

**GAO**

Report to the Chairman, Employment and  
Housing Subcommittee, Committee on  
Government Operations, House of  
Representatives

January 1992

# HUD REFORMS

## Progress Made Since the HUD Scandals but Much Work Remains



**Resources, Community, and  
Economic Development Division**

B-244223

January 31, 1992

The Honorable Tom Lantos  
Chairman, Employment  
and Housing Subcommittee  
Committee on Government Operations  
House of Representatives

Dear Mr. Chairman:

As you requested, this report summarizes actions taken by the Department of Housing and Urban Development (HUD) in response to the widespread fraud, waste, abuse, and mismanagement that was uncovered in 1989. Specifically, it discusses the progress HUD had made as of December 4, 1991, in correcting 4 departmentwide deficiencies in management systems, internal controls, organizational structure, and staffing, and in correcting problems in 14 individual programs providing mortgage insurance, assisted housing, and community development services. We plan to review the effectiveness of HUD's corrective actions once they have been fully implemented and sufficient time has passed to allow an evaluation. A detailed assessment of HUD's corrective actions is premature at this time because some actions, such as the appointment of a chief financial officer for HUD, have been taken only recently, while others are still being planned.

As you know, we testified on this matter before your Subcommittee last year.<sup>1</sup> This report expands on our testimony and provides greater details.

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**Results in Brief**

The underlying causes of the HUD problems uncovered in 1989 involve long-standing departmentwide deficiencies that remain largely unresolved. These departmentwide deficiencies—inadequate information and financial management systems, including computerized systems; weak internal controls; inappropriate organizational structure; and insufficient staffing—leave the Department open to fraud, waste, abuse, and mismanagement. While HUD is in various stages of implementing many program-specific corrective actions, HUD is only in the initial stages of resolving the underlying, departmentwide deficiencies. Consequently, until corrective actions for these departmentwide deficiencies are implemented, actions correcting individual program deficiencies, no matter how extensive, cannot fully guarantee that abuses similar to those uncovered 2 years ago will not occur.

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<sup>1</sup>HUD Reforms: Limited Progress Made Since the HUD Scandals, (GAO/T-RCED-91-62, June 12, 1991).

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## Background

As has been widely reported, a series of abuses at HUD began unfolding in April 1989. Continuing reports of these abuses during the following months spurred a major effort by the Congress and HUD to prevent their reoccurrence. Investigations were conducted; congressional hearings were held; the Congress enacted the HUD Reform Act of 1989; and HUD initiated a series of reviews, conducted by its own staff as well as several independent accounting firms, to document its problems and develop solutions.

Reviews of HUD operations by us, HUD's Office of the Inspector General, and several independent accounting firms uncovered deficiencies in many departmentwide and program-specific areas. Although many problems were identified by these organizations, we focused our work on HUD's actions to correct deficiencies in 4 departmentwide areas and 14 of the agency's most troubled programs. The four departmentwide areas involve functions such as management systems that provide data for accounting, decision making, and financial reporting (information and financial management systems); controls to ensure compliance with laws, regulations, and policies and to safeguard assets (internal controls); responsibilities and authority of different HUD organizational units (organization structure); and sufficiency of staff to perform activities such as monitoring programs and updating procedures (staffing).

The 14 troubled programs include (1) 6 mortgage insurance programs through which HUD insures mortgages for single-family homes, multifamily rental housing, manufactured homes, land development projects, and property improvements; (2) 6 assisted-housing programs under which HUD provides an array of rental subsidies to families with very low-income, to HUD-insured and HUD-held projects facing serious financial difficulties, and to project owners or Public Housing Authorities (PHA) who agreed to rehabilitate and modernize properties; and (3) 2 community development programs that provide general and project-specific grants to cities and urban communities to promote sound community development. See appendix I for a description of each program included in our review.

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## Departmentwide Deficiencies Will Take Time to Resolve

Four departmentwide deficiencies remain largely unresolved and continue to threaten the integrity of the overall operations of HUD and its specific programs. These deficiencies are inadequate information and financial management systems, weak internal controls, inappropriate organizational structure, and insufficient staffing. In an effort to remedy these deficiencies, HUD has just begun to implement a number of corrective actions.

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The absence of adequate information and financial management systems—including computerized systems—and internal controls is pervasive throughout HUD, affecting all of its major programs and operations. In 1989, we testified that HUD's accounting systems for the federally insured housing programs run by the Department's Federal Housing Administration (FHA) did not provide HUD officials with timely and accurate financial data needed for oversight, program implementation, and budgetary analysis, and did not include the necessary internal controls to adequately protect against fraud, waste, and mismanagement.<sup>2</sup> The absence of internal controls over FHA's single-family property disposition management systems, for example, allowed several private real estate agents to steal millions of dollars in FHA funds. The most prominent instance of this was the "Robin HUD" incident. After collecting proceeds from the sale of FHA-owned properties, the real estate agents retained the proceeds for their own benefit instead of transferring them to the U.S. Treasury. This occurred because FHA did not have the accounting data or internal controls in place that would have permitted it to reconcile the sales of government-owned properties with deposits in its treasury account.

In other situations, HUD program officials were unable to effectively oversee the activities of HUD-insured loans because an automated system for producing the data needed for monitoring loan activities was not in place. In May 1991, we reported that serious system weaknesses had prevented HUD from determining the extent to which premiums on one of FHA's insurance funds covered losses. We concluded that there was a direct correlation between the effectiveness of internal controls, the accuracy and timeliness of financial information, and the magnitude of losses incurred by various HUD programs.<sup>3</sup>

HUD's flawed organizational structure and lack of sufficient staff also contributed to management problems throughout the agency. HUD's organizational structure problems have been long-standing, dating back to the early 1980s. Nevertheless, a senior agency official believes that these problems are still the most pressing ones the Department faces today. These problems include such areas as overlapping and ill-defined responsibilities and authorities in HUD headquarters, regional offices, and field offices; lack of consensus on program priorities; and poor communication of policy updates and management directives.

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<sup>2</sup>GAO Audits of Accounting and Financial Management Systems at the Federal Housing Administration, (GAO/T-AFMD-89-14, Sept. 13, 1989).

<sup>3</sup>Letter to the Chairman, Senate Committee on Banking, Housing, and Urban Development, (B-206207, May 17, 1991).

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HUD's Inspector General has reported that staffing constraints contributed to the problems experienced throughout the Department during the HUD scandals. According to the Inspector General, HUD programs lacked sufficient staff to perform necessary functions, such as monitoring and updating procedures, after dramatic staff cutbacks in the 1980s.<sup>4</sup>

With the exception of insufficient staff, these departmentwide problems are not new to HUD. In a 1984 report on HUD's management, we concluded that these problems were largely responsible for the managerial difficulties afflicting HUD's programs during the early 1980s.<sup>5</sup>

HUD has taken initial steps to correct these long-standing problems. For example, it has hired a chief financial officer to oversee its financial management systems, as required by the HUD Reform Act. It has also hired five program area comptrollers, realigned some of its organizational structure, and approved a strategic plan for new, integrated financial management systems. However, much work remains to be done by HUD before its reforms are completed. Meanwhile, senior HUD officials believe that existing staff levels are adequate to efficiently run the agency's programs once program and system reforms are implemented. While this may be true, until HUD's systems and level of automation can be substantially improved, persisting inadequacies in the information and financial management systems may cause some HUD programs to continue to suffer from staff shortages. Further details of these four departmentwide deficiencies are discussed in appendix II.

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## Progress in Reforming Individual Programs Varies

While HUD has just begun to correct its departmentwide deficiencies, the Department is in various stages of resolving problems in the 14 programs we reviewed. As shown in table 1, reforms have been completed in 7 of the 14 programs, are under way in another 5, and have just begun in the remaining 2 programs.

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<sup>4</sup>HUD's staffing level fell from 17,041 in 1980 to 13,264 in 1990.

<sup>5</sup>Increasing the Department of Housing and Urban Development's Effectiveness Through Improved Management, (GAO/RCED-84-9, Jan. 10, 1984).

**Table 1: Status of Reforms for 14 Individual HUD Programs**

Program	Status of reforms		
	Completed	In progress	Just begun
<b>Mortgage Insurance Programs</b>			
Multifamily Coinsurance	X		
Title X Land Development	X		
Retirement Service Centers	X		
Title I Manufactured Homes	X		
Title I Property Improvement	X		
Single-Family Mortgage Insurance		X	
<b>Assisted Housing Programs</b>			
Moderate Rehabilitation		X	
Section 8 Certificates			X
Section 8 Vouchers			X
Discretionary Loan Management Set-Aside	X		
Comprehensive Improvement Assistance		X	
Public Housing Authority Decontrol		X	
<b>Community Development Programs</b>			
Community Development Block Grant Entitlement	X		
Secretary's Discretionary Fund		X	

Note: Detailed information on the problems, causes, corrective actions, and status of reforms in these programs is contained in appendix III

Six of HUD's mortgage insurance programs, including the agency's multifamily coinsurance and single-family mortgage insurance programs, incurred high default rates and monetary losses over the past several years. HUD's Inspector General, an independent accounting firm, and GAO have all reported that losses and defaults in these programs occurred primarily because of improper program management, lack of effective controls over program operations, fraudulent activities, and unfavorable economic conditions. Also, in some instances these programs did not help the low- and moderate-income families they were intended to benefit. To correct these problems, HUD has eliminated some programs and modified others.

Reports over the last several years have indicated that eight assisted housing and community development programs have been plagued with favoritism, fraud, and mismanagement of HUD funds and subsidies. Problems existed at HUD as well as at PHAs, which are heavily involved in carrying out many of these programs. According to HUD's Inspector

General, the problems in these programs—which included HUD’s moderate rehabilitation and community development block grant programs—were primarily caused by poor project selection processes, inadequate information and financial management systems, inappropriate program organizational structure, and insufficient written directives and monitoring of program activities. To correct these problems, HUD has suspended some programs, modified procedures for others, and begun making improvements to its management systems and organizational structure. Further details on these 14 programs are contained in appendix IV.

