



Audit Report

District Inspector General for Audit Pacific/Hawaii District

Report: 98-SF-112-0001

Issued: August 31, 1998

TO: Saul N. Ramirez, Acting Deputy Secretary, SD

FROM: Glenn S. Warner, District Inspector General for Audit, 9AGA

SUBJECT: HUD Earthquake Loan Program (HELP)

We performed a review of the HUD Earthquake Loan Program. Our objective was to determine if the program was designed and implemented in accordance with Chapter 7 of the Emergency Supplemental Appropriations Act of 1994 and administered in a manner that minimized fraud, waste, or abuse of HUD funds. This report contains one finding. We are recommending that all Assistant Secretaries whose programs/staffs are expected to provide assistance to disaster victims in the future develop plans that address known requirements. We are also recommending that the Director of the Los Angeles Multifamily Hub be required to identify and recover all HELP funds that were a duplication of other funds.

Within 60 days please furnish us, for each recommendation in this report, a status report on: (1) the corrective action taken, (2) the proposed corrective action and the date to be completed or, (3) why action is not necessary. Also, please furnish us copies of any correspondence or issued directives related to the audit.

If you have any questions, please call me at (415) 436-8101.

Executive Summary

We performed an audit of the HUD Earthquake Loan Program (HELP). The purpose of our audit was to determine if the program was designed and implemented in accordance with the Act and administered in a manner that minimized fraud, waste, or abuse of HUD funds. We concluded that HUD needs to develop a detailed response plan for future disasters and take corrective action to identify and recover all HELP funds that were a duplication of other funds.

HUD Responded Rapidly To Aid Multifamily Project Owners

The Emergency Supplemental Appropriations Act of 1994 provided relief to victims of the January 1994 Southern California earthquake. HUD responded rapidly by creating the HELP to aid owners of damaged HUD assisted multifamily projects. Generally, actions taken by the HUD Los Angeles Area Office (LAAO) staff provided prompt and effective relief; however, we found areas where there needs to be more extensive up-front disaster relief planning. We believe that the lessons learned during the response to this disaster can be used to more effectively and efficiently respond to future disasters. This report provides the basis for the planning needed.

HELP Controls Did Not Safeguard HUD Funds

HUD did not design the HELP with controls that adequately safeguarded HUD funds from fraud, waste, or abuse. The weaknesses were most evident in four areas:

- Waivers or modification of statutes, regulations, and handbook requirements created opportunity for abuse;
- HUD did not restrict funding to earthquake repairs and costs;
- Program and loan administration guidance was unclear; and,
- Legal and reporting requirements were not addressed.

Absence Of A Plan And Insufficient Staffing Allowed For Ineligible Expenditures

HUD is required to establish controls to safeguard assets and prevent duplication of benefits through its financial assistance programs. We believe the HELP weaknesses we identified occurred because HUD had no response plan to effectively implement, monitor, and oversee disaster assistance. In addition, insufficient personnel were available to accomplish necessary oversight. As a result, some owners/agents assisted under the HELP (1) received funds even though they had obtained funds from other sources; (2) made ineligible and questionable expenditures; (3) diverted funds for personal use; and, (4) received possible preferential treatment for funding. Specifically, HUD

obligated or disbursed questionable HELP funds of \$7.1 million to owners/agents of the 27 projects that we reviewed.

**HUD-Wide Disaster Response
Plan And LAAO Recovery Of
Duplicate Funds Are
Recommended**

We recommended that all Assistant Secretaries whose programs/staffs are expected to provide assistance to disaster victims in the future develop plans that address known requirements. We also

recommended that the Director of the Los Angeles Multifamily Hub be required to identify and recover all HELP funds that were a duplication of other funds. Due to the inconsistencies and inadequacies of the HELP guidance, we did not recommend that HUD take any further action to resolve the other questioned costs cited in our report.

**HUD Agreed With
The Finding And
Recommendations**

The Acting General Deputy Assistant Secretary for Housing generally agreed with the finding and our recommendations and said that his office was taking or planned to take the necessary steps to implement them. He stated that HUD's disaster response was rapid, comprehensive, and resulted in positive accomplishments. However, he acknowledged that HUD-wide guidance must be complemented with more detailed program office guidance in order to assure that problems such as those cited in this report are avoided in the future. His written response is included as Appendix A to this report.

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Abbreviations

FAC	Financial Assistance Contract
FEMA	Federal Emergency Management Agency
GSA	U.S. General Services Administration
HELP	HUD Earthquake Loan Program
IPA	Independent Public Accountant
LAAO	Los Angeles Area Office
MIOP	Management Improvement Operating Plan
SBA	U.S. Small Business Administration
SFO	San Francisco Office

Introduction

BACKGROUND

Emergency Appropriation

On January 17, 1994 a severe earthquake struck Southern California causing extensive damage to structures in Northridge and surrounding communities. On February 10, 1994, the President signed into law the Emergency Supplemental Appropriations Act of 1994 to provide relief to earthquake victims. Under Chapter 7 of the Act, the Congress appropriated \$100 million for the Flexible Subsidy Fund to be used to restore earthquake damaged apartment buildings. Eligible multifamily project owners applied for these funds through the Los Angeles Area Office (LAAO).

The Program

HUD created the HELP to provide financial assistance to economically viable FHA-insured projects, projects with Section 312 rehabilitation loans, and uninsured Section 8 assisted projects. HUD established two categories of assistance for: limited repair needs and major repair needs. Under these categories, HUD offered a broad range of items for funding such as mortgage payments, loss of rents, temporary staff, tenant relocation expenses, repair or replacement of housing units, retro-fitting and code requirements.

HUD streamlined the HELP to expedite the funding process and encourage eligible owners to use the assistance for their earthquake related damages and losses.

