
AUDIT REPORT



EFFECTIVENESS OF THE DEPARTMENTAL ENFORCEMENT CENTER

2004-AT-0002

JULY 12, 2004

OFFICE OF AUDIT, REGION 4
ATLANTA, GEORGIA



Issue Date	July 12, 2004
Audit Case Number	2004-AT-0002

TO: Kathleen D. Koch, Acting General Counsel, C

James D. McKay

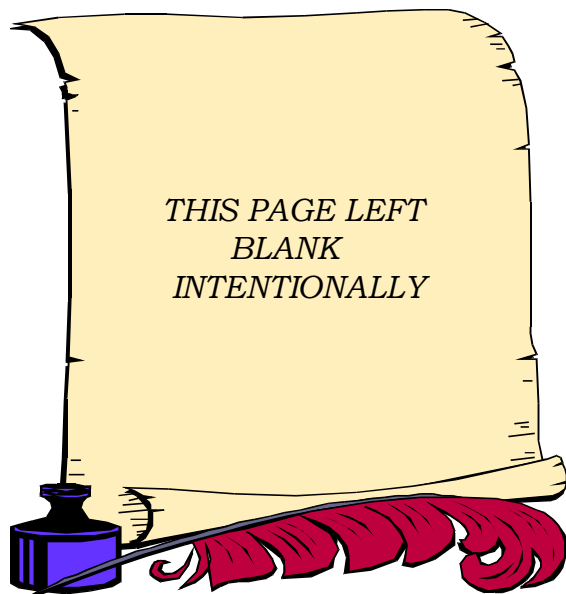
FROM: James D. McKay
Regional Inspector General for Audit, 4AGA

SUBJECT: Effectiveness of the Departmental Enforcement Center

We completed an audit of the effectiveness of the Department of Housing and Urban Development's (HUD) Departmental Enforcement Center (DEC). We conducted this audit as part of our annual audit plan. This report contains four findings that require follow-up by your office to implement appropriate corrective actions.

In accordance with HUD Handbook 2000.06, REV-3, within 60 days please provide us, for each recommendation without management decisions, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Additional status reports are required at 90 days and 120 days after report issuance for any recommendation without a management decision. Also please furnish us copies of any correspondence or directives issued because of the audit.

We appreciate the cooperation provided by DEC and the Office of General Counsel (OGC) officials during the audit. Should you or your staff have any questions, please contact me or Narcell Stamps, Senior Auditor, at (404) 331-3369.



Executive Summary


We conducted an audit to assess the effectiveness of the DEC's enforcement actions. Our objectives were to determine whether: (1) the DEC has had a positive impact on the Department's program enforcement and compliance, (2) the organization change, moving the DEC into the Office of General Counsel (OGC), has improved DEC operations, (3) automated referrals to the DEC warranted enforcement action and/or duplicated work performed by program staff, and whether improvements can be made to eliminate unproductive referrals, (4) the DEC serves as HUD's one organization handling program enforcement, and (5) the DEC initiated appropriate enforcement actions as needed to remedy noncompliance with program requirements.

The DEC had positive impacts related to (1) improving the physical condition of HUD's multifamily portfolio, (2) imposing civil money penalties against multifamily project owners who fail to timely submit annual financial statements, and (3) implementing debarments against program violators. However, the audit identified the following conditions that warrant corrective action by the DEC.

- The DEC is not functioning pursuant to its planned mission as the Department's one enforcement authority. The DEC has not asserted its authority as HUD's one independent enforcement authority with consistent enforcement standards and procedures applied to all HUD programs. The DEC allowed inconsistent enforcement procedures for different HUD program offices, and its satellite offices only received and processed multifamily housing referrals. The DEC also allowed the Office of Housing to control referrals to the DEC and certain enforcement decisions the DEC was intended to control.
- The DEC needs to improve its development and pursuit of administrative and civil sanctions, and referral of potentially criminal actions to Office of Inspector General (OIG), when warranted by documented violations. On physical condition cases, the DEC did not pursue enforcement action against owners who did not bring their properties up to HUD's minimum physical condition standards. For financial referrals, the DEC did not pursue certain violations that warranted enforcement sanctions. Our audit tests identified 24 cases where project owners committed violations under the equity skimming and double damage statutes, but the DEC did not pursue enforcement actions beyond requiring owners to pay back some or all of the misused funds. The DEC did not refer equity skimming cases to the OIG as required by HUD policy.
- The DEC needs to eliminate unwarranted referrals from the Office of Housing and premature case closure practices. The unwarranted referrals occurred due to flaws in automated system referrals, and flawed referral criteria. These conditions inflated the DEC's workload and accomplishments, and wasted DEC staff resources that could have been used on other referrals.
- OGC has not filled five key vacant DEC positions because the OGC had exceeded its overall staff ceiling. DEC also could not document some changes in its staff ceiling that resulted from its merger with OGC. OGC also had not filled eight Associate Regional Counsel positions created in conjunction with the merger. OGC's budget did not

separately identify DEC funding and staff ceiling. The vacant OGC/DEC positions and reduced DEC staffing may have increased the burden on existing staff and hindered OGC/DEC's ability to manage and reduce its backlog of referred cases.

We concluded it was too soon to assess whether the DEC merger into OGC would be effective because the merger was incomplete and certain merger actions had only recently been completed.



Recommendations

We recommend that OGC/DEC: (1) revise the DEC's operating practices to bring them into harmony with HUD's 2020 Management Reform Plan and the DEC implementation plan, or obtain written HUD authorization for deviations from the published provisions, (2) establish uniform enforcement standards and procedures for use by all HUD offices, (3) eliminate unwarranted referrals from the Office of Housing, (4) fill the key DEC vacancies, and (5) establish a staff ceiling for the DEC in the OGC budget.

Auditee Comments

We discussed our results with OGC/DEC and HUD officials during the audit. We provided a copy of the report to OGC/DEC and HUD officials on April 30, 2004. We discussed the draft report with OGC/DEC officials at the exit conference on May 21, 2004, and received their written comments on June 16, 2004. We included excerpts of their response in the auditee comments section of each finding, followed by our evaluation of their comments. OGC/DEC officials disagreed with several facts and conclusions presented in the audit report, but they generally agreed with seven of ten audit recommendations. Their comments are included in their entirety as Appendix D.

Table of Contents

Management Memorandum	i
-----------------------	---

Executive Summary	iii
-------------------	-----

Introduction	1
--------------	---

Findings

1. The DEC Is Not Functioning Pursuant To Regulatory Plans As The Department's One Enforcement Authority	5
---	---

2. The DEC Has Had A Positive Impact On The Multifamily Portfolio, But Needs To Improve Its Use Of Sanctions	17
---	----

3. Improvements Are Needed To Reduce Unwarranted Referrals, To Control Workload, and To Report Meaningful Accomplishments	27
---	----

4. The Merger With OGC Restricted Hiring For Key DEC Positions	37
---	----

Internal Controls	43
-------------------	----

Follow-Up On Prior Audits	45
---------------------------	----

Appendices

A. Schedule of Equity Skimming Violations	47
B. Schedule of Unwarranted Referrals	49
C. Schedule of Referral Criteria Needing Revision	51
D. OGC/DEC Comments	53

Abbreviations

CPD	Community Planning and Development
DEC	Departmental Enforcement Center
FHEO	Fair Housing and Equal Opportunity
HUD	U.S. Department of Housing and Urban Development
OIG	Office of Inspector General
OGC	Office of General Counsel
PIH	Public and Indian Housing
REAC	Real Estate Assessment Center
REMS	Real Estate Management System

Introduction

On June 26, 1997, former Secretary Andrew Cuomo released the “HUD 2020 Management Reform Plan.” The plan contained six reforms with the stated purpose of restoring HUD's reputation and credibility by improving the efficiency and effectiveness of the Department's programs, operations and provision of services. The plan stated that the greatest breach of the public trust at HUD is the waste, fraud, and abuse in HUD's existing portfolio of millions of housing units¹. Reform number 3 provided for the creation of an Enforcement Authority with one objective: To restore the public trust. The plan stated that each of HUD's program offices, Office of Housing, Public and Indian Housing (PIH), Community Planning and Development (CPD), and Fair Housing and Equal Opportunity (FHEO), operated independent enforcement functions with different standards and procedures. The plan stated that the new Enforcement Authority would combine enforcement actions for Office of Housing, PIH, CPD, and FHEO (non-civil rights enforcement) into one authority. The creation of an Enforcement Authority was also intended to free other agency staff to better service and support the Department's programs.