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## Conclusions

Much work remains to be done at HUD in implementing reforms. Because many reforms have been implemented only recently, it is too early to determine whether they will be effective in correcting targeted problems. Furthermore, no matter how extensive or effective HUD’s reforms are for individual programs, the agency’s programs may be subject to further fraud, waste, abuse, and mismanagement until corrective actions for the departmentwide deficiencies are completed. Although HUD has previously acknowledged many of these long-standing problems and taken some corrective actions, these problems were never totally corrected.

For these reasons, the Congress, HUD’s Inspector General, and GAO must continue to monitor and review HUD’s progress to ensure that HUD sustains its efforts to rectify problems, that corrective actions become an integral part of program operations, and that the actions have a lasting effect. Congressional interest and support for the necessary investment in staff resources and financial and information management systems are also vital to achieving success. Only continued support and oversight can assure the public that HUD’s resources are being efficiently used to serve the intended beneficiaries.

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## Agency Comments and Our Evaluation

We received written comments on a draft of this report from HUD that addressed the departmentwide deficiencies and program-specific corrective actions (see app. V).

HUD stated that it has taken initial steps to correct the major structural deficiencies that contribute to management problems throughout the agency. It pointed to the fact that it has hired a Chief Financial Officer, five program area Comptrollers, and has plans for hiring Regional Comptrollers. HUD also said that it has approved a strategic plan for new integrated financial management systems and submitted it to the Office of

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Management and Budget. In addition, the agency is working on plans to improve its organizational structure and take maximum advantage of its staff resources. HUD acknowledged, however, that much work remains to be done before its reforms will be complete.

HUD also said that it was in various stages of resolving problems in the 14 programs and it had forwarded to our office comments on these areas prepared by HUD staff. The staff comments updated the status of HUD's program-specific corrective actions and have been incorporated in this report.

HUD also stated that the overall tone of our draft report gives the impression that very little has been accomplished in the Department and that any changes that either have been made or will be made will not be effective until the agency's major structural deficiencies are corrected. HUD stated that it did not believe this is the case. The agency believes significant progress has been made that will have a positive impact on the 14 programs reviewed.

We agree, as stated in the report, that HUD has made progress in implementing many program-specific corrective actions and that these changes will have a positive impact. However, we are concerned about the progress being made in correcting departmentwide deficiencies and the contribution of these deficiencies to the abuses that were uncovered 2 years ago. As discussed in the report, we are concerned because the underlying causes of the HUD problems uncovered in 1989 involve departmentwide deficiencies. Although HUD has previously acknowledged most of these problems and taken some corrective actions, the problems have not been totally corrected. Until changes that ensure adequate information and financial management systems, strong internal controls, an appropriate organizational structure, and sufficient staff are fully implemented, HUD's programs will remain vulnerable to the types of problems experienced in recent years. Also, until corrective actions for departmentwide deficiencies are implemented, actions correcting individual program deficiencies, no matter how extensive, cannot fully guarantee that abuses similar to those uncovered 2 years ago will not occur.

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## Scope and Methodology

In selecting the 4 departmentwide deficiencies and 14 program-specific areas for review, we considered several factors: the amount of monetary losses, program funding levels, HUD's and the Office of Management and Budget's ranking of the seriousness of the problems, and the amount of media and congressional attention devoted to a particular problem. Many



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of these programs received widespread media and congressional attention because of influence-peddling and the misuse of HUD funds.

We obtained the information presented in this report by reviewing HUD and GAO reports; trade journal articles; congressional hearing transcripts, statements, and reports; and by interviewing HUD officials, including staff from the Office of the Inspector General. Our work was conducted from March 1990 to September 1991 in accordance with generally accepted government auditing standards. Our work on the status of corrective actions was updated by HUD as of December 4, 1991.

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We are sending copies of this report to the appropriate House and Senate committees and subcommittees, interested Members of Congress, the Secretary of HUD, the Office of Management and Budget, and other interested parties. We will make copies available to others on request. If you would like additional information on this report, please call me at (202) 275-5525. Major contributors to this report are listed in appendix VI.

Sincerely yours,

A handwritten signature in cursive script that reads "John M. Ols, Jr.".

John M. Ols, Jr.  
Director, Housing and Community  
Development Issues



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Table 1: Status of Reforms for 14 Individual HUD Programs

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**Abbreviations**

CDBG	Community Development Block Grant
CIAP	Comprehensive Improvement Assistance Program
FHA	Federal Housing Administration
GAO	General Accounting Office
HUD	Department of Housing and Urban Development
LMSA	Loan Management Set-Aside
PHA	Public Housing Authority

# Description of 14 HUD Programs Reviewed

<b>Program</b>	<b>Program description</b>
<b>Mortgage Insurance Programs</b>	
Multifamily Coinsurance	Provides mortgage insurance for multifamily rental housing on which private lenders agree to share in financial losses.
Title X Land Development	Provides mortgage insurance to private developers for land development projects, such as water and sewer systems.
Retirement Service Centers	Insures mortgages for multifamily housing for low- or moderate-income retirees.
Title I Manufactured Homes	Insures loans that finance the purchase of manufactured homes.
Title I Property Improvements	Insures loans that finance the purchase of property improvements.
Single-Family Mortgage Insurance	Insures single-family mortgages for first-time homebuyers and others who otherwise might not qualify for a conventional loan.
<b>Assisted Housing Programs</b>	
Moderate Rehabilitation	Provides owners who agree to rehabilitate properties to meet safety and sanitation standards with rental subsidies for low-income tenants.
Section 8 Certificates	Provides rental subsidies to very low-income families for private housing whose rents are within the fair market rents set by HUD.
Section 8 Vouchers	Provides rental subsidies similar to those in the section 8 certificates program and, in addition, allows rents to exceed the fair market rents set by HUD, with tenants incurring the additional expense.
Discretionary Loan Management Set-Aside	Provides rental subsidies to FHA-insured and HUD-held projects facing serious financial difficulties.
Comprehensive Improvement Assistance	Provides modernization funds to qualified PHAs to upgrade physical condition, management, and operations of public housing projects.
Public Housing Authority Decontrol	Provides well-operated PHAs with greater operational autonomy and flexibility.
<b>Community Development Programs</b>	
Community Development Block Grant Entitlement	Provides grants to metropolitan cities and urban counties to promote sound community development.
Secretary's Discretionary Fund	Provides special project grants and technical assistance for community development programs.

# Departmentwide Deficiencies

This appendix discusses the four major departmentwide deficiencies facing HUD: lack of adequate information and financial management systems, weak internal controls, inappropriate organizational structure, and insufficient staffing. Because HUD has just begun to address these deficiencies, we recognize that time will be needed before these deficiencies are fully resolved.

## Information and Financial Management Systems and Internal Controls

HUD's lack of adequate information and financial management systems and internal controls affects all of its major programs and operations.

**Status of Reforms**

Completed	In Progress	Just Begun
		✓

## Background

Under the Federal Managers' Financial Integrity Act of 1982, HUD, like all federal agencies, is required to have adequate financial management systems and internal controls throughout its programs. HUD's financial management systems provide data for accounting, decision making, and financial reporting. Internal controls ensure compliance with laws, regulations, and policies; safeguarding of assets; and generation of reliable statistical and financial information.

## Problems Reported

The absence of adequate information and financial management systems, including computerized systems, and internal controls has serious repercussions on HUD operations. In 1989, we testified that HUD's accounting systems for its Federal Housing Administration (FHA) programs do not provide HUD officials with timely and accurate financial data needed for oversight, program implementation, and budgetary analysis, and do not include the necessary internal controls to adequately protect against fraud, waste, and mismanagement.<sup>1</sup> Furthermore, in May 1991, we reported that serious system weaknesses have precluded HUD from determining the extent to which premiums for FHA's General Insurance Fund's will cover losses. The

<sup>1</sup>GAO Audits of Accounting and Financial Management Systems at the Federal Housing Administration, (GAO/T-AFMD-89-14, Sept. 13, 1989).

General Insurance Fund is used for a large number of specialized mortgage insurance programs, such as the Multifamily Coinsurance Program. Of the \$3.5 billion in losses sustained by the General Insurance Fund in fiscal year 1989 when the HUD scandals surfaced, \$2.7 billion (77 percent) was due to the coinsurance program—which has since been canceled. We concluded that there is a direct correlation between the effectiveness of internal controls, the accuracy and timeliness of financial information, and the magnitude of losses incurred by various HUD mortgage insurance programs.<sup>2</sup>

Information and financial management system deficiencies have been reported not only in FHA programs but also in HUD's section 8 multifamily assisted housing programs as well. According to a March 1990 Inspector General's report, a lack of adequate and reliable data has made management of section 8 programs difficult. As a result, there is no assurance that program funds are being used effectively, nor do HUD and the Congress have reliable information for administering and funding the programs. For example, HUD has not been able to provide Congress with accurate estimates of its section 8 funding needs. The agency hired an independent accounting firm in February 1990 to investigate deficiencies in the section 8 programs. The firm determined that systems used in the section 8 moderate rehabilitation, certificate, voucher, and loan management set-aside programs were inadequate in many respects and were highly vulnerable to fraud, waste, and abuse. Among other things, the firm found that inadequate systems and financial controls permitted the misdirection of some section 8 subsidies to ineligible tenants.

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## Status of Reforms

HUD has begun to correct its departmentwide deficiencies in information and financial management and internal controls. The agency recently took corrective actions required by the HUD Reform Act, as well as actions HUD itself initiated.

As required by the HUD Reform Act passed in December 1989, HUD hired an FHA comptroller in May 1990 and a chief financial officer in January 1991. On its own initiative during the summer of 1990, HUD hired four other comptrollers to oversee the financial management of its major program areas. Before filling these positions, HUD obtained advice from the National Academy of Public Administration on the appropriate responsibilities and authority of the chief financial officer and comptrollers. HUD also has plans to place comptrollers in its regional offices. According to the

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<sup>2</sup>GAO's letter to the Chairman, Senate Committee on Banking, Housing, and Urban Affairs (B-206207, May 17, 1991).

Secretary of HUD, the chief financial officer's highest priority is to restructure and integrate HUD's financial management systems. To assist in this effort, HUD hired an independent accounting firm to help the chief financial officer develop a detailed 5-year systems integration plan for the Department. This plan has been approved by HUD and submitted to the Office of Management and Budget. Other responsibilities of the chief financial officer include establishing policies and standards to govern the maintenance and operations of all HUD financial management systems.

