U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
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on

"Oversight of HUD's HOME Program"

June 3, 2011

Chairman Bachus, Ranking Member Frank and Members of the Committee, thank you for the opportunity to testify today regarding HUD's oversight of the HOME Investment Partnerships Program (HOME) within the Office of Community Planning and Development.

As the Assistant Secretary for the Office of Community Planning and Development (CPD), I have the privilege of overseeing HOME, along with CDBG, Special Needs and Economic Development programs. This CPD portfolio of formula and competitive programs provides the critical resources for homelessness prevention, affordable housing and job creation--the foundation for healthy communities across our country.

I am happy to appear before you today to discuss the HOME program's success over the last twenty years, our oversight and enforcement tools and actions, and to provide you with the facts about the program that the Washington Post omitted in its May 15, 2011 article.

HOME: 20 Years of Success/Over 1 Million Units

The HOME Investment Partnerships Program (HOME) is the largest federal block grant to state and local governments designed exclusively to produce affordable housing for low-income families. HOME was authorized in 1990 as Title II of the Cranston-Gonzalez National Affordable Housing Act (42 U.S.C 12701 et seq.)..."to provide participating jurisdictions, on a coordinated basis, with the various forms of Federal housing assistance, including capital investment, mortgage insurance, rental assistance, and other Federal assistance, needed to expand the supply of decent, safe, sanitary, and affordable housing; to make new construction, rehabilitation, substantial rehabilitation, and acquisition of such housing feasible; and to promote the development of partnerships among the Federal Government, States and units of general local government, private industry, and nonprofit organizations able to utilize effectively all available resources to provide more of such housing."

As such, HOME funds may only be used for four primary purposes, production of new single or multi-family housing units, rehabilitation of housing, direct homeownership assistance, or time-limited tenant-based rental assistance (for up to two years with possibility of renewal). HOME provides funding to 642 state and local governments, 'participating jurisdictions' (PJs) or 'grantees.' For most of these jurisdictions, HOME is the only reliable stream of affordable housing development funds, and their principal tool for the production of rental and for-sale housing for low- to extremely low-income families, including mixed-income housing and housing for persons with special needs (e.g., the homeless and persons with HIV-AIDS).

HOME is an anchor of our nation's affordable housing finance system. The program provides state and local governments with to the discretion to determine the type of housing product they will invest in, the location of these investments and the segment of their population that will be housed through these investments. Although tax credits can provide 40-50% of the capital, the HOME gap financing influences where affordable housing is built. Since 1992, these PJs have completed over one million affordable housing units, including 428,373 for new homebuyers, 197,780 for owner-occupied rehabilitations, and 381,883 rental units produced. In addition, 242,768 tenants have received direct rental assistance. The program has leveraged $3.94 dollars of other public and private investment for every dollar of HOME funds expended to date. Over the life of the program, HUD has leveraged more than $80 billion of other funds for affordable housing. In addition to leveraging other funds, PJs must provide a 25 cent cash or in-kind match for each dollar of HOME funds they expend.

All HOME funds must be used to benefit families and individuals who qualify as low-income, or below 80% of Area Median Income (AMI). The investment of HOME funds in rental projects increases affordability for families at the very lowest income levels by requiring long-term income targeting and affordable rents. Of the tenants occupying HOME units completed during the last five years, 47% were extremely low-income (i.e., income less than 30% of the area median income) and another 38% were very low-income (i.e., income less than 50% of area median income but greater than 30%).

Traditionally, HOME funds have also provided critical gap financing that makes Low-Income Housing Tax Credit (LIHTC) projects feasible. During the same five year period, 147,919 HOME-assisted rental units have been completed. Of that number, 47% or nearly 70,000 units were part of LIHTC projects. In all, HOME gap financing helped complete 132,198 LIHTC units during that period. During the recent economic crisis, when Tax Credits were selling at much reduced prices or not at all, HOME funds provided essential gap financing for LIHTC projects. Moreover, HOME was essential to keeping construction jobs going in communities where market rate housing construction came to a halt.

HOME is also a catalyst for economic development, serving as an anchor to revitalizing communities as can be seen in the following example:

Trolley Square Project, Cambridge, MA

The Trolley Square Project in the North Cambridge neighborhood is an excellent example of a sustainable project that has contributed to the area's vitality. The project site was a previously fenced-in unattractive parcel occupied by out-of service MBTA buses. Today, it is a mixed-use, mixed-tenure 40 unit project. Thirty-two of the 40 are affordable rental units, the remaining eight are homeownership, of which 5 are affordable. It was designed to incorporate green technologies and permit residents to live a high-quality car-free life. It is situated on Massachusetts Avenue, the transit, retail, commercial and services corridor of North Cambridge. The State of MA provided $2.1 million in HOME funds for the project, which leverage over $18.4 million in other public and private resources.

HOME and Disaster Recovery

While Congress has not made supplemental disaster appropriations for the HOME Program in recent years, regular HOME funds play a significant role in disaster recovery in communities across the country. HOME PJs can reprogram their uncommitted or unexpended HOME funds to provide emergency housing assistance and disaster recovery. HUD has authority to suspend statutory provisions and waive regulations to facilitate the use of HOME funds for disaster recovery. These suspensions can provide additional administrative and planning funds, reduce property standard requirements to facilitate emergency repairs, and provide more flexible income documentation requirements for households whose homes and documentation have been destroyed.

In the past several years, HOME funds have played an important role in recovery efforts for Hurricanes Katrina, Rita, Ike and Wilma in Louisiana, Texas, Mississippi and Florida; tornadoes in Missouri, Tennessee and Alabama; and severe storms and flooding in Washington and Oregon. When Hurricane Katrina displaced thousands of people from New Orleans, communities across the country opted to use HOME tenant-based rental assistance to assist evacuees to settle into new communities. Just last month, within two-days after receiving the State's request, HUD provided statutory suspensions and regulatory waivers to the State of Alabama to help address the urgent need for housing assistance caused by the damage to units and displacement of families caused by severe storms, winds, tornadoes, and flooding.

HOME: A Formula Program—HUD Oversight/Local Decision Making

Formula block grants, such as HOME, are based on the premise that local communities understand their needs better than the federal government. As such, state and local governments are provided with the discretion and flexibility to design programs based on their jurisdiction's housing market conditions and needs. In exchange for this flexibility, participating jurisdictions, who are the HUD grantees, have the responsibility for managing the day-to-day operations of their HOME program, ensuring that the funds are invested in accordance with all program requirements and written agreements, tracking and monitoring construction progress by their development partners; and taking appropriate action when project performance issues arise. HUD's charge in managing HOME, and other block grant programs, is to balance this right of state and local governments to make funding decisions with our fiduciary responsibility as stewards of the taxpayers' trust and money. As such, HUD has the ultimate oversight responsibility and has exercised this responsibility consistently. HUD assesses PJ risk, monitors grantee performance to ensure compliance with program regulations and reporting, and takes enforcement action(s) when necessary.

Setting the Record the Straight: The Facts the Washington Post Omitted

On May 15, 2011, the Washington Post published the first in a series of articles focused on the HOME program. After a year-long investigation, the Post concluded, what we have always known: 1) producing affordable housing is hard and has been especially challenging during the worst housing crisis since the Great Depression; and 2) with 642 state and local governments as HUD PJs/grantees, the capacity levels will vary and capacity gaps exist.

The Post article was full of numbers - and misstatements - but lacking in context and balance. Its one-sided nature made it impossible for fair-minded readers to understand what the numbers presented really meant. Its failure to mention the recent recession's ongoing effects on real estate markets and residential construction is confounding. The article, and its conclusions, also displayed a lack of basic understanding of the housing development process itself, and the particular difficulties inherent in developing affordable housing. Typically these projects have many layers of funding – each source with its own set of regulations and deadlines. HOME is one of these layers of funding, providing "gap financing"—the difference between a project's total development cost and the amount the private lenders and investors can reasonably finance. The numerous layers of funding are critical to ensure affordability of these housing units for up to 20 years or more (depending on financing sources and restrictions). When one adds to the financing process, the politics of the local decision making process, even the best of projects can be thwarted. Even in a good economy, it is not uncommon for new multi-family construction projects to take 3-5 years from the initial planning to completion. On average, the construction phase may take up to 24 months for affordable housing developments compared to 18 months for market rate developments (See Attachment 1).

The Post's Incorrectly Labeled "700 Delayed Projects"

The Post stated that its analysis found "about 700 troubled projects that were awarded $400 million." It is our understanding that the Post reached this conclusion by analyzing the 28,000 HOME "open" projects in some state of development process as reported by PJs in the Integrated Disbursement and Information System (IDIS), HUD's electronic reporting/disbursement system, as of November 30, 2010. For context, over 700,000 HOME projects have been undertaken and completed over the years resulting in more than one million HOME units produced. Based on a four-year average, there are over 30,000 open activities at any one time and about 40,000 are completed or closed in the system annually creating over 70,000 HOME funded units per year.

It is also our understanding that the Post eliminated all homeowner rehabilitation activities from the report and only reviewed those with at least a $50,000 HOME commitment and no draws in 18 months, for a subset of 5,100 activities. Of those, the Post deemed 700 "idling" or "stalled" - 14% of the 5,100 subset and only 2.5 percent of the 28,000 HOME projects underway or "open" at that time.

It is important to note that HUD's Office of the Inspector General (HUD-OIG) has defined a project as "stalled or potentially terminated" if the open activity is more than five years old with less than

50% of the funded amount having been drawn down. In 2010, the HUD-OIG determined that there were 108 projects in this category, all of which have since been completed or terminated. The differences between the Post definition (no funds drawn in the preceding 18 months) and the HUD-OIG's definition reflects the difficulty in assuming a project is "stalled" based on a defined time period as the HUD review of these projects illustrates.

HUD's Review of the Post's Incorrectly Labeled "700 Delayed Projects"

When the Post declined to identify the specific 700 projects that they were referring to, HUD applied the Post's criteria to the universe of HOME projects open as of November 30, 2010, and identified 797 projects with $469 million in HOME commitments. HUD has analyzed these 797 projects and found that the majority of these been completed or are progressing towards completion. Only 214 projects or 27 % actually appear to be delayed, (based on the Post's definition), the majority due to market conditions, such as unavailability of financing or inability to sell completed units due to the collapse of the housing market. Another 44 projects will be canceled by grantees and HUD will require appropriate repayment of funds. Overall, 539 of the 797 are projects HUD are completed or progressing towards completion.

