 24 months. HUD has no authority to permit PJs to keep these funds and HUD must deobligate them after 24 months. The HOME program regulations also contain a requirement to expend HOME funds within five-year years after the last day of the month in which HUD notifies the PJ of HUD's execution of the HOME Investment Partnerships Agreement. In rare cases, the five-year expenditure regulatory requirement may be waived.

To determine compliance with the commitment and expenditure requirements, field office staff must compare the PJ's cumulative allocations from program inception through the deadline requirement year, minus any deobligations, to its cumulative commitments to HOME activities and cumulative HOME expenditures from program inception through its deadline. A PJ meets the requirements if its cumulative commitments or expenditures through its deadline are equal to or greater than its cumulative allocations minus any deobligations through the deadline year.

If it is determined that a deobligation is necessary, HUD, in conjunction with the respective field office, will determine the source year(s) of any remaining available funds. In most cases, funds will be deobligated from the most recent year's (or next previous year's) obligated grant. This allows the deobligated funds to be reallocated in the next HOME formula, and prevents loss of funds to Treasury. If it is a non-CHDO entity, then next year's appropriations are reallocated to all PJ's, even the one that had the funding reduction.

The OIG has expressed its disagreement with this "cumulative" approach for measuring compliance, as well as the process of recapturing current or future funds due to non-compliance. The cumulative technique enables PJs to offset older year commitment and expenditure requirements with commitments and expenditures that actually pertained to more recent years' activities. As a result, HUD effectively allowed the PJs more time to complete activities than the five-year expenditure requirement. Furthermore, because PJs can commit more than their grant award for a particular year, the cumulative approach also balances years that were over-committed with years that were under-committed. In addition, by deobligating funds from the most recent years' allocation(s), the funding from the years in which the grantee was non-compliant remains available for disbursement and augments the current or future allocation. This approach breaks the link between source and use of funding.

In fiscal year 2002, HOME funds became subject to the National Defense Authorization Act of 1991² expenditure requirements which states that appropriation accounts available for definite

¹ Regulations at 24 CFR 92.2(1) define commitment as an executed legally binding agreement to use a specific amount of HOME funds to produce affordable housing or provide tenant-based rental assistance, an executed written agreement reserving a specific amount of funds to an organization, or having met the requirements to commit funds to a specific local activity.

² The National Defense Authorization Act of 1991(Public Law 101-510, November 5, 1990) established rules governing the availability of appropriations for expenditure. This law mandates that on September 30th of the fifth fiscal year after the period of availability for obligation of a fixed appropriation account ends, the account shall be closed and any remaining balance in the account shall be canceled.

periods are only available for disbursing for a period of five years from the last date of availability. Starting in 2002, HOME funding changed from an indefinite period to a fixed three-year period of availability. Based upon this change, at the end of fiscal year 2009, and for each subsequent fiscal year, any remaining funding from the fixed-term appropriation is cancelled and remitted to Treasury. This expenditure requirement is not unique to the HOME program and is based upon the actual liquidations from a single Treasury account, related to a single grant year. For example, the fiscal year 2003 HOME appropriation was no longer available after September 30, 2010 and the 2004 appropriation will not be available after September 30, 2011. This is different from the HOME Program's five-year expenditure deadline requirement which is regulatory and calculated cumulatively, taking into consideration expenditures from all HOME grants awarded to the participating jurisdiction.

HOME addresses a need for affordable housing in our country; a need that is increasing in the wake of the economic downturn and rise in unemployment. However, OIG has expressed concerns about the controls, monitoring and information systems related to the HOME program. Over the past five years, the OIG has conducted 64 external audits of HUD's HOME program. At least twelve of these audits were requested by the Department to address concerns that they had. Many others were selected based on grantee risk assessments that included informal input from HUD staff.

