STATEMENT OF
KENNETH M. DONOHUE
INSPECTOR GENERAL
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

HOUSE COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

"SAVING TAXPAYER MONEY THROUGH SOUND FINANCIAL MANAGEMENT"

THE UNITED STATES HOUSE OF REPRESENTATIVES
JUNE 25, 2003

Thank you for inviting me to submit a statement for the record on areas where our audits and investigations have identified cost savings opportunities to the Federal Government. Additionally, we want to discuss other audit and investigative work where we found the Department can do more to detect and deter waste, fraud and abuse. My focus will be on some of our most recent endeavors.

Remaining obligated funds from expired contracts should be promptly identified and used to offset future budgetary needs

Most of HUD's funding obtained through its annual appropriation process are no-year monies. That is, the funding does not automatically expire and it is used to cover the obligations throughout the many years of the contract life.

HUD must recapture any remaining obligated funds when contracts are completed. Our annual financial audit looks for obligated balances no longer needed. At the close of fiscal year 2002, we identified more than $1.1 billion in obligations no longer valid and subject to recapture. This is over and above the $ 2.4 billion in Section 8 recaptures already identified by the Department ($1.1 billion project-based and $1.3 billion tenant-based). HUD's procedures for identifying and de-obligating these funds were ineffective. This internal control weakness has been reported each year in our financial audit since 1998.

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Annually, HUD is required to perform a review of unliquidated obligations to determine whether the obligations should be continued, reduced, or canceled. We evaluated HUD's internal controls over this process. This year, as in prior years, we found: (1) some HUD program offices not performing the required reviews or not acting timely on review results, and (2) underlying HUD financial systems not supporting the process for identifying excess budget authority. As a result, funds that could offset future budgetary needs were not being identified in a timely manner.

Section 8 Program. HUD's Section 8 Program provides billions of dollars of rental assistance payments each year to qualified low-income households. HUD administers its Section 8 program in two parts. In general, HUD's Office of Public and Indian Housing (PIH) manages the tenant-based program and the Office of Housing (Housing) manages the project-based program. A contract for Section 8 assistance may cover multiple years and HUD reserves funds to cover the estimated needs. HUD needs to periodically identify excess program reserves from expiring Section 8 contracts. These excesses can be used to offset future budget requirements. Since 1997, HUD has made efforts to identify and recapture excess Section 8 budget authority. However, weaknesses in the review process and the lack of automated system interfaces between the Chief Financial Officer's general ledger and the subsidiary records maintained by the Office of Public and Indian Housing and the Office of Housing continues to hamper HUD's efforts.

Project-based Program. Project-based assistance is linked to specific housing units. Qualified residents in these subsidized units generally pay 30 percent of their income towards rent and HUD pays the difference. The project-based contracts—generally between HUD and the owners of private rental housing—were entered into beginning in the 1970s and 1980s, typically for 15, 20, or 40 year terms. For some of these long-term contracts, actual expenditures have proven to be lower than anticipated. In such cases, HUD can recapture the unneeded funds and use them to help fund other Section 8 contracts with insufficient funding. In addition, the long-term contracts that were entered into during the 1970s and 1980s, began expiring in the early 1990s. Initially contracts were renewed for several years. Currently, expiring contracts are being renewed for one year.

The Office of Housing has been hampered in its attempts to evaluate unexpended Section 8 project-based budget authority balances. The requirement to evaluate data from two payment methods, managed by two HUD accounting systems, has made this process difficult. In fiscal year 2002, HUD recaptured $1.1 billion in unliquidated obligation for expired contracts. There were other excess funds for Section 8 project-based contracts not being recaptured.

A review of the HUD budget estimate of shortfalls and excesses for project-based Section 8 contracts for fiscal year 2003 and outyears showed an estimated $365 million in excess contract authority expected to be realized during fiscal year 2003 related to expiring Section 8 project-based contracts that would be renewed. HUD's fiscal year 2003 budget request, nevertheless, included full funding for Section 8 project-based contract renewals. Housing did not have a process in place to estimate recoveries from expired contract authority associated with this group of contracts. Review of fiscal years 2001 and 2002 contract renewals showed an additional $123 million and $245 million, respectively, in excess contract authority that was rolled over to contract renewals.

In addition, our review of other Section 8 project-based contracts showed 259 contracts that had expired prior to September 30, 2001. These 259 contracts had $34 million in excess funds potentially available for immediate recapture. HUD needs to address data and systems weaknesses to ensure that all contracts are considered in the recapture/shortfall budget process.

