

Testimony before the U.S. House of Representatives  
Committee on Appropriations  
Subcommittee on Transportation, Housing and Urban Development,  
and Related Agencies

“HUD Oversight and  
Management Issues”



Testimony of  
The Honorable David A. Montoya  
Inspector General  
Office of Inspector General  
U.S. Department of Housing and Urban Development

March 16, 2017, 9:00 a.m.  
Room 2358A, Rayburn House Office Building

Chairman Diaz-Balart, Ranking Member Price, and Members of the Subcommittee, I am David A. Montoya, Inspector General of the U.S. Department of Housing and Urban Development (HUD). Thank you for the opportunity to discuss the Department's top management and performance challenges and my office's oversight of its programs and operations. As part of this written testimony we ask that the attached report entitled, "Inspector General's Statement Summarizing the Major Management and Performance Challenges Facing the U.S. Department of Housing and Urban Development for Fiscal Year 2017 and Beyond," dated October 17, 2016, be made part of the record.

### [The Department's Primary Mission](#)

The Department's primary mission is to create strong, sustainable, inclusive communities and quality, affordable homes for all. It accomplishes this mission through a wide variety of housing and community development grant, subsidy, and loan programs. Additionally, HUD assists families in obtaining housing by providing Federal Housing Administration (FHA) mortgage insurance for single-family and multifamily properties. It also oversees HUD-approved lenders that originate and service FHA-insured loans and Government National Mortgage Association (Ginnie Mae) mortgage-backed security issuers that provide mortgage capital. HUD relies on many partners for the performance and integrity of a large number of diverse programs. Among these partners are financial institutions that have delegated authority to issue FHA-insured mortgages, cities that manage HUD's Community Development Block Grant funds, public housing agencies (PHA) that manage assisted housing funds, and other Federal agencies with which HUD coordinates to accomplish its goals. HUD also has a substantial responsibility for administering disaster assistance programs.

### [The Office of Inspector General's Primary Mission](#)

The Office of Inspector General's (OIG) mission is to prevent and detect fraud, waste, abuse, and mismanagement in more than 300 programs and operations of the Department, but it also helps to promote economy, efficiency and effectiveness as well. We accomplish this by conducting independent, objective, and impactful audits, evaluations, and investigations. HUD OIG also plays a critical role in its information security, cybersecurity and program oversight for two HUD programs that contain sensitive private information relating to the multi-trillion dollar portfolios of the FHA and Ginnie Mae. Both programs have played imperative roles in supporting the national economy particularly during and after the economic downturn in 2008.

*Just this last year, HUD OIG's contribution realized financial benefits to the government of nearly \$8.5 billion, which represents a leading return on investment of 67 to 1 for every dollar spent on our work.* The work performed by our staff provides the means to keep the Secretary and the Congress fully and currently informed about the Department's problems and deficiencies while also highlighting best practices. We also make recommendations to improve operations and follow up with departmental officials on corrective actions.

We are committed to reducing fraud at the outset or at least halting it at the earliest opportunity. Protecting taxpayer dollars is one of the Inspector General's highest priorities in order to account for money going to the right place, doing what it was supposed to do, and having the results it was intended to have. We actively pursue financial and other fraud schemes in all of HUD's programs that can have a significant economic impact often at the expense of the American taxpayer.

### [Key Management and Performance Challenges Facing the Department](#)

In October 2016, OIG reported on ten key management and performance challenges facing the Department for fiscal year 2017 and beyond. The Department's management challenges are so interrelated that, in many cases, the Department will not be able to remedy one without first correcting another. This becomes a taxing challenge to determine which corrective action needs to come first or whether several need to be addressed simultaneously. Achieving HUD's mission continues to be an arduous task for its limited staff, given the agency's diverse programs, the thousands of intermediaries assisting the Department, and the millions of beneficiaries of its housing programs. The report discusses our assessment of ten key management and performance challenges facing HUD, which are:

1. Human capital management and financial management governance,
2. Financial management systems,
3. Digital Accountability and Transparency Act compliance,
4. Weaknesses in information technology security control,
5. Single-family programs,
6. Community planning and development programs,
7. Public and assisted housing program administration,
8. Administering programs directed toward victims of natural disasters,
9. Departmental enforcement, and
10. Operational and financial reporting challenges affecting Ginnie Mae.

For purposes of this testimony, however, I would like to highlight the most critical challenges which need to be corrected as soon as possible as they impact HUD's ability to address the remaining management challenges and ensure that the Department is operating effectively.

#### **Human Capital Management and Financial Management Governance**

For many years, one of HUD's major challenges has been to effectively manage its limited staff to accomplish its primary mission. HUD continues to lack a valid basis for assessing its human resource needs and allocating staff within program offices. Several studies have been completed on HUD's use of human capital by the U.S. Government Accountability Office (GAO) that point to a lack of human capital accountability and to insufficient strategic management as pervasive problems at HUD. To some extent, these human capital challenges have contributed to HUD's inability to maintain an effective financial management governance structure, which we have reported on for the last 3 years and which contributed to our issuing disclaimers of opinion as part of our annual audits of HUD's financial statements.

HUD continues to struggle with issues such as (1) the General Schedule classification system, (2) mission-critical skills gaps, (3) performance management, and (4) employee engagement. More than 43 percent of HUD career permanent employees onboard as of September 30, 2014, will be eligible to retire by 2019. Given this statistic, HUD will need to ensure that it has steps in place to fill the critical skills gap needed to ensure continuity of business and mission fulfillment.