To obtain HELP assistance, the owners were required to submit to the LAAO a management improvement operating plan (MIOP) and other documentation for each earthquake damaged project. The MIOP itemized the estimated earthquake related fiscal needs and repair costs. The LAAO reviewed and approved the MIOP, executed the loan documents, and reserved the loan funds. The owners/agents requested the draw down of HELP funds on a cost reimbursement basis. Upon repair completion, the LAAO was to conduct a final inspection of the repairs and recapture any unused funds from the owner.

HELP Funds Obligated And Disbursed

As of June 1998, HUD had obligated HELP funding of \$84 million for 144 projects and disbursed \$74.7 million to the owners/agents.

In addition to the HELP, HUD also provided Section 8 rental assistance and other HUD funds totaling over \$650 million and/or staff resources to assist earthquake victims and owners of apartment buildings damaged by the earthquake. HUD coordinated with public housing agencies, cities, and counties to process and oversee the disbursement of these funds.

**Recent Actions
Taken By HUD**

In September 1997, the Office of Community Planning and Development promulgated Regulations establishing the HUD Disaster Recovery Initiative. Under this Initiative, HUD intends to provide gap financing for recovery activities to communities impacted by disasters receiving Presidential declarations. HUD's program requires a partnership of Federal, State and local governments, the business community and citizens.

In January 1998, Headquarters issued the "HUD Disaster Recovery Guidebook" which provides a framework to help HUD staff plan, organize, mobilize, and evaluate HUD's response to disasters. The Guidebook also describes HUD's role in relation to other agencies engaged in the recovery process.

**A Disaster Response
Plan Is Needed**

Because disasters generally occur suddenly and tend to be widespread, HUD's best course of action is to get prepared for the next one. As acknowledged by the Acting General Deputy Assistant Secretary for Housing, prudent planning, sufficiently knowledgeable personnel, and clearly stated and disseminated policies and procedures are essential elements of an effective disaster response plan.

AUDIT OBJECTIVE, SCOPE, AND METHODOLOGY

Objective and Scope

The objective of our review was to determine if the HELP was designed and implemented in accordance with the Act and administered in a manner that minimized waste, fraud, or abuse of HUD funds.

We conducted the audit field work at the LAAO and generally covered the period January 17, 1994 through October 31, 1997. We reviewed project files, interviewed HUD's Headquarters, LAAO, and San Francisco Office (SFO) staff, and obtained comments and documentation from owners/agents. We obtained comments from officials of other Federal, State, and local agencies about their disaster assistance programs and the HELP. We performed desk reviews or external audits of 27 HELP funded projects. Twenty of these projects made up our original sample which included our desk review of 12 projects and external audits of eight projects. Four additional projects were selected for limited review to address the LAAO staff's concern that excessive funding may have been approved for a particular owner/agent. We also included the results of another external audit of three projects where we reported the diversion of HELP funds.

Our audit generally covered the HELP guidelines and HUD's design, implementation, and oversight of the program. An exit conference was not conducted because the Acting General Deputy Assistant Secretary for Housing generally agreed with the finding and our recommendations.

Standards We conducted the audit in accordance with generally accepted government auditing standards.

Finding

HELP Design Weaknesses Exposed HUD Funds To Fraud, Waste, Or Abuse

HUD did not design the HELP with controls that adequately safeguarded HUD funds from fraud, waste, or abuse. The weaknesses were most evident in four areas:

- **Waivers or modification of statutes, regulations, and handbook requirements created opportunity for abuse;**
- **HUD did not restrict funding to earthquake repairs and costs;**
- **Program and loan administration guidance was unclear; and,**
- **Legal and reporting requirements were not addressed.**

HUD is required to establish controls to safeguard assets and prevent duplication of benefits through its financial assistance programs. We believe the HELP weaknesses we identified occurred because HUD had no response plan to effectively implement, monitor, and oversee disaster assistance. In addition, insufficient personnel were available to accomplish necessary oversight. As a result, some owners/agents assisted under the HELP: (1) received funds even though they had obtained funds from other sources; (2) made ineligible and questionable expenditures; (3) diverted funds for personal use; and, (4) received possible preferential treatment for funding. Specifically, HUD obligated or disbursed questionable HELP funds of \$7.1 million to owners/agents of the 27 projects that we reviewed.

As authorized under the Emergency Supplemental Appropriations Act of 1994 (Act), the Secretary waived statutes and regulations of the Flexible Subsidy Program except those relating to fair housing and nondiscrimination, the environment, and labor standards. The waivers were necessary in order to provide assistance to qualified owners as quickly as possible to restore earthquake damaged HUD-associated properties.

HUD Is Required To Have Controls Which Prevent Abuse Of Disaster Assistance Funds

The Federal Manager's Financial Integrity Act of 1982, Section 3512 (b)(3) requires the head of each agency to establish and maintain systems of internal controls that provide effective control over assets for which the agency is responsible, and (c)(1) to reasonably ensure

that all assets are safeguarded against waste, loss, unauthorized use, and misappropriation.

Further, 42 U.S.C. Section 5155(a), Duplication of Benefits, provides that "The President, in consultation with the head of each Federal agency administering any program providing financial assistance to persons, business concerns, or other entities suffering losses as a result of a major disaster or emergency, shall assure that no such person, business concern, or other entity will receive such assistance with respect to any part of such loss as to which he has received financial assistance under any other program or from insurance or any other source."

Waivers Created Opportunity For Abuse

Headquarters waived or modified statutes, regulations, and handbook requirements of the Flexible Subsidy Program to streamline its loan processing functions and expedite funding to owners/agents of HUD-associated multifamily housing projects. Those waivers and modifications created an environment for abuse of the program. Some of the waivers or modifications removed or compromised significant internal controls relating to HUD's oversight and monitoring of the program to restore damaged projects to pre-earthquake condition. As a result, HUD does not have reasonable assurance the HELP funds were properly safeguarded against waste, loss, unauthorized use, and misappropriation.