The Enforcement Center Implementation Plan dated December 1997, provided that the Enforcement Center has the primary responsibility of regaining and maintaining the public trust. The plan further stated that the Center would consolidate HUD's enforcement efforts to bring resolution to outstanding non-compliance issues among recipients of HUD program resources in the areas of Housing, PIH, CPD, and FHEO. To ensure the DEC had the independence and control necessary to do its job, program offices were not to have any supervisory control over the DEC.

The Enforcement Center began operations on September 1, 1998, performing the legal functions necessary to enforce the Department's statutory, regulatory, and contractual rights against program participants. The Center used a team approach with enforcement specialists and attorneys working to develop cases for enforcement. Enforcement actions taken by the DEC may include a wide range of administrative and civil actions such as negotiating agreements to comply with HUD requirements, requiring repayment of improperly used funds, suspensions and debarments, imposition of civil money penalties, and civil litigation to enforce regulatory and contractual provisions.

In October 2001, HUD's Deputy Secretary announced a revision in the DEC's organizational structure. HUD revised the DEC from being a separate organization reporting to the Deputy Secretary and merged it into the OGC. HUD stated that the revised DEC structure would streamline operations and strengthen enforcement capability.

¹ The Inspector General Act created independent and objective Offices of Inspector General, with the responsibility to prevent and detect fraud and abuse in the programs and operations of their respective Federal establishments. HUD policy requires matters of a potentially criminal nature be referred for review by the Office of Inspector General for Investigations (Handbook 2000.3, Office of Inspector General Activities, Chapter 5.)

Audit Objectives, Scope,
and Methodology

The audit objectives were to determine whether:

- The DEC has had a positive impact on the Department's program enforcement and compliance.
- The organization change, moving the DEC into the OGC, has improved DEC operations.
- Automated referrals to DEC warranted enforcement action, and/or duplicated work performed or which should be performed by program staff, and whether improvements can be made to eliminate unproductive referrals and avoid duplicate monitoring by program staff.
- The DEC serves as the Department's one organization handling program enforcement.
- The DEC initiated appropriate enforcement actions as needed to remedy noncompliance with program requirements.

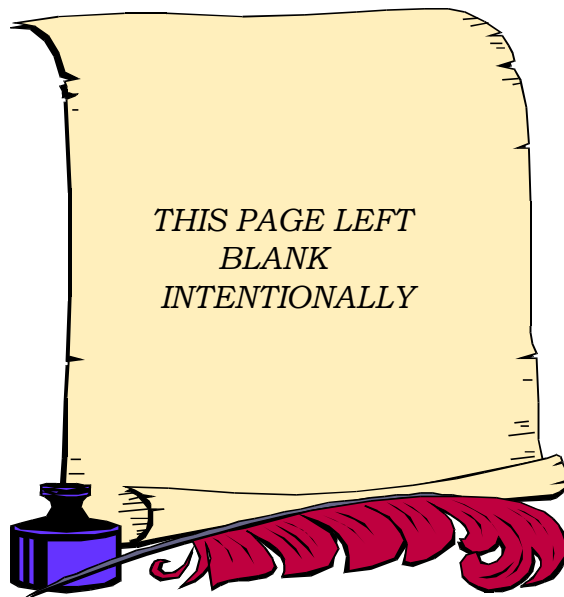
To accomplish our objectives, we performed the following procedures and tests:

- Interviewed DEC, OGC, and Housing Headquarters officials concerning DEC operations and their related involvement and dealings with the DEC.
- Reviewed HUD's 2020 Management Reform Plan provisions relating to the DEC, Federal Register Notice Vol. 62, No. 155, issued on August 12, 1997, and the DEC Implementation Plan. We compared those plan provisions to the DEC's actual policies, operating procedures and the written protocols the DEC executed with HUD program offices.
- Reviewed HUD national Real Estate Management System (REMS) statistics concerning multifamily housing project physical inspection results and financial statement submissions, and DEC tracking

reports concerning the DEC national workload, financial statement submissions, civil money penalties, and debarments.

- Interviewed OGC, CPD, and PIH officials in Chicago and Atlanta to determine the extent of their knowledge and interaction with the DEC satellite and Headquarters offices.
- Reviewed DEC case files for a random sample of 223 multifamily housing project referrals to the DEC that were processed and closed by the DEC's Atlanta and Chicago satellite offices. We selected referrals closed from October 1, 2002, through December 9, 2003, in order to review the DEC's most recent cases. The satellite offices received no referrals from CPD, PIH, or FHEO. The random sample included 86 of 484 physical condition referrals, 97 of 2,976 financial condition referrals, and 40 of 876 financial statement non-filer referrals, all closed during the cited period.

Our audit generally covered DEC enforcement activities during the period October 1, 2001, through December 9, 2003. We performed the audit from July 2003 through March 2004. We conducted the audit in accordance with generally accepted government auditing standards.



The DEC Is Not Functioning Pursuant To Regulatory Plans As The Department's One Enforcement Authority

The DEC is not functioning pursuant to published plans as the Department's one enforcement authority. While the DEC has had a positive impact in certain areas, it has not invoked its planned authority as HUD's one independent enforcement authority, and has not developed written standards and procedures for enforcements to ensure consistent enforcement actions are applied to all HUD programs. Instead, the DEC executed inconsistent enforcement protocols with the different HUD Offices. The workload for DEC satellite office staff was only to receive and process multifamily housing referrals. The DEC also allowed multifamily housing to control decisions and handle sanctions the DEC was intended and established to handle. As a result, planned improvements such as reducing the enforcement workload performed by program staff and establishing consistent enforcement standards and procedures within HUD were not achieved. According to DEC and OGC officials, these conditions occurred because, despite provisions cited in the published implementation plan, the primary aim was for the DEC to handle multifamily housing cases.

HUD's 2020 Management Reform Plan

HUD's 2020 Management Reform Plan, published in a Federal Register Notice, Vol. 62, No. 155, on August 12, 1997, addressed historical enforcement failures within HUD program offices, citing problems with each program office operating independent enforcement functions and using different standards and procedures for enforcement. Reform 3 of the plan stated: "The new HUD will combine enforcement actions for PIH, CPD, FHEO, and Office of Housing into one authority." It stated the Enforcement Authority will be responsible for taking legal action against all PHAs that receive a failing score on their annual assessment, moving against all Office of Housing properties that fail physical and financial audit inspections, cleaning up the historical backlog of 5000-plus troubled Office of Housing properties, and cracking down on all CPD and FHEO grantees who failed audit standards or who engaged in waste, fraud, and abuse. This reform was intended to consolidate the independent enforcement functions operating within each program office, each with different standards and procedures.

The DEC Implementation Plan provided that the DEC was to become HUD's "enforcement arm" designed to "get

tough” with violators. To ensure the DEC had the independence and control necessary to do its job, program offices were not to have any supervisory control over the DEC. The DEC published information on its web site that indicated a mission and objectives consistent with those cited in the 2020 Management Reform Plan and the DEC Implementation Plan.

DEC’s Positive Impact

The DEC has had a positive impact on HUD’s multifamily portfolio. The DEC’s handling of multifamily projects that failed physical condition standards resulted in 53 percent of those project owners improving their project’s inspection score to meet or exceed HUD’s minimum standard. We also noted that the DEC had established and pursued a structured approach to address the large backlog of multifamily projects whose owners had not complied with requirements for submission of annual audited financial statements.

DEC Did Not Develop HUD-Wide Enforcement Standards

Despite these accomplishments, the DEC was not developed into an independent enforcement authority with common enforcement standards and procedures for all HUD programs. Instead, the DEC executed different protocols with each HUD office and followed practices that continued to foster inconsistent enforcement measures. The protocols and practices resulted in the DEC satellite offices only obtaining and processing multifamily project referrals from HUD’s Office of Housing. Other program offices were not relieved of the workload and responsibility to pursue enforcement actions. OIG’s prior audit of the DEC, Report No. 00-NY-177-0001, issued March 28, 2000, also noted that the DEC was not operating as planned under the HUD 2020 Management Reform Plan.