#### **Financial Management Governance of HUD**

HUD continues to struggle to establish and implement effective financial management governance as required by the Federal Managers' Financial Integrity Act of 1982 and the Chief Financial Officers Act of 1990. In our latest financial statement audit report, we expressed a disclaimer of opinion due to HUD's inability to deliver its financial statements in a timely manner and other unresolved audit matters. In addition, in our report on internal control, we reported eleven material weaknesses, seven significant deficiencies in internal controls, and five instances of noncompliance with applicable laws and regulations.<sup>1</sup> Several of the other material weaknesses and significant deficiencies had causes that were attributed in part to weaknesses in HUD's financial management governance structure. HUD has been unable to receive an opinion on its financial statements for the past three years.

#### **Weak Internal Controls Over Financial Reporting Led to Errors and Delays in the Preparation of Financial Statements and Notes**

The absence of key financial staff with appropriate skills, background and knowledge to oversee the preparation of HUD's financial statements continues to contribute to the persistence of disclaimers in the Department's annual financial statement audits and will do so for the foreseeable future until the skillset is

---

<sup>1</sup> Audit Report 2017-FO-0004, Fiscal Years 2016 and 2015 (Restated) U.S. Department of Housing and Urban Development Consolidated Financial Statements Audit, November 18, 2016.

onboard. As a further consequence, this year the Department had to reissue its fiscal year 2016 and 2015 consolidated financial statements due to material errors and other discrepancies.

On November 15, 2016, we reported that HUD was unable to provide final financial statements and accompanying notes in time for OIG to obtain sufficient, appropriate evidence that they were free from material misstatement. The delays were due to insufficiently designed and implemented financial reporting processes and internal controls relating to HUD's transition of its core financial system to a shared service provider. Additionally, late restatements performed by HUD's component entities, FHA and Ginnie Mae, contributed to the delay in providing final consolidated financial statements. For these and other reasons, we were unable to provide an opinion on HUD's fiscal year 2016 and 2015 financial statements.

Despite having to disclaim on HUD's fiscal year 2016 and 2015 financial statements and notes, OIG continued its review of the financial statements and notes and identified additional material errors and misstatements. The results of that review are contained in a recently released report and provide updates to the material weakness reported previously. The financial statements and accompanying notes contained material errors totaling \$557 million and \$278.5 billion, respectively. We identified significant differences in amounts presented between what was submitted to us on November 10, 2016 and certified by HUD as its "final" consolidated financial statements and what was published in HUD's 2016 Agency Financial Report (AFR) just five days later.

We also identified differences of \$19.5 billion in amounts presented in three note disclosures between what was submitted to us for audit and what was published in HUD's AFR. The errors occurred due to weaknesses in HUD's internal controls over financial reporting. OIG notified HUD management in early December 2016 and requested that they perform their own review. HUD concluded their review and agreed with OIG that the errors contained in the financial statements warranted the need to reissue the statements in order to correct the errors. HUD withdrew its AFR and reissued its final AFR "as of March 1, 2017." While HUD attributed the reissuance to the need "...to address presentation issues," in reality, the revisions to the financial statements were the result of the need to correct material and pervasive errors.

We found that well over half of the financial statement notes contained errors with an approximate absolute value totaling \$278.5 billion. Of the \$278.5 billion in errors, \$159.4 billion was due primarily to (1) incorrect data entry, (2) omission of restated balances, or (3) incorrect data provided by HUD's component entities (FHA and Ginnie Mae). The remaining \$119.1 billion were due to inappropriate rounding adjustments. We found several instances in which rounding was performed to the nearest billion and hundred billion instead of the nearest million as required. This practice caused amounts to not agree with supporting files or underlying FHA and Ginnie Mae information. Some of the errors identified flowed through to other note line items or note columns and caused errors in the totals presented. The absolute value of these additional errors was not included in our total.

### **Transition to a Federal Shared Services Provider for Financial Management Services and a Policy and Procedure Framework**

The errors with financial audit reports described above occurred because of an inability to design and implement an adequate system of internal controls over financial reporting necessary to mitigate the challenges and risks in its complex financial reporting process. These challenges and risks were exacerbated with the transition of HUD's legacy general ledger application to a shared service provider. As discussed below in my testimony, this move replaced known processes with undefined or untested processes. The transition also increased the workload on HUD's financial reporting division, and in an attempt to remedy the issue, HUD's management outsourced some of its roles to staff and contractors who were unfamiliar with HUD's financial reporting processes and did not receive adequate training. Rushed implementation in order to meet transition deadlines set by management and inadequate monitoring contributed to the problems despite warnings that processes were not proceeding well.

During 2016, GAO and OIG reported on a number of issues related to this transition and have attributed the cause of many of these issues to weaknesses in governance including outdated or incomplete policies and procedures and a lack of adequate information and communication among key groups. Program office accounting policies and procedures had at times been developed without adequate input from the Office of the Chief Financial Officer (OCFO) due to broad delegation to program office personnel. HUD also lacked documented policies to ensure the quality and consistency of program evaluations. To improve the continuity of accounting policies and procedures in a changing environment, policies and procedures should be centrally located and easily accessible to staff. The lack of a policy framework has hindered, and will continue to hinder, efforts to adapt to changes in a timely manner.

### **Financial Management Systems**

Annually since 1991, OIG has reported on the lack of an integrated financial management system, including the need to enhance FHA's management controls over its portfolio of integrated insurance and financial systems. HUD has been working to replace its current core financial management system since fiscal year 2003. The previous project, the HUD Integrated Financial Management Improvement Project (HIFMIP), was based on plans to implement a solution that replaced two of the applications currently used for core processing. In March 2012, work on HIFMIP was stopped, and the project was later canceled. This attempt to use a commercial shared service provider to start a new financial management system failed after more than \$35 million was spent on the project. Our review determined that OCFO did not properly plan and manage its implementation of the project.