The Committee asked in meetings that we provide an assessment of our work to highlight reoccurring findings and to total costs associated with those. The most common finding throughout our audit reports is the lack of adequate controls, including: subrecipient activities, recapture provisions, over-reporting program accomplishments, and ineligible activities. There is also a repetitive thread of not meeting the HOME objective to provide affordable housing or not meeting local building code requirements for housing rehabilitation work. In our external audits of HOME funds over the past five years, we cited a total of \$179 million in questioned costs and \$58 million associated with recommendations that funds be put to better use. HUD agreed with \$221 million of those combined costs; disagreed with \$14 million of those costs; recovered or realized savings of \$93 million of those costs; and resolved another \$66 million by subsequently obtaining documentation from the grantee to support eligibility of previously unsupported costs or determining that cost savings were not realized.

Monitoring

For the past three years, there were approximately 650 PJs receiving HOME funds. Those participating jurisdictions distributed the HOME funds to many thousands of sub-grantees. HUD focuses its monitoring at the grantee level through its 42 local field offices which is a large responsibility. Grantees in turn are responsible for monitoring their sub-grantees. Our audits have found that, in some instances, no monitoring is occurring, particularly at the sub-grantee level.

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Information System Issues

The Integrated Disbursement and Information System (IDIS) is used by more than 1,200 HUD grantees, including urban counties and states, to plan projects and activities, draw down program funds, and report on accomplishments. IDIS has more than 15,000 individual grantee users, as well as several hundred HUD headquarters and field office users. HUD employs the real-time mainframe-based computer application to accumulate and provide data to monitor compliance with HOME requirements for committing and expending funds. HUD also uses the information system to generate reports used within and outside HUD, including the public, participating jurisdictions, and the Congress.

Grantees and sub-grantees are able to update, change, cancel, re-open and increase or decrease project funding without any review by HUD. Grantees and sub-grantees also self-report the number of families housed by their projects without a comprehensive review by HUD.

Through our annual audits of HUD's Financial Statements, we have found that the Department did not ensure that adequate application controls for IDIS were properly placed and operating effectively. HUD OIG noted the following deficiencies: (1) incompatible functions such as system administration and security administration were not adequately separated, and (2) there was no formal user recertification process to ensure that all users were properly recertified. These weaknesses existed because HUD designed IDIS with decentralized security without adequate controls in place to ensure that the overall security of the system remained within the control of HUD staff. By not separating incompatible system administration and security responsibilities, and reviewing the continued appropriateness of access to the financial systems, HUD increased its risk that sensitive financial data could be modified, disclosed, or misused or that erroneous, or fraudulent transactions, could be placed.

We have also found that HUD's design and implementation of IDIS is not in compliance with federal financial management system requirements. The system arbitrarily liquidates obligations on a "first-in-first-out" (FIFO) basis, irrespective of the budget fiscal year funding source. We believe this process is not in compliance with federal financial management system requirements. In addition, we have asked the Government Accountability Office for their opinion on whether HUD is mismanaging grant funds and violating appropriation law as a consequence of using FIFO. Additionally, with the enactment of the Defense Authorization Act of 1991, liquidating the funds on this FIFO basis also intentionally decreases the amounts that HUD would be required to return to the Treasury after fixed-year appropriations cancel, and we believe is in contradiction with congressional intent.

In sum, we believe that HUD's information systems used to administer the HOME program are incapable of producing complete and reconcilable audit trails throughout the entire grant life cycle and are unable to produce reports which would facilitate timely identification of fraud, waste and abuse in the programs. Additionally, we have concerns about HUD's methods for

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assessing compliance with commitment and expenditure deadline recapture requirements and HUD's methodology for addressing non-compliant grantees.

Data Integrity

HUD OIG has found data integrity issues with the information within IDIS used to monitor compliance with these regulations, such as:

- Entries in IDIS for non-community housing development organization activities in which the participating jurisdiction was unable to produce written agreements.
- Agreements being executed after the 24-month deadline.
- Commitments in IDIS exceeding the contract amounts shown in the agreements.
- IDIS entries for community housing development organization activities in which written agreements did not exist at the time of the entries but were executed before the 24-month deadline.

We also found that the Department did not always ensure that participating jurisdictions complied with HUD's requirements in their use of program income and did not report program income in HUD's system accurately or in a timely fashion.

The OIG has concerns about the data integrity in the IDIS system and the impact that has on HUD's overall financial statements. We believe with a more robust, up to date information system, HUD would be able to better monitor the HOME program.