It is also important to note that, often, HOME funds are used upfront for land acquisition or to pay for other pre-development or early-stage project costs. Therefore, it would not be unusual at all for many months to pass without any additional HOME funds being drawn down while the development of the project proceeds.

Projects in Final Draw

The Post also mentions 2,800 projects in "final draw" or projects having all or nearly all of the HOME funds committed to them by the participating jurisdictions expended, yet the projects still appear as 'incomplete' or open in IDIS. HUD is not clear how the Post arrived at this number. The HOME regulations require that participating jurisdictions enter projects as "completed" in IDIS within 120 days of the final draw. While there are many reasons for a participating jurisdiction to need additional time beyond the 120 days (e.g., mechanics' liens may not have been cleared, Davis-Bacon violation complaints remain outstanding, pending litigation), there may be projects that are actually completed and appear as incomplete in IDIS. HUD has been working to reduce the number of overdue completion entries in IDIS for several years and in a number of ways – e.g., public disclosure of this information and published ranking of participating jurisdictions for compliance through the HOME Performance SNAPSHOT, and HUD Field Offices directly calling their PJs to ensure timely reporting. We are also aware that our PJs face financial pressures that have resulted in agency consolidations, furloughs and layoffs, and data entry and reporting may not be the first priority. However, since December 2009, HUD has reduced the final draw open activities by 48 percent, from 8,217 to 4,235 as of April 30, 2011.

HOME in the Real Estate Market

The fact is that housing development undertaken by the private sector alone or in combination with HOME program assistance is a process that typically stretches over years and regularly encounters problems and delays along the way. Under these circumstances, it would be ill-advised for an oversight body such as HUD to act precipitously or prematurely. Grantees must retain the flexibility to deal with, and have the time and opportunity to correct, problems, before a regulatory body intervenes. When project delays come to CPD's attention, the first response may be to offer technical assistance to the grantee which is provided by either CPD staff or technical assistance providers that are under contract for this purpose.

Overall, HOME's record of performance under the current market conditions compares very favorably to the private market success rate. HUD's Policy Development and Research Division, compared new housing starts to the number of certificates of occupancy issued from 2007-2010, and found that 34% of all housing units had not been completed within three years of permitting. In comparison, the 216 delayed HOME projects represent only 4% of the projects in the Post's sample of 5,100 HOME projects.

HUD Oversight and Enforcement

HUD takes its role as steward of taxpayers' money seriously and our oversight of HOME is no exception. The HOME program has a track record of vigilance in attempting to prevent and, when necessary, to remedy the misuse of federal funds. These actions have accelerated since 2009. In early 2009, we conducted an overall assessment of the program and found that a HOME is a solid production program that needed regulatory and system improvements. We requested Transformation Initiative (TI) funds approved in HUD's FY 2010 budget for improvements to IDIS and started working on revisions to the HOME regulations. Moreover, it was clear that we had to improve our technical assistance and capacity building to support our grantees in becoming true placed-based players in the housing market. Based on this assessment, we have improved and will continue to improve our oversight, monitoring, enforcement and our partnership with the HUD Office of the Inspector General.

Oversight

Risk Assessment and Monitoring by Field Offices

HUD has taken steps to improve its on-site and remote monitoring ability and, consequently, its oversight of grantees. These include a stricter risk management assessment, improved comprehensive monitoring exhibits and clear procedures for field offices to provide oversight of CPD's programs.

Each year HUD field offices conduct a risk assessment of all formula and competitive grantees based on several factors, including size of formula grant, complexity of activities undertaken, management capacity, and length of time since last monitoring visit. Based on the risk assessment results, field offices target staff resources to monitor grantees that pose the greatest risk of fraud, waste, abuse and mismanagement. This monitoring includes a PJ review to assess policies and procedures governing sub-recipient management, financial management, cost allowability, written agreements, match requirements and beneficiaries' data. It also includes a review of specific project files and on-site inspection of selected sample project(s)

In the last two fiscal years (FY 2009-10), field offices monitored 238 of 642 HOME PJs nationally (37 percent), and identified 591 findings related to compliance and/or performance. It must be noted that CPD field staff are responsible for monitoring all CPD programs, including other major programs such as CDBG and Homeless Assistance programs. In addition, considerable field resources were devoted to monitoring the $3.92 billion HERA-Neighborhood Stabilization

Program to ensure that it operated free from fraud and abuse. In FY 2010, 162 of 307 NSP 1 grantees were monitored.

Reporting

HUD has developed a range of innovative tools and system improvements over the years to improve HOME oversight and to assist grantees to better manage their programs. These tools help to track program funds, to rate and rank grantee performance, and to identify and lower risk in the HOME program – most are publicly available on HOME's website, http://www.hud.gov/offices/cpd/affordablehousing/reports/. These reports include,

- **HOME Performance SNAPSHOT Report** – posted for the first time in 2003. This quarterly report tracks the progress of individual participating jurisdictions and ranks them against others for eight performance factors. It is an important tool in helping to evaluate the performance of participating jurisdictions by ranking them and providing a context for accomplishments. It includes a special "redflags" report indicating particularly poor performance in any of the five areas related to HOME-assisted rental production. Attachment 2 is an example of this report for Jefferson County, AL, a PJ in Chairman Bachus' district.

- **Dashboard Report** – first posted in 2004. It provides elected officials, department and agency heads with a quick overview of their jurisdiction's performance in delivering affordable housing assistance with their HOME program funds. Using just a few key indicators in easy to understand graphic format, these state and local leaders are able to obtain information on both the cumulative HOME Program performance as well as accomplishments for the most recent quarter. Attachment 3 is an example of this report for Will County, IL, in Chairman Biggert's district.

- **Open Activities Report**- first posted on the HOME website in 2005. This report permits HOME administrators at the state and local level, and HUD field offices, to more easily identify and track the progress of individual HOME projects.

- **Vacant Units Report**- first posted in 2007. This report helps PJs identify units in HOME projects that are marked "vacant" in IDIS. For vacant units that are occupied in a completed HOME project, the grantee must enter occupancy and beneficiary data for each assisted family (household).

- **Expiring Funds Report**- first posted in 2009. This report's purpose is to assist participating jurisdictions in identifying expiring funds in IDIS so that they may put these funds, at risk of recapture/deobligation, into productive use.

- **PJ Analysis Report**- first posted in 2009. This report shows the status of a number of key performance and compliance indicators for each PJ within each Field Office. This report is updated quarterly and consolidates the information found on other

HOME and IDIS reports to provide a quick overview of each PJ's HOME performance - highlighting areas of particular concern for each PJ.

- **Auto-Cancellation** - In 2009, HUD started working on a system improvement to ensure the timely execution of projects consistent with the HOME regulation that all project activity begins within 12 months of a funding commitment. HUD notified grantees that an auto-cancellation of commitments in IDIS over 12 months old and no funds disbursed would take effect January 2011 in the June 2010 'HOME FACTS" (the HOME programs newsletter to grantees for reporting and funds management issues). Since this system control was initiated in January, 2011, HUD has cancelled 1,778 activities, freeing up $290 million of HOME funding for viable projects.

- **Final Draw Report** – Initiated in January, 2011, this report provides Field Offices the monthly list of projects in final draw (all committed funds have been expended but project has not been "completed"/closed out in IDIS) for more than 120 days for follow up with the PJs.

Enforcement: Deobligations, Repayments, Grant Reductions, and Suspension of Future HOME Funds

HUD was not "looking the other way", as the Post writes. To the contrary, we are focused on realizing a full return on the taxpayers' investment in affordable housing. HUD has a number of enforcement tools available when PJs do not meet commitment or expenditure timelines, fail to complete a project, or cannot administer their HOME program due to mismanagement/noncompliance issues.

HUD produces monthly "Deadline Compliance" status reports to track compliance with statutory HOME funds commitment and expenditure deadlines which are strictly enforced, as any grantee can attest. PJs have two years to commit funds to a viable project and five years to expend these funds. A total of $65.8 million has been de-obligated for failure to meet those deadlines. These funds are reallocated as part of the annual formula reallocation. Recent PJ deobligations include, Orange, TX, College Station, TX and the Municipality of Carolina, PR.

HUD always receives repayment of HOME funds that are misspent. Such actions had already been underway with a number of the agencies mentioned in the Post article – i.e., Washington D.C. and East Orange, NJ. Moreover, CPD takes its enforcement role seriously and has collected over $190.3 million in repayments from PJs for ineligible costs or activities. PJs are required to repay these funds from non-federal funds. HUD permits reduction of a future HOME grant in lieu of repayment from non-federal funds only if the chief elected official of the participating jurisdiction submits a written request along with documentation demonstrating that it is unable to make repayment from non-federal funds. Generally, HUD will only approve such requests if the repayment amount exceeds one-third of the participating jurisdiction's HOME grant amount, and fiscal incapacity is demonstrated. Of the $190.3 million, only $19.8 million represent grant reductions. If a PJ refuses to pay, CPD will refer the PJ for HUD enforcement. We have only had to refer 4 PJs for enforcement. If a PJ refuses to pay after it is referred for enforcement, HUD can involuntarily reduce the PJ's grant after notice and an opportunity for a hearing before an Administrative Law Judge or refer the case to the Department of Justice and seek repayment through a civil False

Claims Act case. In the program's 20-year history, HUD has so far never had to pursue either of these actions, because HUD has received 100% of all repayments requested. Overall, HUD has collected over $255 million in repayments and forfeited funds.

HUD has taken more serious action against participating jurisdictions where there is a pattern of mismanagement or noncompliance with HOME regulations. After providing notice and opportunity to respond, since 2004 HUD has withheld annual HOME fund allocations to seven participating jurisdictions, some for multiple years, to enforce program requirements. For example, as a result of the OIG audit of Mobile, AL, CPD rejected the HOME certification submitted with the City of Mobile's Fiscal Year 2010 Consolidated Plan / Action Plan and withheld the City's FY 2010 HOME grant. Since the City has not completed the required corrective actions, CPD has notified it of our intention to reject the FY 2011 certification and withhold its FY 2011 HOME grant. This year, HUD will consider withholding HOME funds from a number of other jurisdictions.