OGC and DEC representatives agreed that the DEC’s actual operations did not match the enforcement authority described in the HUD 2020 Management Reform Plan, the DEC Implementation Plan, and the DEC’s web site. OGC’s Chief Counsel, Office of Program Enforcement, said he was directly involved in the formation of the DEC, and that the DEC was created to handle the large backlog of multifamily properties with physical and financial deficiencies. OGC representatives were agreeable to pursuing revisions in written statements of the DEC’s mission. Changes in the DEC mission, as stated in its Implementation Plan, will require written authorization

from the Secretary or Deputy Secretary. Departmental policy may require a published Federal Register Notice of changes from the previously published HUD 2020 Management Reform Plan.

Inconsistent Protocols With HUD Offices

The DEC did not establish uniform enforcement standards and procedures for use throughout HUD, and different enforcement standards and procedures continued to exist. The DEC executed written protocols with five HUD program offices: CPD, PIH, Office of Housing, FHEO, and Real Estate Assessment Center (REAC)². The protocols focused nearly all satellite office resources on multifamily project referrals. The protocols did not transfer the enforcement workload to the DEC from the program staff of PIH, CPD, and FHEO. The DEC also allowed Office of Housing to control the criteria for referrals to DEC and certain enforcement decisions and actions the DEC was intended to handle.

The DEC executed inconsistent protocols that allowed Office of Housing to make multifamily project referrals to the DEC satellite offices but did not allow direct referrals by other HUD offices. The protocol with Office of Housing allowed it to refer cases directly to DEC satellite offices for multifamily projects that:

- Did not meet HUD’s physical condition standards,
- Appeared to violate HUD’s financial requirements, and
- Failed to timely provide required annual financial reports.

The DEC protocols with PIH and CPD prevented those offices from referring cases directly to DEC satellite offices. The PIH and CPD protocols provide that the local program offices would work with program participants to resolve compliance issues. The protocols provided that if the local offices could not resolve issues, they would refer the issues to their respective headquarters office. The protocols with PIH and CPD further provide that any decision to refer compliance issues to the DEC would be

² The DEC could not provide a signed copy of the REAC protocol. The protocol described the agreement with the DEC for making physical and financial referrals.

made by their respective Assistant Secretary offices. Thus, these protocols effectively precluded direct referrals to DEC satellite offices. The protocol with FHEO allowed referrals to the DEC, but provided no criteria for issues that should be referred for enforcement. During the audit period, DEC workload reports showed that its satellite offices received no referrals from PIH, CPD, and FHEO. The DEC Compliance Division in Headquarters did impose 1,013 suspensions and debarments, of which at least 10 percent were referred by program offices and DEC satellite offices. (See Finding 2, Positive DEC Impacts, for further details.)

Office of Housing, PIH, and CPD all require certain program participants to submit annual audited financial statements, but the DEC has only addressed violations of those requirements in the multifamily program. When multifamily program participants do not timely file the statements, they are automatically referred to the DEC. Further, the DEC has imposed civil money penalties on multifamily project owners for violations of the financial statement requirements. The written protocols with PIH, CPD, and FHEO did not establish any criteria for referring compliance violations such as those cited in the Federal Register Notice to the DEC satellite offices and no referrals were received from those offices. The inconsistent treatment of multifamily projects versus other HUD projects is not in harmony with the DEC's planned mission to develop consistent enforcement standards and procedures.

We interviewed several HUD Field Office Directors for PIH and CPD and they stated that the protocols prevented them from referring cases directly to DEC satellite offices. One of the CPD directors stated he had cases he could have referred to the DEC were it not for the protocol restriction.

The DEC Deferred Certain Enforcement Decisions And Actions To Office of Housing

The DEC's protocol with the Office of Housing allowed Housing Officials to control enforcement decisions and actions that the DEC was intended to handle. The protocol provided that when DEC actions were unsuccessful in getting a project owner to improve a property up to HUD's required physical condition standards, the DEC would refer the case back to Housing with recommendations for action and possible sanctions. DEC then closed the case referrals and did not follow up to track action actually taken by

Office of Housing. (See Finding 2 for further discussion and cases identified by our audit.)

Office Of Housing
Controlled Criteria For
Referrals To DEC

The DEC allowed the Office of Housing and REAC to control the criteria for financial referrals to the DEC. The DEC was working with Housing and REAC to revise compliance flags but had not completed the process because it was awaiting Housing and REAC’s approval. The DEC Implementation Plan provided that the DEC was not to be supervised by other HUD offices. Further, to be effective, the DEC must control its workload and be able to reject referrals that do not warrant enforcement action. (See Finding 3 for further details of this condition.)

We agree that the DEC should coordinate with other HUD offices, and consider the views of Office of Housing in establishing procedures for handling enforcement actions, but the DEC was planned to be responsible for enforcement actions, and must control the criteria for referrals it will accept as warranting enforcement action.

The DEC needs to establish operations that are in harmony with the published HUD objectives and provisions for creating an enforcement authority. The DEC should take the leadership role to ensure consistent department wide enforcement actions against program violators.

OGC/DEC Comments

OGC concurred with Recommendation 1A, stating that it would revise published plans to reflect its current operating environment. OGC did not concur with Recommendation 1B, and cited other concerns with the audit report as follows:

”The nature of the work handled by the DEC has evolved as the priorities of the Department and our clients have changed. We disagree that the DEC was created to handle all enforcement matters. In fact, we provided the audit team with documentation supporting the fact that from its inception, the DEC was not to handle fair housing enforcement cases. Rather, such cases are by law the responsibility of the Assistant Secretary for FHEO.”

OGC’s response notes that the DEC Implementation Plan states: “The Enforcement Center is a Department-wide

operation. It is not associated with any one Program Office even though the majority of its inventory may originate from **one program office** [emphasis added].”

“In the field, the majority of our referrals come from Multifamily field offices. In Headquarters, we receive referrals from various program offices as discussed with the audit team. Therefore, we believe that overall, the DEC is operating as designed.

“The draft audit report states that the “Enforcement Authority” will be responsible for taking legal action against all housing authorities that receive a failing score on their annual assessment. However, the report fails to discuss a subsequent *Federal Register* notice placing a moratorium on these types of referrals to the DEC for a period of over three years. The audit report ignores post HUD 2020 publications that further define and redefine the role of the DEC. These include:

- Physical Condition Standards and Inspection Requirements
- Uniform Financial Reporting Standards
- Redlegation of Authority to the DEC Regarding Authority to Initiate Civil Money Penalty Actions Under Certain Civil Money Penalty Regulations and to Issue a Notice of Violation of a Regulatory Agreement and a Notice of Default of a HAP Contract.

“In support of its findings for the improper variation from the 2020 vision statement, the OIG states that the DEC was not developed into an independent enforcement authority and was under the supervision and control of program offices. Working protocols do not equate to supervision. The DEC, being oriented within the Office of General Counsel, is now aligned within a long-existing, critically necessary, independent authority of the Department. The General Counsel is responsible to the Secretary, not any program office.

“The OIG tends to prescribe its unilateral perspectives with little regard for the consequences of its recommendations (i.e., impact on residents, preservation of housing, etc.). We recognize that this is in line with the charge of the OIG. Respectfully, the DEC takes a bigger picture approach in crafting its recommendations. That is, the DEC provides recommendations to program offices and remains available to support and implement its recommendations.

Regarding inconsistent Protocols, OGC’s response stated that certain factors made it unrealistic to implement uniform enforcement standards and stated that OIG’s suggestion that it establish uniform Department-wide standards “* * * runs contrary to another finding in the audit opining that the DEC should have the latitude to set referral thresholds because of the inherent differences between programs.” OGC also stated: “We do not agree that all referrals must be made the same way (i.e., by the field or by headquarters offices, electively or directly). Like the OIG, we accept referrals from different sources and in different formats.”