***Section 8 Moderate Rehabilitation Program*.** The Section 8 Moderate Rehabilitation Program is another form of project-based housing assistance administered by local housing agencies under contract with HUD. The program was created in 1978 to upgrade assisted rental housing units requiring moderate repair. HUD provides rental subsidies and administrative fees to contracted housing agencies. Housing agencies entered into multi-year Housing Assistance Payments (HAP) contracts with property owners. This program was funded for eleven years. These contracts require owners to rehabilitate their housing units and rent them to eligible families. As of fiscal year 2002, the majority of these assistance contracts had expired and, therefore, many projects had excess Section 8 reserves.

HUD had not reviewed the unexpended obligations in the Section 8 Moderate Rehabilitation Program since fiscal year 2000 when they recaptured $246 million in unexpended funds. As part of our 2002 financial audit, we requested that HUD update their analysis of these contracts through September 30, 2002. HUD identified an additional $217 million in unexpended funds for recapture. As a result, HUD adjusted its 2002 Consolidated Financial Statements for $200 million in excess unexpended funds. In April 2003, HUD recaptured the $200 million.

Tenant-based Program. HUD provides funding to Public and Indian Housing Agencies to administer the Section 8 tenant-based voucher program. Housing authorities make assistance payments to landlords who lease their rental units to Section 8 assisted households with vouchers.

In August 2002, HUD performed an analysis of budget authority for all years related to the Section 8 tenant-based program and estimated that approximately $1.3 billion of the unexpended budget authority was not needed and available for recapture. These funds were recaptured before the close of the fiscal year.

Section 236 Multifamily Mortgage Interest Reduction Program. HUD has been hampered in attempts to determine and account for unexpended Section 236 Interest Reduction Program (IRP) budget authority balances. HUD's reporting of commitments under the insured mortgage component of the Section 236 IRP program was not accurate. There was a difference of approximately $790 million between the subsidiary and general ledgers for the Section 236 program at the end of fiscal year 2002. The cause of the problem was the lack of an aggressive program to identify excess funds and an ineffective accounting system.

The Section 236 program was created in the 1960s and ceased new activity during the 1970s. The mortgage and assistance payments contracts typically run up to 40 years. This program includes making interest reduction payments directly to mortgage companies on behalf of multifamily project owners. Participants were given the right to prepay their subsidized mortgage after 20 years as an incentive to stay in the program.

HUD has historically chosen to estimate the amount of commitments reported in HUD's financial statements due to time needed to review manual records. Our review found the methodology used to make this estimate flawed. Consequently, commitments were overstated by approximately $128 million, and another $487 million in contract authority associated with prepaid mortgages was not identified and recaptured in fiscal year 2002.

As a result of our review, HUD processed an adjustment to the 2002 Consolidated Financial Statements for $705 million in excess unexpended funds. HUD plans to review the computation of estimated 236 subsidy payments using the proper amortization factors. In addition, for the Section 236 program HUD needs to: (1) review and de-obligate, where appropriate, unexpended funds no longer required; (2) strengthen procedures to remove expired contracts in a timely manner; and (3) develop an integrated automated accounting system.

Rent Supplement and Rental Assistance Payments (RAP) Programs. HUD is not recapturing excess undisbursed contract authority from the Rent Supplement and Rental Assistance Payments (RAP) programs in a timely manner. The Rent Supplement program and RAP, operate much like the current project-based Section 8 rental assistance program. Rental assistance is paid directly to multifamily housing owners on behalf of eligible tenants. HUD's subsidiary ledgers show, for each fiscal year, the amount authorized for disbursement and the amount that was disbursed. Funds remain in these accounts until they are paid out or de-obligated by the accounting department. At the end of fiscal year 2002, the general ledger balances for RAP and Rent Supplement totaled $2.18 billion. Our audit projected that at least $46 million in excess funds could be recaptured.

Other Operating Programs. Each program and administrative office was requested to review each outstanding obligation over $200,000. Exclusive of Section 8 (discussed above), $34 billion in obligations were identified. Our audit found that of the $34 billion reviewed; $94.3 million (1,094 program transactions) could be de-obligated. We followed up on whether the balances were actually de-obligated. As of October 11, 2002, 125 of the 1094 transactions with obligation authority of $34 million had not been de-obligated.

