



Issue Date	June 24, 2003
Audit Case Number	2003-KC-0001

To: Carolyn Peoples, Assistant Secretary for Fair Housing and Equal Opportunity, E

Roger E. Niesen

FROM: Roger E. Niesen, Regional Inspector General for Audit, 7AGA

SUBJECT: Survey of HUD's Administration of Section 3 of the HUD Act of 1968

INTRODUCTION

We have completed a survey of HUD's administration of Section 3 of the Housing and Urban Development Act of 1968. Our objective was to determine if HUD is administering Section 3 in accordance with the HUD Act of 1968. We determined that HUD does not have adequate controls in place to ensure it is meeting the intended purpose of Section 3 of the Act. However, HUD is in the process of taking action to address the control weaknesses. The Office of Fair Housing and Equal Opportunity recently expanded the Section 3 staff by 53 percent in fiscal year 2001 and an additional 32 percent in fiscal year 2002. This allowed them to conduct 25 monitoring reviews of housing authorities that received HOPE VI funding during fiscal year 2002, and to increase the planned number of monitoring and technical assistance reviews to 30 in fiscal year 2003. The implementation of additional planned actions to correct the control weaknesses should help ensure Section 3 is more effectively managed.

During our survey we conducted interviews with appropriate headquarters and field staff in both the Office of Fair Housing and Equal Opportunity and the Office of Public Housing. In addition, we reviewed the applicable Code of Federal Regulations, Office of Management and Budget Circular A-123 and the Section 3 portion of the HUD Act of 1968. We attempted to review HUD's guidance for the program, but found that it was outdated.

The survey period was October 1, 2001 through September 30, 2002. We provided a draft report to the Office of Fair Housing and Equal Opportunity on April 25, 2003. The Office provided their written comments on June 11, 2003. The comments were considered in developing this final report. We conducted the survey in accordance with Generally Accepted Government Auditing Standards.

In accordance with HUD Handbook 2000.06 REV-3, please provide us any correspondence or directives issued because of the audit.

Should you or you staff have any questions please contact me at (913) 551-5870.

SUMMARY

HUD does not have adequate controls in place to ensure Section 3 is meeting its purpose as intended by the HUD Act of 1968. We found that HUD has not implemented necessary controls for effective program oversight. Section 3 has not been an area of priority in the past because the recipients that receive HUD funding have the primary responsibility for compliance. The regulations governing Section 3 are also vague as to determining the extent economic opportunities are to be awarded to low-income individuals. As a result, HUD has no assurance that Section 3 is functioning as intended by the HUD Act of 1968.

The Office of Fair Housing and Equal Opportunity has initiated actions to identify and correct program control weaknesses. They have identified weaknesses in the Section 3 program and have begun developing corrective actions to be completed by December 31, 2004.

BACKGROUND

Congress established HUD's Section 3 program with the Housing and Urban Development Act of 1968. HUD's Office of Fair Housing and Equal Opportunity administers the program. The purpose of Section 3 is, to the greatest extent feasible, to provide jobs and economic opportunities to low-income and very-low income persons, particularly public housing residents. Section 3 also provides contracting opportunities for businesses that are owned by low-income people or that provide employment to low-income people.

For training and employment, four categories of low-income persons (called Section 3 residents) receive priority:

- (1) Residents of public and assisted housing.
- (2) Those living near a HUD-assisted project.
- (3) Participants in Youthbuild programs.
- (4) Homeless persons.

For contracting, businesses owned by Section 3 residents, businesses that employ Section 3 residents full time, and subcontractors using such businesses receive priority.

With respect to HUD's public housing programs, Section 3 applies to funds spent for development, operations, and modernization. For HUD's other housing and community development programs, Section 3 applies to:

- Housing rehabilitation (including lead-based paint hazard reduction).
- Housing construction.
- Other public construction projects.

Employment opportunities to be made available under Section 3 include administrative/management positions, services such as appliance repair, carpet installation, landscaping, manufacturing, carpentry, and various construction positions.