Other departmentwide efforts by HUD to improve information and financial management systems and internal controls include

- establishing the Secretary's Management Report, a centralized information-management reporting system that tracks progress made in implementing important management initiatives and in correcting identified internal control weaknesses in areas such as the section 8 subsidy payment systems;
- increasing the frequency of internal control reviews of high-risk agency operations, such as cash collection, from every 5 years to every 3 years.

## Organizational Structure and Staffing

HUD's inappropriate organizational structure and lack of sufficient staff resources contribute to management problems that exist in many of its programs.

### Status of Reforms

Completed	In Progress	Just Begun
		✓

## Background

HUD's programs are operated through the combined efforts of its headquarters office, 10 regional offices, and 71 field offices. Headquarters is primarily responsible for setting policy, directing and evaluating administration of programs by regional and field offices, and allocating funds and staffing to regions. Four offices at headquarters have direct responsibility for most of HUD's programs: housing, public and Indian housing, community planning and development, and fair housing and equal opportunity. The Office of Housing is responsible for all FHA mortgage insurance programs, as well as HUD's section 8 assisted-housing programs. The Office of Public and Indian Housing is responsible for all public housing and Indian housing programs. The Office of Community Planning and



Development is responsible for community and urban development programs. The Office of Fair Housing and Equal Opportunity is responsible for governmentwide fair housing programs and for equal opportunity activities within the Department. The responsibilities of each of the regional offices include ensuring that programs administered in their regions comply with headquarters policy and evaluating performance of field offices. HUD's field offices supervise and direct programs within their jurisdictional area.

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## Problems Reported

Independent accounting firms have detected flaws in HUD's organizational structure in a variety of programs.<sup>3</sup> An accounting firm hired by HUD to review its section 8 programs determined that organizational aspects of the certificate, voucher, and moderate rehabilitation programs—which provide rental assistance for multifamily housing to low-income families—were particularly vulnerable to fraud, waste, and abuse. One of the problems discovered was that program responsibilities and authority were fragmented between HUD headquarters and its regional and field offices, between the Office of Housing and the Office of Public and Indian Housing, and within the Office of Housing. For example, the accounting firm found that responsibility and authority for policy formulation, development activities, and management operations were divided between the Office of Housing and the Office of Public and Indian Housing in a complex manner. In auditing FHA's 1989 financial statements, another accounting firm found that assigning the mortgage insurance accounting function to the Office of Administration—rather than to FHA, where these programs are managed—had created system redundancies and conflicting duties between program management and the accounting function.

On June 29, 1990, HUD's Inspector General reported that staffing constraints in a variety of HUD programs also contributed to the problems exposed during the HUD scandals.<sup>4</sup> The number of staff at HUD decreased dramatically during the 1980s, from 17,041 in 1980 to 13,264 in 1990. According to the Inspector General, the size and qualifications of the staff in many programs were insufficient to perform necessary functions such as monitoring and updating procedures. For example, the Inspector General found that funds for modernizing public housing units under the

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<sup>3</sup>Phase I Report: Multifamily Assisted Housing Program Review, Arthur Andersen & Co., S.C., (May 1990) and Price Waterhouse's report on FHA Internal Controls, (November 30, 1990).

<sup>4</sup>Statement of Paul A. Adams, Inspector General, Department of Housing and Urban Development, before the Subcommittee on HUD/Mod Rehab Investigation of the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, June 29, 1990.

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Comprehensive Improvement Assistance Program were wasted or were used for inappropriate purposes because staff was not available to monitor the allocation of these funds.

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## Status of Reforms

HUD began to improve its organizational structure by realigning program responsibilities in 1990. The independent accounting firm hired by HUD to review the organizational structure of the section 8 programs made several recommendations to improve accountability and simplify reporting relationships among the section 8 programs. For example, the contractor recommended that HUD shift responsibility for the section 8 certificates, vouchers, and moderate rehabilitation programs from the Office of Housing to the Office of Public and Indian Housing to consolidate program responsibilities and authority in a single office. HUD began implementing the recommendations in June 1991 with a targeted completion date of September 1992. HUD also moved the mortgage insurance accounting function from its Office of Administration to FHA. This move is expected to improve coordination between the accounting and financial management function and program management by consolidating the two functions in a single office.

As for staff resources and expertise, HUD has provided some training to increase the skills of existing staff. It is also working on plans to improve its organizational structure to take maximum advantage of its staff resources. However, senior HUD officials do not plan to substantially increase staff levels. They believe that staff levels are adequate to run HUD's programs once system reforms are implemented.

# Problems, Causes, Corrective Actions, and Status of These Actions for 14 HUD Programs

Program	Problems	Causes	Corrective Actions	Status
<b>Mortgage Insurance Programs</b>				
Multifamily Coinsurance	High monetary losses and default rates.	Program design flaws; inadequate enforcement of program requirements.	Termination with replacement.	Reforms implemented, but management of acquired properties still required.
Title X Land Development	High monetary losses and default rates; lack of benefits to low- and moderate-income people.	Poor project selection; inadequate management and monitoring of projects; poor property disposition.	Termination.	Reforms implemented.
Retirement Service Centers	High default rate; lack of benefits to low- and moderate-income people.	Poor project selection and underwriting; limited potential market.	Termination.	Reforms implemented.
Title I Manufactured Homes and Property Improvement <sup>a</sup>	High monetary losses and default rates, fraudulent activities by private third parties and borrowers.	Inadequate monitoring, standards, procedures, and delegation of program responsibilities	Modification of program operations.	Modifications made; reforms implemented.
Single-Family Mortgage Insurance	High monetary losses and default rates; improper activities by private third parties and borrowers.	Economic factors; poor loan origination activities and monitoring; inadequate property disposition controls and systems.	Modification of program operations.	Modifications made; others to take effect in the future.
<b>Assisted Housing Programs</b>				
Moderate Rehabilitation	Appearance of favoritism in selecting projects for funding; excessive subsidies paid.	Noncompliance with selection criteria; weak written guidance, and monitoring; lack of skills, accountability, and documentation.	Subsidy reviews and funding of new project suspended.	Subsidy reviews in progress.
Section 8 Certificates and Vouchers <sup>a</sup>	Payment of inaccurate subsidies; admission of ineligible tenants.	Poor subsidy calculation and eligibility determination; inadequate systems, written guidance, and accountability.	Comprehensive program review and recommendations provided by external audit firm.	Implementation of recommendations begun.
Discretionary Loan Management Set-Aside	Poor selection of projects for funding.	Noncompliance with selection criteria; poor selection documentation.	Modification of project selection documentation.	Reforms implemented.
Comprehensive Improvement Assistance	Mismanagement of CIAP funds at PHAs.	Inadequate monitoring and guidance, PHA resistance to requirements.	Modification of program administration.	Reforms in progress.
PHA Decontrol	Poorly operated PHAs relieved of HUD oversight; failure to reach program goals.	Decontrol of unqualified PHAs.	Termination with replacement.	Program suspended; Replacement being prepared.

(Continued)

**Appendix III  
Problems, Causes, Corrective Actions, and  
Status of These Actions for 14 HUD  
Programs**

<b>Program</b>	<b>Problems</b>	<b>Causes</b>	<b>Corrective Actions</b>	<b>Status</b>
<b>Community Development Programs</b>				
CDBG Entitlement	Unmet community development needs; non-performance of contracted activities.	Poor grantee monitoring of subgrantees; poor management and monitoring of program income.	Modification of program operations regarding grantee monitoring of subgrantees and use of program income.	Reforms implemented.
Secretary's Discretionary Fund	Appearance of favoritism in awarding technical assistance and special projects from the fund.	Inadequate selection process.	Elimination of special project grants and modification of technical assistance project selection process.	Modifications made, others pending final regulations.

<sup>a</sup>Includes two separate programs

Note: CDBG - Community Development Block Grant  
CIAP - Comprehensive Improvement Assistance Program  
PHA - Public Housing Authority

# Individual HUD Programs

This appendix discusses problems that have surfaced in 14 individual HUD programs in the mortgage insurance, assisted housing, and community development areas.

## Mortgage Insurance Programs

Reports from HUD, independent accounting firms, and our office identified major problems in six of HUD's mortgage insurance programs—the multi-family coinsurance, title X land development, retirement service centers, title I manufactured home, title I property improvement, and single-family mortgage insurance programs. HUD's efforts to reform these programs have been completed for all but one program—the single-family mortgage insurance program.

## Multifamily Coinsurance

Flaws in the program's operational structure and inadequate enforcement of program requirements contributed to a high default rate and loss reserves of \$3.7 billion for fiscal year 1989.<sup>1</sup>

### Status of Reforms

Completed	In Progress	Just Begun
✓		

### Program Description

The multifamily coinsurance program provided mortgage insurance for multifamily rental housing projects initiated as a joint venture between HUD and private lenders. As of July 1990, several months before the program was terminated, mortgage loans for 1,579 projects containing about 365,000 housing units were coinsured through the program. These loans were recorded by FHA at over \$10 billion.

This program functioned on a risk-sharing basis in which private lenders assumed approximately 20 percent, and HUD 80 percent, of the responsibility for potential losses incurred through defaulted coinsured mortgages. Private lenders were responsible for issuing commitments binding HUD to coinsure mortgages, mortgage underwriting, and servicing.<sup>2</sup> In exchange for assuming these responsibilities and a portion of the risk associated with coinsured mortgages, lenders were permitted to retain fees of up to approximately 4 percent of the mortgage amount.

<sup>1</sup>Loss reserves are liabilities recorded for incurred losses that are unpaid as of the balance sheet date, including estimated losses incurred but not reported to FHA.

<sup>2</sup>Underwriting is the process of identifying potential risks associated with a loan. Servicing activities include detecting troubled loans in a timely manner and minimizing mortgage default coinsurance losses.

In addition, the program allowed private lenders to pool coinsured mortgages into securities guaranteed by the Government National Mortgage Association (Ginnie Mae)—a federally owned corporation within HUD. When individual coinsured loans default, HUD pays the lender approximately 80 percent of the losses on the mortgage. However, if a lender who has pooled coinsured loans into Ginnie Mae securities defaults, the Ginnie Mae guarantee renders HUD responsible for the lender's entire portfolio and 100 percent of the losses.