Working Collaboratively with the HUD-OIG

The HUD OIG has been an important partner in our oversight efforts of the HOME Program, both through internal audits of the program's administration at HUD and external audits of the program's implementation at the PJ level. HOME Program staff provides technical assistance to OIG staff across the country as they assess the technical and regulatory components of grantee programs.

HUD refers HOME participating jurisdictions that have evidence of particularly serious management or financial control issues to HUD-OIG for auditing. For example, since 2009 alone, HUD has referred six participating jurisdictions to the OIG for audits of their HOME program or specific HOME-funded activities: Huntsville, AL, Mobile, AL, Washington D.C. (later featured in the Post article), East Orange, NJ, Cleveland, OH, and Montebello, CA.

In the last 5 years, the OIG has performed 66 audits on HOME participating jurisdictions, some at the request of HOME Program staff in Washington and in the Field, as noted above. Forty-four (44) of those 66 audits have been closed and all recommendations implemented. Twenty –three (23) audits have at least one open recommendation, and we are in the process of working with the participating jurisdictions to ensure that the all recommendations are implemented.

The HUD-OIG has performed three internal audits of HUD's HOME Program Office. These audits all completed since 2009, have covered treatment of program income, oversight of resale and recapture provision for homebuyer assistance, and management of compliance with HOME commitments and expenditure deadlines. CPD is working swiftly to address the HUD-OIG findings; the only items that had been delayed are related to improvements to IDIS due to lack of resources. Although first developed in 1995, IDIS had its first major improvement in 2009 when it was converted from the main frame to a web-based format. Since 1999, CPD had requested resources for system control improvements but funds were not made available for this purpose. However, the recently approved Transformation Initiative (TI) provides funding to improve HUD's grants management systems, including upgrades to HOME financial controls that will address the HUD-OIG findings. All management decisions that been agreed to have been implemented or will be implemented by May 2012 when the IDIS improvements are slated for completion. These improvements include:

1. Program Income controls to improve reporting and ensure that PJs are drawing down program income first before drawing program funds from their treasury accounts;
2. Controls to ensure that draws are from committed funds only; and
3. Implement function to assist large grantees to streamline data entry process for sub grants to increase data accuracy.

There is only one major outstanding issue pending, the use of the first-in first-out (FIFO) accounting method. In a 2009 audit, HUD-OIG made three findings related to the timely commitment and expenditure of HOME funds. CPD is in the process of closing-out recommendations agreed to on the first two findings. CPD disagreed with the third finding relating to the use of the first-in first-out (FIFO) accounting method through IDIS for applying payments in formula block grant programs. The HUD-OIG described the use of the FIFO accounting method as out of compliance with the Federal Financial Improvement Act of 1996 (FFMIA) and U.S. Generally Accepted Accounting Principles (GAAP). In response to this finding, CPD agreed to seek an OGC opinion.

The OGC considered and then agreed with CPD's view that use of FIFO accounting for formula block grants was compliant with both FFMIA and GAAP. In addition, the CFO and an independent accountant with extensive system compliance review experience subsequently agreed with CPD's position. A joint memorandum dated June 10, 2010, from General Counsel Kanovsky and Chief Financial Officer Criscitello addressed to then Inspector General Donohue concluded that "CPD's use of cumulative and FIFO accounting in its financial management represents a reasonable interpretation of the statutory duties imposed on the Secretary and addresses the complex administrative challenges inherent in managing the HOME Investment Trust." The independent compliance review by Leon Snead & Company, P.C., requested by CPD, resulted in a letter dated June 30, 2010, in which the auditor found that "the IDIS Online first-in first-out (FIFO) method of applying payments to formula grants complied with the requirements of FFMIA." Both the OGC/CFO memorandum and the compliance review were sent to the CFO on July 14, 2010, in a memorandum concluding that no further action was needed in regard to the reported deficiency (See Attachment 4).

In light of the unanimous opinion from OGC, CFO, and an outside analyst, HUD will continue its use of the accepted FIFO method. Although we disagree with the HUD-OIG on this point, they remain an important partner in our overall oversight efforts.

Technical Assistance/Capacity Building

One of HUD's key roles as responsible steward of taxpayers' funds is to provide technical assistance to help our grantees build capacity. HUD has developed numerous HOME programmatic and technical training courses to build capacity of PJ staff, including three "HOME certification" courses in Regulations, Administration, and Rental Housing Compliance, after which participants take a two hour exam to obtain certification. In addition, HUD has used HOME technical assistance funds for one-on-one capacity building for PJs and for "troubled project technical assistance" to help PJ staff complete "workouts" on HOME rental projects experiencing financial or physical problems during the compliance period. Most recently, however, CPD, through HUD's Transformation Initiative (TI), has redesigned its technical assistance/capacity building and is improving its grant reporting systems to ensure that grantees are able to more efficiently manage, design and align their programs to maximize scarce resources.

Traditionally, HUD has delivered compliance-oriented technical assistance, funded through individual program accounts and separately geared toward the rules governing HUD's disparate programs. The TI effort has allowed CPD to combine all of its program technical assistance accounts into one to develop comprehensive technical assistance efforts that will focus on skills needed to improve program outcomes not just reinforcing program compliance rules. Known as OneCPD, this effort allows synergies impossible in a siloed approach. Through OneCPD, PJs will be assisted in a holistic approach with all of their CPD funds. This will not only provide cost savings, but will ensure that a PJ's overall capacity is assessed and that a technical assistance plan is developed to address the PJ's individual capacity needs, not just fix the HOME "problem project" and ignore the underlying skills gap.

Regulatory/System Changes to Improve HOME Oversight and Enforcement

As stated earlier, CPD's review of needed improvements to ensure program effectiveness is on-going, both as this relates to program regulations and IDIS improvements. In 2009, we began working on changes to the current HOME regulation to strengthen program oversight and accountability. This proposed rule will be placed into HUD departmental clearance this month. In addition, to the improvements to IDIS mentioned above, system alerts will be added to improve project risk mitigation.

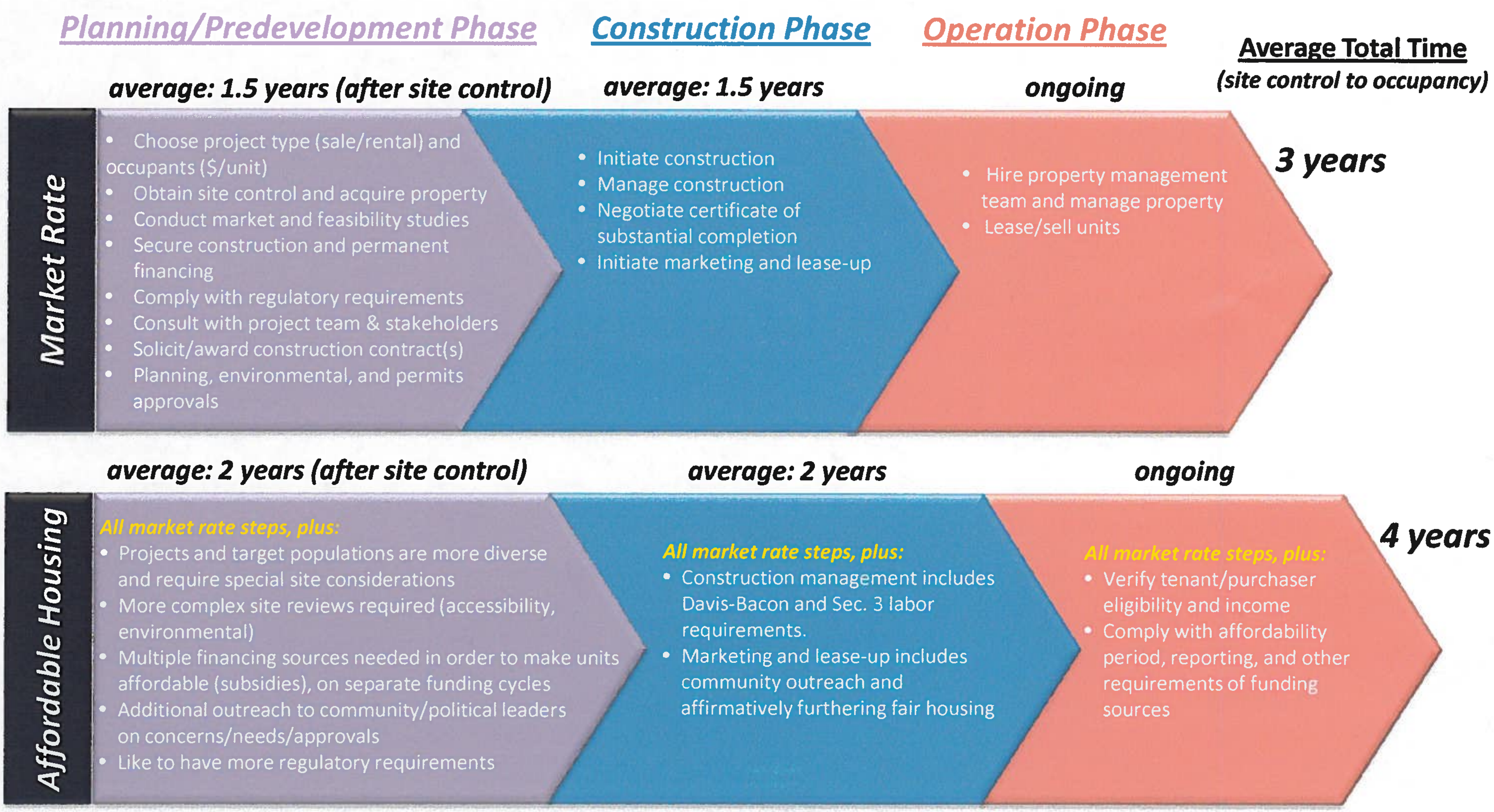
Conclusion

Thank you for the opportunity to set the record straight as far as the Washington Post article is concerned, and to explain both the active oversight of the HOME program performed by CPD staff and the ongoing efforts to improve that oversight and enforcement.

As I stated earlier, the HOME program gives local communities great flexibility – but, as with any block grant program, that flexibility requires that state and local housing agencies manage this program responsibly and in accordance with the program regulations and requirements. Together, over the past 20 years, state and local governments with their nonprofit and for-profit development partners have produced more than a million affordable units of housing with HOME funds, primarily for very low- and extremely low-income families.