“The DEC Deferred Certain Enforcement Decision and Actions to the Office of Housing – * * * During the meeting on your survey results, we also stated that certain enforcement decisions are more appropriately handled by Housing because it has resources the DEC does not. For example, Housing has the ability and resources to order vouchers when relocation of tenants is deemed necessary. The DEC does not. Like the OIG, the DEC makes recommendations and the program offices ultimately decide whether or not to implement them. * * * the DEC advised the OIG that we routinely participated in conference calls Housing held with its offices on physical referral cases. In fact, the audit team was provided with a sample report used by Housing and the DEC on these calls. The DEC communicates daily with the Office of Housing in Headquarters and the field on actions relative to these properties. We do agree that a formal tracking process could be implemented.

“Office of Housing Controlled Criteria for Referrals to the DEC - The established referral thresholds have, since inception, been negotiated between the DEC, Housing and the Real Estate Assessment Center (REAC). This is because we maintain a collaborative relationship with these

offices. * * * Of course, improvements can be made with respect to what matters are referred to the DEC. The DEC agrees that it should have the ongoing discretion to assess all forms of referrals from all program offices.”

**OIG Evaluation of
OGC/DEC Comments**

OGC concurred with Recommendation 1A, but did not concur with Recommendation 1B. OGC will need to provide details of the actions planned for Recommendation 1A including a timeframe for completing such actions before OIG can concur with its management decision. At the audit exit conference, OGC officials stated that they planned to issue informational brochures that could provide the type of guidance specified in Recommendation 1B to HUD program officials. We continue to recommend such guidance to ensure knowledge of available enforcement measures and their applicability to common violations, and consistency in enforcement, as specified in Recommendation 1B. We request OGC to reconsider its response and provide further information on the planned brochures.

The audit report presents the DEC’s enforcement role as specified in the HUD 2020 Management Reform Plan and the DEC Implementation Plan. Finding 1 questions DEC operations and protocols that have focused nearly all DEC Operating Division resources on multifamily housing and have restricted other Program Office contacts to the Headquarters level. The audit report does not state that the DEC was created to handle all enforcement actions, such as fair housing violations that are the responsibility of FHEO.

The DEC implementation plans provided that the DEC would establish consistent enforcement standards and would handle specified enforcement actions, on a Department-wide basis. The audit report recognizes the DEC Headquarter’s Compliance Office processed administrative sanctions (e.g. suspensions and debarments) for various HUD program offices. As cited in the finding, the DEC did not develop and implement consistent enforcement standards for use by all program offices, and the DEC Satellite offices (field offices of the DEC Operating Division) handled almost no referrals outside of multifamily housing.

The report quotes the 2020 Management Reform Plan in regard to housing authorities that fail their annual assessment. However, our report did not cite any specific exceptions in DEC performance in regard to housing authorities because the 2020 Plan also assigned responsibilities for troubled housing authorities to the PIH Troubled Agency Recovery Center, which was recently dissolved.

Our audit did consider the Federal Register publications cited in OGC's response. These notices contained no revisions to the DEC mission and responsibilities as set forth in HUD's 2020 Management Reform Plan and the DEC Implementation Plan. The Physical Condition Standards and Inspection Requirements established new procedures to measure and assess the physical condition of multifamily and public housing projects. The Uniform Financial Reporting Standards set new procedures for financial reporting by multifamily and public housing projects. The redelegations of authority delegated various authorities to the DEC including authority to initiate civil money penalties and to issue notices of violation and default. These delegations strengthened the DEC's ability to carry out enforcement actions.

The audit report does not state that the DEC was under the supervision and control of other HUD program offices. The report does cite DEC protocols and practices that deferred certain enforcement actions to the Office of Housing and allowed Office of Housing and REAC to control the criteria for case referrals to the DEC.

We agree and recognize in the audit report that the DEC cannot unilaterally implement all enforcement measures and must coordinate actions with program offices.

We disagree with OGC's comment that uniform enforcement standards across program areas is contrary to another audit finding that the DEC should have the latitude to set referral thresholds. HUD's 2020 Management Reform Plan specified that the DEC would establish consistent enforcement standards. The establishment of consistent enforcement standards is not in our view in conflict with the DEC controlling thresholds used for automated referrals of certain violations.

The DEC did inform us that it regularly meets with and discusses actions taken by Office of Housing on DEC enforcement recommendations. However, as stated in the report, the DEC did not track enforcement actions taken by Office of Housing on cases where it had made recommendations to Office of Housing.

Recommendations

We recommend that OGC/DEC:

- 1A. Revise the DEC's operating procedures to bring them into compliance with the published HUD 2020 Management Plan and the DEC Implementation Plan, or obtain written authorization for changes in the DEC mission and plans. If material changes are made, OGC should determine whether Departmental policy calls for a revised Federal Register Notice. Significant changes from the published plan would include as a minimum: (a) leaving separate enforcement functions in some program offices, (b) changes in the enforcement responsibilities specifically cited in the Federal Register Notice, and (c) deferring enforcement decisions to program offices.

- 1B. Establish written enforcement standards and procedures for use by all HUD program offices and DEC staff. Such standards and procedures should be designed to ensure consistent enforcement actions for common compliance issues that impact two or more HUD offices. Examples would include annual financial statement requirements, common requirements for grant and loan fund accountability, and physical condition of housing properties. The standards should provide guidance to all HUD program managers. Such guidance should address when to consider enforcement actions, enforcement procedural requirements such as issuing a Notice of Violation and timeframes allowed, reference to the various available sanctions such as debarments and civil money penalties and their applicability to

common violations, and information on making referrals to or seeking advice from OGC/DEC. (See also Recommendation 2B for other improvements in written guidance.)



The DEC Has Had A Positive Impact On The Multifamily Portfolio, But Needs To Improve Its Use Of Sanctions

The DEC has had a positive impact on the multifamily portfolio, but needs to improve its development and pursuit of administrative and civil sanctions, and referral of potentially criminal violations to OIG, when warranted by documented violations. Our tests identified 24 cases where documented violations warranted consideration of various sanctions, but such sanctions were not taken by the DEC and there was no case documentation that they were considered. Additionally, the DEC deferred the imposition of sanctions on physical condition cases to the Office of Housing. We attribute these conditions to DEC written procedures that emphasized administrative recoveries, and did not adequately address the use of other enforcement actions and referring potentially criminal violations to OIG. These conditions diminished the DEC's effectiveness as an enforcement organization by allowing individuals and firms to escape the administrative, civil, or criminal consequences designed to address the violations. They also burdened multifamily housing staff with the responsibility for some enforcement actions.

HUD's 2020 Management Reform Plan

The HUD 2020 Management Reform Plan, Multifamily Housing Section, states that Asset Managers monitor and service an average of 55 projects per person, are overburdened with non-asset manager responsibilities, are poorly trained, and lack the experience to handle a broad range of troubled and non-troubled projects. The Plan states that the DEC would handle a backlog of 5,400 troubled Office of Housing properties, reduce the staff burden of overseeing/resolving troubled properties and taking enforcement actions, and cites the need for common standards and procedures for enforcement.

Positive DEC Impacts

The DEC has had positive impacts related to improving the condition of HUD multifamily housing stock, addressing a large backlog of multifamily property owners who did not file annual audited financial statements or filed the statements late, and pursuing debarments initiated by sources other than DEC satellite offices.

- Nationally, DEC enforcement actions resulted in improved physical conditions in multifamily housing stock, with condition scores of 60 or more,

for 511 of 971 Multifamily properties referred to the DEC and closed during the period October 1, 2001, through December 9, 2002. Those improved properties represented 53 percent of the physical referrals processed and closed by the DEC during that period.

- The DEC initiated action to address the large backlog of multifamily project owners who failed to comply with requirements for filing annual financial statements. The DEC developed and consistently implemented a strategy to address 7,291 non-filer referrals it received on September 21, 2001. As of February 27, 2004, this backlog was reduced to 4,329 cases. Since the start of fiscal year 2002, the DEC levied \$2,501,659 in civil money penalties against multifamily project owners that failed to file required annual financial statements in a timely manner.
- The DEC Compliance Division in Headquarters imposed 1,013 suspensions and debarments during the period October 1, 2001, to August 19, 2003. These cases included 639 single-family housing cases, 224 assisted housing cases, 109 multifamily housing cases, 26 CPD cases, and 15 cases from other HUD Offices.