FINDING
HUD Does Not Have Adequate Controls Over Section 3

HUD does not have adequate controls in place to ensure Section 3 is meeting its intended purpose. We found that HUD has not implemented important Office of Management and Budget Circular A-123 controls that are necessary for effective program oversight. Although HUD considers Section 3 an important goal, Section 3 has not been a priority area of emphasis because the primary responsibility for compliance is centered on recipients that receive HUD funding and HUD does not have direct oversight. As a result, HUD has no assurance that Section 3 is functioning as intended by the HUD Act of 1968.

Office of Management and Budget Circular A-123, Management Accountability and Control, provides the specific requirements for developing and implementing appropriate cost-effective management controls for results-oriented management and for assessing the adequacy of controls in place. The Circular guidance requires agency managers to continuously monitor the effectiveness of management controls associated with their programs. Management has primary responsibility for monitoring and assessing controls, and should use other sources as a supplement to its own judgment. Among the sources of information to be utilized by management are program evaluations conducted on a regular basis. In addition, the agency managers are responsible for taking timely and effective action to correct deficiencies identified by the variety of assessment and monitoring tools available to management. Correcting deficiencies is an integral part of management accountability and must be considered a priority by an agency.

We found that HUD did not have adequate controls to oversee the Section 3 program. We determined the following key controls had not been effectively implemented:

- Tracking of recipients.
- Recipient reporting system.
- Monitoring of recipients to include:
 - Review of recipient/contractor/subcontractor contracts to ensure they contained the required Section 3 clause.
 - Evaluation of the recipient reporting process.
 - Verification that the recipients are notifying Section 3 residents about training and employment opportunities.
 - Verification that the recipients recruited/hired Section 3 residents.

HUD does not have a system in place to track the recipients subject to Section 3 guidelines. HUD staff said that since HUD does not directly distribute funding, it would be very difficult to track the recipients subject to the Section 3 guidelines. However, tracking of recipients is a critical control that needs to be in place to determine program compliance. HUD needs to develop a system as part of the funding process to identify recipients subject to Section 3 requirements. Only after identifying all the recipients will HUD be able to develop and implement an effective monitoring plan to ensure that awarded contracts contain the required Section 3 clause, recipients accurately report information, and Section 3 residents are given the opportunity to be employed.

HUD has developed an on-line reporting system for recipients to file their annual reports as required by 24 CFR 135, but the recipients of Section 3 are not required to use the system. HUD's regulation 24 CFR 135.90 requires that each recipient who receives direct HUD financial assistance subject to

Section 3 requirements shall submit an annual performance report. The mandatory use of the reporting system coupled with annual performance reports should be used as part of the control process that needs to be developed.

HUD's regulation, 24 Code of Federal Regulations Part 135.74, says that the Assistant Secretary shall periodically conduct Section 3 compliance reviews of selected recipients and contractors. However, currently, HUD does not have an effective system to accurately monitor the recipients subject to Section 3 guidelines. Prior to fiscal year 2002, no monitoring reviews were conducted of Section 3 recipients. The Office of Fair Housing and Equal Opportunity conducted 25 monitoring reviews in fiscal year 2002, but selected only housing authorities that received HOPE VI funding. HUD selected HOPE VI grants because they were large projects that could be easily identified using Public Housing Authority records.

Within the last six months, the Office of Fair Housing and Equal Opportunity has initiated several actions to identify and correct program control weaknesses, such as expand the Section 3 staff. They have identified weaknesses in the Section 3 program and have begun developing corrective actions. Examples of some of the corrective actions HUD plans to undertake are as follows:

- Expand the number of reviews in 2003.
- Develop comprehensive methodologies for compliance and monitoring reviews.
- Draft clearer governing documents.
- Develop a strategy work plan for tracking complaints.
- Develop a clear definition of "to the greatest extent feasible."
- Incorporate HUB Directors into the Section 3 planning and monitoring process.
- Revise the Section 3 regulation.

The Office of Fair Housing and Equal Opportunity has developed a schedule to have the corrective actions completed by December 31, 2004.

We believe the weaknesses in the program have occurred primarily because HUD does not directly distribute funding for Section 3 activities. While the funding comes from various departments within HUD, it is the activities undertaken with those funds that are subject to Section 3 guidelines. The primary responsibility for compliance is at the recipient level. In addition, the regulations governing Section 3 are vague as to determining the extent economic opportunities are to be awarded to low-income individuals.