The facts speak for themselves -- HOME has been a catalyst for change in the lives of low-income families and for communities nationwide. Recent HOME Door Knocker Award winners and the HOME is a Catalyst video can be found at http://www.hometa.info/

Attachment 1 - Development Process Comparison Under Favorable Market Conditions



Extra steps in the process add time to affordable housing development.

Attachment 2 - Sample

Snapshot Report

SNAPSHOT of HOME Program Performance--As of 03/31/11
Local Participating Jurisdictions with Rental Production Activities

Participating Jurisdiction (PJ): Jefferson County **State:** AL

PJ's Total HOME Allocation Received: $18,239,500 **PJ's Size Grouping*:** B **PJ Since (FY):** 1992

Category	PJ	State Average	State Rank	Nat'l Average	Nat'l Ranking (Percentile):** Group B	Nat'l Ranking (Percentile):** Overall
			PJs in State: 6			
Program Progress:						
% of Funds Committed	100.00 %	98.07 %	1	97.21 %	100	100
% of Funds Disbursed	88.61 %	91.46 %	3	90.53 %	32	34
Leveraging Ratio for Rental Activities	0.61	1.95	5	4.97	7	10
% of Completed Rental Disbursements to All Rental Commitments***	100.00 %	82.29 %	1	85.01 %	100	100
% of Completed CHDO Disbursements to All CHDO Reservations***	100.00 %	72.77 %	1	73.71 %	100	99
Low-Income Benefit:						
% of 0-50% AMI Renters to All Renters	88.96 %	81.04 %	4	81.48 %	68	66
% of 0-30% AMI Renters to All Renters***	53.99 %	47.81 %	2	45.54 %	67	0
Lease-Up:						
% of Occupied Rental Units to All Completed Rental Units***	100.00 %	95.11 %	1	96.14 %	100	100
Overall Ranking:		In State:	1 / 6	Nationally:	63	
HOME Cost Per Unit and Number of Completed Units:						
Rental Unit	$44,824	$21,475		$28,248	163 Units	35.90 %
Homebuyer Unit	$30,126	$20,824		$15,487	289 Units	63.70 %
Homeowner-Rehab Unit	$69,237	$16,336		$0	2 Units	0.40 %
TBRA Unit	$0	$4,263		$3,211	0 Units	0.00 %

* - A = PJ's Annual Allocation is greater than or equal to $3.5 million (59 PJs)

B = PJ's Annual Allocation is less than $3.5 million and greater than or equal to $1 million (216 PJs)

C = PJ's Annual Allocation is less than $1 million (287 PJs)

** - E.g., a percentile rank of 70 means that the performance exceeds that of 70% of PJs.

***- This category is double-weighted in compiling both the State Overall Ranking and the National Overall Ranking of each PJ.

Source: Data entered by HOME Participating Jurisdictions into HUD's Integrated Disbursement and Information System (IDIS)

Program and Beneficiary Characteristics for Completed Units

Participating Jurisdiction (PJ): Jefferson County | AL

Total Development Costs: (average reported cost per unit in HOME-assisted projects)

	Rental	Homebuyer	Homeowner
PJ:	$72,328	$81,315	$71,737
State:*	$73,352	$80,535	$19,578
National:**	$101,183	$78,322	$24,013

CHDO Operating Expenses: (% of allocation)

PJ: 2.7 %

National Avg: 1.2 %

R.S. Means Cost Index: 0.86

	Rental %	Homebuyer %	Homeowner %	TBRA %
RACE:				
White:	42.3	17.3	0.0	0.0
Black/African American:	56.4	81.3	100.0	0.0
Asian:	0.0	0.0	0.0	0.0
American Indian/Alaska Native:	0.6	0.0	0.0	0.0
Native Hawaiian/Pacific Islander:	0.0	0.0	0.0	0.0
American Indian/Alaska Native and White:	0.0	0.0	0.0	0.0
Asian and White:	0.0	0.0	0.0	0.0
Black/African American and White:	0.0	0.0	0.0	0.0
American Indian/Alaska Native and Black:	0.0	0.0	0.0	0.0
Other Multi Racial:	0.0	0.0	0.0	0.0
Asian/Pacific Islander:	0.6	0.0	0.0	0.0
ETHNICITY:				
Hispanic	0.0	1.4	0.0	0.0
HOUSEHOLD SIZE:				
1 Person:	89.6	13.1	0.0	0.0
2 Persons:	9.8	30.8	0.0	0.0
3 Persons:	0.6	27.0	100.0	0.0
4 Persons:	0.0	19.0	0.0	0.0
5 Persons:	0.0	7.3	0.0	0.0
6 Persons:	0.0	2.1	0.0	0.0
7 Persons:	0.0	0.7	0.0	0.0
8 or more Persons:	0.0	0.0	0.0	0.0

HOUSEHOLD TYPE:	Rental %	Homebuyer %	Homeowner %	TBRA %
Single/Non-Elderly:	6.7	12.1	0.0	0.0
Elderly:	92.0	5.2	50.0	0.0
Related/Single Parent:	0.0	63.7	50.0	0.0
Related/Two Parent:	0.0	16.3	0.0	0.0
Other:	1.2	1.7	0.0	0.0

SUPPLEMENTAL RENTAL ASSISTANCE:	Rental %	Homebuyer %
Section 8:	44.8	0.0#
HOME TBRA:	1.2	
Other:	0.0	
No Assistance:	54.0	

# of Section 504 Compliant Units / Completed Units Since 2001 16

* The State average includes all local and the State PJs within that state

** The National average includes all local and State PJs, and Insular Areas

Section 8 vouchers can be used for First-Time Homebuyer Downpayment Assistance.

Source: Data entered by HOME Participating Jurisdictions into HUD's Integrated Disbursement and Information System (IDIS)

— HOME PROGRAM —
SNAPSHOT WORKSHEET - RED FLAG INDICATORS
Local Participating Jurisdictions with Rental Production Activities

Participating Jurisdiction (PJ): Jefferson County **State:** AL **Group Rank:** 63 **(Percentile)**

State Rank: 1 / 6 PJs **Overall Rank:** 0 **(Percentile)**

Summary: 0 / **Of the 5 Indicators are Red Flags**

FACTOR	DESCRIPTION	THRESHOLD*	PJ RESULTS	RED FLAG
4	% OF COMPLETED RENTAL DISBURSEMENTS TO ALL RENTAL COMMITMENTS	< 79.77%	**100**	
5	% OF COMPLETED CHDO DISBURSEMENTS TO ALL CHDO RESERVATIONS	< 57.73%	**100**	
6	% OF RENTERS BELOW 50% OF AREA MEDIAN INCOME	< 70%**	**88.96**	
8	% OF OCCUPIED RENTAL UNITS TO ALL RENTAL UNITS	< 92.23%	**100**	
"ALLOCATION-YEARS" NOT DISBURSED***		> 2.200	**2.01**	

* This Threshold indicates approximately the lowest 20% of the PJs

** This percentage may indicate a problem with meeting the 90% of rental units and TBRA provided to households at 60% AMI requirement

*** Total of undisbursed HOME and ADDI funds through FY 2005 / FY2005 HOME and ADDI allocation amount. This is not a SNAPSHOT indicator, but a good indicator of program progress.

Source: Data entered by HOME Participating Jurisdictions into HUD's Integrated Disbursement and Information System (IDIS)

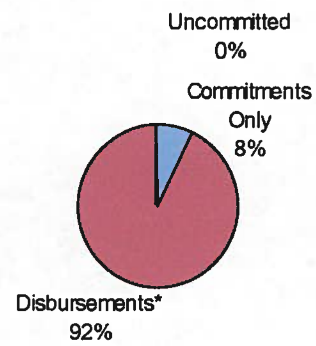
Attachment 3 - Sample Dashboard Report

— HOME Investment Partnerships (HOME) Program —
Program Progress Dashboard
Cumulative as of 03/31/11

Participating Jurisdiction (PJ) **Will County, IL** **PJ Since:** **1992**

(1) Status of Funds

Total HOME Allocations Received: **$8,816,457**



* "Disbursements" include previously committed funds.

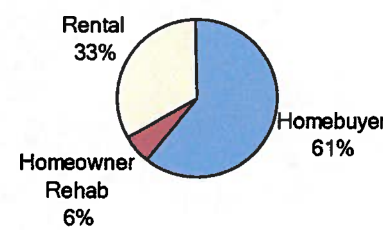
(2) Unit Production - Completions

Last Quarter (January 1 - March 31, 2011): Net Increase: **0**

No net increase in reported units.

New Tenant-Based Rental Assistance (TBRA): **2 Households**

Cumulative Since: 1992 Total: **477**

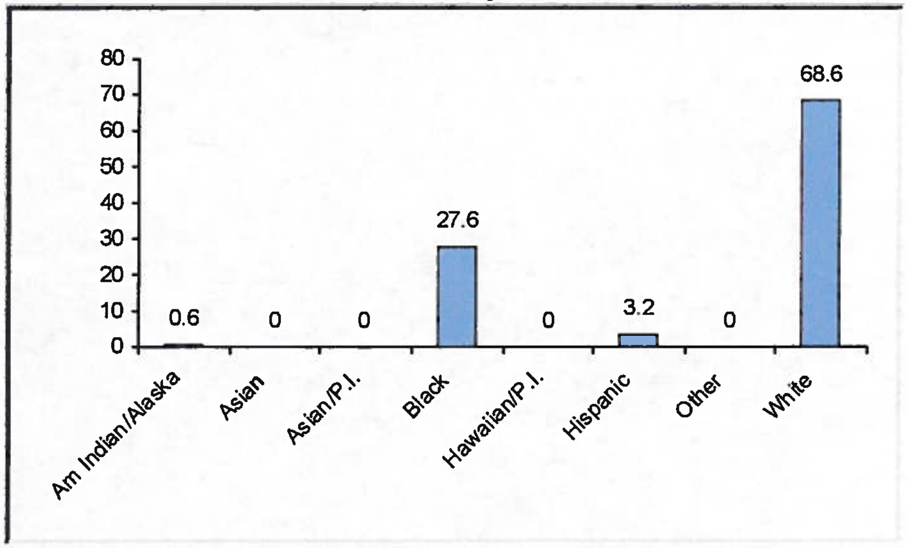


Tenant-Based Rental Assistance (TBRA) Total: **183 Households**

Source: Data entered by HOME Participating Jurisdictions into HUD's Integrated Disbursement and Information System (IDIS)