### **New Core Project**

In the fall of 2012, HUD started the widely publicized "New Core" Project to move its core financial system to a shared service provider at another Federal agency, the first cabinet-level agency to do so. We have completed four audits of this project. The most recent, published in February 2017,<sup>2</sup> found that HUD's transition to the federal shared service provider did not significantly improve the handling of its financial management transactions. Weaknesses identified with the controls over the New Core Interface Solution and the conversion to the federal shared service provider's procurement application contributed to this issue. A year after the transition, HUD had inaccurate data resulting from the conversions and continued to execute 97 percent of its programmatic transactions using legacy applications. The transition increased the number of batch processes required to record programmatic financial transactions and introduced manual processes and delays for budget and procurement transactions. In addition, the interface program that allowed for and translated the financial transactions between HUD and the federal shared service provider was not covered under HUD's disaster recovery plan.

These conditions occurred because of funding shortfalls (due to delays because of a non-submission by HUD of an expenditure plan and to cuts in modernization and enhancement funding) as well as HUD's decisions to (1) separate phase 1 of the project into smaller releases, (2) move forward with the implementation despite unresolved issues, and (3) terminate the project before its completion. These system issues and limitations inhibited HUD's ability to produce reliable, useful, and timely financial information. While HUD management considered its New Core Project implementation successful, we differ in our assessment. HUD acknowledged that all of the originally planned capabilities were not deployed. Moreover, HUD will need to pursue new projects to address the functionalities that were not achieved, requiring additional time and funding. In April 2016, HUD ended the New Core Project after spending \$96.3 million; however, the transition did not allow HUD to decommission all of the applications it wanted to or achieve the planned cost savings.

Since 2003, HUD has spent more than \$131 million on two separate projects to replace its core financial system. HUD encountered significant challenges with its transition to the shared service provider. Funding shortfalls as well as the impact of HUD's decisions regarding the project ultimately impaired the

---

<sup>2</sup> Audit Report 2017-DP-0001, HUD's Transition to a Federal Shared Service Provider Failed to Meet Expectations, February 1, 2017

effectiveness of HUD’s internal controls and the efficiency and effectiveness of its operations. Despite evidence that HUD was not prepared to transition key functions without putting departmental operations in possibility of disruption, financial management and information technology governance weaknesses led management to disregard or underestimate the risks at hand. As HUD assesses future financial management improvements, it needs to ensure that each project is properly planned and managed, its objectives are sequentially met during implementation, and additional funding spent is appropriate. Our findings were consistent with conclusions reached in two GAO reports, one issued in July 2016<sup>3</sup> and the other in February 2017.<sup>4</sup>

### **Outdated Information Technology Systems**

Overall, funding constraints diminished HUD’s ability to integrate updated application systems and replace and deactivate legacy systems. Limited progress has been made in modernizing applications and enhancing capabilities to replace manual processes. As a result, many legacy systems remain in use. As workloads continue to gain complexity, it becomes challenging to maintain these legacy systems, which are 15 to 30 years old, and ensure that they can support the current market conditions and volume of activity. The use of aging systems has resulted in poor performance, high operation and maintenance costs, and increased susceptibility to security breaches. As part of our annual review of information systems controls in support of the financial statements audit, we continue to report weaknesses in internal controls and security regarding HUD’s general data processing operations and specific applications. The effect of these weaknesses is that the completeness, accuracy, and security of HUD information is at risk of unauthorized access and modification. As a result, HUD’s financial systems continue to be at risk of compromise.

HUD’s voucher and project-based Section 8 and public housing programs accounted for 78 percent of HUD’s 2016 enacted discretionary budget authority of \$47.2 billion. Also, HUD’s FHA program has insured more than 33.5 million mortgages valued at more than \$3.8 trillion since 1980. HUD has 20 major information systems supporting the management of those programs, and those systems contain in excess of 300 million records on program recipients – with data fields that include Social Security numbers; birth dates; address history; income; financial; dependent; and in those cases in which disability and medical status is considered, health-related data. In short, the management information systems supporting these four critically important HUD programs contain personally identifiable information for all American citizens who received HUD-sponsored housing assistance, lived in public housing, and obtained an FHA-insured mortgage, including such information on all dependents within those households.

We are also concerned about the current state of FHA’s information technology (IT) systems and the lack of systems capabilities and automation to respond to changes in business processes and the IT operating environment. In August 2009, FHA completed the Information Technology Strategy and Improvement Plan to address these challenges, which identified FHA’s priorities for IT transformation. The plan identified 25 initiatives to address specific FHA lines of business needs. Initiatives were prioritized, with the top five relating to FHA’s single-family program. The FHA transformation initiative was intended to improve the Department’s management of its mortgage insurance programs through the development and implementation of a modern financial services IT environment. The modern environment was expected to improve loan endorsement processes, collateral risk capabilities, and fraud prevention. However, to date, few initiatives have been completed because of a lack of funding. The transformation team is in operations and maintenance mode for the few initiatives that have been implemented and has limited capability to advance with the project due to the continued lack of funding.

---

<sup>3</sup> Report GAO-16-656, Financial Management Systems – HUD Needs to Address Management and Governance Weaknesses That Jeopardize Its Modernization Efforts, July 2016

<sup>4</sup> Report GAO-17-281, Information Technology – HUD Needs to Address Significant Weaknesses in Cost Estimating Practices, February 2017

## **Digital Accountability and Transparency Act Compliance**

One of the Department's major emerging management challenges is compliance with the Digital Accountability and Transparency Act of 2014 (DATA Act). In our August 2016 DATA Act readiness review, we found that HUD was not on track to meet the DATA Act's requirements.<sup>5</sup> The DATA Act builds on agency transparency reporting requirements established by the Federal Funding Accountability and Transparency Act of 2006 (FFATA) and has an implementation date of May 2017. HUD's efforts to comply with the DATA Act have been hindered by management turnover and indecision, resource limitations, and disparate IT systems that reside on different platforms with dissimilar data elements.