We commend HUD for its attempts to improve its administration of the Section 3 program. If implemented, HUD's planned improvements will certainly improve this program. Therefore, HUD should now work on finalizing and implementing a plan that will identify all of the recipients that are subject to Section 3 requirements, require accurate and complete reporting by the recipients, and ensure an effective method of monitoring of the recipients. The plan should include a specific timetable for implementation.

AUDITEE COMMENTS

A summary of HUD's comments on our draft report follow. Appendix A, page 8, contains the complete text of the comments.

In fiscal year 2001 the Office of Fair Housing and Equal Opportunity expanded the Section 3 staff by 53 percent, and an additional 32 percent in fiscal year 2002 to enable staff to conduct monitoring reviews of housing authorities. In fiscal year 2003, Section 3 staff not only increased monitoring and technical assistance reviews from 25 to 30, but exceeded this amount by 6 additional reviews to date [June 11, 2003].

Most recently, the Section 3 staff has developed a strategic plan to enhance the efficiency and effectiveness of the program. The goals of the strategic plan are to

- Evaluate existing policies and procedures;
- Update education and outreach materials;
- Increase collaboration with other major HUD program areas.

Also under this strategic plan, Section 3 staff has affected actions to execute Memoranda of Agreement with other federal agencies (e.g. Department of Labor, Department of Health and Human Services, etc.) and Memoranda of Understanding for training, outreach, and education with faith-based and community-based organizations, advocacy groups, and other community stakeholders. The plan seeks also to increase awareness among residents of the Section 3 program. Increased awareness will likely result in a rise in the number of Section 3 grievances filed.

The Office of Fair Housing and Equal Opportunity also provided a specific list of corrective actions to be completed by December 31, 2004 to address the finding in the report pertaining to:

- Tracking of recipients
- Recipient reporting system
- Monitoring of recipients to include:
 - Review of recipient/contractor/subcontractor contracts to ensure they contained the required Section 3 clause
 - Recruiting/hiring of Section 3 residents.

OIG EVALUATION OF AUDITEE COMMENTS

We commend the Office of Fair Housing and Equal Opportunity for the great strides it has taken towards developing and implementing controls over the Section 3 program. If the controls described by the Office of Fair Housing and Equal Opportunity are fully implemented, they should strengthen the Section 3 program and correct program control weaknesses.

The Office of Fair Housing and Equal Opportunity provided their planned actions and dates for corrective action with their comments. Therefore, we have input December 31, 2004 as the planned completion date for Recommendation 1A and have closed Recommendation 1B in the Department's Audit Resolution and Corrective Action Tracking System.

RECOMMENDATIONS

We recommend the Assistant Secretary for Fair Housing and Equal Opportunity:

- 1A. Develop and implement necessary controls to ensure the Section 3 program is functioning as intended by the HUD Act of 1968. At a minimum, these controls should include:
 - Developing a system to track recipients
 - A method to evaluate the recipient reporting system
 - Developing a system to monitor recipients that ensures contracts contain the Section 3 clause, recipient reporting system is effective and Section 3 residents are informed of and given available job and training opportunities.

- 1B. Develop a timeline to ensure controls are implemented expeditiously.

MANAGEMENT CONTROLS

Management controls include the plan of organization, methods, and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

We determined that the following management controls were significant to our audit objective:

- Controls over the monitoring process.
- Controls over recipient contracts.
- Controls over recipient reporting.
- Controls over recipient hiring.
- Controls over recipient tracking.

It is a significant weakness if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet an organization's objectives.

Based on our survey, as presented in the finding, we believe the following issues represent significant weaknesses in HUD's control environment:

- HUD does not have a system in place to accurately monitor the recipients subject to Section 3 guidelines.
 - HUD does not have a system in place to track the recipients subject to Section 3 guidelines.
 - HUD does not have controls over the review of awarded contracts for the required Section 3 clause.
 - HUD does not have controls over the recipients reporting process.
 - HUD does not have controls over the recruiting and hiring of Section 3 residents.
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FOLLOW-UP ON PRIOR AUDITS

This is the first OIG review of the Section 3 of the Housing and Urban Development Act of 1968.