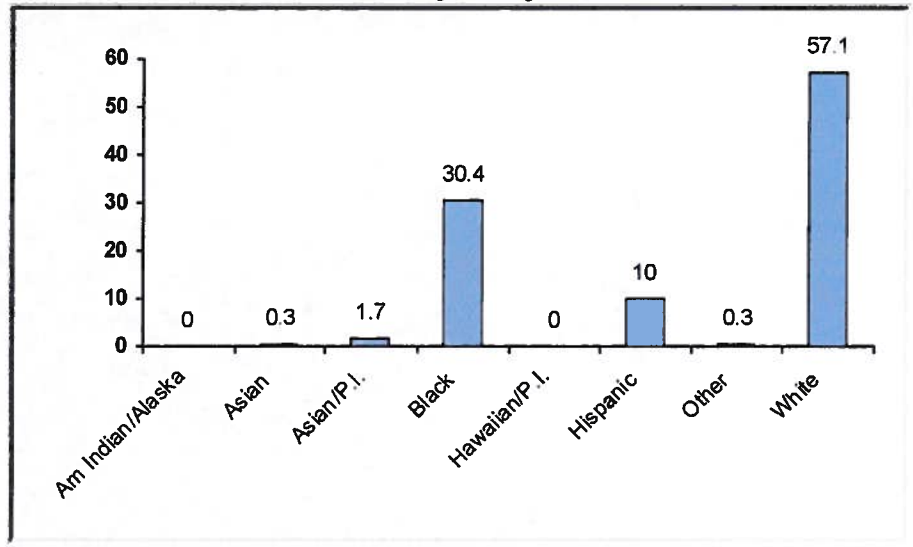
(3) Production Detail
Racial/Ethnic Breakout

Rental Projects



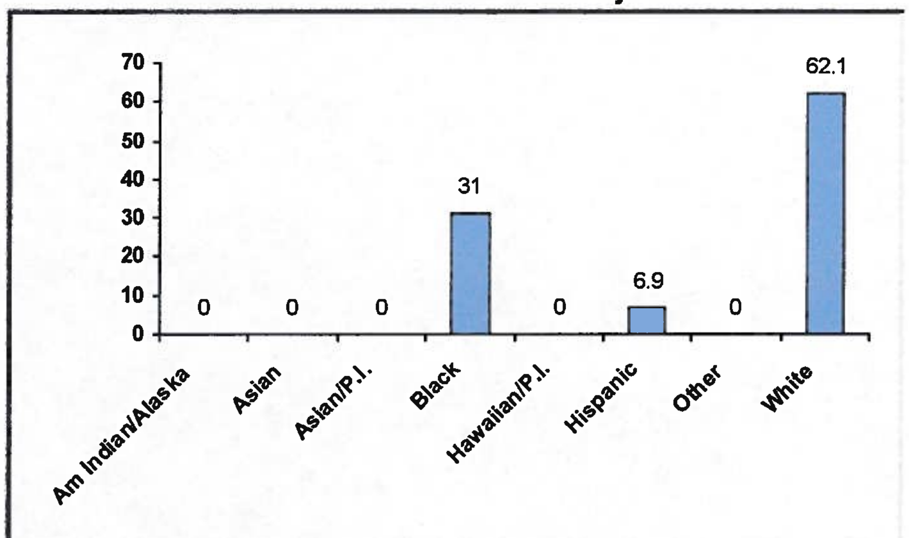
Avg. Total Dev. Cost (TDC)* Per Unit: **$75,211**

Homebuyer Projects



Avg. Total Dev. Cost (TDC)* Per Unit: **$60,377**

Homeowner Rehabilitation Projects

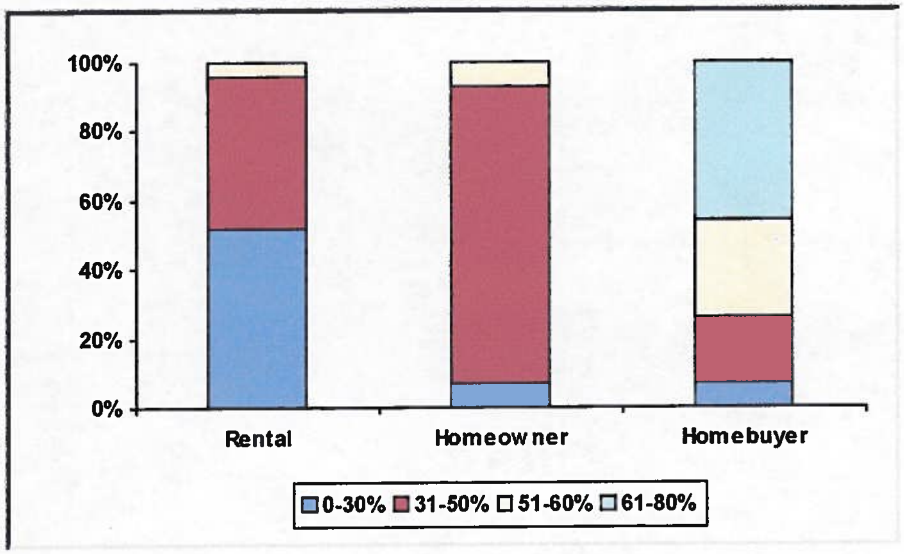


Avg. Total Dev. Cost (TDC)* Per Unit: **$18,481**

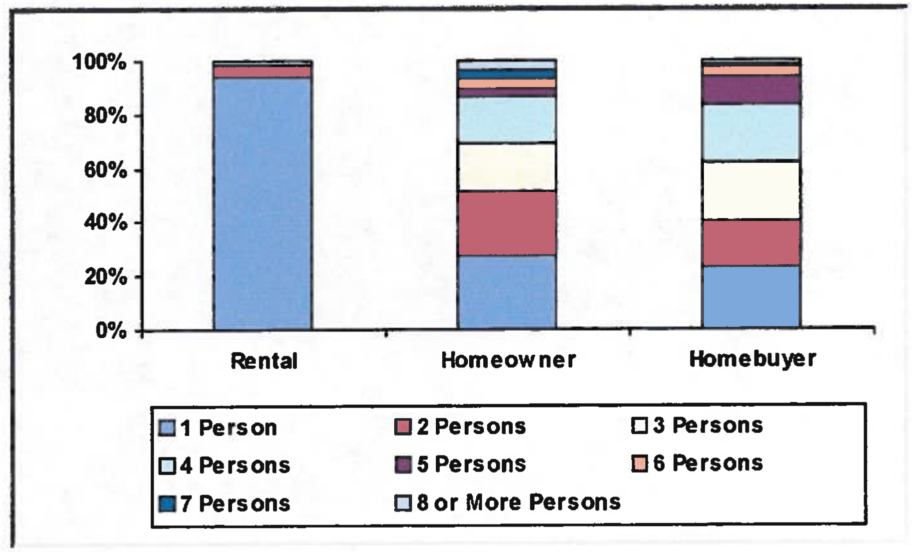
* TDC - Includes all sources of funds

Source: Data entered by HOME Participating Jurisdictions into HUD's Integrated Disbursement and Information System (IDIS)

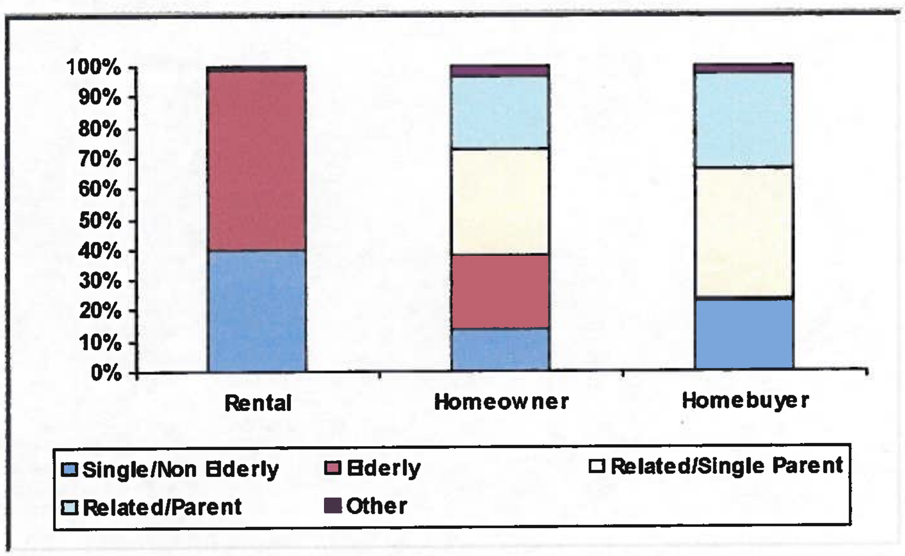
b. Income Range Breakout



c. Family/Size Breakout



d. Household Type Breakout



Source: Data entered by HOME Participating Jurisdictions into HUD's Integrated Disbursement and Information System (IDIS)

Attachment 4 - Memo on First in/First Out

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-0500

GENERAL COUNSEL

JUN 10 2010

MEMORANDUM FOR: Kenneth M. Donohue, Inspector General, G

FROM: Helen R. Kanovsky, General Counsel, C; Doug Criscitello, Chief Financial Officer, F

SUBJECT: Disagreement about Audit Recommendations (2009-AT-0001 issued on September 28, 2009)

This correspondence is in response to your March 31, 2010 memorandum regarding the above-captioned audit. In that memorandum, you discussed your disagreement with the Office of Planning and Community Development (CPD) and the Office of General Counsel (OGC) regarding the recapture requirements of the HOME program statute, codified at 42 U.S.C. § 12748, and CPD's use of cumulative accounting and the "first in, first out" (FIFO) method for financial management. Because the primary focus of your memorandum involves specific disagreements with the legal opinion rendered by OGC in this matter, additional information is provided below.

At the outset, we note that the cumulative accounting method at issue has been described in HUD's regulations at 24 CFR § 92.500(d)(1)(B) since 1997 and, along with FIFO, have been a part of the funds control plan that CPD has submitted to the Office of the Chief Financial Officer (OCFO) pursuant to HUD Handbook 1830.2 REV-5, Chapter 4. Given the role of our three respective offices in the clearance process for proposed rules and in ensuring that financial management methods comply with relevant Federal statutory and accounting requirements, we take this matter very seriously and appreciate this opportunity to address the issue.