The waivers coupled with Headquarters instructions to follow certain provisions of the Flexible Subsidy Handbook 4355.1 REV-1 issued in May 1992, in our view, only confused oversight responsibilities. In fact, Headquarters did not provide the LAAO staff or the owners/agents with a cross referenced listing of those Handbook provisions that continued or were deleted under the HELP. Instead, Notice H 94-15 (HUD) issued March 17, 1994 provided a general caveat that "...any existing Flexible Subsidy statute and/or regulation which is inconsistent with the guidance in this Notice is superseded by this Notice for the purpose of administering funds under the HELP program." This generalization allowed HUD personnel and owners/agents to make varying interpretations of the HELP requirements.

Examples of waivers and other program modifications that removed or compromised funding safeguards are as follows:

Least Cost Method Did Not Prevent Funding Duplications

To streamline HELP, the Secretary waived many statutes including Section 201(d)(2) of the Housing and Community Development Amendments of 1978. Under this section of the statute, HUD could not provide Federal assistance to a recipient without determining if the funding was less costly to the Federal Government than other reasonable alternatives. Even though this section was waived, HUD in Notice H

94-15 referenced the "least cost method" as an integral part of program. The least cost method was referenced in the Notice as follows:

"HELP funds are designed to restore eligible HUD-associated housing to pre-disaster condition and economic viability utilizing the least cost method to HUD."

"Other sources of funds -- ... When the acceptance of funding under these loans would present an additional debt service burden to the property, the HUD HELP Servicing Team in Los Angeles should be contacted prior to the owner committing to the additional funding so that the least cost method may be determined."

Notice H 94-15 did not provide any further definition of procedures to be followed or documentation to be completed by HUD staff and owners/agents to calculate the least cost of funding under HELP.

HUD issued Notice H 94-25 in April 1994 which included related instructions that contradicted the Act. That Notice stated that both earthquake and non-earthquake related repairs for Title VI preservation projects were eligible for HELP funding. Conversely, the Act stated that only repairs and losses attributable to the earthquake were eligible for funding. Notice H 94-25 also directed the LAAO multifamily housing development division to complete an analysis called the "lowest-cost determination" to determine if preservation related repairs should be funded from HELP or from a preservation loan to be repaid from Section 8 funds.

In an October 1994 memorandum issued by the Assistant Secretary for Housing-Federal Housing Commissioner, the HUD field office was instructed not to approve non-earthquake related repairs of preservation projects for HELP funding. The memorandum referenced the least cost certification procedure and stated that code work, upgrades, deferred maintenance or any repair required by a project's preservation capital needs assessment must be paid from preservation or other funding resources.

Our review of selected HELP project files disclosed that the LAAO multifamily development division director signed least cost certifications but did not insert any supporting calculations or other documentation in the HELP project files to show how the determinations were made. LAAO staff advised that the director simply signed the certification because Headquarters had concluded that the HELP loan was always less costly than the preservation program's 241(f) loan/Section 8 alternative. Further, the Director of the Los Angeles Multifamily Hub commented that the supporting calculations should not have been required because the market rate preservation loans were more costly than the HELP loans. We disagree because the preservation loans represented only one of several other possible sources of disaster assistance funding (e.g., insurance, Federal Emergency

Management Agency, U.S. Small Business Administration, etc.) available to the owners/agents. Accordingly, HUD must consider the source and scope of these funds to prevent possible funding duplications.

HUD disbursed the HELP funds without reasonable assurance the funds did not duplicate other funding sources. HUD's streamlined methods may have accelerated the funding approval process; however, they did so at the expense of approving potentially duplicate funds. The duplication of funding is contrary to both the Federal Manager's Financial Integrity Act of 1982 and 42 U.S.C. Section 5155(a).

Under the "APPLICATION" section of Notice H 94-15, HUD instructed owners/agents to report the amount of funds received or anticipated from insurance or other sources in their MIOP submissions, as these funds were to be fully used prior to HELP funds. Under the "TERMS AND CONDITIONS" section of the Notice, the owner/agent was required to use funds received from other sources for approved costs/repairs or to prepay the HELP loan.

Insurance Proceeds Unfortunately, Notice H 94-15 did not require the owners/agents to submit insurance policies or other government assistance application information and documentation as part of the HELP application process. Without this information, the LAAO staff could not query or further examine potential funding duplications. Instead, the LAAO staff advised us that they relied on the owners/agents to provide the required disclosure in their MIOP applications or revisions. No further supporting documentation was required. Because the HELP guidelines did not require the LAAO staff to obtain and review insurance policy coverage and payment information for each project, the LAAO staff overlooked the need for MIOP revisions, did not recover unneeded HELP funds, and approved draw downs without regard to insurance proceeds.

Our review of the 20 projects in our sample disclosed five where insurance proceeds totaling over \$1.2 million were either not reported by owners/agents or not identified by LAAO staff. (Appendix B)

Preservation Funds After we started our survey of the HELP, the LAAO preservation branch staff requested project owners with both Preservation loans and HELP applications in process to identify those repairs claimed under both programs that overlapped. Several of the owners provided responses to the LAAO that confirmed numerous instances of overlapping costs that were then removed from the Preservation loan.

Unlike HUD, other Federal agencies involved in earthquake assistance, required applicants to provide sufficient disclosure of, and documentation for, other funding sources as a condition of funding. For instance, the U.S. Small Business Administration (SBA) required the applicant to assign the insurance proceeds to

the agency before the loan was approved. At the Federal Emergency Management Agency (FEMA), an applicant's funding application was not approved until the insurance policy information and amounts of coverage were submitted for review by the agency.