### **Compliance Milestones and Human Resource Limitations**

Key HUD milestones have been delayed. Specifically, HUD had not completed its inventory of data elements or the mapping of agency data to the DATA Act schema as of December 16, 2016. To assist agencies with implementation, OMB and Treasury issued a playbook with eight key steps to help agencies fulfill the requirements of the DATA Act, and OMB issued a memorandum detailing key guidance. HUD's project plan dates for milestones, including completing an agency data element inventory or mapping agency data to DATA Act schema, significantly exceeded previous Treasury and OMB guidance, and according to GAO, HUD's project plan dates may not have been sufficiently reviewed and approved by OMB and Treasury.<sup>6</sup> HUD submitted updated implementation plans to OMB and Treasury in August 2016.

Competing departmental priorities such as HUD's transition to a shared service provider for financial management services have worsened existing resource limitations. Human capital resources are limited compared to the level of effort required to modify systems and perform the required data inventory and mapping. While Treasury may provide resources to supplement HUD's resources and support HUD's compliance efforts, substantial challenges remain.

### **Information System Weaknesses and Data Quality Issues**

HUD has experienced challenges with DATA Act (and FFATA) implementation due to the Department's reliance on many financial systems with differing technologies and data elements. To provide quality spending data, agencies will be required to make available financial obligation and outlay data and award-level data based on agency financial systems. As we have previously reported in our annual financial statement audit, HUD's legacy systems have hindered efficient and effective financial reporting. As the DATA Act requires the use of agency financial systems, many of the issues reported in the financial systems management challenge also apply.

In addition, HUD has been unable to resolve data quality issues that have impeded the complete and accurate reporting of departmental contract, grant, loan, and other financial assistance awards in USAspending.gov. We concluded that data quality issues limited HUD's ability to map agency data to the established DATA Act schema, including assigning the Federal Award Identification Number.

### **Weaknesses in Information Technology Security Controls**

As touched on briefly earlier in discussions of IT systems, HUD conducts hundreds of thousands of transactions with the American public daily and is responsible for safeguarding hundreds of millions of records containing the personal information of private individuals. However, HUD continues to face both long- and short-term challenges as it strives to modernize its legacy systems, adequately secure its IT infrastructure, and properly protect sensitive data. HUD has not adequately planned for its future IT and IT security needs. One of two primary HUD infrastructure services contracts was recently re-awarded using a long-term sole-source contract, while the second has been in a period of transition since fiscal year 2014, creating risk for HUD. Further, a significant number of critical HUD applications are legacy systems that

---

<sup>5</sup> 2016-FO-0802, Independent Attestation Review: U.S. Department of Housing and Urban Development, DATA Act Implementation Efforts, dated August 26, 2015

<sup>6</sup> GAO-16-698, DATA Act – Improvements Needed in Reviewing Agency Implementation Plans and Monitoring Progress, July 29, 2016



are increasingly difficult to maintain and present security risks that HUD will be challenged to mitigate without modernization. More than 400 HUD IT products are running on unsupported platforms, increasing the risk of unknown and unpatchable vulnerabilities. Legacy systems are difficult or unable to migrate to cloud technology, further complicating HUD's long-term efforts to modernize and secure its systems and data while creating efficiencies and cost savings.

HUD has taken some initial steps to address these long-term challenges. HUD realigned the functions of the Office of the Chief Information Officer (OCIO) to better support the business of the Department and filled several key positions. However, we are concerned that turnover in IT leadership roles, including that of the enterprise architect, the vacancy of the IT Chief Operations Officer position since December of 2014, the retirement of the Chief Information Security Officer in March 2017, and the conclusion of the CIO's tenure in January 2017, will impinge HUD's momentum. Major HUD initiatives have been negatively impacted by recent turnover in key positions and loss of technical expertise.

HUD has begun key initiatives, such as the development of several long-term plans, including an enterprise architecture roadmap aimed in part to guide modernization efforts; a Cybersecurity Framework to address IT security program deficiencies; and a recently implemented enterprise incident handling program to improve security incident detection capabilities. However, notable change and implementation of these initiatives are not anticipated to be fully realized until fiscal year 2017 and beyond with parts of the enterprise architecture roadmap being halted and re-planned. Successful implementation of these plans will be directly dependent upon HUD's ability to instill accountability, implement performance measures, and obtain adequate technical expertise and resources. In the process of outsourcing infrastructure and application maintenance and support, HUD has divested itself of much of its own technical expertise and continues to face significant staffing challenges. For example, an organizational chart provided to OIG during its fiscal year 2016 Federal Information Security Modernization Act (FISMA) evaluation showed that 16 of the 36 key IT managerial and supervisory positions stationed at HUD headquarters were either vacant (11) or filled by temporary "acting" personnel (5) during fiscal year 2016 and continues to be the case in the first quarter of fiscal year 2017. This condition significantly challenges HUD's ability to manage and perform vendor oversight of its technology infrastructure and conduct technical assessments. It has also resulted in HUD's extensive dependence on decentralized IT contracts throughout the HUD IT environment.