I. <u>OGC's Legal Opinion of Regulations Promulgated under 42 U.S.C. § 12748</u>

A. *Statutory Authority*

As noted in the March 5, 2010 legal opinion, section 218(g) of the Cranston-Gonzalez National Affordable Housing Act (the "Act"), codified at 42 U.S.C. 12748(g), states that:

> If any funds becoming available to a participating jurisdiction are not placed under binding commitment to affordable housing within 24 months after the last day of the month in which such funds are deposited in the jurisdiction's HOME Investment Trust Fund, the jurisdiction's right to draw such funds from the HOME Investment Trust Fund shall expire.

HUD reads the statutory requirements of Section 218(g) in conjunction with Section 218(h), codified at 42 U.S.C. 12748(h) and entitled "Administrative provision," which states:

> The Secretary shall keep each participating jurisdiction informed of the status of its HOME Investment Trust Fund, including the status of *amounts under various stages of commitment*.

(emphasis added)

Reading the two sections in tandem makes clear Congress' intent for the Secretary to administer the HOME Investment Trust in a manner that equates commitment of "such funds" described in 218(g) with the "amounts under various stages of commitment" described in 218(h). The two sections require that the Department track the *amount* of commitments along a dynamic continuum that recognizes both the fungibility of monies deposited into the HOME Investment Trust and the fact that there are more stages of commitment than merely pre-commitment and commitment stages. For example, a participating jurisdiction that has committed funds prior to the statutory deadline under 218(g) may later be forced to decommit those funds due to actions of a subrecipient or contractor. A reading that only contemplates pre-commitment/commitment stages for funding would only require a one-time assessment of commitments the day prior to the statutory deadline and ignore "such funds" thereafter. Instead, CPD's use of cumulative and FIFO accounting in its financial management represents a reasonable interpretation of the statutory duties imposed on the Secretary and addresses the complex administrative challenges inherent in managing the HOME Investment Trust.

B. *HUD's Regulatory Requirements*

Because the Act does not define the term "commitment," HUD has done so by notice and comment rulemaking. The regulation defines commitment as, *inter alia*, the instance when "[t]he participating jurisdiction has executed a legally binding agreement with a State recipient, a subrecipient or a contractor to use a *specific amount* of HOME funds to produce affordable housing . . . ." 24 CFR § 92.2 (emphasis added). Again, HUD understands its statutory duty under Sections 218(g) and (h) to include tracking commitment amounts rather than tracking a specific dollar transferred at a specific point in time. When HUD codified the requirements of Section 218(g), it included Subpart K, entitled "Program Administration." This Subpart requires the recapture of "any funds in the United States Treasury account that are not committed within 24 months after the last day of the month in which HUD notifies the participating jurisdiction of HUD's execution of the . HOME Investment Partnership Agreement." *See*, 24 CFR § 92.500(d)(1)(B); 61 Fed. Reg. 48779. After the proposed final rule was published, HUD made technical amendments to that Subpart by codifying the cumulative accounting method, stating:

> For purposes of determining the *amount* by which the HOME Investment Trust Fund will be reduced or recaptured under paragraphs (d)(1)(A), (B) and (C) of this section, HUD will consider the sum of commitments to CHDOs, commitments, or expenditures, as applicable, from the fiscal year allocation being examined and from subsequent allocations. This sum must be equal to or greater than the amount of the fiscal year allocation being examined, or in the case of commitments to CHDOs, 15 percent of that fiscal year allocation.

See, 62 Fed. Reg 28926· 24 CFR § 92.50((d)(_) (emphasis added).

When this cumulative accounting method is combined with FIFO, the resulting financial management system enables CPD to ensure that participating jurisdictions have commitment *amounts* in excess of any fiscal year's allocation that has been held for more than 24 months after the last day of the month in which HUD provided notice of an executed agreement. This method of tracking funds also allows CPD to ensure that funds committed in good faith in a legally binding agreement within the statutory period are not recaptured simply because a subrecipient or project partner does not follow through on its responsibilities, provided the participating jurisdiction still has commitments in excess of that fiscal year's funding amount. The inclusion of a five-year regulatory deadline for *expenditure* of funds provides a further control to ensure that funds are still utilized in a timely manner. 24 CFR § 92.500(d)(1)(C).

In sum, OGC concludes that the Department's regulations are a reasonable and comprehensive interpretation of the statutory requirements for the financial administration of the HOME program.

II. <u>OCFO's Financial Analysis</u>

The OCFO reviewed the HOME account in HUD's FY 2010 Appropriations Act and found the following language, which is typical for this account: "For the HOME investment partnerships program, as authorized under title II of the Cranston-Gonzalez National Affordable Housing Act [hereinafter "the Authorizing Act"], as amended, $1,825,000,000, to remain available until September 30, 2012: . . ." With this language, Congress explicitly established the amount and period of availability of HOME funds for FY 2010, and cited the HOME authorizing statute to establish other terms and conditions for this HOME funding, including the purposes for which such funds can be used.

In an effort to reach agreement on proper accounting for obligations and expenditures under this program, it is essential that HUD and OIG reach agreement on the fundamental nature of this program. The General Accountability Office has explained:

> A **categorical grant** is a grant to be used only for a specific program or for narrowly defined activities. A categorical grant may be allocated on the basis of a distribution formula prescribed by statute or regulation ("formula grant"), or it may be made for a specific project ("project grant"). A block grant is a grant given to a governmental unit, usually a state, to be used for a variety of activities within a broad functional area. Block grants are usually formula grants. Under a block grant, the state is responsible for further distribution of the money. States naturally prefer block grants because they increase the states' spending flexibility and at least in theory reduce federal control...
>
> **Block grants** reduce federal involvement in that they transfer much of the decision-making to the grantee and reduce the number of separate grants that must be administered by the federal government.

The Principles of Federal Appropriations Law, 3d Vol. II at 10-60 to 61, 62 (2006) (emphasis added)

Based on OCFO staff's review and discussions with CPD and OGC, pursuant to the authorizing and appropriation Acts, the HOME program issues formula block grants. *See, e.g.*, §§ 212 and 217 of the Authorizing Act. Pursuant to their broad five-year plans and readily amendable one-year plans devised within the framework of the Authorizing Act, the participating jurisdictions, through flexible grant agreements and procedures, can and do choose and change activities and objectives from year-to-year and within years, applying available funding from the proper fund type which may contain amounts from more than one fiscal year. Accordingly, with respect to accounting for funds made available under the HOME program, it would seem to contravene the block grant nature of both the Authorizing Act and Appropriations Act to require that amounts from each fiscal year be tracked inflexibly to individual, unchangeable grant activities. The very nature of the HOME program Congress created gives participating jurisdictions the flexibility to mix and match activities and implementation methods, within fund type, and to change such activities and objectives, over the years.

Specifically, in your memo and audit, your office expressed concern about how CPD has implemented the 24-month commitment requirement that is contained in the Authorizing Act at 42 U.S.C. § 12748 and the five-year expenditure requirement contained in HUD's HOME implementing regulation published at 24 CFR § 92.500(d)(1)(C). Based on our review and discussions with CPD and OGC, it is our understanding that obligations and expenditures under the HOME program are accounted for on a FIFO basis by fund type instead of by fiscal year. In addition, it is our understanding that CPD in enforcing the obligation and expenditure requirements looks to total cumulative obligations and expenditures instead of by fiscal year. Based on OCFO's financial analysis, given the origin of these requirements and the fundamental nature of this block grant program, we believe that the FIFO accounting method for obligations and expenditures by fund type is consistent with Federal accounting requirements, and we have no objection to the total cumulative obligations and expenditures methods used for assessing compliance with the 24-month obligation and 5-year expenditure requirements.

Additionally, in your memo, you expressed concern about whether the FIFO accounting method for expenditures is consistent with the expenditure requirement under 31 U.S.C § 1552, and requested clarification about the relationship between this requirement and the HOME program 5-year expenditure requirement discussed above. First, the OCFO understands the HOME program 5-year expenditure requirement as a program performance measure which begins when the participating jurisdiction receives HOME funds, whereas the 5-year period contemplated under 31 U.S.C. § 1552 begins at the end of the period of availability of the funds. Each requirement operates under its own authority, but both are similarly affected by the fundamental nature of this block grant program and the FIFO accounting method for expenditures. As expressed above, from the OCFO's perspective, given the fundamental nature of this block grant program, we believe that the FIFO accounting method for expenditures is consistent with Federal accounting requirements.

III. Authority to Render Legal Opinions of Program Regulations

In your memorandum, you made the following comment regarding the legal opinion provided by OGC:

> As an initial matter, the legal opinion should have been obtained from the Office of the Chief Financial Officer, Appropriations Law Division. Public Law 108-7 vested the Chief Financial Officer of the Department with sole authority to investigate potential violations under the Anti-Deficiency Act and all other statutes and regulations related to the obligation and expenditure of funds made available in Pub. L. 108-7, or any other Act. We therefore ask that the Office of the Chief Financial Officer provide an opinion on this matter.

(emphasis in original).

The legal opinion at issue was properly provided by OGC rather than the Office of the Chief Financial Officer (OCFO). The review of the Department's regulatory enactments of program statutes for legal sufficiency is an OGC function specifically delegated by the Secretary. This authority is explicitly acknowledged in your own findings in the initial audit, where you stated:

> We recommend that the Assistant Secretary for Community Planning and Development
>
> 3A. Obtain a formal legal opinion from the Office of General Counsel on whether HUD's cumulative technique for assessing compliance with commitment deadlines is consistent with and is an allowable alternative to the 24-month commitment requirements stipulated at Title II of the Cranston-Gonzalez National Affordable Housing Act.
>
> 3B. Obtain a formal legal opinion from the Office of General Counsel on whether HUD's first-in first-out method for assessing compliance with HOME expenditure requirements is consistent with and is an allowable alternative to the eight-year recapture deadline pursuant to Public Law 101-510.