Highlights from External Audits

We conducted an audit of the District of Columbia, Washington, DC, and determined that it did not administer its HOME funds in accordance with Federal requirements. Specifically, we found that the grantee; (1) obligated more than \$2.5 million in HOME funds for an activity/project that was significantly delayed and not completed, (2) did not properly manage funds that it drew for down payment assistance and financing of home repairs, (3) committed and disbursed CHDO operating funds for an ineligible CHDO, and (4) did not properly account for program administrative funds. These deficiencies occurred because the grantee did not have and/or implement sufficient procedures to ensure that it complied with program requirements. As a result, it charged more than \$1.6 million in ineligible costs to its HOME program and could not

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support approximately \$6.5 million in costs charged to the program. The grantee also accumulated more than \$1.5 million in funds that it could have used to improve its administration of its HOME program and/or fund additional eligible HOME projects.

We conducted an audit of the Mobile Housing Board, Mobile, AL, and found that the Board used HOME funds for ineligible or unsupported costs for its HOPE VI redevelopment. Specifically, we found that the city did not perform annual monitoring of the Housing Board to ensure that its HOME funds were used in accordance with all program requirements. This condition occurred because the city did not maintain an adequate subrecipient agreement with the Housing Board that provided current and sufficient detail as a sound basis on which to effectively monitor the Housing Board's performance. In addition, the city did not establish procedures for monitoring the Housing Board. As a result, the city failed to detect or prevent the Housing Board's use of more than \$1.1 million for unsupported and ineligible costs for the HOPE VI redevelopment. Cost allocation plans were not developed by the Housing Board to properly allocate or prorate its HOME program costs for several phases of the project. The Housing Board arbitrarily charged more than \$1 million to certain phases. This condition occurred because the Housing Board expended the funds to meet program expenditure deadlines without regard to HOME regulations. As a result, the Housing Board disbursed \$839,713 in unsupported costs on both phases. The Housing Board used \$339,657 of its HOME funds to pay for ineligible costs in all four phases of its HOPE VI redevelopment project. This condition occurred because (1) the Housing Board's controls and procedures to separate its public housing agency operations from its administration of CPD programs were ineffective in preventing and detecting ineligible costs and (2) the City did not monitor the Housing Board. As a result, \$339,657 in HOME funds was not used as intended under the HOME program.

We conducted two audits of The Puerto Rico Department of Housing and found that it failed to properly manage its HOME Investment Partnerships Program. Specifically, we found that the Department did not reimburse the HOME program more than \$2 million for three activities that were terminated and did not meet HOME objectives or generate the intended benefits. In addition, it failed to reprogram and put to better use more than \$1.84 million in unexpended HOME funds assigned to one of the terminated activities. As a result, HUD had no assurance that funds were used solely for eligible purposes and that HOME objectives were met. In the second audit, we reported that the grantee did not have adequate controls and procedures to ensure that HOME-funded activities met program objectives. It disbursed more than \$4.4 million for ineligible expenditures and activities that failed to meet the HOME program objectives, disbursed more than \$9 million for activities that reflected slow progress without assurance that the activities would generate the intended benefits, and failed to reprogram and put to better use more than \$7.9 million in unexpended HOME funds for activities that were not

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carried out or were terminated. As a result, HUD had no assurance that funds were used solely for eligible purposes and that HOME objectives were met.

Potential Corruption Issues and Criminal Investigations

Over the past three years, we have opened 43 investigations based on allegations of potential fraud in the HOME program. Several of these cases were referred to us by HUD. Some of the subjects of our investigations have included Executive Directors of Community Development Departments and non-profit entities, elected officials, construction companies, developers, and investment companies.

The Committee also asked us in meetings to relay to them any trends or commonalities we see in our investigative cases. Because of the emphasis on local control of HOME funds, we find that some of the same developers are annual recipients of HOME funds and can be for many years. Having the same players receive HOME funds from year to year is a double-edged sword. On the one hand, the recipients are knowledgeable about how the program works. On the other, they can also exploit and manipulate the program since they may be aware of the weaknesses in the controls and potential limited oversight. Additionally, because the program is entitlement based, recipients know that they will receive funding year after year and may face limited monitoring. In other cases, developers or non-profits lacked the experience and capacity to handle HOME project development. This has caused floundering and failing projects.