### Problems Reported

During the summer of 1989, the coinsurance program became highly scrutinized during congressional hearings and was the topic of a number of media reports. An independent accounting firm contracted by HUD estimated that coinsured project defaults occurring between 1983 and 1989 would ultimately result in losses to HUD of at least \$3.7 billion. Defaults occurring after 1989 could increase losses even further. Reviews conducted by FHA, the independent accounting firm, and the HUD Inspector General suggested that these losses were the result of several flaws in the program's operating structure and inadequate enforcement of program requirements by HUD.<sup>3</sup> These reviews cited program flaws and lack of enforcement as contributing to high mortgage default rates and, in some cases, defaults by lenders participating in the multifamily coinsurance program.

FHA officials and the independent accounting firm concluded that two major flaws in the structure of the program were responsible for losses. First, virtually all coinsured mortgages were pooled into securities guaranteed by Ginnie Mae, rendering HUD responsible for 100 percent of all losses when lenders themselves defaulted. FHA officials considered this to be a major flaw in the program because it prevented HUD from sharing the responsibility for losses on defaulted mortgages with lenders. Second, the independent accounting firm determined that weak HUD selection criteria permitted lenders with too few capital reserves and experience to participate in the program. Consequently, some coinsuring lenders collapsed because they lacked the financial stability necessary to withstand defaulted loans.

In addition, HUD's program staff and Inspector General found that coinsuring lenders failed to comply with several HUD program requirements. Although HUD's monitoring of lenders disclosed critical deficiencies in mortgage underwriting and servicing, its enforcement of

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<sup>3</sup>Report on Audit of the Section 223(f) Coinsurance Program Inspector General of HUD, (89-TS-119-0002, Dec. 9, 1988).

these requirements was considered less than adequate. HUD did not enforce sanctions, such as suspension from the program, against lenders who failed to comply.

### Status of Program Reforms

HUD issued final regulations terminating the program in October 1990. These regulations took effect on November 12, 1990; they limited eligibility for additional coinsurance to projects for which a lender had already collected applicable fees from a mortgagor by this date. HUD conducted precommitment reviews of these additional mortgages to prevent further losses. Although the coinsurance program was terminated, HUD is still responsible for managing and disposing multifamily projects it acquires as a result of foreclosure.

Before the program's termination, HUD attempted to preclude further defaults by notifying lenders in January 1990 and publishing regulations in March 1990 requiring that, until the program could be terminated, all new coinsured loans would be reviewed by HUD before insurance was committed. However, protests from coinsuring lenders prevented HUD from quickly implementing precommitment reviews. A U.S. district court order supporting coinsuring lenders prevented HUD from instituting precommitment reviews before the process of terminating the program was complete.

In addition, before terminating the program, HUD increased its efforts to evaluate the coinsurance program and to monitor all participating private lenders. An independent accounting firm reviewed the coinsurance program's capital and financial reporting requirements. The firm found that the level of capital was too low to sustain the program. In addition, HUD reviewed lender processing and underwriting for all current coinsurance commitments and evaluated the overall performance of all participating lenders. Through increased enforcement activities during the months preceding the program's termination, HUD imposed administrative sanctions on 22 lenders. Of the 22 lenders, 11 were suspended from the program and 11 were placed on probation and permitted to issue coinsurance commitments only after HUD's review. In April 1991, HUD replaced the coinsurance program with a new system that delegates technical processing functions, such as mortgage credit analysis, to lenders. Although HUD assumes 100 percent of the liability for insured mortgages under this system, it retains the responsibility for approving firm commitments to insure mortgages—a function previously held by private coinsuring lenders.

Title X Land Development

Status of Reforms

Completed	In Progress	Just Begun
✓		

HUD's inadequate implementation and oversight of title X projects contributed to the program's monetary losses, a default rate of nearly 50 percent, and the program's failure to benefit low- and moderate-income families.

Program Description

Title X of the National Housing Act, as amended in 1965, established this program to provide mortgage insurance to private developers for land development projects and related new construction improvements, such as water and sewer systems. By 1989, when the program was terminated, it had insured 99 projects, including 50,604 lots valued at approximately \$700 million. HUD staff used a series of eligibility standards to select projects for participation in the program. These standards were designed to identify projects that would be economically viable and promote sound land use and regional growth patterns. The standards were also intended to provide a proper balance of housing for low- and moderate-income families and to encourage the maintenance of a diversified local homebuilding industry.

In addition to selecting projects for participation in the program, HUD staff were responsible for monitoring the financial status of title X projects, managing troubled projects, and selling foreclosed title X properties.

Problems Reported

HUD's title X program became the subject of several media articles during the summer of 1989 alleging that the program had been used to assist in the development of luxury, resort-type projects rather than affordable housing units. Criticism of the program began with the Inspector General's 1986 report that pointed out the program's high monetary losses and default rate and failure to benefit low- and moderate-income families.<sup>4</sup> However, because of management's lack of commitment to rectify these problems, the Inspector General reported the same problems when he reviewed the program again in 1990.<sup>5</sup> The Inspector General determined that inadequacies in the way HUD carried out and monitored the program contributed to losses of \$177 million, a default rate of nearly 50 percent, and HUD's inability to adequately target program benefits to low- and moderate-income families.

<sup>4</sup>Inspector General of the U.S. Department of Housing and Urban Development, National Report - Title X Mortgage Insurance for Land Development Program, (86-TS-112-0012, March 31, 1986).

<sup>5</sup>Inspector General of the U.S. Department of Housing and Urban Development, Multi-Region Audit



The Inspector General's reports noted that HUD selected inappropriate projects for participation in the program and failed to effectively monitor current projects and manage defaulted and foreclosed properties. During a review of HUD's processing of title X loan applications, the Inspector General found that ineligible resort projects and projects with questionable marketability were approved for participation in the program. Additionally, HUD's ineffective monitoring of title X projects prevented HUD from identifying and addressing financially troubled projects in a timely manner. Furthermore, HUD was unable to minimize losses by resolving mortgage defaults or promptly foreclosing and selling properties.

Status of Program Reforms

The title X program has been terminated. The Secretary of HUD initially suspended the program in July 1989. Subsequently, on December 15, 1989, the Congress passed the HUD Reform Act, which formally abolished the program and prohibited HUD from insuring any additional loans except for commitments made before this date. HUD officials do not expect the program to be replaced. They believe the program is not necessary because the private sector finances virtually all land development projects without the need for federal insurance.

Retirement Service Centers

Status of Reforms

Completed	In Progress	Just Begun
✓		

Inadequate project selection and the underwriting of loans by HUD in conjunction with a limited potential market caused this program's high default rate and failure to meet its objective of serving low- and moderate-income retirees.

Program Description

The Retirement Service Center Program insures mortgages for multifamily housing for low- or moderate-income retirees. Retirement service centers house individuals who are at least 70 years old, able to live independently without special medical care, and able to pay market rates for rent and services such as meal preparation and transportation. In a June 1990 report, HUD stated that 156 retirement service centers with 22,804 units valued at approximately \$1.4 billion were insured. According to a HUD headquarters official, few additional centers were insured after January 1990 and before the program was terminated in September 1991.

HUD may either bear the full retirement service center insurance liability or share the liability with an authorized lender through its multifamily coinsurance program. By January 1990, 92 retirement service centers were fully insured by HUD and 64 were coinsured. For fully insured retirement service center loans, project applications are reviewed by HUD economists and

underwritten by other staff at HUD field offices. For coinsured loans, private lenders underwrite the loan and assume between 10 to 20 percent of the insurance liability.

To participate in the program, HUD requires that project owners have expertise in managing the housing of retirees targeted by the program. Projects must also meet design, marketability, capital reserve level, and cost requirements to participate in the program.

### Problems Reported

During the spring and summer of 1990, the media and two HUD offices reported problems in the Retirement Service Center Program. The program's primary problems were a high default rate and failure to serve low- and moderate-income retirees. In June 1990, HUD's Office of Policy Development and Research found that 29 percent of all retirement service centers insured had defaulted and that another 23 percent were at risk of default. Furthermore, because these projects charge market rents, they served the upper-income elderly almost exclusively—thus limiting the access of low- and moderate-income retirees. According to HUD officials, HUD's selection and underwriting of these projects and the program's limited potential market contributed to these problems.

HUD's Inspector General found several weaknesses in HUD's process of selecting projects for participation in the program. The majority of approved projects reviewed by the Inspector General had mortgagors who lacked the prerequisite market experience because HUD did not verify the management expertise of loan applicants. Additionally, the Inspector General discovered that HUD headquarters overturned many field office rejections of project applications. According to the Inspector General, headquarters reversals of field office decisions were often unsound and undocumented and lacked accountability.

HUD investigators also found weaknesses in field offices' and coinsuring lenders' underwriting of retirement service center loans. HUD field office underwriters were not required to adhere to recommendations of its field economists, such as the number of units the project should contain. As a result, some mortgagors were not able to cover their mortgage payments because a number of units in retirement service centers remained vacant. Also, because of questionable underwriting by coinsuring lenders, the cost of coinsured retirement service center projects was considerably greater than that of fully insured projects. The Inspector General found that many coinsuring lenders over-mortgaged properties by using improper estimates

of the costs and revenues a center would experience when calculating the amount of coinsured retirement service center loans.

HUD's Office of Policy Development and Research also determined that the potential market for retirement service centers is very limited, since about 5 percent of the total elderly households can afford this type of housing. The monthly rent for a typical retirement service center unit is \$1,000 to \$1,200. Fewer than 300,000 individuals need and can afford the services that the centers provide.

### Status of Program Reforms

HUD issued final regulations terminating the program in September 1991. The Secretary initially suspended the program in July 1989. At that time, HUD initiated a comprehensive internal review to determine what changes should be made to correct the program's problems. Eleven months later, in June 1990, the reviewers recommended that HUD terminate the program to protect its insurance fund from additional losses. However, industry representatives sued HUD over the program's suspension, including its coinsurance component. As a result of the suit, the court reinstated the program until HUD completed the formal rulemaking process to terminate the program.

In November 1990, draft regulations terminating the program were published. While final regulations were being processed, HUD imposed an increased reserve requirement and an additional layer of review for all projects applying to participate in the program. HUD officials are not planning to replace it with another program.