Improper Housing Assistance payments

Under the provisions of the U.S. Housing Act of 1937, HUD provides housing assistance funds through various grant and subsidy programs to multifamily project owners and housing authorities. These intermediaries, acting for HUD, provide housing assistance to benefit primarily low-income families and individuals (households) that live in public housing, Section 8 assisted housing, and Native American housing. In fiscal year 2002, HUD spent about $23 billion to provide rent and operating subsidies that benefited over 4 million households. Weaknesses continue to exist in HUD's controls that prevent HUD from assuring that these funds are expended for rent subsidies in accordance with the laws and regulations authorizing the grant and subsidy programs.

The Office of Public and Indian Housing (PIH) provides funding for rent subsidies through its public housing operating subsidies and tenant-based Section 8 rental assistance programs. These programs are administered by housing authorities (HAs) that are to provide housing to low-income households or make assistance payments to private owners who lease their rental units to assisted households.

The Office of Housing (Housing) administers a variety of assisted housing programs including parts of the Section 8 program and the elderly and disabled (Section 202/811) programs. These subsidies are called "project-based" because they are tied to particular properties, therefore tenants who move from such properties may lose their rental assistance. Historically, unlike public housing and tenant-based Section 8, most of these subsidies have been provided through direct contracts with multifamily project owners. HUD has responsibility for processing payments to project owners and ensuring that they provide support only to eligible tenants and that they comply with the contract, program laws and regulations. More recently, HUD has been contracting with "performance based contract administrators" who have begun taking over significant aspects of Section 8 contract administration. However, a sizable number of project owners remain that HUD must monitor.

Legislation authorizing HUD's housing assistance programs includes specific criteria concerning tenant eligibility and providing assistance for housing that meets acceptable physical standards. Moreover, legislation authorizing HUD's programs also establishes minimum performance levels to be achieved. For example, subsidized housing must comply with HUD's housing quality standards.

We continue to report concerns that HUD's intermediaries are incorrectly calculating housing assistance payments. HUD's control structure does not adequately monitor to ensure acceptable levels of performance are achieved. Also, there is an absence of an on-going quality control program that would periodically assess the accuracy of rent determinations by intermediaries. We also found significant control weaknesses in HUD's income verification process. These weaknesses related to tenant income, which is the primary factor affecting eligibility for, and the amount of, housing assistance a family receives, and indirectly, the amount of subsidy HUD pays. Generally, HUD's subsidy payment makes up the difference between 30 percent of a household's adjusted income and the housing unit's actual rent or, under the Section 8 voucher program, a payment standard. The admission of a household to these rental assistance programs and the size of the subsidy the household receives depend directly on its self-reported income.

A significant amount of excess subsidy payments occur as a result of undetected, unreported or underreported income. This year we reported on HUD's measurement of erroneous payments resulting from intermediaries' housing assistance billings for HUD's subsidy payments. HUD identified significant errors in the billings and payments processes, which also results in excess subsidy payments. By overpaying rent subsidies, HUD serves fewer families. The impact of payment errors of this magnitude takes on added significance in light of a HUD estimate that the "worst case housing needs" is around 5.4 million households; that is, unassisted very low-income renters who pay more than half of their income for housing or live in severely substandard housing.

A contract study completed in November 2000, substantiated there was significant risk in HUD's reliance on intermediaries to ensure that rent calculations for assisted households were based on HUD requirements. The study estimated that HUD incorrectly paid $2.3 billion in annual housing subsidies of which about $1.7 billion in subsidies was overpaid on behalf of households paying too little rent, and about $600 million in subsidies was underpaid on behalf of households paying too much rent based on HUD requirements. Last year, HUD revised this estimate to report an additional $978 million in overpayments resulting from underreported and unreported income.

With regard to detection of unreported income, HUD, Housing Authorities and project owners have various legal, technical and administrative obstacles that impede them from ensuring tenants report all income sources during the certification and re-certification process. Since unreported income is difficult to detect, HUD began pursuing statutory authority from Congress to access and use the Department of Health and Human Service's National Directory of New Hires Database to detect such income. In addition, HUD continues to encourage HAs to verify income and to computer match with State wage agencies to detect underreported and unreported income.