DEC Can Improve Its Use
Of Enforcement Sanctions

We conclude that the DEC has had a positive impact on multifamily issues. However, the DEC can improve its use of enforcement sanctions on physical and financial referral cases processed by its satellite offices. The DEC's debarment tracking report showed 99 percent of the 1,013 debarment cases cited above originated from outside of the DEC: OIG (55 percent), press (16 percent), Homeownership Centers (9 percent) and other (19 percent). Only 11 of the cases (about 1 percent) originated from enforcement actions by DEC Satellite Offices.

Our random sample of 86 physical and 97 financial cases closed by the DEC identified the following conditions.

Physical Condition Referrals

Our randomly selected sample of 86 physical referrals identified 29 cases (34 percent) that warranted taking or considering additional enforcement action that the DEC did not take. The DEC received the referrals and worked with the owners in an effort to raise the projects' inspection scores to HUD's minimum 60-point standard. However, when the owners failed to meet the standard, the DEC referred the cases to multifamily housing staff with recommendations for remedial action. The DEC referred the cases to multifamily staff pursuant to the November 2002 protocol executed between the DEC and Office of Housing. The protocol provision for multifamily housing staff to resolve noncompliance with physical condition standards or impose sanctions conflicted with provisions of the 2020 Management Reform Plan. The Plan specifies that the DEC will handle enforcement on properties that fail physical condition inspections and relieve housing staff of that responsibility and burden.

Financial Referrals

Our randomly selected sample of 97 financial referrals identified 58 cases where the DEC functioned as a loan servicer, recovering portions of misspent funds, versus functioning as an enforcement organization. In 24 of the 58 cases (24.7 percent of the financial case sample) case files documented \$2.7 million of improper distributions that met the statute definition of equity skimming. Improper owner distributions in the 24 cases ranged from \$10,058 to \$1.3 million. Generally, HUD limits owner distributions to a project's prior year surplus cash. The 24 cases constituted equity skimming violations because the projects had no prior year surplus cash or the distributions exceeded the prior year surplus cash.

The 24 case files contained no documentation to show whether the DEC recognized the violations as equity skimming and double damage violations, and whether such violations warranted referral to OIG or other enforcement actions. The DEC did not refer any of the 24 cases to the OIG, as required by HUD policy. Thus, the DEC missed many opportunities to achieve deterrents and recover monetary penalties through additional enforcement actions,

and did not make required referrals to OIG. (See Appendix A for a summary of the 24 cases.)

The case of Spring Creek Towers illustrates the DEC's handling of an equity skimming violation. REAC referred the case to the Chicago DEC for \$176,784 in improper distributions identified in its review of the project's year 2000 financial statement. The DEC determined that as of December 31, 1999, the project had a surplus cash deficiency of \$89,965 and was not entitled to any distribution. In addition, DEC determined the project owner also improperly distributed \$122,135 for 2001 when the project had a surplus cash deficiency of \$102,383 at December 31, 2000. Thus, the project owner improperly distributed \$298,919 in 2000 and 2001. The DEC settled the improper distributions by requiring the owner pay \$22,548, the amount of surplus cash deficiency shown in the project's 2001 annual financial report. The file showed no evidence that the DEC referred this matter to the OIG or considered additional administrative or civil sanctions.

In 14 of the 24 cases, the DEC allowed owners to settle improper distributions by merely repaying the surplus cash deficiency reported in the latest annual financial report, or if the project's subsequent fiscal year financial statement showed positive surplus cash, the DEC settled with no repayment. For example, in the case of Lorien Nursing and Rehabilitation, the DEC required no repayment of a \$36,008 improper distribution because the project had positive surplus cash in the subsequent fiscal year.

The DEC's practice of settling improper distributions for an amount of surplus cash deficiency in a later year incorrectly assumed the owners would automatically be entitled to withdraw surplus cash generated by repayment of the past improper distributions. However, the HUD program office and the DEC have the authority to restrict how repaid funds may be used and the funds are not automatically available to owners for future distributions. Furthermore, HUD Handbook 4370.1, Reviewing Annual and Monthly Financial Reports, Exhibit 2-14, Section C-4, provides that excess distributions must be refunded to the project.

DEC Staff Lacked Adequate
Written Standards Or
Guidance

We attribute these conditions to an absence of adequate written standards or guidance for pursuing administrative and civil actions, referring potentially criminal violations to OIG, and to the procedures emphasis on administrative recoveries. The DEC procedures did not provide adequate guidance for referring cases to the OIG, and did not adequately address when DEC staff should consider administrative and civil sanctions. OGC staff stated they did not want to establish such specific criteria because the information may become subject to release during the course of enforcement actions.

DEC's written guidance for pursuing improper distributions focused on seeking repayments versus enforcement sanctions. Generally, the guidance provided that improper distribution cases should be settled by requiring owners to repay the negative surplus cash reflected in the project's most recent financial statement, and did not require repayment if the project's most recent financial statement showed positive surplus cash. The guidance provided an example showing that the full distribution should be repaid for projects that are in disrepair, had repair plans that have not been acted on, had under funded reserves for replacement funds, and the program center sent letters to the owner demanding repayment of unauthorized distributions 5 of the past 7 years with no response. These conditions diminished the DEC's effectiveness as an enforcement organization. The DEC practices allowed individuals and firms such as the 24 cited cases to escape consideration of administrative, civil, or criminal actions designed to address improper distributions.

The DEC needs to improve its effectiveness by establishing written standards and procedures to ensure its staff considers and initiates appropriate sanctions, and refers potentially criminal violations to OIG, when warranted by the documented facts. The DEC should also issue such standards and procedures to ensure consistency in enforcement actions throughout HUD as provided in HUD's 2020 Management Reform Plan and the DEC's Implementation Plan. The standards and procedures should serve as guidelines for assessing whether or not a particular case warrants sanctions and should specify requirements for DEC staff to document the actions considered and decisions made. The DEC should also revise its practice of

settling improper distribution cases for significantly less than the amount of improper distributions.

OGC/DEC Comments

OGC's response acknowledged its appreciation of the positive DEC impacts cited in the audit report. OGC stated that Recommendation 2A should be deleted as being inconsistent with Recommendation 1A. OGC concurred with Recommendations 2B and 2C, and stated that it looked forward to receiving guidelines from OIG on when cases should be referred to OIG.

OGC expressed the following concerns with the audit report.

“* * * we believe the cases cited by the OIG were handled appropriately. In many cases, it appears the OIG looked at individual audited financial statements in a vacuum without regard to subsequent statements filed or the overall administrative record.

“Financial Referrals – The audit reports that for 58 of 97 cases, the DEC functions as a “loan servicer,” recovering portions of misspent funds, versus functioning as an enforcement organization. The OIG misses the point that achieving compliance and establishing a record upon which to pursue repeat violations is an enforcement action. Instead, it improperly concludes that only equity skimming cases, debarments, and civil money penalties are measurable enforcement actions. Compliance and future program violation deterrence, achieved through strength and action, is the goal of enforcement.”

OGC stated that a contractor recently completed an independent assessment of over 15,000 insured loans over a four-year period, to develop a risk assessment program for the Office of Housing. OGC further stated: “The contractor's report concluded that DEC referrals are effective in decreasing the likelihood of claims. * * * Because the independent study was based on a greater scale than the sample used by the OIG and indeed, our own analysis, it is imperative that we consider the results of this study in revising the existing thresholds for referral.”

“In terms of the 24 cases the OIG feels should have been referred to its offices for equity skimming or double damages violations, we believe we are being held to a higher standard than the OIG sets for itself. We also believe there is adequate justification for each of our actions. In fact, the DEC’s practice of settling improper distributions for an amount of surplus cash deficiency or recognizing subsequent positive surplus cash, has at times, been employed by the OIG. In an examination of numerous OIG audits, at times the OIG required owners to repay the entire amount of unauthorized distributions or just the negative surplus cash amount, yet did not pursue equity skimming or double damages.

