



**STATEMENT OF KENNETH M. DONOHUE
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AND URBAN DEVELOPMENT**

**BEFORE THE
COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS
SUBCOMMITTEE ON FEDERAL FINANCIAL
MANAGEMENT, GOVERNMENT INFORMATION,
AND INTERNATIONAL SECURITY
UNITED STATES SENATE**

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Statement of Kenneth M. Donohue, Inspector General
Department of Housing and Urban Development
Before the Senate Committee on Homeland Security and Governmental Affairs,
Subcommittee on Federal Financial Management, Government Information
and International Security

Chairman Coburn, Ranking Member Carper, members of the Subcommittee; thank you for inviting me to testify today on this important topic.

Background:

The U.S. Department of Housing and Urban Development (HUD), Office of Inspector General (OIG) is one of the original 12 Offices of Inspector General established by the Inspector General Act of 1978. The OIG provides independent oversight of HUD's programs and operations. While organizationally located within the Department, it maintains independence to initiate and carry out audits and investigations. The OIG strives to make a difference in HUD's performance and accountability. The OIG is committed to its statutory mission of detecting and preventing waste, fraud, and abuse and of promoting the effectiveness and efficiency of government operations.

The Department's primary challenge is to find ways to improve housing and to expand opportunities for families seeking to better their quality of life. HUD does this through a variety of housing and community development programs aimed at helping Americans throughout the nation. These programs are funded through HUD's \$30+ billion annual budget. For FY 2006, HUD received \$4.2 billion for its community development activities.

Each year in accordance with the Reports Consolidated Act of 2000, HUD OIG is required to submit a statement to the Secretary with a summary assessment of the most serious challenges facing the Department. The OIG submitted an assessment on October 18, 2005 and is updating that assessment for the 2007 fiscal year. The Department's management challenges include the Community Planning and Development (CPD) and specifically the Community Development Block Grant (CDBG) program. Through our audit and investigative efforts, the OIG hopes to strengthen HUD programs, such as CDBG grants, into a more targeted, unified program that sets accountability standards in exchange for flexible use of the funds. Because HUD has to oversee a vast number of partners in hundreds of cities, the task is a daunting one for HUD, as well as for the OIG.

While HUD maintains a departmental staff, it still relies on the performance and integrity of a large group of entities to administer its many diverse programs. Among HUD fund administrators are hundreds of cities that manage CDBG funds, many State entities that receive the CDBG funds, thousands of Public Housing Authorities and Multifamily Housing projects that provide HUD assistance, and thousands of HUD-approved lenders that originate FHA insured loans.

The annual CDBG appropriation is allocated between States and local jurisdictions called "non-entitlement" and "entitlement" communities respectively. Entitlement communities are comprised of central cities of Metropolitan Statistical Areas (MSAs); metropolitan cities with populations of at least 50,000; and qualified urban counties with a population of 200,000 or more (excluding the populations of entitlement cities). States distribute CDBG funds to non-entitlement localities not qualified as entitlement communities.

HUD determines the amount of each grant by using a formula comprised of several measures of community need, including the extent of poverty, population, housing overcrowding, age of housing, and population growth lag in relationship to other metropolitan areas.

The HUD CDBG program, begun in 1974, is one of the longest continuously run programs at HUD. The CDBG program provides annual grants to 1180 general units of local government and States. Relying on the proposals and projects developed at the community level, the resulting finished works cover a range of activities. Housing, historic villages, museums, street lights -- there are any number of projects that CDBG funds have been used for, each reflecting the community's idea of a good use for the money that will, at least in the design, result in the elimination of slums and blight or foster economic development.

Communities of 50,000 people or more, especially those in what used to be called the "Rust Belt" northeastern United States, look upon CDBG as an important part of their annual budget. Making use of what can sometimes be an industry of CDBG consultants or municipal development staffs, communities draw up project ideas that are at least designed on paper to meet HUD's eligibility criteria. Some communities' projects do not always match the intent of their paper submission as described in their initial application.

We continue year after year to identify the same problems in our audit and investigative efforts with the CDBG program and CPD's activities in general.

Weaknesses of the CDBG Program:

Shortcomings in the program are usually the result of misfeasance, nonfeasance and, when it is willful, malfeasance -- all of which could have been avoided with the right direction and with the right motives.