**Delayed Procurement Reviews
And Unclear Guidelines Created
Opportunities For Abuse**

HUD's oversight responsibility and functions pertaining to the owners/agents compliance with the HELP procurement requirements were not adequately addressed in the HELP guidance issued to the LAAO staff and owners/agents. Neither of the issued Notices addressed this aspect of the program. Only general guidelines were provided to the LAAO staff in the memorandum issued by the Assistant Secretary for Housing in October 1994. Due to the heavy HELP workload, HUD staff subsequently revised these guidelines to expedite the funding approval process.

None of the issued HELP guidance clearly addressed the timing, extent, and staff responsibility for the LAAO's oversight of an owners'/agents' procurement of professional and contractor services. The LAAO's oversight function was partially addressed in the Assistant Secretary for Housing's October 1994 memorandum. It stated that HUD staff would "...concur in the selection of the lowest responsive bidder..." but did not identify the staff or when and how HUD's concurrence function would be accomplished.

According to the LAAO staff, HUD's concurrence function was effectively voided in late 1994 and was replaced with a delayed review of the owners'/agents' records after work completion. This change was made at the direction of HUD staff from Headquarters, the LAAO, and the Seattle office. The new procedure, however, was not documented in revised program instructions issued to the LAAO staff or owners/agents.

The Headquarters staff who drafted the HELP guidance and the LAAO staff who conducted the on-site reviews of the owners'/agents' records interpreted the procurement rules differently. Headquarters staff advised that HUD generally does not require an owner to procure architectural and/or engineering services using a competitive process and thus it would not be required under the HELP. Headquarters staff said that the owner/agent was free to select any firm without HUD's concurrence. The LAAO staff, on the other hand, said that based on the October 1994 Headquarters memorandum, owners/agents were required to procure both professional and construction contract services on a competitive basis. The Director of the Los Angeles Multifamily Hub commented that the competitive procurement of architectural and engineering services required by Headquarters was not typical, and could result in inflated costs.

The HELP guidance did not promote sound principles of contract administration to be followed by the LAAO staff and owners/agents. For example, the guidance

was silent on the LAAO's role or any expectations placed on the owner/agent when executing construction contracts with either identity of interest companies or independent contractors. The guidance also did not include provisions for liquidated damages and performance and payment bonds. This is inconsistent with the Flexible Subsidy program which required a Latent Defects Bond for a period of 15 months beyond completion, the minimum requirements for a multifamily project with HUD mortgage insurance, and prudent construction industry standards promoted by the State of California.

Contract administration was nonexistent. The LAAO staff was not directed to oversee the owners' contract activities and the owners/agents were not required to ensure that liquidated damages or bonding requirements were included in their HELP funded construction contracts.

**Project Reviews Disclosed
Serious Problems And
Misspent Funds**

Our project reviews disclosed or encountered serious problems with vague MIOP action item descriptions approved by the LAAO; therefore, approved items could not be correlated to the work specifications used in the construction contracts let by owners/agents. At a minimum, the LAAO should have required the owners/agents to obtain MIOP approval for the cost of the bonds, and approved or required owners'/agents' revisions of MIOP action items comparable to the work specifications used in the executed contracts funded under HELP. The bonds are designed to protect funds from abuse and HUD's security interest against substandard work that does not comply with local building codes. The Director of the Los Angeles Multifamily Hub agreed that bonds should be considered for large contracts, but believed that planning, better construction documents, and supervision would safeguard HUD funds much more than bonds.

In addition, we noted instances where the HELP funded work was not completed on time or funds were released for work that was not approved in the project MIOP. We also noted planned work that did not comply with housing quality standards without any substantive remedial action required of the owners/agents.

Our ongoing external audit of one owner/agent with seven projects disclosed that the agent took advantage of HUD's streamlined program and participated in procurement related abuses that resulted in misspent HELP funds. The agent's abuses included possible bid-rigging, fraudulent bids, and not using open and free competition to procure professional and contract services. As a result, the LAAO staff approved over \$1.8 million in misspent HELP funds to pay for inflated, unsupported/ineligible costs, and possible false claims for HELP funds for those seven projects.

**HUD Did Not Restrict Funding
To Earthquake Repairs**

Chapter 7 of the Emergency Appropriations Act of 1994 states that HUD will provide emergency assistance to owners of eligible multifamily

housing projects damaged by the January 1994 earthquake to repair damages or recover losses directly attributable to the earthquake.

During the first nine months after the earthquake, Headquarters did not provide written guidance to the owners/agents or HUD staff as to how HUD would inspect and document damages at the affected projects. The Assistant Secretary for Housing - Federal Housing Commissioner's October 1994 memorandum provided only very general directions under DAMAGE REPAIR PROGRAM stating:

"Initially, a physical inspection must be conducted by a HUD engineer or construction analyst prior to or after receipt of the owner's application at HUD's discretion. This inspection will determine if the project contains any earthquake damage."

"Only damage that is determined to be the result of the earthquake can be considered."

"Only code enforcement work required because of the earthquake repair program is permitted..."

The very limited HELP guidance excerpted above clearly lacks the minimum inspection criteria, procedures, and references that HUD staff needed to properly determine the scope of repairs and estimated costs to be funded under HELP. For example, the HELP guidance did not provide or reference the inspection methodology and procedures, reporting criteria and documentation requirements, repair/cost eligibility references, safety rules and procedures, etc. The Director of the Los Angeles Multifamily Hub commented that HUD staff do not have the necessary skills to make comprehensive inspections and cost estimates and that a structural engineer with extensive earthquake repair experience was required. HUD could perform "threshold inspections", but comprehensive inspections should be performed by outside professionals. Also, the LAAO and SFO staff who conducted the earthquake related inspections advised that they received no preparatory training on the inspection requirements or the reporting process.