Our annual evaluation of HUD's IT security program for fiscal year 2016, as mandated by FISMA, revealed continual IT security improvements, but extensive noncompliance with Federal IT guidance continues. As shown in OIG's fiscal year 2016 FISMA report, HUD was 60 percent compliant with the FISMA metrics on which OIG reports to OMB, compared to 46 percent compliant in fiscal year 2015. HUD showed progress in several of the eight FISMA reportable domains, however, HUD continues to have an extensive lack of effectiveness (less than 50 percent) in the risk management and contractor systems oversight programs. HUD is showing some progress in remediating these deficiencies, however, it has 59 open FISMA evaluation recommendations spanning several FISMA evaluations from 2013 through 2016. These recommendations need to be addressed to rectify longstanding security weaknesses. Further, the privacy program has an additional 21 open recommendations for the fiscal years 2013 through 2016 evaluation period, with no progress made on those recommendations within the last fiscal year.

To ensure improvement in the above areas and reduce vulnerabilities to the IT security environment, all HUD program offices will need to collaborate effectively and establish ownership and oversight of IT security controls. HUD's fiscal year 2016 IT funding decreased 16.3 percent from fiscal year 2015 and again decreased another 16 percent for fiscal year 2017, which continues to impact agency modernization and IT security efforts. With the constrained budgets and the hiring freeze, HUD will be challenged to fund the operation of current systems while also initiating projects to upgrade legacy applications and improve security.

Further, our evaluations have revealed a lack of enterprise risk management, which directly affects HUD's ability to manage all IT risks using a holistic framework and hinders HUD's IT modernization efforts.



HUD's OCIO had begun addressing this weakness by developing an IT Risk Management Office, but unless HUD develops an enterprise-wide risk management program with one management approach, it will not be able to appropriately prioritize all IT risks.

### **Single-Family Programs**

FHA's single-family mortgage insurance programs enable millions of first-time borrowers and minority, low-income, elderly, and other underserved households to benefit from home ownership. HUD manages a growing portfolio of single-family insured mortgages exceeding \$1.2 trillion. Effective management of this portfolio represents a continuing challenge for the Department.

### **Preserving the FHA Fund**

Before fiscal year 2015, FHA's insurance fund had been below its legislatively mandated 2 percent capital ratio for the previous 6 years. However, beginning in fiscal year 2015, the fund met its threshold target capital ratio once again.<sup>7</sup> According to the 2016 actuarial study, the fund had an estimated economic value of \$35.27 billion. Based on the 2016 projections, the fund is expected to maintain a capital ratio above the threshold limit and will gradually build reserves over time if the forecasted trend continues. Restoring the fund's reserves and finances has been a priority for HUD, and it has increased premiums, reduced the amount of equity that may be withdrawn on reverse mortgages, and taken other steps to restore the financial health of the fund.

The Department must make every effort to prevent or mitigate fraud, waste, and abuse in FHA loan programs. OIG continues to take steps to help preserve the FHA insurance fund and improve FHA loan underwriting by partnering with HUD, the U.S. Department of Justice, and multiple U.S. Attorney's offices nationwide in a number of FHA lender civil investigations. In some instances, these investigations involve, not only the underwriting of FHA loans, but also the underwriting of conventional loans and government-insured loans related to Federal programs other than FHA. For those investigations that involved OIG's assistance on the FHA-related part of the cases, the Government has reached civil settlements yielding more than \$14.6 billion in damages and penalties in the last 5 fiscal years.

For the FHA-insured loans, results in the last 5 fiscal years have shown that a high percentage of loans reviewed should not have been insured because of significant deficiencies in the underwriting. As a result, the Government has reached civil settlements regarding FHA loan underwriting totaling \$4.9 billion for alleged violations of the False Claims Act; the Financial Institutions Reform, Recovery, and Enforcement Act; and the Program Fraud Civil Remedies Act. Nearly \$3.2 billion of the \$4.9 billion is of direct benefit to the FHA insurance fund. Ongoing investigations are expected to lead to additional settlements that will significantly help recover losses to the FHA insurance fund.

### **Monitoring Lenders and FHA Claims**

In spite of some positive steps, we remain concerned about HUD's resolve to take the necessary actions going forward to protect the FHA insurance fund. HUD is often hesitant to take strong enforcement actions against lenders because of its competing mandate to continue FHA's role in restoring the housing market and to ensure the availability of mortgage credit and continued lender participation in the FHA program.

### **Downpayment Assistance and Premium Pricing**

As a result of a referral from the Department and through the course of four audits,<sup>8</sup> we learned about, and continue to be concerned with, a funding arrangement for downpayment assistance to FHA borrowers,

---

<sup>7</sup> Our calculation of the capital ratio was based the information we obtained from FHA's final actuarial report, published in November 2015, and using the amortized insurance-in-force as the denominator.

<sup>8</sup> Audit Report 2015-LA-1010, LoanDepot's FHA-Insured Loans With Golden State Finance Authority Downpayment Assistance Gifts Did Not Always Meet HUD Requirements, September 30, 2015; Audit Report 2015-LA-1009, LoanDepot's FHA-Insured Loans With Downpayment Assistance Funds Did Not Always Meet HUD Requirements, September 30, 2015; Audit Report 2015-LA-1005, NOVA Financial & Investment Corporation's FHA-Insured Loans

which we believe violates the National Housing Act regarding prohibited sources for downpayment assistance. Specifically, we learned that NOVA and loanDepot had entered into triparty agreements among the FHA lender, a housing finance agency (HFA), and U.S. Bank, a Ginnie Mae issuer. These agreements were part of a scheme in which the HFA would provide downpayment assistance in a grant or loan to the borrower. The FHA lender would provide the primary financing to the borrower in the form of an FHA-insured loan, which included the downpayment assistance at closing. Upon origination, the FHA loan would be sold to U.S. Bank, which would reimburse the FHA lender for the downpayment, securitize the mortgage loan through Ginnie Mae security, and service the mortgage. Although not a party to the FHA loan, the HFA required the FHA lender to inflate the interest rate on the loan.