In fiscal year 2001, HUD initiated a Rental Housing Integrity Improvement Project (RHIIP). The project plans to address the problems surrounding Housing Authorities and project owners' rental subsidy determinations, underreported income and assistance billings. The Department also continued operations for large-scale income verification and matching involving Social Security (SS) and Supplemental Security Income (SSI) information. This information is made available to Housing Authorities, project owners and administrators of the Office of Housing's rental assistance programs who access the SS and SSI information via a secure Internet facility as a "front-end" way to verify income and annual tenant re-certifications. Our financial audit details the many efforts underway in the Department to improve the accuracy and reliability of subsidy calculations. We are encouraged by the Department's on-going actions.

Investigative initiative to focus on Section 8 Housing Assistance fraud

In concert with the President's Management Agenda, the OIG is announcing a newly focused, prioritized effort to detect and prevent fraud in Housing Assistance Programs. Prior to my tenure, rental subsidy fraud cases were generally assigned a low investigative priority. There had been a somewhat reluctance to investigate these tenant fraud cases because of limited financial payoff; that is, significant recoveries or prosecution were unlikely. We have received input from various Public Housing Executive Directors across the country that a more focused and publicized OIG effort would have a positive effect on accurate reporting. (We have decided to refocus our efforts in this area due to the increasing growth in tenant fraud.)

In an effort to outreach with the Public Housing community, I have addressed conferences of major public interest groups including the National Association of Housing and Redevelopment Officials and the Public Housing Agency Directors Association. It is well understood that HUD serves only a portion of those families needing housing assistance. Consequently, it is important that every dollar be spent for deserving participants with zero tolerance for fraud. Prosecutions will send a message that there are consequences for failing to report income. Persons not entitled to federal benefits will be removed to make way for eligible tenants.

The GAO now lists rental subsidy overpayments as one of the Department's high risk areas. While the amount attributable to fraud is unknown, the Department estimates losses linked to improper housing assistance payments to exceed one billion dollars annually. It is clear that OIG must address this problem using a systemic, multidimensional approach that not only addresses the individual cases referred, but also calls for a partnership with the Department to implement measures that will reduce the overall problem.

This multi-year initiative includes the following steps to assure a comprehensive approach to the problem:

1) **Identify the scope of the problem**. HUD has an automated tenant certification database and the authority to conduct income computer matches with IRS data. OIG will partner with the Department to statistically estimate the extent of rental subsidy fraud. HUD's Office of Policy, Development and Research is already conducting such studies, but this focuses primarily on subsidy miscalculations, not potential fraud. OIG will encourage them to expand their sample to include the fraud rate. By verifying the existence of fraud in the statistical sample, a nationwide fraud baseline can be established. This rate should be recalculated annually or bi-annually in order to measure progress and to determine which detection and prevention techniques are most effective.

2) **Use analytic techniques to extract the most egregious cases.** Income computer matching will be used to identify cases where tenants report little or no income, but wage data indicates significant unreported income. Various U.S. Attorneys offices have already been contacted to coordinate our activities. These cases will provide the basis for a tenant awareness campaign that should serve to deter future crimes.

3) **Identify systemic weaknesses in HUD directives/controls, or in PHA/management agent execution.** Problems often occur because HUD's instructions are not strong enough or program administrators may lack the know-how or will to implement controls effectively. OIG auditors and agents are working with program management staff to develop stronger controls and detection methods. By reviewing entities with high error rates, HUD will have the leverage to correct those administrators who are reluctant to conduct strong tenant screening and verification procedures.

4) **Develop a Rental Fraud training program.** HUD must invest in training new staff by creating certification standards that will continue to provide and enhance a skilled and educated workforce to administer HUD subsidy programs. HUD and its contractors need to teach PHA and management agent staff on ways to prevent, and to detect, fraud and errors. Awareness alerts could also serve as a way to reinforce a strong detection and sanction program, and to signal tenants that HUD will not tolerate fraud in its programs.

5) **Use various computer-matching techniques to test for the most effective methods to reduce crime.** OIG is currently working directly with the Executive Directors of various Housing Authorities in New York, Indiana, Illinois, Virginia, and the District of Columbia. OIG is also working cooperatively with the

Department's Rental Housing Integrity Improvement Program (RHIIP) staff. Presently, HUD is conducting a pilot program with 20 PHAs in Florida, Texas and Ohio to obtain State wage base data. The PHAs will conduct matching programs and will then make referrals to OIG.

OIG Special Agents' in Charge in all ten Regions are making Section 8/ housing assistance fraud an investigative priority, whether committed by a tenant, the Section 8 administrator, the Management Company, or the PHA employee. By announcing this today, it is my hope that our strategy will send a message that this is a high priority for our organization.