Since, these critical factors were not addressed in the design of HELP, the LAAO management and technical staff did not consistently use the HELP damage inspection reports to control or limit the amount of HELP funds approved for the projects. In fact, at times the LAAO management and inspection personnel discounted or disregarded the HELP inspection reports. As a result, they approved potentially excessive amounts for HELP funding.

In response to LAAO staff's concern that excessive funding had been approved for a particular owner/agent, we selected four projects from 39 HELP funded projects owned and managed by the owner/agent concerned and found that the LAAO provided over \$500,000 more in funding than the cost estimates cited in the

inspection reports for three of those four projects. (See Appendix C for a project summary of the excess amounts.) Although some SFO staff said that the formula used by the LAAO staff produced reasonable results, other SFO and LAAO staff disagreed and said that the owner/agent received preferential treatment. These SFO and LAAO staff also said the LAAO approved funding was inflated or very generous and was not supported by HUD's project inspections. In fact, both offices indicated the excessive repairs in question were not earthquake-related, but instead deferred maintenance, and should have been paid from the projects' operating or reserve for replacement funds. This owner/agent submitted MIOPs for its projects after the repairs were completed; therefore, the LAAO could not verify that costs over and above the original damage inspection reports were valid earthquake related repairs. Nevertheless, the LAAO approved the increased costs in the owner's approved HELP loans.

In one sampled project, the LAAO staff approved HELP funds totaling over \$1.3 million to repipe and make related repairs at a project even though the SFO staff who inspected the project proposed that the repairs not be funded because they were pre-existing conditions that were not attributable to the earthquake. The LAAO project files clearly showed the project plumbing was deteriorated and in need of repiping six months before the earthquake. The project was undergoing a transfer of physical assets when the MIOP revision was approved for the plumbing work. The LAAO loan management branch chief advised that the HELP loan was a vital part of the transaction and that Headquarters staff were heavily involved in the process. The Director of the Los Angeles Multifamily Hub commented that the LAAO staff made correct decisions for this project considering the extent of damage sustained and the fact that the ineligibility of deferred maintenance costs was not specifically addressed in the HELP guidance until after the LAAO approved the project's MIOP for funding. In our opinion, the director's contention that the plumbing repair costs were not ineligible deferred maintenance costs when the project's MIOP was approved is not the issue. Rather, our concern is that the LAAO erroneously approved HELP funds for repair work which was not attributable to the earthquake. That action was contrary to the findings of the SFO inspection staff and the intent of the program.

The LAAO staff approved questionable deferred maintenance repairs or upgrades totaling \$896,004 for six of the 20 projects in our sample. The LAAO staff explained that the costs were justified to enhance the economic viability of the projects. However, we found no documented economic viability assessment or justification in the project files. It appears that the staff used the term "economic viability" to justify approving repairs that were not earthquake related. As discussed in the next section of the finding the term "economic viability" was never adequately defined.

Our review of one project in our sample disclosed the LAAO staff approved the project's MIOP and HELP funds totaling \$833,788 without performing an

inspection of the project. The LAAO staff, however, was able to provide a damage survey log which noted an estimated \$40,000 in cosmetic damage to the project. The LAAO staff advised that the heavy HELP workload and HUD Headquarters' general push to quickly commit HELP funds may have been the primary reasons why the inspection was not made.

Headquarters staff who drafted the HELP guidance and the LAAO and SFO staff who conducted the earthquake inspections disagreed on the purpose of the "HUD Earthquake Damage Inspection Report" (damage inspection report). The Headquarters staff advised the damage inspection report was developed by the LAAO and SFO staff to quickly assess the extent of the damages and to determine how much Federal funding was required. The report was not intended to determine the allowable HELP funding for each project.

The LAAO and SFO staff who designed the report, however, advised they intended it to document the extent of visible damages of the buildings caused by the earthquake and to be used to review, revise, and approve the earthquake related repairs/costs identified in the MIOPs submitted by the project owners/agents. Other LAAO and SFO staff had different views on the purpose of the inspection report. One LAAO staff inspector advised that the inspection report was used to review submitted MIOPs. Two SFO staff inspectors believed that the report was only used to arrive at rough estimates for HELP budgetary/funding purposes.

Three of the six LAAO and SFO staff who conducted property inspections and completed the HELP inspection report said the report was inadequate. They advised the report did not provide sufficient information to review, revise, and approve an owner's/agent's MIOP.

Officials from FEMA and the General Services Administration (GSA) reviewed the HELP inspection report and related program guidance and found the report to be inadequate. FEMA's Federal Coordinating Officer in Pasadena, California commented that the HELP inspection report should have had more detail supporting the cost estimates. He said the report should provide for each level of damage (Cosmetic, Moderate, Structural), the square footage area impacted, and the unit costs for each repair category (electrical, plumbing, concrete, and building). GSA's Branch Chief, Technical Services Branch, Region 9, in San Francisco said the HELP inspection report was too short and incomplete. She said that as a minimum, the inspection report should include the type of construction, approximate square footage, and space for a sketch. She suggested that HUD consider using inspection forms designed by the Applied Technology Council that were widely used by GSA and other Federal agencies in the Loma Prieta and Northridge earthquake recovery efforts.

**Program Guidance
Was Unclear And
Lacked Safeguards**

We noted that the program's inadequate guidelines forced HUD staff to make subjective assumptions to arrive at funding decisions under very stressful circumstances. The problems HUD staff had with interpreting the least cost method and the use of HELP inspection reports were addressed above; however, there were also problems with determining economic viability and the drawdown process.