The HFA providing the downpayment assistance had previously determined what interest rate above the market interest rate would be necessary on the FHA loan to net a premium payment from the investor when the loan was securitized. The HFA uses funds generated from the sale of the security to reimburse U.S. Bank for the downpayment and pay other program-related fees. The HFA, U.S. Bank, and the FHA lender agreed to charge the borrower additional securitization, administration, and tax fees as part of the origination totaling \$300-\$600, which would not have otherwise been paid on the lower interest rate mortgage. We determined that U.S. Bank had similar agreements with FHA lenders and HFAs around the country.

Since the issuance of the first and later similar audits, we have attempted to resolve the findings and recommendations with the Department to no avail. HUD has failed to recognize disturbing parallels to the seller-funded downpayment assistance arrangements practiced from the late 1990s to 2008, which caused wide-scale problems for FHA that continue to be felt today (see earlier discussion relating to the FHA fund's capital ratio going below statutorily mandated levels and its multi-year effort to recover). On May 25, 2016, the Department issued its decision regarding our disagreement over the HFA's downpayment assistance and premium pricing in the NOVA audit. The decision relied heavily on a HUD, Office of General Counsel, legal opinion released publicly by HUD in the middle of our audit work that did not review the specific details or funding structure of borrower-financed downpayment assistance arrangements. Instead, the legal opinion was meant to opine on HFAs as permissible sources of downpayment assistance since they are government entities. The opinion also failed to provide what would give HUD the legal authority through rulemaking and policy interpretation to ignore specific congressionally enacted statutory requirements. While HFAs are permissible sources, we continue to strongly disagree with HUD's opinion because it ignored the main issue that downpayment assistance provided or reimbursed directly or indirectly by a party that benefits financially from the transaction is expressly prohibited under statute and negatively affects the borrower.

HUD's requirements, guidelines, and interpretations on downpayment assistance from government entities allow for increased risk to the FHA Single Family Mortgage Insurance program and have enabled the creation and growth of questionable borrower-financed downpayment assistance schemes. Current requirements and guidelines provide little oversight and give HFAs broad access to the FHA program that other entities do not have. For example, a comparison of Handbook 4155.1 provisions in effect at the time of the OIG audits to the provisions in Handbook 4000.1, which were modified during the pendency of the OIG audit work, reveals major changes in policy. Handbook 4000.1 was modified to strictly define premium pricing and eliminated the prohibition on premium pricing as a source of funds for the borrower's minimum required investment that was previously in Handbook 4155.1.

---

With Downpayment Assistance Gifts Did Not Always Meet HUD Requirements, July 9, 2015; and Audit Report 2017-LA-0003, HUD Failed To Adequately Oversee FHA-Insured Loans With Borrower-Financed Downpayment Assistance, March 3, 2017

## Public and Assisted Housing Program Administration

### Environmental Review Requirements

HUD has a duty to ensure that its projects are free of environmental hazards. As a result of recent OIG reports,<sup>9</sup> HUD began providing more training to staff and grantees and implemented processes to improve its training program and curriculum to better support all program areas. Also, HUD was piloting a recently developed electronic data system, HUD's Environmental Review Online System (HEROS), which is part of HUD's transformation of IT systems. HEROS will convert HUD's paper-based environmental review process to a comprehensive online system that shows the user the entire environmental process, including compliance with related laws and authorities. It will allow HUD to collect data on environmental reviews performed by all program areas for compliance. HUD's Office of Environment and Energy has also implemented an internal process within HEROS to track findings, which will allow the program areas to focus training on recurring issues. Risk-based compliance monitoring by HUD's field staff will target the highest risk PHAs and responsible entities based on identified factors and will result in improved compliance with environmental review requirements as well as align Public and Indian Housing with previously OIG-endorsed models within HUD.

While HUD has made improvements, it faces several challenges, including a lack of resources, unclear guidance, and a perceived lack of authority to impose corrective actions or sanctions on responsible entities. Until HUD fully addresses these needed improvements, inadequate environmental reviews may contribute to an increased risk in the health and safety of the public and possible damage to the environment. For the five Office of Public Housing field offices we visited, PHAs spent almost \$405 million for activities that either did not have required environmental reviews or had reviews that were not adequately supported.

We are auditing HUD's oversight of safe water requirements for FHA-insured loans nationwide. We're conducting the audit because recent news reports have identified elevated levels of lead contamination in water across the country and our recent audit of HUD's oversight of FHA-insured loans on properties in Flint, MI determined that HUD did not ensure that lenders verified that properties in Flint that were approved for FHA mortgage insurance had a continuing and sufficient supply of safe and potable water. Our audit objective is to determine whether HUD provided sufficient guidance and oversight to ensure that properties approved for mortgage insurance had a continuing and sufficient supply of safe and potable water. As part of the audit, we are reviewing Federal guidance regarding water quality issues and the requirements for public notifications, relevant news reports, relevant reports from GAO and Environmental Protection Agency, and publicly available information about water systems that have found elevated levels of lead in tap water. We also plan to review a sample of loan files for properties that are served by seven water systems for which we identified publicly available notifications of water contamination. Our review will determine whether the files contain evidence of water testing or other discussion related to the water quality.