Many of our HOME program cases involve fraud schemes associated with embezzlement of funds, bribery, theft, false billing and kickbacks. For example, some of our recent investigative caseload include:

The owner of a construction company, a contractor for the HOME project, was sentenced in U.S. District Court to 39 months incarceration and three years' probation and ordered to pay HUD restitution for his earlier guilty plea to committing mail fraud, obtaining property through fraud, and offering and giving a corrupt thing of value. For a six-year period, the owner paid bribes to an unnamed conspirator in exchange for more than \$652,448 in HOME contracts.

The former director of a Community Development Department was sentenced to 87 months incarceration and 36 months supervised release and ordered to pay restitution for his earlier guilty pleas to committing a conspiracy to extort under color of law, soliciting and accepting corrupt payments, and filing a false Federal income tax return. The former director accepted \$112,500 in bribes from construction and maintenance companies under contract with HOME-funded programs identified above and failed to report the kickbacks on his Federal income tax return.

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The director of a Community Development Department, an organization that receives HOME and other funds, and the owner of a Construction company, were each indicted in U.S. District Court, for allegedly committing bribery and wire fraud, corruptly accepting something of value in connection with a program receiving federal funds, and aiding and abetting in the commission of wire fraud. From April 2009 to March 2010, the owner of the construction company allegedly submitted false information and fraudulent documents associated with the construction of a low-income housing development partially funded with HOME funds, and the director allegedly approved the fraudulent expenses submitted by the construction company and accepted cash payments from the construction company representatives in exchange for his future employment. HUD realized losses of about \$100,000.

Project Delays

Regional areas with especially hard hit housing markets appear to be more likely to sometimes have HOME deals fall apart. HOME funding is usually part of a larger funding package for an affordable housing development, and those other funding sources may be subject to the local credit market for new housing. If one piece of a financing package falls apart, the whole deal may fall apart or be delayed. HUD may want to identify the best practices of high-performing states in order to determine ways to improve low-performing states. Additionally, HUD may want to consider requiring grantees to provide a timeline of beginning and finishing points, along with cost projections, against which they could more directly use to monitor and identify slow and cost overrun projects.

We believe that some of the delays may have been avoided by closer oversight to ensure that projects were moving along in a timely fashion. A number of the troubled projects are in the same PJs. We recommend that HUD focus additional monitoring on these trouble spots. The Department states that they have started sending regular reports on delayed projects to its field offices “so that they can work more aggressively with local agencies to push for completion.” We endorse this and recommend that HUD establish methods to quickly “red flag” these projects and adjust personnel to provide technical assistance and continual monitoring of PJs with stalled or problematic projects. Again, increased oversight and specific policies, procedures, deadlines, and non-compliance remedies could help improve this area of vulnerability. The need for an information system which provides accurate, timely, and reliable data is also imperative for proper oversight.

Enforcement Actions Available to HUD

In addition to the legal authority to recapture misspent HOME funds, HUD also has the ability to refer program violators to its Departmental Enforcement Center, as well as to the OIG, for possible civil, criminal or administrative sanctions. Some of the possible penalties for misusing HOME funds include the sanctions provided in the False Claims Act and the Program Fraud Civil Remedies Act, suspensions, debarments, and criminal penalties. Our audit and investigative work has shown that we use all of these statutes to address violators. Over the past three years, we have had 16 indictments of individuals involved in fraud in the HOME program and have referred approximately 14 individuals or entities to the Departmental Enforcement Center for administrative action.

Conclusion

OIG believes that HOME is an important program which provides affordable housing to low income Americans. Given the current economic and housing crisis in our county, the need for affordable housing may never have been greater than in these tumultuous times. There are many successful examples of how HOME funds have been used for their intended purpose. Since much of our work focuses on high risks in the program, however, we highlight areas where improvements need to be made particularly in the controls and monitoring of the program by the Department as well as in the areas of data integrity and systems enhancements. We look forward to working with the Department and the Congress in addressing ways to improve the effectiveness of this vital program.