Your prior understanding of the proper source for a legal opinion is supported by clear statutory authority. The Department of Housing and Urban Development Act, codified at 42 U.S.C. 3531 *et. seq.* (the "HUD Act"), provides that "[t]he Department shall be administered under the supervision and direction of the Secretary." HUD Act § 3(a). In addition the HUD Act states that "[t]here shall be in the Department . . . a general counsel, who shall be appointed by the President by and with the advice and consent of the Senate, and who shall perform such functions, powers and duties as the Secretary shall prescribe from time to time." HUD Act §4(a). Finally, the HUD Act provides that "the Secretary may delegate any of his functions, powers, and duties to such officers and employees of the Department as he may designate . . . and may make such rules and regulations as may be necessary to carry out his functions, powers, and duties." HUD Act § 7(d).

Pursuant to this statute, the Secretary has delegated to the General Counsel the power "[t]o interpret the authority of the Secretary and to determine whether the issuance of any rule, regulation, statement of policy or standard promulgated by HUD is consistent with that authority." 229 Fed. Reg. 62802 (Tuesday, December 1, 2009). This authority to determine if a HUD program regulation is consistent with a statute, is not shared with the OCFO as a result of Public Law 108-7.

Notwithstanding the emphasis in your quotation, Public Law 108-7, passed on February 20, 2003 as HUD's FY2003 Appropriation, was never designed to vest sole authority to the OCFO on any or all matters related to the obligation and expenditure of funds. The sweep of your assertion is much broader than any reasonable statutory construction would allow, and would essentially transfer most of the delegated functions of OGC described above to the OCFO. The full relevant quotation from Public Law 108-7 states:

> the Secretary shall, within 30 days of enactment of this Act, permanently transfer no fewer

than four appropriations law attorneys from the Legislative Division of the Office of Legislation and Regulations, Office of General Counsel to the OCFO: *Provided further*, That personnel transferred pursuant to the previous proviso shall report directly to the Chief Financial Officer: *Provided further*, That, notwithstanding any other provision of law, hereafter, the Chief Financial Officer of the Department of Housing and Urban Development shall, in consultation with the Budget Officer, have sole authority to investigate potential or actual violations under the Anti-Deficiency Act (31 U.S.C. 1341 et seq.) and all other statutes and regulations related to the obligation and expenditure of funds made available in this, or any other Act; shall determine whether violations exist;

(underlining added). Pub. L. 108-7 at 489.

Public Law 108-7 transferred appropriations attorneys to OCFO to function as part of a unit that investigates potential or actual violations of the Anti-Deficiency Act and other relevant appropriations statutes. This authority is distinct from making a legal determination on behalf of the Department about whether a program regulation properly interprets a statutory requirement.

In support of this interpretation, we note that on August 12, 2003, The Office of the Legal Counsel at the Department of Justice provided a legal opinion to OMB's General Counsel concluding that the applicable provisions of Public Law 108-7 do not even assign exclusive responsibility for *appropriations law* matters to the OCFO. The relevant paragraph states:

> We find no basis in the text of these provisions . . . to support the broader contention that the CFO was given sole authority, exclusive of the HUD General Counsel and his Office, to provide advice, counsel or analysis for the Secretary or other HUD components on *all matters and issues of appropriations law*. The extensive *investigative* authority, respecting actual or potential violations of law, that was indisputably granted to the CFO simply cannot be equated with the exclusive authority to interpret, analyze and provide advice respecting the federal appropriations laws for HUD and its components.

(emphasis added).

Based upon the discussion above, we find that absent an investigation respecting actual or potential violations of appropriations law, there is no authority for your request that the OCFO provide a legal opinion on this matter that supplants the proffered OGC opinion.

If you have any additional questions, please contact Damon Smith at (202) 402-5099 or Mike Moran at (202) 402-5150

cc: Mercedes M. Marquez, Assistant Secretary for Community Planning and Development, D

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-7000

OFFICE OF COMMUNITY PLANNING
AND DEVELOPMENT

JUL 14 2010

MEMORANDUM FOR: Jerome A. Vaiana, Acting Chief Financial Officer for Financial Management, FM

Larry E. McGhee, Director of Audit Liaison Division for Financial Management, FMA

FROM: William H. Eargle, Jr., Deputy Assistant Secretary for Operations, DO

SUBJECT: Resolution of FY 2009 Financial Statement Audit Finding

On November 16, 2009, the HUD Office of Inspector General (OIG) issued audit report no. 2010-FO-0003 entitled "Additional Details to Supplement Our Audit Report on HUD's Fiscal Years 2009 and 2008 Financial Statements." The report included the finding "Significant Deficiency: HUD Financial Management Systems Need to Comply with Federal Financial Management System Requirements."

Paramount in the finding discussion was the reported failure of the system that supports CPD formula programs to comply with Federal financial management system requirements. The system is the Integrated Disbursement and Information System (IDIS). It was stated that the IDIS system is not compliant with the Federal Financial Management Improvement Act of 1996 (FMFIA) and OMB A-127 reporting requirements due to system design which uses the first-in, first-out (FIFO) methodology for processing accounting transactions.

CPD disagreed with the significant deficiency and in response to the HUD OIG noted that the IDIS system had been reviewed over many years by both internal and external entities, and in all cases found to be in substantial compliance with FMFIA/A-127. To gain further insight into the matter, CPD issued a contract to Leon Snead & Company, P.C., a firm steeped in system compliance review experience, to assess and determine if the IDIS FIFO methodology was compliant with requirements. If found not in compliance, they were to recommend what needed to be done to bring the system into compliance.

On June 30, 2010, Leon Snead and Company issued a final report (copy attached) on their assessment of whether the FIFO methodology of processing formula grant disbursement transactions was in compliance with FMFIA requirements. They concluded for reasons cited in their report that the FIFO method employed by IDIS was compliant with FMFIA.

In addition, on June 10, 2010, the HUD General Counsel (GC) and Chief Financial Officer (CFO) sent a joint memorandum to the HUD Inspector General (copy attached) that addressed a disagreement about audit recommendations included in a HOME audit issued by the HUD OIG. At issue was CPD's use of cumulative accounting and the FIFO method for financial management; the same matter addressed in the Leon Snead and Company IDIS FIFO compliance review. Although the memo addressed elements of the HOME program, the conclusions reached apply to all of CPD's block grant programs including our largest, the Community Development Block Grant program. Supporting narrative and conclusions reached by the GC and CFO fully support the use of FIFO for processing accounting transactions.

Based on (1) the results of the Leon Snead and Company compliance review and (2) the June 10, 2010, legal decision, we conclude that no further action is needed in regard to this reported deficiency. Therefore we will be closing Recommendation 4.a. from the above referenced report

Attachments

Final Report

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Office of Community Planning and Development

COMPLIANCE REVIEW ON IDIS FIFO METHODOLOGY

Submitted By

Leon Snead & Company, P.C.
Certified Public Accountants & Management Consultants

LEON SNEAD
& COMPANY, P.C.

Certified Public Accountants
& Management Consultants

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leonsnead.companypc@erols.com

June 30, 2010

Mr. William H. Eargle, Jr.
Deputy Assistant Secretary for Operations
U.S. Department of Housing and Urban Development
Office of Community Planning and Development
451 7th Street, SW, Room 7128
Washington, DC 20410

Dear Mr. Eargle:

In response to your request, Leon Snead & Company completed an assessment to determine whether the first-in first-out method by which the Integrated Disbursement and Information System (IDIS) Online system processes formula grant transactions complies with the requirements of the Federal Financial Management Improvement Act (FFMIA) of 1996.

Based on our assessment, we found that the IDIS Online first-in first-out (FIFO) method of applying payments to formula grants complied with the requirements of FFMIA. Presented later in this report are the details of our analysis of each of the requirements of FFMIA, as implemented by Office of Management and Budget (OMB) Circular A-127, *Financial Management Systems*, and the supplemental guidance in OMB Memorandum 09-06, *Implementation Guidance for the Federal Financial Management Improvement Act*.

BACKGROUND

On November 16, 2009, the Office of Inspector General (OIG) of the Department of Housing and Urban Development (HUD) issued an audit report, Audit Case Number 2010-FO-003, *Additional Details to Supplement Our Report on HUD's Fiscal Years 2009 and 2008 Financial Statements*. That report included a significant deficiency titled *HUD Financial Management Systems Need to Comply with Federal Financial Management System Requirements*. The deficiency criticized the method by which HUD's Office of Community Planning and Development (CPD) systems applied disbursement transactions to the oldest grant obligations available. The deficiency was based in part on a finding in an audit report issued on September 28, 2009, by the OIG Atlanta regional office (2009-AT-001). The Atlanta report stated:

> HUD's first-in first-out method resulted in incorrect classification and reporting of HOME expenditures and their related unliquidated obligations. HUD's guidance to participating jurisdictions provides an explanation of the first-in first-out method. It states that HUD's

> information system uses the method for both committing funds to activities and for recording disbursements made to participating jurisdictions. Under this method, funds are first committed and disbursed from the "oldest" available funds. When a commitment or disbursement request is entered in the information system, the system searches for the "oldest" funds first by grant program, then by source year of funds, recipient of funds, and type of funds. In this way, HOME funds are committed and disbursed to the participating jurisdictions from the oldest grant year to the newest grant year by recipient and fund type...
>
> The first-in first-out method, as described in HUD guidance, prevents the direct association that should exist between fixed-year appropriations, expenditures, and unliquidated obligations (difference between obligated amounts and expenditures). The technique distorts reporting of expenditures against fixed appropriations and could make it erroneously appear that HUD was in compliance with Public Law 101-510's eight-year recapture deadline and thus mask funds that should be recaptured by the United States Treasury.

The Atlanta report also included Appendix D, which stated:

> The first-in first-out technique for HOME expenditures may affect the accuracy of HUD's accounting for HOME program activity based on requirements in Office of Management and Budget Circular A-127, Financial Management Systems, and other related standards for federal agency financial management systems and reporting requirements. These requirements include but are not limited to compliance with the U.S. Government Standard General Ledger. HUD officials stated that they used the technique for all community planning and development programs. Thus, the technique could impact HUD's financial statement for all community planning and development programs...