These failures in performance result from grantee actions, departmental actions or both. HUD OIG audit reports over the years show that repeated problems fall into the following six categories:

- 1) The improper use of funds;
- 2) A lack of capacity (internal controls, accounting systems, processing deficiencies, etc);
- 3) The requirements are not followed;

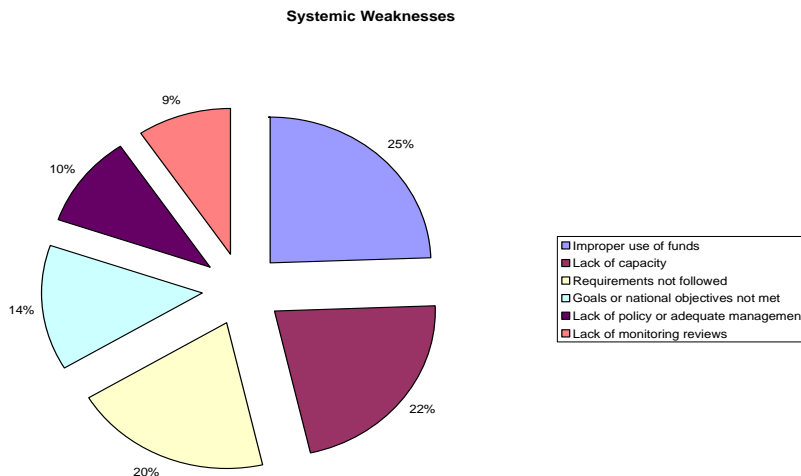
- 4) A lack of policy direction or adequate management;
- 5) Goals or national objectives not met; and
- 6) A lack of monitoring reviews.

In addition, the HUD OIG has assessed the Economic Development Initiative (EDI) program through its audits and investigations. Though not the focus of the hearing, but a focus in discussions with your committee staff, our work is replete with instances of inherent programmatic weaknesses in this CPD program as well and we have included instances in this testimony from our portfolio of audit and investigative work.

Vulnerabilities Uncovered During Audits:

The OIG selected CDBG programs for review to ensure that the flexibility afforded to these communities does not negatively affect the accountability standards. Over the past 2 ½ years, HUD OIG has issued over 35 audit reports that deal with the CDBG area. These CDBG-related reports identified over \$100 million in questioned costs and funds that could be put to better use. During the same time period, the HUD OIG indicted 159 individuals, caused administrative actions against 143 individuals, had 5 civil actions, 39 personnel actions, and over \$120 million in recoveries and funds put to better.

A distribution of the OIG’s concerns discussed in audit reports regarding systemic weaknesses in the program are highlighted in the chart below:



A. Improper use of funds

“Improper use of funds” is the largest repeat audit finding in our CDBG reviews, with nearly one-quarter being classified as such. For example, in response to a congressional request, we reviewed the Los Angeles Community Development Bank’s Economic Development Initiative/Section 108 Loan Guarantee Program and found the LACDB incurred related management fees of more than \$2.6 million that provided minimal benefit, and used funds totaling at least \$44,650 for unnecessary or unreasonable expenses due to requirements not being followed and improper use of funds. Further, the LACDB did not meet the national objective standard of 51% for creating or retaining jobs for low- and moderate-income persons. Similarly, the LACDB had not met the EDI Agreements’ requirement of creating jobs predominantly for Empowerment Zone target area residents.

B. Lack of capacity

A grantee organization’s “lack of capacity” is the second largest category of repeat audit findings. A grantee that cannot allocate its resources in people, training and material to administer grant money will encounter problems. For example, the City of Hartford, Connecticut, established an Emergency Demolition and Repairs Program using CDBG funds but failed to devote people with the proper training to monitor the program. By the time HUD OIG auditors initiated a review in response to a citizen’s complaint, over \$1 million had been granted for ineligible activities that then had to be repaid.

C. Requirements not followed

A prime example of this category is actions by the City of San Juan, Puerto Rico, which used a non-profit corporation to administer a development program funded with CDBG funds. The Corporacion para el Fomento Economico del Ciudad Capital retained more than \$1.48 million in interest revenue from its CDBG revolving account and allowed the use of \$463,618 for ineligible activities due to requirements not being followed and improper use of funds. Further, the Corporacion could not demonstrate that activities relating to four loans met at least one of the three block grant national objectives – 1) it directly benefited low- and moderate-income persons; 2) it aided in the elimination or prevention of slums or blight; or 3) it met other community needs that had a particular urgency.

D. Lack of policy or adequate management

Since 2000, HUD OIG has questioned the policy and effectiveness of the Housing and Economic Development Financial Corporation (HEDFC) of Kansas City, Missouri. In a joint review, with the City Auditor, we found that the Kansas City system for managing housing program funds provided little assurance that payments to vendors and contractors met its housing needs. The HEFDC spent \$900,000 more in program income than authorized on a project in Beacon Hill and failed to repay \$600,000 owed on a Section 108 loan for a business park due to lack of policy or adequate management. Lastly, the

HEFDC's operational deficiencies contributed to overall poor performance as it did not meet its housing production goals for the year ending May 31, 2003.