“The OIG report criticizes the “netting” of excess surplus cash distributions to achieve compliance. Like the OIG, we have done this where there are timing issues that caused premature distributions and the owners subsequently had positive surplus cash or we required the repayment of the surplus cash deficiency only. The draft audit report states that all distributions, netted, repaid or not, are equity skimming cases that require action. They are not. Accordingly, we feel that the OIG’s list of cases that were improperly “netted” is an invalid audit finding, to which we take exception.

“In looking at the list of cases in Chicago identified as type “e” for which unauthorized distributions were taken after referral to the DEC, the audit’s impression is that the DEC took no action on these matters, and the owners again made unauthorized distributions and the DEC did nothing. This is inaccurate. The audit focuses on a single year’s referral without noting the results of the DEC’s combined review of subsequent referrals and the fact that the DEC made decisions on the basis of the entire administrative record.

“Like the OIG, we consult with Assistant US Attorney Offices to determine if certain cases meet their referral thresholds. We also discuss cases with OIG offices for the same reason. We do agree that our files could be better documented to provide evidence of these conversations.”

OIG Evaluation of
OGC/DEC Comments

We informed OGC at the exit conference that Recommendation 2A may require no action dependent on its response to Recommendation 1A. Once OGC has provided its complete management decision on Recommendation 1A, we will consider closing 2A without further action.

Regarding Recommendation 2B, at the exit conference OIG officials assured OGC that we will work with them to ensure a streamlined process for receiving and responding to potentially criminal cases referred by the DEC to OIG – Office of Investigations. OIG officials pointed out that OIG Field Agents work with Assistant US Attorneys on a regular basis, are knowledgeable of the criteria for prosecution in their respective jurisdictions, and thus can normally provide fast turnaround on cases referred by the DEC. OIG did not agree to provide written guidelines for referring cases to OIG since the criteria for prosecution will differ in each jurisdiction. Referral of potentially criminal violations to OIG is required by Departmental policy.

We disagree with the OGC’s assertion that we looked at cases in a vacuum and that the DEC appropriately handled the 24 equity skimming cases. The DEC either did not consider or did not document consideration of the 24 cited cases as equity skimming or double damage violations, and it settled and closed these potentially criminal cases without first referring them to OIG.

At the exit conference and in its written response, OGC agreed that it could better document its enforcement case files.

OGC’s comments do not acknowledge its obligation to refer potentially criminal violations to OIG. The requirement to refer potentially criminal violations to OIG is not relieved by the DEC’s desire to establish a track record of owner violations or financial settlements. Settlements obtained on potentially criminal cases without consulting OIG may jeopardize prosecution actions, and undermines the intent of the Inspector General Act for handling and coordinating potentially criminal matters.

We have not received the independent study cited in OGC's response as being received after the audit exit conference. We look forward to OGC sharing the study as part of its further response to the audit, and support use of the study results where they are relevant in developing management decisions on the audit recommendations.

OGC is incorrect in its belief that the audit held DEC to a higher standard than the OIG sets for itself. Before equity skimming violations are reported in an audit, OIG - Office of Audit personnel discuss the cases with Office of Investigation personnel and obtain clearance to report the violations and recommend civil or administrative actions. Office of Investigation discusses such cases with Assistant US Attorneys when necessary. These internal OIG discussions are not reflected in the text of audit reports. This process was explained to OGC and DEC officials at the exit conference. Thus, OGC's belief that it is being held to a higher standard is based on incorrect assumptions about audit report content and about OIG procedures and actions.

OGC misquoted the audit report in its assertion that the report states: "* * * all distributions, netted, repaid or not, are equity skimming cases that require action * * *". OIG recognizes that all improper distribution cases are not equity skimming. Improper distributions taken by project owners when the project is in a negative surplus cash position are included in the Statute definition of Equity Skimming. We recognize that all 24 equity-skimming cases cited in the report may not have merited criminal prosecutions, and that settling some cases was a reasonable result. However, the 24 cases serve to illustrate the effect of deficient DEC procedures. DEC procedures did not address the Departmental policy requiring referral of potentially criminal violations to OIG, and DEC procedures over emphasized settlement of improper distribution cases for less than the amount of the violation.

Our report does not assert that only equity skimming cases, debarments, and civil money penalties are measurable enforcement actions. The audit report cites administrative and civil actions, and referral of potentially criminal cases to OIG, as actions that DEC enforcement staff should consider in cases of improper distributions by project owners. DEC enforcement case files contained no

evidence that these actions were considered in the 24 cited cases.

OGC's comment about Chicago cases labeled type "e" refers to Appendix A, footnote e. We disagree that the audit gives a false impression that the DEC took no action on these cases. In fact, every case footnoted "e" contains a second footnote indicating the collection action taken by DEC.

Recommendations

We recommend that the OGC/DEC:

- 2A. Revise DEC's procedures for handling physical condition cases to require DEC staff to handle enforcement actions rather than closing the cases and recommending actions to the Office of Housing. DEC should coordinate with Housing as needed to implement actions requiring Housing's involvement such as abatements and foreclosures.
- 2B. The written standards proposed in Recommendation 1B should include procedural steps for DEC staff to (1) consider the use of available sanctions and civil actions, (2) determine whether violations must be referred to OIG, (3) determine amounts to be repaid when HUD regulated funds are improperly disbursed and restrictions to prevent project owners from subsequently withdrawing the repaid funds, and (4) documenting these assessments and decisions in DEC case records.
- 2C. Provide training to DEC staff on implementation of the new standards and procedures.

Improvements Are Needed To Reduce Unwarranted Referrals, To Control Workload, and To Report Meaningful Accomplishments

The DEC needs to initiate or complete actions it started to eliminate unwarranted referrals and their adverse impact on workload, and to report more meaningful case closure accomplishments. The DEC receives a high number of automated referrals that do not warrant enforcement action. The automated referrals are based on REAC analysis of multifamily project financial statements. Processing and closure of these cases adversely impacts the satellite office workloads and inflates reports of closed case accomplishments. Other premature case closure practices also inflate closed case reports. We could not determine the precise number of unwarranted referrals, but our audit tests and discussions with DEC staff indicated the number is high. For example, audit analysis indicated that unwarranted referrals were a primary reason why 11,448 of the 12,869 financial referrals (89 percent) were closed with no enforcement actions. Unwarranted referrals occurred due to flaws in automated system referrals, and flawed referral criteria. Eliminating or reducing the unwarranted referrals would allow more efficient use of DEC staff resources, and would make reports of cases closed more meaningful.

HUD 2020 Management Reform Plan

The DEC was created under the HUD 2020 Management Reform Plan³ with a mission to restore the public trust. The Reform Plan provided for reforming HUD's enforcement system by consolidating enforcement resources and eliminating the different standards and procedures then in use by each program office. To maximize its mission accomplishments, the DEC needs to focus its staff resources on the highest priority cases warranting enforcement action.

Unwarranted Referrals

We identified the following types of unwarranted referrals:

- financial referrals erroneously sent when no compliance flags were identified (described by DEC as phantom referrals),
- financial referrals based on flawed referral criteria, and
- financial referrals that did not meet pre-established referral threshold criteria.

³ Federal Register Notice, Vol. 62, No. 155, page 43204, dated August 12, 1997.

Eliminating or reducing the unwarranted referrals can improve DEC productivity. It would free staff to work on higher priority cases such as a backlog of financial statement non-filer referrals. The DEC Acting Director informed us she needs more staff to handle DEC’s high volume workload. However, until the unwarranted referrals are eliminated, it is difficult to accurately assess the workload level and number of staff needed to handle it.

We assessed the DEC’s national financial referral activity for the period October 1, 2001, through December 9, 2003, using the DEC workload report. The workload report showed that 89 percent of financial referrals were closed with no enforcement action or monetary restitution.