Economic Viability

The LAAO staff did not evaluate a project's "economic viability" as a prerequisite to HELP funding as required. Under the Act and the HELP guidance, HUD staff were required to make this assessment based on the project's marketability, repair costs and financial viability, taking into consideration pre-quake vacancies, access to Section 8, and HUD's rejection of any pre-quake applications for assistance. Instead of providing specific criteria and procedures for the owners/agents and the HUD staff to follow to demonstrate and corroborate the economic viability test, the HELP guidance was limited to only general terms and appeared to shift the burden of compliance over to the owner. To accomplish this, HUD required the owner to certify to HUD for each HELP funded project that the LAAO approved MIOP would restore the property to economic viability as defined under Notice H 94-15.

The Headquarters person who drafted Notice H 94-15 told us that economic viability was not defined because he "*didn't think it necessary. Its subjective case by case.*" His understanding was contrary to the HELP guidance provided in the Assistant Secretary's October 26, 1994 memorandum clarifying Notice H 94-15 which stated,

"Before an application is approved for a HELP loan, the long term economic viability of the property must be assessed...Not all projects are economically viable, therefore, some of them should not be funded."

In fact, the Headquarters staff who drafted the HELP guidance commented in a March 30, 1994 electronic mail message to the LAAO acting loan management director that:

"I'm not sure how else to DOCUMENT evaluation of something as potentially subjective as "Economic Viability." However if anyone out there has other ideas or sees the matter differently, please let me know ASAP."

The Director of the Los Angeles Multifamily Hub agreed that conflicting instructions were provided but pointed out that both physical and economic viability, in normal times, are complicated and usually require the services of a professional appraiser. He also noted that in a disaster situation, economic

viability may need to be simplified to the point of assuming that if the project was working before the disaster, it will also work after the disaster.

Draw Down Process

Under HELP, the LAAO staff approved owner/agent draw requests without requiring pre-draw progress inspections or otherwise ensuring that project repairs were properly completed in accordance with the approved MIOP. Instead, HUD effectively removed the draw down safeguards in Notice H 94-15 by requiring the owner/agent to certify to the LAAO that the HELP funds previously drawn down had been spent in accordance with the MIOP requirements. As a result, the LAAO staff approved owner draw requests for the projects without reasonable assurance that the scope, type, and amount of labor and materials requested by the owner/agent were consistent with the LAAO approved MIOP and addressed known violations of HUD's housing quality standards.

Our external audits disclosed draw requests totaling over \$1.8 million were approved even though: (1) when combined with insurance proceeds they exceeded the approved MIOP costs; (2) the LAAO staff could not relate the requests to approved MIOP action items; and, (3) the LAAO had no assurance that previously noted housing quality standards violations had been corrected. Had the HELP program guidelines required the LAAO staff to reconcile owner/agent draws to the approved MIOP action items, conduct pre-draw inspections, and ensure that noted HQS violations had been corrected prior to draw approval, we believe that inappropriate draw requests could have been identified and properly resolved before they were approved.

An OIG external audit of three HELP assisted projects requested by the LAAO disclosed the owner diverted for personal use \$484,880 in HELP funds approved by HUD to make earthquake damage repairs for the projects. The completed external audit revealed evidence of fraud, false statements, and other irregularities committed by the owner that were referred to the Assistant United States Attorney. The LAAO staff also provided needed assistance in the conduct of this audit. Subsequently, the owner/agent was indicted on 16 counts and pled guilty on four felony counts, agreed to make restitution to HUD of between \$200,000 and \$350,000, pay an additional \$1 million in penalties to the United States Treasury, and received a sentence of 18 months in prison for his crimes. We believe that the results of this external audit reaffirm the need for HUD to devise and implement a disaster recovery plan with supporting systems which effectively protects and safeguards HUD funds from abuse.

HUD Did Not Enforce Legal And Reporting Requirements

We noted three areas where the LAAO did not enforce legal and reporting requirements of the HELP.

Environmental Requirements Were Not Met

Contrary to the environmental laws and regulations, the LAAO did not take appropriate action to ensure that the required

environmental reviews were performed before approving HELP funds for earthquake damaged HUD-associated projects. As a result, the LAAO approved HELP funds of over \$23 million for the 20 sampled projects without conducting any environmental reviews.

Under the Emergency Supplemental Appropriations Act of 1994, the Secretary was authorized to waive, or specify alternative requirements for, any provision of any statute or regulation to administer the HELP program, except for statutory requirements relating to fair housing and nondiscrimination, the environment, and labor standards.

Our review of 20 projects found no documentation showing that environmental reviews were done or verified by the LAAO staff. The HELP construction analyst advised that he did not review or verify that projects met the environmental review requirements. Further, he said that the professional engineers were responsible for conducting the reviews and the city would not have approved the final inspection if the requirements were not satisfied. Notwithstanding the fact that the city's inspections could have validated that the environmental reviews had been conducted, the LAAO HELP project files did not contain any such documentation. Therefore, the LAAO has no assurance that each HELP funded project was in compliance with HUD's environmental requirements. The Director of the Los Angeles Multifamily Hub acknowledged that environmental reviews and Section 3 employment programs discussed below should be decided before the next disaster, not during the event.

**Section 3
Requirements
Were Not Met**

The Assistant Secretary for Housing's October 26, 1994 memorandum reminded the LAAO staff that HELP recipients must comply with Section 3 requirements. Our review of 20 projects disclosed the LAAO staff approved and disbursed HELP funds without ensuring that owners/agents offered preferences to lower-income businesses and individuals for new jobs and contracting opportunities. This requirement is also referred to as "Section 3" requirements.

The Assistant Secretary's October 1994 memorandum described the Section 3 requirements and referenced 24 CFR Part 135, Employment Opportunities For Businesses And Lower Income Persons In Connection With Assisted Projects as contained in the Housing Act of 1968. The memorandum stated that all owners/agents who received HELP assistance must comply with Section 3 if: (1) the contractor(s) have not been selected, (2) the amount of HELP funds used for housing rehabilitation exceeds \$200,000, and (3) the repairs are for rehabilitation and construction work. Under Section 3, the owner is responsible for ensuring that to the greatest extent feasible, the procurement practices used encourage a preference for Section 3 businesses that train, hire, and employ low and very low income people. Our review of 20 projects disclosed that HELP funds totaling over

\$23 million for housing rehabilitation were approved and/or disbursed without ensuring the owners/agents complied with Section 3 requirements.