Regarding a CDBG loan made by the City of New Orleans to the Jazzland Theme park, the City paid \$1.3 million in ineligible funds and \$6.4 million in unsupported costs due to a lack of policy or adequate management and the improper use of funds. Jazzland eventually defaulted on the City's loan and the City was required to repay HUD from the rents it received from the new owners of the amusement park and from its general fund.

In another example, the City of Atlanta and its sub-recipient, the Atlanta Development Authority (ADA), did not adequately manage and control the Historic Westside Village project due to a lack of capacity, lack of policy or adequate management, and improper use of funds. Among the things uncovered by our audit, the City did not adequately monitor the performance of sub-recipients to ensure compliance with HUD program requirements. ADA, acting for the City, did not competitively procure and execute a contract for vendor services. As a result, \$1.35 million was improperly paid. Further, they lost ownership and control of project land acquired with HUD funds that eliminated, or greatly reduced, program income as was pledged to HUD as part of their loan repayment. With the loss of control of this land parcel, the City lost the opportunity to collect at least \$1.7 million.

Exhibiting a major lack of policy, adequate management, as well as the improper use of funds, the East Meyer Community Association of Kansas City, Missouri, squandered nearly \$800,000 of its CDBG money on company picnics, Christmas Tree lighting ceremonies, luncheons, gifts and bonuses. East Myer improperly spent \$726,850 of its Neighborhood Initiative Grant, and incurred \$57,464 of unsupported expenses charged to its Neighborhood Initiative Grant, and charged \$65,379 of unsupported expenses to its Community Development Block Grant.

E. Goals or national objectives not met

As stated previously, CDBG national objectives are, in general, the elimination of slums and blight as well as economic development. The Department repeatedly warned Utica, New York, that construction of a boat marina and a ski chalet were not eligible activities for CDBG money. Our review of two development projects, a marina project and a parkway recreation center (which includes the ski chalet), found that the projects did not meet CDBG goals or national objectives. Accordingly, the City incurred \$903,000 in ineligible costs and \$214,000 in questioned costs for the marina. The city is still trying to establish that \$255,000 for the parkway recreation center was an eligible activity.

F. Lack of monitoring reviews

In response to a congressional inquiry, we reviewed how CPD ensures grantees and sub-grantees have sufficient capacity to successfully participate in its programs. We found that CPD has management controls to minimize the risk that grantees and sub-grantees lacking capacity receive funding; however, unverified assumptions, incomplete and

outdated guidance, and limited on-site monitoring undermine these controls. Therefore, management controls are not sufficient to provide reasonable assurance that grantees have the capacity to participate in CPD's programs.

I have seen the success of active monitoring efforts with "monitors" used by the Lower Manhattan Development Corporation in preventing waste and fraud in post-9/11 rebuilding activities and I have testified previously to this effective concept for use in disaster relief efforts in the Gulf States.

Common Fraud Schemes in the CDBG Program:

A review of HUD OIG investigative activities show that there are, in general, five major fraudulent types of schemes affecting the CDBG program: making false claims for funds; soliciting/receiving bribes or kickbacks; procurement or contracting rigging; theft or embezzlement; and public corruption. The following cases are examples of each:

A. False Claims. A former employee embezzled nearly \$160,000 from the East Saint Louis Community Development, a non-profit organization funded by CDBG. False vendor numbers and invoices were created to receive checks for services and materials never provided. The employee, utilizing her personal checking account, deposited and spent the fictitious vendor payments.

B. Soliciting Bribes/Kickbacks. Two former City of Rochester, New York rehabilitation specialists were sentenced for bribery. They had solicited "kickbacks" from contractors in exchange for City of Rochester rehabilitation contracts funded by CDBG.

In another case, the Mayor of Chicopee, Massachusetts, extorted campaign contributions from a developer with the promise he would intercede on the developer's behalf in a planned economic development project, while promising the developer that his towing company would continue to have city contracts.

C. Procurement and Contracting. Two senior civic leaders of Springfield, Massachusetts, together with a real estate developer, and a builder were convicted for steering CDBG funds to renovate bars owned by the civic leaders.

In another case, a wrecking company admitted using another wrecking company as a "front company" to satisfy the HUD-funded St. Louis Community Development Authority's (CDA) regulations relating to minority business participation in the renovation of old St. Louis City Hospital. The wrecking company funneled payroll checks through the second one to make it appear as if a minority contractor was involved in the St. Louis City Hospital project, as certified to CDA.

D. Theft or Embezzlement. A New York Rabbi was charged in federal court with misappropriating \$700,000 in federal grant money. The Rabbi, president and director of a Jewish day school in Brooklyn, received an EDI grant from HUD. He misrepresented

to HUD that the entire grant amount would be used to pay off a mortgage on a building to house educational and therapeutic programs for disabled preschool children. In addition to the \$700,000 grant, the school received over \$2.7 million in other EDI grants from HUD for FYs 1999, 2001, and 2002.