**Title I Manufactured Homes and Title I Property Improvement**

Fraudulent activities by dealers, loan brokers, and borrowers involved in the Title I Manufactured Homes and Property Improvement Program went undetected by lenders and HUD staff because of administrative and oversight problems.

**Status of Reforms**

Completed	In Progress	Just Begun
✓		

**Program Description**

Title I of the National Housing Act, as amended (12 U.S.C. 1703), authorizes HUD to insure loans that finance the purchase of manufactured homes or property improvements.<sup>6</sup> As of December 1990, title I insured 382,012 manufactured home loans valued at about \$6.5 billion and 34,415,014 property improvement loans valued at about \$38.5 billion.

Borrowers often obtain title I manufactured home or property improvement loans through a dealer or loan broker. Somewhat like an automobile dealer, a manufactured home dealer participating in the title I program provides the borrower with a manufactured home and assists the borrower in obtaining financing by overseeing completion of the financing application and the related paperwork required to obtain a title I loan. Dealers initiate almost all manufactured home loans. Property improvement dealers who participate in the title I program, sometimes called "home improvement contractors," function in a similar way: they agree to make an improvement to the borrower's property and assist the borrower in obtaining a title I loan to pay for the improvement. About one-third of all property improvement loans are initiated by dealers. All other title I property improvement loans are arranged directly by the borrower or by a loan broker. Brokers assist borrowers in obtaining title I loans for property improvement projects from lenders.

**Problems Reported**

In 1989 and 1990, HUD officials reported that fraudulent activities by dealers, loan brokers, and borrowers involved with both title I programs went undetected by lenders and HUD staff because of administrative and oversight problems. As of September 1990, these problems had contributed to defaults and monetary losses over \$600 million for the manufactured home program. Although the property improvement program has experienced significant problems, a HUD official responsible for both title I

<sup>6</sup>Under title I, a manufactured home is defined as a transportable structure built on a permanent chassis to function as a principal single-family residence. Title I loans may also be used to finance the purchase of manufactured home lots. Property improvements are defined as repairs or improvements to individual homes, apartment buildings, and nonresidential structures.

programs claims that it has not experienced any significant losses compared to the manufactured home program.

According to a HUD official, many manufactured home and property improvement dealers were responsible for the initiation of fraudulent applications for title I loans. For example, some dealers coached borrowers to overestimate their income on the application so that they would appear more qualified for the loan than they actually were. Other dealers encouraged borrowers to inflate the loan amount by including items or services, such as manufactured home options or additional property improvements, that were never actually delivered.

In addition to fraudulent activities of dealers and borrowers, HUD officials also found that many loan brokers caused several problems for the title I property improvement program. They often advised borrowers to use title I property improvement loans for ineligible expenses such as vacations, swimming pools, and children's education. Also, borrowers using brokers often paid higher interest rates than those who made their own financing arrangements. This occurred because brokers referred borrowers to lenders paying the highest broker fees instead of finding the most favorable loan terms for borrowers. In addition, some property improvement loan amounts were inflated because brokers' fees were included in the loan amount.

The problems in both title I programs were largely due to administrative and oversight weaknesses. According to HUD officials, the specific weaknesses were: (1) ineffective monitoring by lenders and HUD staff; (2) failure to require normal real estate underwriting standards, such as face-to-face meetings between lenders and prospective borrowers; (3) inclusion of "soft cost," such as the cost of furniture that has little salvage value if HUD later forecloses on the loan, in manufactured home loans; and (4) inappropriate delegation of program responsibilities among dealers, loan brokers, and borrowers.

## Status of Program Reforms

To address these problems, HUD issued three separate sets of regulations that modified program procedures. These regulatory changes were either initiated by HUD or required by the HUD Reform Act. All three sets of regulations have been issued in final form.

The first set of final regulations, issued in August 1989, primarily addressed the defaults and monetary losses in the manufactured home program. Specifically, the regulations increased manufactured home loan

insurance premiums and revised collection procedures so that more of the premium is paid in the early years of the loan when there is greater risk of default. In addition, the regulations prohibited using the proceeds from manufactured home loans for purchasing furniture. These regulations became effective on October 9, 1989.

The second set of final regulations, issued in May 1991, imposed civil monetary penalties against property improvement dealers who provide false information during the loan application process. These penalties, which are required by the HUD Reform Act, became effective on June 21, 1991.

The remaining regulations, published in October 1991, became effective on November 18, 1991, and addressed the activities of dealers, brokers, and lenders. These regulations made the following changes:

- established higher qualification standards for dealers and lenders and more objective criteria for use in evaluating title I loans;
- required lenders to provide greater oversight of dealers to prevent fraudulent activities;
- required certain property improvement borrowers to have a minimum level of equity in their homes to reduce potential losses to HUD in the event that a borrower defaults on the loan and the lender files a claim with HUD; and
- excluded other soft costs such as the cost of extended warranty contracts in manufactured home loans to reduce losses to HUD in the event of foreclosure or repossession by HUD.

To eliminate the programmatic abuses of title I property improvement loan brokers, these regulations also replaced loan brokers with loan correspondents. Unlike loan brokers, who were unregulated and unsupervised, loan correspondents are subject to several HUD-established requirements that include (1) being a financial institution approved by HUD, (2) meeting net worth and financial statement requirements, and (3) closing and funding all loans in the name of loan correspondents before their sale or transfer to a sponsoring title I lender.

## Single-Family Mortgage Insurance

The single-family mortgage insurance fund incurred high losses because of unfavorable economic conditions, improper loan origination activities, and inadequate controls over the disposition of foreclosed properties.

### Status of Reforms

Completed	In Progress	Just Begun
	✓	

### Program Description

The single-family mortgage insurance program assists in qualifying borrowers—first-time buyers and others who might not qualify for conventional loans—for mortgage financing by guaranteeing the lender that FHA will repay the outstanding loan if the borrower does not meet repayment terms. The latest available information shows that as of September 30, 1990, FHA-insured single-family mortgages were valued at approximately \$278 billion. Single-family mortgage insurance is provided through the Mutual Mortgage Insurance Fund, the largest of the four funds managed by FHA. This fund covers potential losses for insured loans that default and undergo foreclosure. The fund is intended to be self-sustaining by charging home buyers a premium on the mortgage. The fund is required to be actuarially sound so that over the life of the fund premiums are sufficient to pay claims due to defaults and other expenses.

When borrowers default on their loans, their lender usually forecloses and files an insurance claim with HUD. HUD pays the claim and becomes the owner of the property. HUD's field office property disposition staff then contracts with private area management brokers, who manage the property. Private realtors show the properties to prospective buyers and receive a commission on properties they sell. Closing activities are conducted by private closing agents, who are responsible for transferring sales proceeds to the U.S. Treasury. Closing agents are also responsible for submitting closing documents and deposit records to HUD.

### Problems Reported

Beginning in 1989, several critical components of the single-family mortgage insurance program figured prominently in media reports and congressional hearings. Reports and hearings focused on high losses incurred by the Mutual Mortgage Insurance Fund because of unfavorable economic conditions and fraudulent activities in the origination of single-family mortgages and disposition of foreclosed properties. The "Robin HUD" case, in which a private closing agent stole \$6 million in HUD proceeds from foreclosed single-family property sales, was one of the most prominent of the HUD scandals. In June 1990, the Secretary reported that the fund's problems could eventually make it insolvent if corrective action

was not taken. Then in May 1991, the Deputy Secretary of HUD testified that the fund sustained a \$1.4 billion loss in fiscal year 1988 and a \$617 million loss in fiscal year 1989. Although the fund is currently solvent, its net worth in constant 1989 dollars has steadily eroded from \$7.8 billion in 1980 to \$2.6 billion in 1989.

Several economic factors have increased the fund's losses and reduced its financial stability. A large number of claims occurred because of an unusually high number of newly insured mortgages during 1986 and 1987. Historically, the number of claims tends to increase during the second and third years after the insurance is written. Also, defaults and foreclosure rates have remained persistently high in economically stressed regions, particularly the Rocky Mountain and Southwest regions.

In addition to the unfavorable economic conditions affecting the health of the fund, HUD's Inspector General, our office, and others have identified problems in the origination of single-family loans and in the disposition of single-family foreclosed properties. Loan origination problems included fraudulent activities of borrowers, real estate agents, and lenders; approval of loans exceeding the statutory loan limit; inadequate assessment of applicants' repayment ability; and inflated appraisals. Property disposition problems included poor controls over the collection of property sale proceeds, as in the "Robin HUD" case; less than fair market values collected for sold properties; and excessive losses from maintaining foreclosed properties.

The underlying factors contributing to loan origination and property disposition problems included HUD's

- inadequate oversight of underwriting, property management, and collection of property sale proceeds;
- inability to account for acquired properties and their value with the agency's foreclosed property inventory system;
- insufficient cash management system to ensure that proceeds of foreclosed property sales collected by third parties are promptly deposited in FHA's Treasury accounts;
- lack of routine and basic accounting functions;
- inaccurate financial information produced by fragmented, overlapping automated systems; and
- poorly delegated responsibility for carrying out various aspects of the program to private sector third parties.



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Status of Program Reforms

Reforms designed to restore financial stability to the fund and to correct problems in the loan origination and property disposition processes are in progress. HUD and the Congress have originated these reforms. HUD's efforts consisted of initiating several audits of the fund, making program modifications primarily to tighten controls and improve monitoring, and developing automated systems. The Congress' efforts included passage of the HUD Reform Act in 1989 and the Cranston-Gonzalez National Affordable Housing Act in 1990.

To determine the financial condition of the Mutual Mortgage Insurance Fund, HUD initiated audits of its financial statements for fiscal years 1988 and 1989—the first such audits to be conducted in 13 years—and an actuarial study of the Mutual Mortgage Insurance Fund. An independent certified public accounting firm conducted these audits. Additionally, we evaluated the effects of various policy options on the fund. The financial information produced by these audits and reviews assisted the Congress and HUD officials in their efforts to restore actuarial soundness to the fund.