The LAAO construction analyst assigned to the HELP program advised that he did not conduct a review to determine if an owner/agent complied with the Section 3 requirements because HUD did not address the subject until a later date (October 1994) after most of the owners had already started the earthquake repairs. He stated further that HUD did not have sufficient staff to verify the owners' compliance.

Contracts, Reports, And Audits Not Amended Or Submitted As Required

Our review of 20 projects disclosed that the LAAO staff did not ensure that the owners/agents submitted or secured: (1) amended Financial Assistance Contracts (FAC) for 11 projects, (2) quarterly performance reports for four projects, and (3) independent public accountant (IPA) annual audits with Notice H 94-15 compliance certification for seven projects. In total, one or more of the deficiencies was noted for all of the 20 projects we reviewed.

Notice H 94-15 and the Financial Assistance Contract contained HELP reporting requirements for annual audits, cost and completion changes, quarterly reports and close-out procedures.

The LAAO staff stated reporting problems occurred mainly because there was insufficient staff resources to ensure that the owner/agent complied with the FAC and related reporting requirements. As a result, the LAAO does not have assurance that the contractual documentation executed for each HELP assisted project is accurate and complete and the IPA annual audits for each project were or are performed as required by the Rider To Financial Assistance Contract and Notice H 94-15 (HUD). Concerning the delinquent annual audits, the LAAO multifamily director advised that \$10,000 is being withheld from each project until an acceptable audit is received by the LAAO.

Ineligible And Questionable Uses Of Funds Were Identified

In order to assess the effect of the program weaknesses we selected 27 projects for review. We accomplished on-site external audits of 11 projects and desk reviews of the other 16. The results of those audits and desk reviews clearly show that the weaknesses discussed in this report allowed owners/agents to spend significant HELP funds for ineligible and/or questionable purposes. In summary, ineligible and/or questionable costs totaled \$7.1 million (25%) of the \$27.9 million in HELP funds that were approved for those 27 projects.

Causes

We attribute the problems that we found with the LAAO's disaster assistance to owners of projects damaged by the earthquake to be twofold. There was no existing plan that provided timely and clear procedures to be followed by

the LAAO personnel in providing assistance. In addition, there were insufficient personnel assigned to accomplish all tasks necessary to ensure that HUD funds were spent in accordance with applicable laws, regulations and other instructions.

No Existing Disaster Plan There was no plan in place that could be used to coordinate HUD's efforts with other agencies. The use of HUD's flexible subsidy program was the best under the circumstances; however, it was confusing for persons responsible for implementation of the HELP. As discussed in this finding the waivers coupled with numerous written and verbal instructions seemed to leave much open to individual employee's interpretation. As a result, there was no up-front plan as to how disaster assistance could be coordinated with other agencies and other programs. We believe that a disaster assistance plan for providing funds to restore projects to their previous pre-disaster condition is necessary.

Insufficient Personnel Contrary to the Federal Manager's Financial Integrity Act of 1982 and basic internal controls, HUD did not make available or assign enough qualified and trained staff to design and execute the procedures and controls needed to minimize program abuse. Only seven core LAAO staff members were assigned the responsibility for administering the HELP, conducting project inspections, reviewing and approving loans/grants, owner submitted draw down requests, etc. The LAAO staff received the temporary assistance of 24 staff members from the LAAO, SFO, the San Diego Office, the Denver Office, the Seattle Office, and Headquarters to administer the program and conduct project inspections. The Director of the Los Angeles Multifamily Hub also noted that the outside staff assistance provided was not substantial and did not encompass a significant length of time. In contrast, the City of Los Angeles hired 126 persons consisting of rehabilitation construction specialists, rehabilitation finance officers, and management assistants to administer a comparable HUD funded earthquake loan program.

According to an April 28, 1994 report entitled "Strategic Planning for Housing" issued to the LAAO/SFO by the Deputy Assistant Secretary for Multifamily Housing Programs, the LAAO housing staff's workload was overwhelming and that earthquake activities exacerbated routine processing in all areas. The report stated that the LAAO's 1994 fiscal year staffing shortfall was most severe in housing management where its on board strength was only 51.6 percent of staffing needs. The Director of the Los Angeles Multifamily Hub advised that the HELP staff worked many months after the program was initiated before any significant staffing relief was provided.

Conclusion Based on the facts available to HUD before and after the earthquake, we believe that HUD should not have attempted to use the understaffed LAAO personnel to administer the HELP program. In our opinion, the responsible and justified course of action would have been for HUD to (1) enter into collaboration agreements with other more capable and experienced

Federal, state, and local government agencies to operate the program and/or (2) secure the services of professional engineers and contractors who have disaster related experience to provide assistance as needed.

Unlike other Federal agencies and local governments that administered disaster assistance programs, HUD did not establish effective management controls to ensure that HELP funds were safeguarded and used for eligible project repairs or costs directly attributable to the earthquake and in compliance with the Act. These controls should have included (1) a standardized damage inspection and cost estimation/reporting system, (2) ready access to a sufficient number of qualified staff to conduct the property inspections, and (3) training on inspection methodology and documentation.

Headquarters has recently taken action to establish a disaster recovery program and has issued a guide book on HUD staff's functions and relationships with other agencies engaged in the disaster recovery process. We believe, however, there is a need for detailed planning and instructions to address problems that we found during this review.