Auditee Comments

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06/23/03 01:24 PM

To: Roger Niesen/KAN/HUDOIG@HUDOIG
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Subject: Section 3

Per our discussion today - see attached



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Congress established the Section 3 program with the passage of the Housing and Urban Development Act of 1968. Since its enactment, Section 3 has been a statutory basis for providing to low- and very low-income residents, economic opportunities generated from projects receiving HUD financial assistance. The Housing and Community Development Act of 1992 (1992 Act) significantly revised Section 3 but did not alter the objective. The 1992 Act instead strengthened the Section 3 mandate by clarifying the types of HUD financial assistance, activities and recipients subject to the requirements of section 3, identified the specific individuals and businesses that are the intended beneficiaries, and established the order of priority in which these individuals and businesses should be recruited and solicited.

On October 8, 1993 (58 FR 52534), HUD published a proposed rule to incorporate the comprehensive changes required to make part 135 consistent with the changes made by the 1992 Act. On June 30, 1994, an interim rule (59 FR 33866) was published. This rule reduced and simplified the provisions of the October 8, 1993 proposed rule.

Since that time, outside of the cursory nods given to the Section 3 proposed final rule, Section 3 has not occupied a position of great priority; the recipients themselves have been deemed to be responsible for monitoring their own compliance.

In Fiscal Year (FY) 2001, however, the Office of Fair Housing and Equal Opportunity expanded the Section 3 staff by 53 percent to enable staff to conduct monitoring reviews of housing authorities, adding in FY 2002 an additional 32 percent. In FY 2003, Section 3 staff not only accommodated the increase from 25 planned monitoring and technical assistance reviews the previous fiscal year, but also exceeded the management plan goals of 30 by 6 additional reviews to date. These are a few of the actions that have been implemented to begin correcting the weaknesses in effectively managing the Section 3 program.

Most recently, Section 3 staff has developed a strategic plan designed to enhance the efficiency and effectiveness of the program. The goals of the strategic plan are to

- Evaluate existing policies and procedures;
- Update education and outreach materials;
- Increase collaboration with other major HUD program areas.

Also under this strategic plan, Section 3 staff has affected actions to execute Memoranda of Agreement with other federal agencies (e.g. Department of Labor, Department of Health and Human Services, etc.) and Memoranda of Understanding for training, outreach, and education

with faith-based and community-based organizations, advocacy groups, and other community stakeholders. The plan seeks also to increase awareness among residents of the Section 3 program. Increased awareness will likely result in a rise in the number of Section 3 grievances filed.

Following is a specific list of corrective actions planned (or in place) to address the findings of this audit:

HUD does not have a system in place to accurately **monitor the recipients subject to Section 3 guidelines.**

- Organize task forces of staff members from Section 3 and other major HUD program areas to develop and implement a successful policy for monitoring HUD recipients subject to Section 3 guidelines.
By When: September 30, 2003
- Incorporate HUB Directors into the planning of Section 3 monitoring reviews.
By When: Ongoing
- Update procedural Handbook 8023.1 dated July 1992.
By When: September 30, 2003 – Begin clearance process

HUD does not have a system in place to **track the recipients subject to Section 3 guidelines.**

- Develop with HUD Program staff an internal system for tracking all non-exempt HUD funding assistance and their corresponding recipients.
By When: December 31, 2004
- Develop an on-line Summary Reporting Form for recipients to report Section 3 hiring activities.
By When: September 30, 2004

HUD does not have controls over the **review of awarded contracts for the required Section 3 clause.**

- Work with HUD program staff to establish a pre-award review process, which would assess the potential recipients' Section 3 compliance capability and/or history.
By When: December 31, 2004

HUD does not have controls over the **recipients' reporting process.**

- Develop an online system for tracking the receipt (or lack) of all HUD recipients' HUD Form 60002.
By When: September 30, 2004

HUD does not have controls over the **recruiting and hiring of Section 3 residents.**

- Revise the Section 3 regulation to clear definition of “to the greatest extent feasible.”
By When: September 30, 2004
- Increase the number of technical assistance and monitoring reviews in FY 2003.
By When: Completed
- Develop a strategy work plan for tracking complaints.
By When: September 30, 2004
- Develop and conduct marketing and outreach campaigns to inform Section 3 residents of recruitment and hiring opportunities available through HUD-assisted projects.
By When: September 30, 2004