DEC Satellite Office	Financial Cases Closed	Financial Cases Closed with No Action ⁴	Percentage Closed with No action
Atlanta	2,871	2,685	94
Chicago	2,412	2,192	91
Ft. Worth	2,785	2,512	90
Los Angeles	2,936	2,525	86
New York	1,736	1,407	81
Headquarters	129	127	98
Totals & Percent	<u>12,869</u>	<u>11,448</u>	<u>89</u>

At the DEC’s Atlanta and Chicago Satellite Offices, we randomly selected and reviewed 223 closed cases which included: 97 financial, 86 physical, and 40 non-filer cases referred to the DEC primarily via REAC automated systems. To ensure our analyses considered the DEC’s most recent review procedures, our samples were selected from cases closed between October 1, 2002, and December 9, 2003. The review identified 48 unwarranted financial referrals (49.5 percent of the related sample). Thus, our review indicated the high rate of financial referrals closed without enforcement action were the result

⁴ Closed with no action denotes cases closed by the DEC without administrative sanctions (suspensions, debarments, limited denial of participation), without civil legal action, and with no monetary recoveries. The DEC efforts included reviewing and closing the referrals.

of the DEC's receipt, processing, and closure of the following types of cases:

- Thirty automated financial referrals (30.9 percent) involved no compliance flags (phantom financial referrals). DEC staff stated that phantom referrals are cases REAC automatically sends to the DEC, but the project's financial statements contained no compliance flags to trigger the referrals. DEC staff said the problem with phantom referrals resulted from a computer system flaw that started in 2001 following a data transfer of non-filer cases. DEC officials stated that a system adjustment was made in October 2003, which they thought would fix the problem. However, the DEC continued to receive phantom referrals.
- Eight automated referrals (8.2 percent) based on criteria that did not identify cases warranting DEC attention. For instance, the criteria in question included incomplete funding of security deposit accounts and unauthorized withdrawals from residual receipt funds. The DEC closed the referrals based on servicing actions that produced compliance but which did not warrant enforcement action (such as sanctions or civil action). Compliance was achieved by negotiating with project managers to make monetary payments to project accounts to correct the violations. The Office of Housing should have initially handled such cases and made an elective referral to the DEC only if the owners refused to comply and the violation warranted DEC action.
- Ten automatic referrals (10.3 percent) were made even though the conditions identified as the basis for the referrals did not meet established dollar thresholds for referral. These cases appeared to be the result of human error.

See Appendix B for a schedule of the 48 unwarranted referrals.

Prior to this audit, the DEC began efforts to revise certain referral criteria that generated unwarranted automated REAC financial referrals. In June 2003, the DEC

communicated its recommendations to Housing. We reviewed the matter because at the time of our audit the process was not complete. The DEC's Acting Director stated Housing and REAC had to approve the recommended revisions and the DEC has not received a response from Housing. The DEC's inability to independently establish and modify referral criteria (aside from criteria cited in the Federal Register) shows that it lacks the autonomy needed to control and manage the type referrals it will accept for review (see also Finding 1).

We reviewed the criteria used for REAC's automatic financial referrals to the DEC and identified other needed revisions. Except for one instance, we agreed with the DEC's recommended changes and they agreed with the additional changes we proposed. See Appendix C for details of the proposed changes in referral criteria.

The one exception was the DEC's desire to retain a criteria that results in an automatic financial referral for all projects with open physical condition referrals. We agree that the DEC may need to obtain financial statements for projects with an open physical referral, but it could obtain the financial statements without creating a new referral that inflates workload statistics and does not exhibit financial conditions that separately warrant enforcement action. Only 1 percent of our random sample identified this type of referral, but we believe the DEC should avoid practices that inflate workload statistics.

Inflated Workload
Accomplishments

The unwarranted referrals and a DEC case closure policy inflated the DEC's overall caseload and accomplishments (closed cases) to an unknown extent⁵. Our audit sample was not designed to be representative of all DEC closed cases. However, we determined that the DEC workload and accomplishments were overstated due to the following conditions:

- Receipt and closure of the previously discussed unwarranted referrals (49.5 percent of our financial

⁵ DEC caseload statistics have been cited in HUD's Annual Performance and Accountability Reports, which are available as public information and are shared with the Congress and Office of Management and Budget. The 2002 annual report included the DEC's accomplishments on physical condition, financial, and non-filer case referrals and the 2003 report included the DEC's accomplishments on physical referrals.

referrals sample) that required no DEC enforcement and did not merit referral to the DEC.

- A DEC headquarters directive that resulted in the premature closure of physical referrals and counted them as closed case accomplishments. On June 16, 2003, DEC headquarters directed its satellite offices to close physical referrals into a category entitled “closed monitoring” while they awaited receipt of a second REAC inspection. The DEC needed the inspections to determine whether a project’s physical condition had improved or whether additional enforcement action was needed to achieve compliance. The directive stated that the practice would allow the DEC to count the closures toward its performance goals. This practice inflated the DEC’s accomplishments for closed physical referrals. For instance, as of December 9, 2003, the REMS showed 20 percent of the DEC’s closed physical referrals were classified as closed monitoring cases. The number of financial and non-filer cases shown as closed monitoring was insignificant (less than one percent).

The DEC’s accomplishments (closed cases) should reflect actual case completions and should not be inflated with cases that did not warrant enforcement action. The DEC could use its staff resources more efficiently on other referrals that warrant enforcement actions such as the backlog on non-filer cases.

OGC/DEC Comments

OGC agreed with recommendation 3A, but stated their prior agreement with OIG on needed changes may be impacted by the recent independent contractor study. OGC disagreed with Recommendation 3B stating: “We had considered revising the types of DEC statuses, but we have been informed that system changes would again take at least a year to effectuate due to funding constraints. Again, it is important to remember that we often continue work on “Closed” cases and this work is not reflected in our quantified accomplishments.

OGC provided the following comments:

“As the audit report demonstrates, the DEC has initiated efforts to reduce unwarranted referrals. We believe the system had been fixed in October 2003 but continue to receive some financial referrals when an owner files an audited statement after we received a non-filer referral for the late submission. These are what we define as “phantom” referrals. Lack of funding resources to ensure systems corrections make it difficult to determine when the final fixes will take place. We agree that it is important for the DEC to focus on the highest priority cases.

“In terms of reporting meaningful accomplishments, while perhaps not intended, the report gives the perception that the DEC willfully tried to overstate its accomplishments. This is not the case. As can be seen in our internal 2002 annual report, the DEC chose not to include financial referrals in its goals due to the problems with the unwarranted financial referrals.”

OGC stated that Footnote 5 is misleading. The footnote states: “DEC caseload statistics have been cited in HUD’s Annual Performance and Accountability Reports, which are available as public information and are shared with the Congress and Office of Management and Budget. The 2002 annual report included the DEC’s accomplishments on physical condition, financial, and non-filer case referrals and the 2003 report included the DEC’s accomplishments on physical referrals.”

“We disagree that we have premature case closure practices. Several years ago, we created a DEC status of “Closed-Monitoring” to reflect when active processing was not taking place on a given referral, but future actions might be required. * * * The decision to return to “Closed-Monitoring” was two-fold. First, the use of this status allows DEC management to effectively determine which cases are actually being worked on at any given time. This is especially critical when shifting workload between offices based on capacity. * * * Second, we recognized that it is inappropriate for the DEC to rely on another part of HUD to determine whether or not we achieve our goals.

“The audit report’s reference to the then Acting Director’s statement that she needed additional staff to handle the high volume of work is incorrect or perhaps, taken out of context. * * * In fact, it was the then Acting Director who

first raised the issue of the considerable number of unwarranted (phantom) referrals at the entrance conference. It is inconsistent that she would then state she needed additional staff without qualification as implied by the audit report.”

OGC agreed that elimination of unwarranted referrals would allow the DEC to be more productive in other areas. OGC further stated: “We note, however, this section of the audit stresses that the DEC could make better use of its resources by reducing unwarranted referrals and focusing on the backlog of non-filer referrals. This section gives the impression the DEC has not been proactive (let alone successful) in implementing a strategy to reduce the backlog.”

“In this section of the audit, the term “phantom” as used by the OIG appears to include all financial referrals for which there are no DEC compliance flags. In actuality, this phrase was developed by the DEC to include only those financial referrals received simply because of an existing open non-filer referral. Since the initial stages of the DEC’s implementation, the DEC and Housing agreed that the DEC would receive all subsequent referrals when it had an existing open referral. The thought was that this would allow greater control of the overall administrative record. We agree that the above practice should continue when the DEC has an open physical or financial referral. We do not agree that this practice should continue solely because of an open non-filer referral.