The Cranston-Gonzalez National Affordable Housing Act, enacted in 1990, required a number of changes to the single-family mortgage insurance program designed to improve the Mutual Mortgage Insurance Fund's financial condition. HUD has implemented all of the provisions of the act that include

- requiring borrowers to pay more in cash when their mortgage is originated to reduce defaults;
- restructuring premiums charged by FHA for single-family mortgage insurance to reflect the risk of loans being insured;
- requiring that the ratio of capital held by the fund to its insurance-in-force increase to 1.25 percent within two years and to 2 percent within 10 years to improve actuarial soundness of the fund; and
- requiring HUD to increase its monitoring of these lenders to reduce loan defaults.

To reduce fraud and abuse in the loan origination process, the HUD Reform Act also required modifications to the program. In compliance with the act, HUD made several changes, such as ending investor loans, tightening the rules governing FHA mortgage assumption, and imposing more rigorous standards for appraisers.<sup>7</sup>

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<sup>7</sup>Mortgage assumption is the process by which the purchaser of a home takes over an existing mortgage from the original mortgagor.

HUD took a number of other actions in addition to these legislative requirements. To reduce loan origination problems, HUD tightened its applicant screening, took steps to improve how it targets its lender monitoring efforts, and strengthened appraisal requirements. To reduce property disposition problems, HUD primarily tightened controls over closing agents and area management brokers and took actions to improve property pricing and automated accounting and management systems. For example, HUD increased bonding requirements and required regular reconciliation of unmatched closing packages with proceeds. HUD also implemented the Single-Family Accounting and Management System in all its regions. The system is undergoing a post-implementation review.

According to the Secretary of HUD, these corrective actions have had a positive impact. However, HUD's Inspector General has found that some deficiencies still exist. For example, HUD's Chicago regional office did not enforce increased bonding requirements and failed to maintain accurate and current data on properties handled by closing agents. The Inspector General also found serious problems in the operations of most of the area management brokers it reviewed. HUD is exploring alternatives to address these problems.

## Assisted-Housing Programs

Reports from HUD's Inspector General and an independent accounting firm identified major problems in six of HUD's assisted-housing programs—moderate rehabilitation, section 8 certificates, section 8 vouchers, discretionary loan management set-aside, comprehensive improvement assistance, and public housing authority decontrol. HUD's efforts to reform these programs have been completed for one program—discretionary loan management set-aside. Reforms are in progress for three programs—moderate rehabilitation, comprehensive improvement assistance, and public housing authority decontrol. Reforms have just begun for two programs—section 8 certificates and vouchers.

### Moderate Rehabilitation

**Status of Reforms**

Completed	In Progress	Just Begun
	✓	

#### Program Description

Certain project owners were favored when projects were selected to participate in the moderate rehabilitation program and some received excess rent subsidies totaling about \$100 million.

The moderate rehabilitation program's purpose is to upgrade substandard, privately owned rental housing and assist very low-income families in obtaining decent, safe, and sanitary housing. To achieve these goals, HUD

provides rent subsidies for these families to private owners of rental housing. As of February 1990, when the program was reviewed by an independent accounting firm, more than 116,000 families were served by the program. Total appropriations for fiscal year 1989 were \$42.4 million. No additional funds were provided in fiscal years 1990 and 1991.

HUD provides moderate rehabilitation funds to public housing authorities (PHAs). These funds subsidize the difference between a PHA-established rent level and the amount the low-income family is designated to pay.<sup>8</sup> PHAs competitively select property owners to participate in the program. Owners selected agree to rehabilitate the properties to meet safety and sanitation standards. In return, HUD provides the owner with rental subsidies to eligible tenants for 15 years.

Over time, the moderate rehabilitation program has shifted from funding relatively small projects to much larger projects requiring more than moderate rehabilitation. Prior to fiscal year 1984, HUD field and regional offices competitively selected PHAs to participate in the program. In fiscal year 1984, HUD headquarters took control of selecting not only PHAs but the individual projects to participate in the program. PHAs were then chosen on a noncompetitive and discretionary basis—a reversal of the funding and selection procedures that existed prior to fiscal year 1984.

## Problems Reported

The HUD Inspector General's April 1989 report on the moderate rehabilitation program prompted a myriad of media articles on influence peddling for HUD awards and the creation of a special congressional subcommittee on "HUD/Mod Rehab Investigations." In addition, the House Judiciary Committee requested that an independent counsel appointed by the Attorney General investigate allegations of fraud among the former Secretary of HUD and others.

HUD's Inspector General reported that headquarters officials appeared to show favoritism in selecting PHAs, project owners, developers, and consultants to participate in the moderate rehabilitation program—a selection process that went largely undocumented. In addition, certain project owners received preferential treatment in the selection process and were scheduled to receive rent subsidies totaling about \$100 million for projects funded after October 1984. As a result, projects most in need were not funded and certain states and PHAs received a disproportionate share of

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<sup>8</sup>Within HUD-established rent maximums for the area, the PHAs set rent levels that are necessary to make the project economically viable, considering the costs of owning, rehabilitating, managing, and maintaining the property. Families pay the higher of either 30 percent of adjusted income, 10 percent of gross income, or the portion of welfare assistance designated for housing.

funding. The Inspector General determined that these problems were largely due to noncompliance with project selection criteria and a lack of effective internal controls. In addition, numerous shifts of responsibility for the program within HUD offices confused lines of authority and resulted in little accountability for the program.

The Moderate Rehabilitation Program's problems developed partly because HUD's internal controls were weak and ineffective. According to the Inspector General, these weaknesses specifically included

- unclear project selection criteria that contributed to the arbitrary selection of projects to receive moderate rehabilitation assistance;
- outdated written directives governing the program that did not reflect actual program practices and confused staff and program participants about their roles and responsibilities in carrying out the program; and
- inadequate monitoring by HUD field office staff to detect noncompliance with program requirements.

In addition to ineffective internal controls, the Inspector General found that staffing at HUD and PHAs was not sufficient to properly operate the program. HUD lacked the staff necessary to update procedures, provide needed technical assistance to both field and PHA staff, and follow-up on problems disclosed by HUD and the Office of the Inspector General. PHA staff lacked the expertise to ensure that rental subsidy calculations were correct. Rental subsidy calculation procedures were cumbersome and poorly documented. As a result, they often passed this responsibility on to developers, consultants, or mortgage lenders, who found it to their advantage to inflate rental subsidy calculations.<sup>9</sup>

## Status of Program Reforms

Efforts to address the problems of the Moderate Rehabilitation Program are in progress. The objective of corrective actions initiated by HUD and the Congress in the HUD Reform Act regarding this program are threefold: (1) to have an immediate impact on the way the program operates, (2) to recoup past losses due to payment of excess rental subsidies, and (3) to prevent future excess subsidies. HUD has not approved any new moderate rehabilitation projects since fiscal year 1990.

The Secretary of HUD took several immediate actions to address the problems reported in the HUD Inspector General's April 1989 report.

<sup>9</sup>Some moderate rehabilitation projects were insured through HUD's multifamily coinsurance program. HUD often allowed coinsuring mortgage lenders to compute rental subsidies for coinsured moderate rehabilitation projects.

Initially, the Secretary suspended all projects for which moderate rehabilitation funds were not yet fully committed. While they were suspended, HUD staff reviewed these projects to ensure that they met appropriate criteria. In addition, HUD transferred responsibility for determining rents on coinsured moderate rehabilitation projects from private lenders to HUD field offices in an effort to ensure that HUD paid accurate rent subsidies. HUD headquarters also issued guidance outlining specific criteria to be used in selecting projects to be funded and returned responsibility for selecting PHAS for participation in the program to field offices.

In an effort to recoup rent subsidy overpayments made by HUD in the past, HUD is reviewing all rental subsidy calculations for the 130 projects funded since 1984—a process that is over 50 percent complete. For projects HUD has completed reviewing, incorrect rents have been adjusted and some overpayments made to project owners have been collected.

HUD also took a number of actions to improve the future operation of the program. To prevent excess subsidy payments from occurring in the future, HUD provided field staff with additional training in rent subsidy calculations in late 1989. Then, in the spring of 1990, HUD implemented several program restrictions required by the HUD Reform Act, such as limiting the size of a project that can qualify to participate in the program.

## Section 8 Certificates and Vouchers

### Status of Reforms

Completed	In Progress	Just Begun
		✓

### Program Description

Weak information and financial management systems and internal controls in the section 8 Certificate and Voucher Programs prompted payment of inaccurate rental subsidies to tenants and admission of ineligible tenants into the program.

Both the certificate and voucher programs provide rental subsidies to assist very low-income families in finding private housing that meets safety and sanitary standards. For fiscal year 1990, over \$2.3 billion was available to provide certificates for 57,725 units and over \$1.2 billion was available to provide vouchers for 43,892 units.

Under both the certificate and voucher programs, eligible families receive rental subsidies for housing units which fall within the fair market rents set by HUD. However, the voucher program provides greater housing selection by permitting assisted families to rent units above the fair market rent. After eligibility is initially determined, tenants are recertified by PHAS

annually or sooner if a change in financial circumstances, such as income, occurs. During the certification process, a tenant's share of the rent is determined by using the higher of three factors—30 percent of adjusted income, 10 percent of gross income, or the portion of welfare assistance designated for housing. PHAs then provide certificate and voucher subsidies equal to the difference between the tenant's rental payment and the actual rent up to the fair market rent. However, under the voucher program, if the actual rent exceeds the fair market rent, the tenant incurs the additional rental expense. HUD reimburses PHAs for all subsidies paid on behalf of households under these two programs.

## Problems Reported

While the media reported cases of tenant fraud regarding the certificate and voucher programs in 1990, HUD studies documented a number of weaknesses in the processes and systems used to pay subsidies and determine applicants' eligibility. These studies indicated that inadequate information and financial management systems and internal controls adversely affected the programs' subsidy payments and determination of applicants' eligibility. An inappropriate organizational structure and lack of updated directives to staff and program participants also detracted from HUD's ability to provide accurate subsidies.

According to HUD studies, internal control weaknesses prevented the Department from ensuring that the subsidies it paid and tenants admitted to these programs were appropriate. PHA staff often did not receive accurate or complete applicant income information from prospective landlords or tenant families. Furthermore, PHAs often made mathematical errors in calculating subsidies. Excessive subsidies also occurred because some landlords received inappropriate special claims reimbursements for unpaid rent, damages, and vacancy losses. These overpayments, based on PHA data and made by HUD, were not detected or collected in a timely manner.