### Operational and Financial Reporting Challenges Affecting Ginnie Mae

Managing counterparty risks and strengthening Ginnie Mae's financial management accountability have been and continue to be the major challenges affecting Ginnie Mae in fiscal year 2016 and in the coming

---

<sup>9</sup> Audit Report 2015-FW-0001, HUD Did Not Adequately Implement or Provide Oversight To Ensure Compliance With Environmental Requirements, June 16, 2015; Audit Report 2014-FW-0005, Improvements Are Needed Over Environmental Reviews of Public Housing and Recovery Act Funds in the Detroit Office, September 24, 2014; Audit Report 2014-FW-0004, Improvements Are Needed Over Environmental Reviews of Public Housing and Recovery Act Funds in the Greensboro Office, July 14, 2014; Audit Report 2014-FW-0003, Improvements Are Needed Over Environmental Reviews of Public Housing and Recovery Act Funds in the Columbia Office, June 19, 2014; Audit Report 2014-FW-0002, Improvements Are Needed Over Environmental Reviews of Public Housing and Recovery Act Funds in the Kansas City Office, May 12, 2014; and Audit Report 2014-FW-0001, The Boston Office of Public Housing Did Not Provide Adequate Oversight of Environmental Reviews of Three Housing Agencies, Including Reviews Involving Recovery Act Funds, February 7, 2014

years. Key factors that contributed to these challenges include the rise of nonbanks, lack of resources, inadequate financial systems, and lack of a fully functioning financial management governance framework.

### **Managing Counterparty Risks**

Ginnie Mae mortgage-backed securities (MBS) are the only such securities to carry the full faith and credit guaranty of the United States Government. If an issuer fails to make the required pass-through payment of principal and interest to MBS investors, Ginnie Mae is required to assume responsibility to do so.

### **Monitoring of Nonbank Issuers Presents Challenges for Ginnie Mae**

By the end of fiscal year 2016, Ginnie Mae had made guaranties on loans with a remaining principal balance (RPB) of approximately \$1.73 trillion. Through these guaranties, Ginnie Mae facilitates capital inflows to the U.S. housing market. Since 2010, Ginnie Mae's RPB has grown by approximately 62 percent. During this time, Ginnie Mae's business has increasingly relied on nonbanks, which now represent a majority of issuances annually.<sup>10</sup> As OIG and Ginnie Mae have previously noted, the increase in the number of nonbank issuers and their complexity present a challenge for monitoring efforts. We are highlighting monitoring challenges in a recently issued Topic Brief so HUD leadership is aware of, and can be better prepared, to address them. It is imperative that Ginnie Mae has the appropriate staffing with the skills, knowledge, and abilities to monitor nonbanks. OIG is focusing on Ginnie Mae's capacity to monitor nonbanks with an ongoing audit.

### **Financial Reporting Challenges**

Although Ginnie Mae has made progress in financial management governance issues in fiscal year 2016, there remain significant issues. For the third year in a row, our annual financial statement audit resulted in a disclaimer of opinion due to Ginnie Mae's nonpooled loans assets being unauditible. In 2016, Ginnie Mae acknowledged that these asset balances are not supportable and not in accordance with generally accepted accounting principles. Ginnie Mae has reengaged its financial reporting and audit readiness contractor to assist in the development of its loan-level accounting system and related infrastructure.

With the approval of OMB and Congress, Ginnie Mae has significantly increased its management capacity. The total number of Ginnie Mae full-time employees increased from 89 in fiscal year 2012 to 140 at the end of fiscal year 2016. However, Ginnie Mae continues to have issues with staffing. Ginnie Mae continues to rely heavily on third-party contractors to perform almost all key operating loan servicing, pool processing, and other functions. It is vital to the country's larger financial health that Ginnie Mae be able to significantly increase staffing and benefit from a pay structure that will allow it to attract and hire individuals with the needed skills, knowledge, and abilities to manage a multi-trillion-dollar program.

The underlying accounting problems that are preventing Ginnie Mae from obtaining an unqualified audit opinion will continue until accounting policies and procedures have been finalized and fully implemented and Ginnie Mae is appropriately staffed with the needed skills to manage its accounting requirements. Ginnie Mae will continue to face challenges in this dynamic environment due to the shift in its business model. Ginnie Mae and HUD have yet to adequately respond to this new concept and properly mitigate these risks by implementing a sound infrastructure and control environment. Ginnie Mae has stated that it would require a significant investment in technology, infrastructure, and people spanning multiple years to make its significant financial assets auditible. HUD and Ginnie Mae need to engage with Congress to lay out priorities, accelerate needed human capital and infrastructure improvements, and mitigate risks faced by Ginnie Mae.

---

<sup>10</sup> GAO has defined banks as "bank holding companies, financial holding companies, savings and loan holding companies, insured depository institutions, and credit unions, including any subsidiaries or affiliates of these types of institutions." Nonbanks are any other entities.

## **Work Where the Department and the OIG Collaborate to Ensure Oversight and Compliance with Rules and Regulations**

### **OIG – Public and Indian Housing (PIH) Collaboration: Monitoring Small and Very Small Housing Agencies**

HUD faces challenges in monitoring PHAs when more than 2,000 of its 3,000 PHAs are small or very small. Since these PHAs receive approximately 12 percent (or an estimated \$732 million) of HUD's \$6.1 billion in low-rent authorized funding, it creates oversight burdens and costs for both HUD and PHAs that are disproportionate to the number of families these PHAs serve. In a recent report,<sup>11</sup> we found that a significant cause of the deficiencies identified in small and very small PHAs was that executive directors and boards of commissioners either chose to ignore requirements or lacked sufficient knowledge to properly administer their programs. In 2015, HUD launched an online training course, Lead the Way, which is designed to help PHAs' boards and staff fulfill their responsibilities in providing effective governance and oversight. However, we remain concerned that the administrators, board members, and local officials do not have the resources or information available to them to properly administer their programs. Further, we are concerned that without additional oversight or outreach, there is increased risk of fraud, waste, and abuse going undetected at these entities.