The criminal complaint stated that the Rabbi diverted funds to several individuals and entities that were not entitled to the funds. For example, \$300,000 was diverted to a corporation in which the Rabbi's son-in-law was an officer and \$80,000 was diverted to a variety of other Rabbis and schools and organizations in Brooklyn. Another \$78,000 in checks were made payable to the Rabbi.

Another example is where a federal employee fraudulently obtained Lower Manhattan Development Corp (LMDC) grant funds after sub-letting and relocating from a LMDC qualified apartment. LMDC, a HUD-funded non-profit, was created to assist in the revitalization of lower Manhattan after the September 2001 terrorist attacks.

In a further example, the president and chief executive officer of Save Our Children Community Project (SOCC), a HUD-funded non-profit corporation, transferred federal grant money from SOCC to his personal account, wrote checks from his personal account to another individual who was the former Program Administrator for HIV Services in the Arkansas Department of Health, and fabricated invoices and other documents to hide the money transfers and personal checks to the other individual.

E. Public Corruption. Every year HUD OIG develops successful cases against elected officials who use their offices for personal or political gain. The former Mayor and Director of the East Cleveland, Ohio, Department of Community Development (ECDCD), a HUD funded organization, was convicted for, among other things, soliciting and receiving bribes, kickbacks and secret payoffs through intermediaries using HUD funds as a "carrot" for contractor bribes.

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The City of Springfield, Massachusetts, was especially hard hit by public corruption. In the past several years, a number of officials including the Public Housing Authority director, and the directors of at least two CDBG funded non-profit or public agencies, have been indicted and/or convicted of crimes that run the gamut, including conspiracy to defraud the U.S. Government, obstruction of justice, extortion, mail fraud, theft of honest services, false statements, perjury, criminal contempt, filing false federal income tax returns, and witness tampering.

CDBG Reform/Proposed Legislation:

We strongly endorse efforts to improve performance and accountability within the CDBG program and applaud proposed changes by the Assistant Secretary, but we are concerned that what appears to be language designed to insert objective performance criteria into grant administration will be undermined by the implementation of vague criteria and a failure to improve deficient enforcement tools.

The legislation provided to us by your committee staff (proposed 42 USC 5304(e)) says that the Performance Plan—which will be the objective performance criteria against which grantee’s will be evaluated—must include objectives measuring the extent to which funded activities “foster a suitable living environment,” “focus on developing decent affordable housing” and “foster and create economic opportunity.”

These criteria may not be adaptable to quantitative measurement. Further, since it will develop the evaluation measure, HUD could choose to implement the proposal in such a way that performance standards are always met and yet conditions never improve. CPD has not always established a consistent history in performance monitoring specifically between its headquarters staff and field sites, and, thus, allowing it to decide what performance measures should be, fosters the human tendency to make the standards achievable rather than accountable.

Moreover, even with the modest performance standards of the past, the CPD problem has been that OIG points out that a grantee committed, for example, to create 100 jobs -- and 5 years and \$20 million dollars later the grantee created 30 jobs. CPD responds to findings of this sort by refusing to pursue any type of sanctions on the grounds that a grantee should not be held responsible for the success of its proposed activities as long as those activities are consistent with the statutory objectives of the grant.

The proposed legislation does nothing to modify this mind set (indeed, it encourages it: 42 USC 5304(e)(4)(A) provides that in the event that HUD determines that a grantee “has substantially failed to meet its performance objectives” for 24 months, HUD “may” take action; if a grantee has not performed for 2 years, then HUD should be required to intervene;) and, even if it did, it does nothing to improve CPD’s enforcement tools under 42 USC 5311. It has been held that HUD must give grantees reasonable notice and an opportunity for a hearing, under section 111(a), before conditioning, reducing or terminating their current grants as a sanction for past noncompliance.

We propose that 42 USC 5311 needs to be amended to eliminate the requirement for a formal hearing before an Administrative Law Judge as a precondition of reducing or terminating current grants as a sanction for past noncompliance. We believe that, without the authority to take prompt enforcement action, grantee noncompliance will not be deterred and performance will not be encouraged.

Additionally, the whole theory of these sorts of grants is that the local officials know better than federal authorities what the locality needs. One check/balance that the existing law includes—to ensure that local officials cater to local needs—is notice to the community and the ability of the community to comment on proposals. This check/balance appears to have been deleted in the proposed amendment of 42 USC 5304(e). There is a provision for community input on the annual performance and evaluation report (i.e., report of what has been accomplished), but there is no such provision for the Performance Plan (i.e., what does the grantee propose to accomplish; what needs to be done). We believe that community input regarding what activities the grant will fund is vitally important and should not be cast aside.

Conclusion:

That concludes my testimony and I thank the Committee for holding this important hearing and I look forward to answering questions that members may have.