Most of these problems were attributable to inadequacies in the programs' information and financial management systems. An independent accounting firm hired by HUD to review the section 8 programs determined that the following control weaknesses contributed to HUD's payment of inaccurate subsidies and admission of ineligible tenants:

- HUD had not standardized the process used by PHAs to prepare certificate payment requests.
- HUD's process for reviewing and approving payment requests before payment was inadequate.

- Management and accounting systems could not properly track subsidy payments.
- PHAs and owners did not have adequate incentives to submit timely and correct tenant recertifications.

Other contributing problems, according to the accounting firm, included weaknesses in HUD's organizational structure and in directives provided to staff and program participants. HUD program management and accountability was fragmented between HUD's housing, public housing, and administration offices, as well as between the field and headquarters which created conflicting and confusing lines of authority and responsibility for operating the program. Program staff were also confused about how to operate the program by regulations, handbooks, and program manuals that were outdated, overly complex, and not comprehensive.

## Status of Program Reforms

HUD has just begun to implement its reforms of the certificates and vouchers programs. The subsidy payment process will be reformed largely as the result of a comprehensive study of section 8 programs that was conducted by an independent accounting firm.

HUD hired the accounting firm in February 1990 to review its multifamily assisted housing programs, including the section 8 certificate and voucher programs. After identifying vulnerabilities in the programs, the contractor made recommendations to HUD on improving and integrating automated systems, standardizing and restructuring program organization, and improving program procedures and handbooks. These recommendations are designed to improve the way HUD carries out its section 8 programs, including the processes HUD uses to pay rental subsidies and admit tenants into the program. Although HUD began implementing these recommendations in April 1991, full implementation of a new comprehensive information system recommended by the contractor is not expected to be completed until 1996.

HUD took several other steps to improve the accuracy of its subsidy payment process. In September 1989, HUD published regulations and instructions requiring tenants to provide social security numbers for matching income information with state wage data. By verifying household income information supplied by tenants, HUD could reduce the likelihood of paying inaccurate subsidies and admitting tenants who are ineligible because of high incomes. To reduce excessive subsidies for special claims submitted by landlords for expenses, such as unpaid rent, HUD reminded its

field offices in February 1990 of the importance of following previously issued procedures for reviewing these claims.

## Discretionary Loan Management Set-Aside

### Status of Reforms

Completed	In Progress	Just Begun
✓		

Discretionary Loan Management Set-Aside (LMSA) awards granted at the discretion of the Assistant Secretary for Housing have been arbitrary and poorly documented. Project award files suggest that regulatory requirements were not met and that subsidies were provided to developers who did not qualify for them.

### Program Description

The LMSA program's purpose is to prevent defaults and preserve FHA-insured and HUD-held projects facing potentially serious financial difficulties. Total funding available for fiscal year 1990 was about \$308 million. Approximately 5 percent of total annual funding for the program is held each year for discretionary awards. Discretionary awards provide financial emergency funds to projects that require immediate attention and cannot wait for the annual LMSA funding cycle.

HUD is required to use a number of regulatory criteria for selecting projects to receive LMSA funding. Applications for funding are required to include information such as the project resident's gross income, family size, and rent, and the project's financial history. HUD may consider only applications that meet regulatory criteria, such as whether the project units meet housing quality standards. Projects are then selected for assistance by HUD headquarters officials through an annual needs survey conducted by regional and field staff that ranks projects according to a number of operational factors. Discretionary LMSA awards are made for projects experiencing financial emergencies that cannot wait for the completion of the regular funding cycle and meet the regulation criteria under annual LMSA funding awards. According to the HUD Inspector General's most recent report on the program dated March 31, 1989, HUD management believed that discretionary LMSA awards were not subject to the same requirements of the annual LMSA program cycle, but administered at the discretion of the Assistant Secretary. However, HUD's Office of the General Counsel responded that all applications for LMSA awards, including discretionary awards, must meet regulatory approval criteria.

### Problems Reported

According to HUD reports, discretionary LMSA awards have been arbitrary and poorly documented, with this component of the program lending itself to favoritism and abuse. Discretionary awards were not used as intended to



solve problems such as high vacancies, poor cash flow, and claims involving FHA's insurance fund. Instead, decisions to fund projects were inappropriate, arbitrary, and unsupported because they did not follow prescribed agency procedures. Documentation contained in discretionary LMSA project award files suggest that subsidies were provided to unqualified developers and that regulatory criteria were not used in the selection process. Furthermore, HUD's Inspector General reported in March 1989 that the then Assistant Secretary for Housing directed the selection of most projects and did not document why these projects were selected—a process that often excluded HUD field and regional office staff. In fact, the Inspector General acknowledged that HUD field offices were sometimes unaware of, or even opposed to, awards made from headquarters.

Status of Program Reforms

HUD has completed its reforms of the discretionary LMSA program. To correct the problems in the selection of projects for participation in the program, HUD provided its field offices with clear policy directions for determining and documenting eligibility for LMSA subsidies in the request to HUD headquarters for emergency funding. In addition, HUD notified its field offices that they are required to establish special files and use standard work sheets to document project eligibility.

Comprehensive Improvement Assistance and the Public Housing Authority Decontrol Programs

Allegations of mismanagement and fraud at several PHAs have resulted in two programs receiving increased scrutiny—the Comprehensive Improvement Assistance Program (CIAP) and the Public Housing Authority Decontrol Program.

Status of Reforms

Completed	In Progress	Just Begun
	✓	

Program Description

HUD initiated both the CIAP and decontrol programs at PHAs during the 1980s. CIAP is intended to upgrade the physical condition, management, and operation of existing public housing projects by providing modernization funds to qualified authorities. The decontrol program permits well-operated PHAs greater autonomy and flexibility so that HUD field offices can focus their monitoring on troubled housing authorities. Approximately \$1 billion in funds was appropriated for CIAP's fiscal year 1990 improvements. By the time of the HUD scandals, in June 1989, about 20 percent of all PHAs were decontrolled.

PHAS must apply to HUD to receive CIAP funding. HUD field offices are responsible for ensuring that authorities that receive CIAP funds are carrying out their modernization activities in accordance with the plans HUD has approved, applicable laws, and program regulations. Field offices are also responsible for helping authorities identify and correct problems that arise during the implementation of their CIAP projects.

Under the decontrol program, PHAS were required to meet seven performance standards to qualify for decontrolled status. For example, one such standard required PHAS to maintain a required level of funds in their reserve accounts. Decontrolled PHAS were relieved from required HUD reviews, allowed greater program operation flexibility, and granted increased management responsibility and authority.

## Problems Reported

Problems in the administration of these programs were highlighted by the media in January 1990, when a variety of abuses were uncovered at the Passaic, New Jersey housing authority. HUD's Inspector General uncovered substantial irregularities in the way this decontrolled authority operated many of its activities, including the management of its CIAP funds. According to the Inspector General, neither CIAP nor the decontrol program was able to achieve its objectives efficiently. The Inspector General found that (1) many PHAS inadequately administered their CIAP funds and (2) the decontrol program allowed unqualified authorities to be decontrolled while failing to meet its objectives of increasing PHA flexibility and redirecting HUD monitoring to troubled authorities.

Millions of dollars in CIAP funds may not be used economically and efficiently because of inadequate program administration by PHAS, according to HUD's Inspector General. The Inspector General attributed CIAP's administrative difficulties to the authorities' inability and unwillingness to comply with HUD requirements and adequately review contractors' invoices and to HUD's failure to provide authorities with adequate oversight and technical guidance. The Inspector General found that some of the 34 PHAS his staff reviewed (1) charged \$4.6 million in ineligible and unsupported costs to CIAP, (2) awarded \$4.2 million in contracts without using required competitive bidding procedures, (3) executed contract change orders for \$1.4 million without HUD's approval and review, and (4) made duplicate payments amounting to \$842,000 for contractor invoices. HUD's specific oversight and guidance inadequacies included insufficient on-site CIAP project reviews and lack of review of PHAS' charges to the program.

HUD's Inspector General also found that the decontrol program (1) allowed some unqualified PHAs to obtain decontrolled status and (2) failed to increase the flexibility of authorities and HUD field staff as intended. Almost all—15 of 17—decontrolled housing authorities reviewed by the Inspector General in February 1990 failed to meet the seven required performance standards. In addition, of the 17 decontrolled authorities reviewed, 13 either did not want to be decontrolled or did not feel they benefitted from decontrol. Furthermore, the decontrol program did not enable any of the HUD field offices the Inspector General reviewed to focus more attention on troubled PHAs.

### Status of Program Reforms

HUD is in the process of taking a number of steps to address the problems at PHAs associated with CIAP and the decontrol program. To resolve CIAP's problems, HUD increased monitoring and revised handbooks and regulations. HUD suspended the decontrol program in January 1990 and is in the process of implementing a replacement program.

HUD's regional and headquarters officials worked to improve CIAP oversight and the program's handbooks and regulations. According to certifications they submitted to headquarters, each HUD regional office corrected the major deficiencies in their oversight of CIAP activities at PHAs by September 1990. Regional offices also reviewed and adjusted established dollar thresholds governing authorities' submission of Request for Proposal advertisements, budget revisions, and contracts.<sup>10</sup> In addition to these regional office activities, HUD attempted to improve its oversight of CIAP by changing its handbook requirements for HUD monitoring visits from 2 to 4 times each year. HUD is also considering alternative methods of contracting out for monitoring of CIAP activities. Furthermore, HUD revised the CIAP handbook and regulations to incorporate program administration improvements, including new instructions on procurement bidding and contracting and a renewed emphasis on having additional costs to HUD for review before expenditure. Field office staff received training on the new CIAP handbook and regulations.

Immediately following reports of mismanagement and fraud at the Passaic public housing authority, HUD sent out an investigative strike force to selected authorities nationwide and subsequently suspended the decontrol program. When the program was suspended, all authorities that had been decontrolled became subject to the same HUD oversight as

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<sup>10</sup>Public housing authorities must submit for HUD's review only those requests for proposal advertisements, budget revisions, and contracts which exceed the dollar threshold set by the HUD regional office.

non-decontrolled authorities. HUD then began developing a successor program, the Public Housing Management Assessment Program, which uses considerably revised and expanded performance standards to determine which PHAS require less and which require more oversight. HUD published interim regulations implementing the new program in April 1991 and subsequently field tested the proposed program at 250 PHAS. The program is expected to become fully operational in early 1992 when HUD publishes revisions to the interim regulations.