Timely and effective communications can go a long way in deterring program fraud

A recent investigative case in Charlotte, North Carolina, involved a major fraud scheme against Ginnie Mae and The Federal Housing Administration (FHA) whereby a mortgage lender placed fraudulent loans in mortgage-backed securities pools. Better communications between the two HUD organizations, FHA and Ginnie Mae, might have prevented this scheme from continuing for more than two and a half years and reduced the nearly $30 million in losses.

FHA insures nearly 1.3 million mortgages each year with an outstanding mortgage insurance portfolio of nearly $600 billion. The secondary market for these FHA loans is under another HUD organization, Ginnie Mae. The vast majority of FHA mortgages are pooled by Ginnie Mae-approved issuers. An issuer will group a pool of mortgages to form a mortgage-backed security. The sale of these securities frees up funds for additional mortgage loans. Approved Ginnie Mae issuers take the FHA monthly mortgage payments for those pooled mortgages and pass the payments through to securities holders. Ginnie Mae guarantees the pass through of these funds.

First Beneficial Mortgage Corporation (FBMC) of North Carolina was an approved FHA direct endorsement lender as well as an approved Ginnie Mae issuer. At the time the fraud was detected, this issuer had a Ginnie Mae mortgage-backed security portfolio worth $45 million. This issuer saw a window of opportunity to originate fraudulent FHA mortgages and then pool them into mortgage-backed securities. By using the investor proceeds from the sale of securities, the issuer was able to continue a "pyramid" scheme by appearing to pass through mortgage proceeds. Over 100 of the pooled mortgages in 11 Ginnie Mae pools were in fact fraudulent. FMBC systematically recruited strawbuyers to sign fraudulent and fictitious mortgage notes for vacant parcels of land. FBMC would then submit these false notes to their registered document custodian as backing for their securities as required by Ginnie Mae.

FBMC, as the issuer, was permitted to sell millions of dollars of Ginnie Mae securities without verification through, or by, FHA that these mortgages were appropriately insured. FBMC was continuing to issue pools using false documents. FHA and Ginnie Mae communications might have detected the fraud earlier. A simple verification by Ginnie Mae that the FHA pooled loans were in fact insured would have raised a red flag. Because of this case, Ginnie Mae has started a process of checking to see that Ginnie Mae pooled mortgages are, in fact, FHA insured. This control should detect improper pools within a few weeks of their origination.

FHA Single-Family mortgage fraud and debt collection activities

Single-Family mortgage fraud continues to be an investigative priority for the OIG. Our investigations of perpetrators of fraud include title companies, loan officers, mortgage companies and brokers, real estate agents, closing attorneys, and appraisers who through a variety of schemes submit fraudulent loan applications, appraisals, and other falsified loan documents and/or utilize straw buyers and other conspirators to effect the schemes.

Our Semiannual Report to Congress for the period ending September 30, 2002 reflected investigative recoveries of $59 million. During the same period, approximately 60% of our cases and 90% of our investigative recoveries was attributed to Single-Family mortgage fraud cases. During the first 6 months of this fiscal year, investigative recoveries are approximately $65 million, a figure which already exceeds our recoveries for all of fiscal year 2002.

Recent statistical information gathered from our ten regional offices shows that investigative efforts expended on these Single-Family cases involve approximately 1400 subjects who have originated more than $1 billion in loans affecting nearly 36,000 FHA-insured properties. These investigations are worked in coordination with 148 Assistant United States Attorneys and with numerous other federal law enforcement agencies.

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In conclusion, we are continuing to work jointly with Departmental officials to correct the many problems I have discussed. It is my understanding that the Department will be offsetting future appropriations with excess obligated balances. I am glad that our work with the Department and the Committee prior to this hearing contributed to this development. This week, my senior managers along with senior program managers in the Department are meeting in Philadelphia. We have characterized this meeting as a "fraud symposium" where we will identify fraud prevention and detection opportunities and work toward making HUD a more efficient and effective agency.

I have been the Inspector General at HUD for little more than a year. It has been a productive time. I have a well-trained and dedicated staff. Our goal is to ensure that the billions of taxpayers' dollars appropriated by the Congress for HUD programs are used effectively to provide safe, decent, and sanitary housing for millions of Americans. The structure of HUD and the diversity of its programs make this a formidable task. But working together with program staff and the Congress, I think we can take positive steps to make HUD operate in an optimum manner.