In an effort to promote awareness and enhance our collaborative work with Ms. Lourdes Castro-Ramirez, then Principal Assistant Secretary, PIH, HUD OIG has issued several industry advisories that highlight areas of risky and illegal activities that jeopardize the integrity of otherwise legitimate housing programs. The advisories are posted on our Web site at [www.hudoig.gov/fraud-prevention](http://www.hudoig.gov/fraud-prevention). Several advisories were directly related to PHAs and were emailed to executive directors. A letter also introduced Lead the Way, as a training module for board members and executive staff.

### **OIG-Community Planning and Development (CPD) Collaboration: Monitoring Grantees and Sub-Grantees**

Recently, OIG and CPD began a joint collaboration to assist grantees and subgrantees in the areas in which OIG reported that grantees and subgrantees were most vulnerable. The work group determined that assistance should be provided in the following areas: procurement and contracting; subrecipient oversight; conflicts of interest; internal controls; documentation and reporting, and financial management.

In addition, the Inspector General coauthored a joint letter with Ms. Harriet Tregoning, then Principal Assistant Secretary, CPD, to State and local governments communicating our collaborative effort to encourage efficient operations and effective accountability for the best use of limited resources. We developed a series of "integrity bulletins" aimed at providing the grantees and subgrantees with information to help safeguard program funds and ensure that communities get the full benefit of awarded funding. The bulletins on procurement and contracting, conflicts of interest, and subrecipient monitoring and oversight were sent to grantees and subgrantees during fiscal year 2016, and we continue to draft remaining bulletins. In addition, the published bulletins are posted on our Web site at [www.hudoig.gov/fraud-prevention](http://www.hudoig.gov/fraud-prevention).

### **Audit Disagreements and the Former Deputy Secretary**

Another area of concern that we hope can be resolved with the Department relates to the sharp increase in disagreements with our audit recommendations that were referred to former Deputy Secretary, Nani Coloretti for resolution (under departmental rules the Deputy Secretary is designated to resolve audit disagreements). This occurs when OIG and the responsible HUD assistant secretary or program cannot agree on the actions needed to address our audit recommendations. For a three-year period, from approximately 2012 to 2014, prior to the arrival of former Deputy Secretary Coloretti, the OIG recorded nine audit disagreements. Of those, two were resolved consistent with the OIG's recommendations and

---

<sup>11</sup> Audit Report 2015-FW-0802, Very Small and Small Public Housing Agencies Reviewed Had Common Violations of Requirements, September 16, 2015

seven were ultimately resolved at the lower assistant secretary level, which never required the Deputy Secretary to make a final decision.

In contrast, for a two-year period, from approximately 2015 to 2016, after the arrival of former Deputy Secretary Coloretti until her departure, the number of disagreements sky rocketed to sixteen. Only one was resolved consistent with the OIG's recommendations. In seven cases, the former Deputy Secretary rejected our recommendations and we continue to disagree with the decisions. Only two were resolved at the assistant secretary level and six, which were before the former Deputy Secretary for decision before her departure, remain unresolved. It's noted that two of the disagreements were resolved by the former Deputy Secretary in HUD's favor on the evening before inauguration day of the new administration. I have asked the new administration to revisit the decisions where we continue to disagree. The troubling part is that many of these recommendations are at the heart of addressing HUD's top management and performance challenges.

It is my opinion that the spike in disagreements resulted from a negative culture created by former Deputy Secretary Coloretti and some of her staff that appeared to produce a distrust of the OIG and an atmosphere where career staff were not allowed to work with OIG, as we had always done, to resolve disagreements. These actions took on the appearance of impeding OIG activities by the former Deputy Secretary including denying or delaying us access to needed information. Former Deputy Secretary Coloretti did not honor former Secretary Julian Castro's commitment to the OIG, as reflected in a joint letter signed by both the IG and former Secretary Castro, to work with the OIG and to provide timely records. On at least two occasions, I was forced to advise the former Deputy Secretary that her decisions would require me to issue the former Secretary a seven-day letter<sup>12</sup> for her failing to provide requested documents and records. If not for the intervention of former Secretary Castro and his team, the OIG would have had to issue them. I would like to acknowledge former Secretary Castro for honoring his commitment to good governance, working with the OIG and for seeing to it that records the OIG requested, that were not timely produced, were received for us to complete our oversight responsibilities.

## **Conclusion**

The Department will continue to face the challenges we have described until it puts controls and resources in place to address these issues. We remain committed to working collaboratively with HUD and will continue to strive to provide best practices and reasonable recommendations that support HUD's mission and responsibilities. My office is also strongly committed to working with the Department and the Congress to ensure that these important programs operate efficiently and effectively and as intended for the benefit of the American taxpayers now and into the future. In closing, I want to share how proud I am of our professional team at the HUD-OIG. We have highly-talented staff covering many varied disciplines that have produced enormous results. Together through the years, we have developed a culture of focusing on impactful and meaningful oversight that has made significant contributions to the American taxpayer and the nation's fiscal interests. It has been an honor for me to serve as HUD's Inspector General.

---

<sup>12</sup> The Inspector General Act authorizes an inspector general to report "immediately" to the agency head when the inspector general becomes aware of "particularly serious or flagrant problems, abuses, or deficiencies relating to the administration of programs and operations." In turn, the agency head must transmit the report, along with any comments, to the appropriate committees or subcommittees of Congress within seven calendar days. In practice, this so-called "seven-day letter" is a powerful tool available in compelling circumstances requiring immediate congressional attention.