## Community Development Programs

HUD's Inspector General reports and congressional investigations and hearings identified major problems in two of HUD's community development programs—community development block grant (CDBG) entitlement and the Secretary's Discretionary Fund. HUD has completed its reforms for CDBG and is currently in the process of implementing corrective actions to address problems under the Secretary's Discretionary Fund.

### Community Development Block Grant Entitlement

Weak internal controls and lack of monitoring of CDBG grantees and subgrantees resulted in unmet community development needs, nonperformance of contracted activities and waste of program funds.

**Status of Reforms**

Completed	In Progress	Just Begun
✓		

### Program Description

The CDBG program provides annual grants to promote sound community development. With CDBG grants, metropolitan cities and urban counties carry out a wide range of community development activities directed toward neighborhood revitalization, economic development, and improved community facilities and services. In fiscal year 1990, over \$2 billion in entitlement funds were appropriated for 741 metropolitan cities and 125 urban counties.

Communities receiving these grants develop their own programs and funding priorities in cooperation with local residents. HUD distributes these CDBG awards to grantees, who often pass some funds on to subgrantees to carry out community development activities. HUD field offices are required to supervise, direct, and monitor grantees according to a number of policies, directives, and handbooks. However, HUD has not developed any regulations or policy guidance regarding grantee requirements for monitoring subgrantees. Grantees are responsible under their grant agreements and

OMB Circular A-102 to monitor subgrantees. Although OMB Circular A-102 defines grantee responsibilities for monitoring subgrantees, each grantee is responsible for developing its own subgrantee monitoring system or procedures.

In addition to the CDBG entitlement, many CDBG grantees receive program income from activities undertaken with CDBG funds in past years. Common forms of program income are repayment of housing rehabilitation and economic development loans, proceeds from the use of CDBG-assisted properties, and sales proceeds from property acquired with CDBG funds. Program regulations require grantees to use program income before drawing from their new CDBG funds and to spend it according to the same rules that pertain to new CDBG funds. The monitoring responsibilities of field offices include overseeing grantee use of program income.

## Problems Reported

In 1989 and 1990, HUD's Inspector General issued two reports on the CDBG entitlement program which stated that weak internal controls and lack of monitoring of CDBG grantees and subgrantees resulted in unmet community development needs, nonperformance of contracted activities, and waste of program funds.<sup>11</sup> Specifically, the Inspector General identified grantee monitoring of subgrantees as an ongoing weakness and insufficient HUD management and monitoring of program income.

Because HUD does not provide grantees with guidance on monitoring subgrantees, the following control weaknesses existed:

- Grantees did not monitor subgrantees effectively or followup to ensure that findings were resolved;
- Controls over reimbursement requests were inadequate;
- Subgrantee budgets and contracts did not show funding by project, so it was difficult to tell if spending was in line with work performed.

In addition, HUD's failure to monitor grantees effectively did not ensure that monitoring systems and procedures were in place and functioning.

Also, according to the Inspector General, insufficient management and monitoring of program income allowed some community development needs to go unmet. The Inspector General found many instances in which grantees failed to report and use CDBG program income in compliance with

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<sup>11</sup>Summary Report: Monitoring of Subgrantee Performance, Inspector General of HUD, (89-TS-141-0003, January 10, 1989) and Review of CDBG Program Income and Miscellaneous Revenue, Inspector General of HUD, (90-TS-145-0011, April 30, 1990).

regulations during fiscal year 1989. During a review of 29 grantees nationwide, the Inspector General identified over \$20 million in program income not reported to HUD as required and over \$19 million spent on ineligible or unsupported uses.

According to the Inspector General, grantees used program income inappropriately because HUD failed to monitor and manage grantees adequately. Particular deficiencies contributing to the misuse of program income included

- ineffective and poorly documented HUD monitoring of grantee program income;
- lack of grantee followup of deficiencies disclosed by HUD monitoring efforts to ensure that corrective action was taken, or that it was effective and timely; and
- inadequate coverage of the use of program income in CDBG program regulations, procedures, and management goals.

#### Status of Program Reforms

HUD has completed its reforms of CDBG subgrantee monitoring and the use of program income. HUD has addressed these problems by issuing revised program regulations, improving handbooks and bulletins, and providing training to appropriate HUD staff and grantees.

In September 1988, HUD issued regulations that increased the amount of information that subgrantees must report to grantees and strengthened controls over the use of program income. Further, in 1989, HUD revised its monitoring handbook to include checklists to assist field staff in determining whether grantees are adequately monitoring subgrantee performance and issued a comprehensive guide for reviewing performance reports submitted by grantees.

In addition, HUD provided training bulletins and conducted training sessions to improve monitoring of subgrantees and program income. HUD headquarters staff published a bulletin on program income for field office staff and grantees in April 1990 and a bulletin on subgrantees in September 1990. Both bulletins explain applicable regulatory requirements and answer common program operation questions. During fiscal year 1989, HUD field office staff were trained on evaluating grantee monitoring of subgrantees and recognizing program income when reviewing grantee community development programs.

**Secretary's Discretionary Fund**

The former Secretary of HUD and some of his assistants appeared to show favoritism in awarding technical assistance and special projects grants from the Secretary's Discretionary Fund.

**Status of Reforms**

Completed	In Progress	Just Begun
	✓	

**Program Description**

Technical assistance and special projects grants were provided through the Secretary's Discretionary Fund to help implement community development programs. Technical assistance grants were used for activities such as group training and written materials needed to improve delivery of community development services. Special projects grants were used for community development activities such as infrastructure, housing, and economic development. Before the special projects grants were terminated in 1989 by the HUD Reform Act, \$12.25 million had been appropriated during the program's final year. For technical assistance grants, \$28.6 million was appropriated for fiscal year 1990.

The selection of projects to receive technical assistance and special projects grants was based largely on unsolicited proposals and relied on the discretion of the Secretary of HUD. Projects sponsored by nonprofit organizations, colleges, universities, state and local governments, and private for-profit firms were selected for technical assistance funding. However, only projects sponsored by state and local governments were eligible for special projects funding.

**Problems Reported**

Reports of favoritism in awarding technical assistance and special projects grants from the Secretary's Discretionary Fund received a great deal of congressional attention during the investigations and hearings on the HUD scandals. Based on the congressional hearings, the fund has been included in the U.S. Attorney General's investigation into allegations of fraud by the former Secretary of HUD and his aides.

The former Secretary of HUD and some of his assistants appeared to show favoritism in awarding technical assistance and special projects grants from the Secretary's Discretionary Fund. The HUD Inspector General reported in August 1986 that the process by which technical assistance projects were selected lacked sufficient review and did not ensure that only the most advantageous projects received funding. Furthermore, selected projects had questionable effectiveness in providing technical assistance to targeted groups. The Inspector General also found that inappropriate

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projects may have been selected for the program because it lacked guidelines for reviewing and approving applications.

Status of Program Reforms

HUD is in the process of implementing corrective actions to address these problems. The HUD Reform Act made a number of modifications to the Secretary's Discretionary Fund to eliminate all discretionary features and to rename the program "Special Purpose Grants." The act modified the technical assistance program to ensure that funds are awarded openly and competitively and that they are used for appropriate technical assistance purposes. Specifically, the act (1) limited eligibility to projects that facilitate planning, developing, and administering community development activities, (2) required that all awards be made competitively, and (3) required publication of selection criteria, funding amounts available through the program, and all regulation waivers in the Federal Register. Because of the problems with special projects grants, the act eliminated them altogether. To comply with these requirements, HUD is publishing notices of funding availability containing selection criteria for technical assistance projects and is in the process of issuing final regulations implementing the changes.



# Comments From the Department of Housing and Urban Development



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
THE DEPUTY SECRETARY  
WASHINGTON, D.C. 20410-0050

December 4, 1991

Mr. John M. Ols, Jr.  
Director, ATUD  
Housing and Community Development Issues  
U.S. Government Accounting Office  
441 G. Street NW, Room 1842  
Washington, DC 20548

Dear Mr. Ols:

Secretary Kemp has asked me to respond to your memorandum dated October 21, 1991, which transmitted your draft report on HUD reforms.

The overall tone of the report gives the impression that very little has been accomplished in the Department and that any changes that will be, or have been, made will not be effective until the major structural deficiencies are corrected. I do not believe this is the case. Significant progress has been made in a number of areas as indicated in comments prepared by HUD staff and forwarded to your office last week. These changes will have positive impact.

While HUD has begun to correct the departmentwide deficiencies, the agency is in various stages of resolving problems in the 14 programs your staff reviewed. As shown in the draft report, reforms have been completed in four of the 14 programs, are underway in another eight, and just begun for the remaining two programs. Once our comments on the draft are incorporated there may be some shifting of these statistics and reforms listed "in progress" may move to the "completed" stage and those listed "just begun" may move into the "in progress" column.

In your report you raised the issue of major structural deficiencies which contribute to management problems throughout the agency. The four departmentwide areas involve functions and activities such as management systems that provide data; controls to ensure compliance with HUD laws and regulations; authority of different HUD organizational units; and sufficiency of staff to perform functions such as monitoring. We have taken initial steps to correct these problems. We have hired a Chief Financial Officer, five program area Comptrollers and have plans for Regional Comptrollers. The Department has approved a strategic plan for new integrated financial management statements and submitted it to OMB. We are working on plans to improve our structure and take maximum advantage of our staff resources. We recognize however that much work remains to be done by HUD before our reforms will be complete.

I appreciate your taking the time to meet with our Chief Financial Officer and Staff from the Office of Inspector General and I look forward to receiving your final report.

Very sincerely yours,

A handwritten signature in dark ink, appearing to read "Al".

Alfred A. DelliBovi  
Deputy Secretary

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# Major Contributors to This Report

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Resources, Community,  
and Economic  
Development Division,  
Washington, D.C.

Clifton Fowler, Assistant Director-in-Charge  
Robert Procaccini, Assistant Director  
J. Michael Bollinger, Evaluator-in-Charge  
Leslie Black-Plumeau, Staff Evaluator

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