AUDITEE COMMENTS AND OIG EVALUATION

The Acting General Deputy Assistant Secretary for Housing generally agreed with the finding and the recommendations. In written comments in response to our draft report (see Appendix A), he agreed to complement HUD's Disaster Recovery Guidebook with HUD-wide detailed guidance which would be provided to the program offices to assure that problems, such as those cited above, are avoided in the future. He also agreed to develop and implement a post review plan to recover any HELP funds that may have duplicated expenditures paid from other sources. Headquarters and the LAAO staff shall coordinate this effort so that adequate guidance and resources are available to implement the plan.

The Director of the Los Angeles Multifamily Hub provided written comments, information, and suggested revisions to the draft report.

Because the Acting General Deputy Assistant Secretary for Housing agreed with our recommendations and said that steps have been taken or were planned to implement them, we have no further comment. Also, we included the comments provided by the Director of the Los Angeles Multifamily Hub or have made specific revisions to our draft report to address his concerns.

RECOMMENDATIONS

We recommend you:

- 1A. Require all Assistant Secretaries whose programs/staffs can be expected to provide assistance to disaster victims in the future to develop plans that address known requirements. As a minimum, each plan should provide for:

Sufficient knowledgeable personnel to accomplish, coordinate, and oversee all aspects of the assistance to be provided;

Clearly stated policies and procedures that will provide reasonable and necessary safeguards against waste, fraud, and abuse of HUD funds including:

Thorough and complete damage assessments to include accurate repair cost estimates;

Thorough and complete inspections of completed work to ensure that work was accomplished as approved and funded;

Procedures that will ensure that HUD funds are not used to fund work/activities that are funded from other sources such as insurance, other HUD programs, or other agencies;

Procedures that will ensure funds are provided only for activities authorized by enabling legislation; and

Procedures that will ensure that reporting and legal requirements of enabling legislation are followed.

- 1B. Require the General Deputy Assistant Secretary for Housing to direct the Director of the Los Angeles Multifamily Hub to identify and recover all HELP funds that were a duplication of other funds.

Internal Controls

Controls Considered In planning and performing our audit, we obtained an understanding of the management controls relevant to our audit. Management is responsible for establishing effective internal controls. Internal controls, in the broadest sense, include the plan of organization, methods, and procedures adopted by management to ensure that its goals are met. Internal controls include the processes for planning, organizing, directing, and controlling program operations. They also include the systems for measuring, reporting, and monitoring program performance.

Risk Assessment We obtained an understanding of the internal controls through inquires, observations, and inspection of documents and records and determined the risk exposure. We focused our review on the internal controls related to: (1) design, implementation, and oversight of the HELP and (2) compliance with the HELP requirements and related laws. Based on our review, we found that there were significant weaknesses in the internal controls over both the design, implementation, and oversight of the HELP and compliance with its requirements (see Finding).

APPENDIX A

***HUD's Written Response To Draft Audit
Report***

APPENDIX B

**INSURANCE PROCEEDS NOT REPORTED
OR DETECTED BY HUD**

Project Name	Insurance Proceeds Not Reported To HUD	Insurance Proceeds Reported but Not Detected By LAAO	Total Insurance Not Reported To Or Detected By HUD
Oakwood Van Nuys	\$307,985		\$307,985
Park Parthenia		\$59,094	59,094
Sunset Apartments	283,128	347,735	630,863
Miramar Apartments	88,943		88,943
Hollywood Parkview		117,801	117,801
Totals	\$680,056	\$524,630	\$1,204,686

APPENDIX C

COSTS IN EXCESS OF INSPECTION REPORT ESTIMATES

Project Name	HUD Inspection Report		HUD Approved MIOP		HUD Approved Excess
	Date	Amount	Date	Amount ¹	Amount
Del Amo Gardens	11/3/94	\$68,000 ²	8/3/95	\$ 185,244	\$123,971 ³
Green Hotel	1/23/94	\$500	5/10/95	\$1,018,677 ⁴	\$233,820 ⁵
Kittridge I	2/15/94	\$288,000 ⁶	7/13/95	\$336,206	\$0 ⁷
Parkview Terrace	9/30/94	\$19,843 ⁸	10/27/95	\$163,719	\$144,500 ⁹
Total					\$ 502,291

¹ The amounts shown below are net of the residual receipts balance applied against the final LAAO approved MIOP for the project.

² LAAO construction analyst who completed the HELP inspection report for this project provided a total repair cost estimate of \$34,000; the LAAO construction analyst assigned to the HELP team, in turn, doubled the estimate to \$68,000 without consulting with the other analyst. The HELP analyst surmised that the analyst who prepared the original estimate was more acquainted with new construction costs and less familiar with the higher costs of property rehabilitation and therefore provided estimates that were too conservative. However, the LAAO analyst disagreed and asserted that his estimates were reasonable for rehabilitation. Further, he commented that the HELP analyst should have consulted with him before making the revision.

³ Amount represents questionable drywall repairs (\$27,833) and repairs/painting of stucco (\$96,138) totaling \$123,971.

⁴ Although the HELP inspection report showed only very minor damage, the LAAO approved additional funding of \$1,562,805 primarily to retrofit unreinforced walls of the building as required by the City of Pasadena. Release of residual receipt funds of \$545,669 and HELP funds of \$1,018,677 were approved to pay for the repair work.

⁵ Amount represents the additional drywall (\$34,320) and stucco costs (\$199,500) totaling \$233,820 allowed in excess of the initial MIOP amount approved by the LAAO.

⁶ Increased by \$88,000 from inspections done immediately after the earthquake.

⁷ No specific work questioned, however, HELP funds approved exceeded the inspection reports by \$48,206.

⁸ Increased by \$1,043 from inspection done immediately after the earthquake.

⁹ Amount represents questionable drywall repairs (\$65,800) and stucco repairs (\$78,700) totalling \$144,500.

APPENDIX D

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