HUD disagreed with the significant deficiency cited in the financial statement audit report and contended that CPD's formula grant reporting process in the Integrated Disbursement and Information System (IDIS) Online system is substantially compliant with FFMIA requirements. As part of the justification for its position, HUD management cited the lack of deficiencies in prior year audit reports and a history of independent assessments that concluded that IDIS was "substantially compliant" with OMB Circular A-127, the guidance that implements the FFMIA. The OIG disagreed with HUD's position. CPD management issued a contract to Leon Snead & Company, P.C. to determine if the method by which IDIS processes formula grant transactions complies with FFMIA requirements.

OBJECTIVE

The objective of the project was to determine whether the first-in, first-out (FIFO) method that the IDIS Online system uses for drawing grant payments from available obligations complies with the requirements of FFMIA.

SCOPE

The scope of our assessment was limited to determining whether the FIFO method of applying payments to obligations complied with the requirements of FFMIA. Our analysis did not extend to compliance related to other aspects of the IDIS Online system or to the system taken as a whole, nor did it cover the FFMIA compliance of any other financial or mixed systems in HUD, except to the extent that the FIFO method could directly affect compliance with FFMIA in another system.

METHODOLOGY

We interviewed knowledgeable officials in HUD and contractor personnel who maintained or used IDIS Online and were familiar with the operation of the system and its interfaces with other HUD financial systems. We also interviewed OIG audit personnel who were most directly involved in and knowledgeable about the issues raised in the pertinent OIG reports. We walked through the processes for grantee commitments of funds to projects and activities and drawdowns of funds for specific activities and observed each step that occurred in each of those processes. We reviewed descriptions of the interfaces between IDIS Online and the Line of Credit Control System (LOCCS) and the specific data elements that are fed to and from IDIS Online and LOCCS. We conducted a walk-through of a payment request transaction from IDIS Online, observed how that transaction flowed through the financial management system, and assessed whether it was posted in the core financial system in a manner consistent with the USSGL at the transaction level.

We also reviewed pertinent government-wide policies, including but not limited to, Office of Management and Budget (OMB) Circular A-127, *Financial Management Systems*; OMB Memorandum M-09-06, *Implementation Guidance for the Financial Management Improvement Act*; *Core Financial System Requirements*, promulgated by the Chief Financial Officer's (CFO) Council[1]; OMB Circular A-11, *Preparation, Submission, and Execution of the Budget*; Statement of Federal Financial Accounting Standards No. 7, *Accounting for Revenue and Other Concepts for Reconciling Budgetary and Financial Accounting*; *Principles of Federal Appropriations Law*, Third Edition, promulgated by the Government Accountability Office; and the *U.S. Government Standard General Ledger, Supplement No. S2 Treasury Financial Manual, S2 09-02 August 2009, Revised by I TFM Bulletin No. 2010-04 (December 4, 2009)*.

RESULTS

FFMIA Section 803(a) contains three components: Federal financial management systems requirements, Federal accounting standards, and the application of the USSGL at the transaction level. We analyzed the FIFO method versus each of the three components using the guidance in OMB Memorandum 09-06 to determine compliance. The OMB guidance defines core financial systems, financial management systems, and mixed systems and provides the thresholds each type of system must meet in order to be in compliance with FFMIA.

Based on the definitions in the OMB guidance, we determined that the core financial system in HUD is the Housing and Urban Development's Central Accounting and Program System (HUDCAPS), which provides general ledger and other subsystems. The Line of Credit Control System (LOCCS) is a payment system and would thus meet the definition of a financial system.

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[1] The CFO Council assumed the responsib[illegible] Financial Systems Integration Office (FSIO), which ceased operations effective M[illegible]rch 31, 2010. FSIO wa[illegible] th[illegible] [illegible]uccessor [illegible]rg[illegible]nizat[illegible]on to the Joint Fin[illegible]al Management Improvement Project [illegible]JFMIP[illegible], which pron[illegible] [illegible]eries of Federa[illegible] Financ[illegible]al Manage[illegible] [illegible]ystem Requirements

The Program Accounting System (PAS) is a grants management system and would also meet the definition of a financial system. The IDIS Online system is primarily a performance management system, which performs the financial activities of allowing grantees to commit funds to projects, subgrants, and activities and to request payments. The IDIS Online system also allocates payment amounts to grants using the FIFO method. The IDIS Online system is thus a mixed system.

Our analysis of whether the FIFO method complies with FFMIA and the OMB requirements for mixed systems is set forth below.

Federal Financial Management Systems Requirements

Since IDIS Online is not part of the core financial system, the FFMIA requirements do not apply directly to IDIS Online. However, because IDIS Online is the source for the information on formula grant payments that eventually update HUDCAPS (the system to which the FFMIA requirements pertain), we analyzed whether IDIS Online would prevent HUDCAPS from complying with the core financial system requirements.

We performed a detailed review of each of the business process requirements related to obligations and payments, as set forth in the core system requirements. During our review, we noted that IDIS Online does not capture or pass along to LOCCS the dates covered by payment requests (periods of performance). The core financial system requirements include mandatory requirements that the core financial system validate the invoice period of performance[2] and the invoice delivery/performance dates[3].

In a legal opinion dated June 10, 2010, the HUD Office of General Counsel (OGC) stated:

> Based on OCFO staff's review and discussions with CPD and OGC, pursuant to the authorizing and appropriation Acts, the HOME program issues formula block grants.... Pursuant to their broad five-year plans and readily amendable one-year plans devised within the framework of the Authorizing Act, the participating jurisdictions, through flexible grant agreements and procedures, can and do choose and change activities and objectives from year-to-year and within years, applying available funding from the proper fund type which may contain amounts from more than one fiscal year. Accordingly, with respect to accounting for funds made available under the HOME program, it would seem to contravene the block grant nature of both the Authorizing and Appropriations Act to require that amounts from each fiscal year be tracked inflexibly to individual, unchangeable grant activities. The very nature of the HOME program Congress created gives participating jurisdictions the flexibility to mix and match activities and implementation methods. within fund type. and to change such activit es and objectives over the years.

[2] Business process PMC-10 defines the requirement as validating that invoice dates that products were delivered or services performed are within the period of performance dates on the referenced obligation.

[3] Business process PMC-11 defines the requirement as validating that the invoice dates that products were delivered or services performed are dates for which the products services have been received and accepted. The system must also prevent he process g of invoices with unmatched da es and the duplicate processing of invoices with matched dates.

The CFO Council's core financial system requirements document states that its guidance "...exempts agencies from meeting individual system requirements relating to business processes they do not perform." Based on the HUD OGC opinion, the business processes defined at PMC-10 and PMC-11 apparently do not need to be performed for the HOME formula block grant program. The other programs to which the FIFO method is applied are also formula block grant programs that HUD administers in a manner similar to the HOME program for committing and disbursing funds. Therefore, we believe the two mandatory business process requirements would not be applicable to other formula block grant programs.

As a result of our analysis, we found no instances in which the FIFO method employed by IDIS Online system would cause the core financial system to be in noncompliance with the core financial system requirements.

Federal Accounting Standards

We performed extensive reviews of criteria promulgated by the OMB, Treasury, and GAO and found no guidance that specifically prohibited the use of the FIFO method for liquidating obligations. We found the FIFO method of applying payments to obligations complied with the accounting standards we reviewed.

USSGL at the Transaction Level

Since IDIS Online is not part of the core financial system, the requirements to apply the USSGL at the transaction level do not apply directly to IDIS Online. We conducted a walk-through of a transaction from IDIS Online and observed how that transaction flowed into LOCCS, then PAS, then HUDCAPS. As discussed under the requirements for mixed systems below, we found that the transaction was posted to HUDCAPS consistent with the USSGL at the transaction level.

OMB Requirements for Mixed Systems

OMB Memorandum 09-06 specifies two requirements that mixed systems must meet.

1. The financial portion of the mixed systems must transmit data such that:
   a. data transferred to the core financial system can be traced to the original financial event(s) in the mixed system(s); and
   b. data transferred adheres to the data exchange format required by the core financial system.
2. A data exchange or interface program must ensure that data transferred from the mixed systems is properly posted using the appropriate USSGL accounting entries and recorded in accordance with applicable standards from the Federal Accounting Standards Advisory Board (FASAB) in the core financial system.

We conducted a walk-through of a transaction from IDIS Online and observed how that transaction flowed into LOCCS, then PAS, then HUDCAPS. We noted that the transaction posted in a manner consistent with a combination of transaction codes B107. B110 and B134 as defined in the Account Transactions section of the USSGL supplement to the *Treasury Financial Manual*. IDIS Online feeds the grant number and grantee tax identification number (TIN) to LOCCS, which uses that information to apply an accounting strip to each transaction. The accounting strip contains data concerning the appropriation, FY indicator, Budget Fiscal Year, Program Code, Regional Office, Field Office, and Project Number. Thus, the data elements transferred to the core financial system can be traced to the original financial events in IDIS Online via the TIN and grant number and meet the data exchange format necessary for HUDCAPS to post the transaction correctly in accordance with the USSGL at the transaction level.

We appreciate the assistance we received from you and other HUD officials and staff in completing this assignment. If you have any questions concerning the report, please contact me or Pat Layfield.

Leon Snead

Leon Snead, President

Attachment 1

List of Officials and Contractors Interviewed

Name	Title	Organization	Phone Number
Robert Brever, Jr.	Director	Community Planning & Development (CPD), Systems Development and Evaluation Division	202-402-4537
Christopher B. Davies	Director, Financial Systems Maintenance Division	Office of the Chief Financial Officer	202-708-1757
William H. Eargle, Jr.	Deputy Assistant Secretary for Operations	CPD	202-401-6367
James A. Heist	Assistant Inspector General for Audit	HUD Office of Inspector General	202-708-0364
Peter Huber	Director, Financial and Information Services Division	Office of Affordable Housing Programs, CPD	202-708-2684
Kendra Johnson	Manager, CPD Audit	HUD Office of Inspector General	202-402-7148
Elizabeth Louis	Budget Analyst	CPD Budget Division	202-708-2182
Thomas McEnanly	Director, FAD	HUD Office of Inspector General	202-402-8216
Vincent Mitchell	Programmer/Analyst, HUD – CPD/IDIS Online Support	CACI	703-647-4132
Clifford Taffet	Director	Office of Affordable Housing Programs	202-402-4589
Sam Walker	Information Systems Security Officer	CPD	202-402-3883
Paul Webster	Director	Financial Management Division	202-708-1871
Jennifer Young	IDIS Help Desk (Contractor)	CPD	202-402-6024