“While the OIG analysis of a DEC report indicates 89% of 12,869 cases were closed with no enforcement action or monetary restitution from the owner, this does not take into account work the DEC may have done to invalidate findings by working with owners on questionable entries or practices they may have. * * * We believe the contractor’s study verifies the point we made to the Senior Auditor that the mere fact that a property has been referred to the DEC has had a positive effect on properties not referred to the DEC.”

unwarranted referrals and focus its efforts on more serious cases. OGC did not agree with Recommendation 3B citing the time and cost of making computer system changes to the “closed monitoring” case status code. This concern was discussed at the exit conference and OIG pointed out reprogramming the computer system was not the only solution. OGC/DEC could revise its policy and take other action to ensure “closed monitoring” cases are not counted as “closed” cases in external reports. OGC’s further response providing details of planned actions and timeframes for completion of those actions is needed before OIG can accept management decisions for Recommendations 3A and 3B. OIG will not accept a management decision that continues the policy of counting “closed monitoring” cases as closed cases, and thus continues the risk of reporting inflated accomplishments to external oversight agents such as the Congress.

Contrary to the OGC’s response, the classification “closed monitoring” did result in overstatements of DEC accomplishments. In 2002, closed case accomplishments were reported internally and in HUD’s Annual Performance and Accountability Report.

Footnote 5 is an informational statement of facts. It states that DEC caseload statistics and accomplishments have been reported in HUD’s Annual Performance and Accountability Reports, and that these reports are shared with the Office of Management and Budget and the Congress. The footnote contains no audit analyses or conclusions. We do not believe any party reading it would find it misleading.

OGC commented that: “The audit report’s reference to the then Acting Director’s statement that she needed additional staff to handle the high volume of work is incorrect or perhaps, taken out of context.” The Acting Director made the statement in her written response to our management control questionnaire. The question read, “Does the Enforcement Center have an adequate number of staff to perform the various duties assigned to the center.” The Acting Director’s response was: “No. Our referrals have increased greatly over the last few years”.

Based on the OGC response we re-examined the 30 phantom cases and determined they included four cases

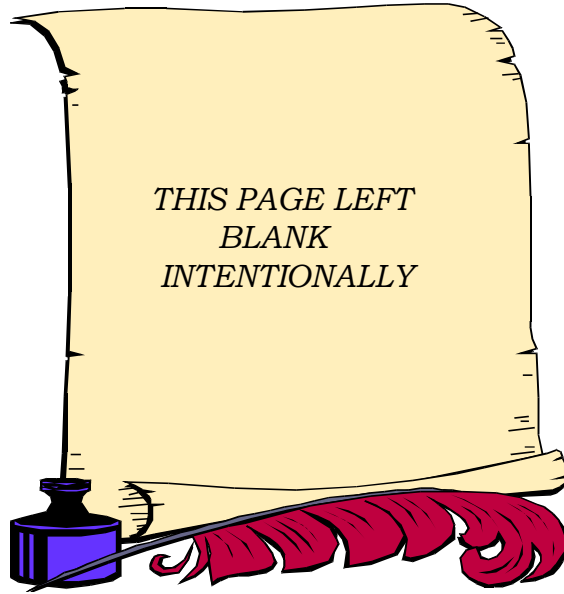
with no compliance flags and with no open non-filer referrals. The four cases therefore were not phantoms per the DEC's definition, but we view any no-flag referral as an unwarranted referral. Thus our classification of the four cases as unwarranted referrals did not change and did not impact our audit conclusions.

We recognize that some of the 12,869 financial referrals with no enforcement actions taken may have involved DEC personnel working with multifamily project representatives to correct errors in their financial reports. However, our point is that these cases did not warrant enforcement actions, and improvements in the compliance flags could eliminate many of the unwarranted referrals. The DEC staff work on these cases (e.g. error corrections) was a servicing or asset management function that could have been performed by multifamily program staff.

Recommendations

We recommend that the OGC/DEC:

- 3A. Complete actions to prevent future unwarranted referrals from inflating the DEC's workload and closed case accomplishments. This includes resolution of the problems with phantom referrals and implementation of the revised REAC referral criteria presented in Appendix C of this report.
- 3B. Revise the policy of counting physical condition referral cases that are pending re-inspection by REAC as closed cases. If the DEC desires to identify the pending status of these cases, a status classification of "pending re-inspection" would be appropriate.



The Merger With OGC Restricted Hiring For Key DEC Positions

Since the merger of the DEC into OGC, OGC has not maintained staffing levels and has not filled key vacant positions in the DEC. The combined OGC/DEC budget and staff ceiling restricted DEC hiring because, according to OGC officials, OGC had exceeded its staff ceiling. Information provided by DEC showed that it has not timely filled five key DEC management vacancies and it could not document or explain the loss of seven positions. The OGC also had not filled eight new Associate Regional Counsel positions created in conjunction with the merger. The vacant OGC/DEC positions and reduced DEC staffing may have increased the burden on existing staff and hindered DEC's ability to manage and reduce its backlog of referred cases.

DEC Implementation Plan

The DEC implementation plan noted that creation of the DEC, as an autonomous organization, was intended to consolidate HUD's enforcement efforts, and that HUD program offices would not have any supervisory control over the DEC. This approach was taken to ensure the DEC had the necessary independence and control over its mission. For the DEC to effectively accomplish its intended mission, OGC needs to ensure that its DEC component can maintain appropriate staffing and expeditiously fill key vacant positions.

Merger Status And Impacts

In October 2001, HUD's Deputy Secretary approved a reorganization plan that merged the DEC into OGC. Although the merger began in 2001, certain significant structural changes did not occur until November 2003 and the staffing component of the merger was not yet complete. Because the organizational changes are recent and components of the merger were not complete, we concluded that it is too early to assess whether the new organizational structure will be effective. However, we observed that the merger has, at least temporarily, had a negative impact on DEC staffing, and the DEC could not document some reductions in its authorized staff ceiling that resulted from the merger.

- The OGC/DEC has been unable to fill five key DEC vacancies. The positions were for the DEC Director, the Deputy Director for Operations and

Compliance, Compliance Division Director, Los Angeles Satellite Office Director, and a Senior Enforcement Analyst. DEC employees were detailed to fill three of the key vacant positions. DEC officials stated the advertisements for the Director and Deputy Director positions closed in September 2003 and selections for the positions were still pending in March 2004.

- As part of the merger, OGC created eight new Associate Regional Counsel positions: five positions to supervise the former DEC satellite office attorneys and three to handle litigation issues. These eight positions remain vacant. In the merged organization, the satellite office attorneys report to, and are part of, Regional Counsel Offices, while satellite office non-attorney staff reports to the DEC Headquarters office. OGC officials stated that the former DEC attorneys will continue to work on DEC cases, but may also handle other work for the Regional Counsel when available. OGC staff stated they have obtained authorization to post the vacancy announcements and expect to do so soon.
- The merger into OGC resulted in the DEC losing its autonomous budget, staff ceiling, and independent authority to hire. The OGC budget submission and its internal tracking of appropriations did not identify separate funding and staff ceiling for the DEC. OGC should establish a separate staff ceiling for the DEC in its budget submissions. Otherwise, the DEC's hiring ability may continue to be restricted by OGC's overall budget and work priorities.
- The DEC could not provide documentation to support reductions in its staff ceiling following the merger. Immediately prior to the merger, the DEC had a ceiling of 218 positions. As part of the merger, the Deputy Secretary authorized the transfer and consolidation of specified DEC positions. Attorney positions were transferred from the DEC to OGC Headquarters and Regional Counsel offices, administrative and information technology (IT) positions were consolidated with existing OGC support offices, and the Mortgagee

Review Board was transferred to the Office of Housing. The Acting DEC Director stated that the DEC's staff ceiling as of February 2004 was 132 positions. In consultation with the DEC, we reconciled the staff ceiling reductions as shown in the table below.

Description of Staff Reductions	Attorney Positions	Other Positions	Total Positions
DEC Staff Ceiling at September 30, 2001	41	177	218
Less Positions Transferred:			
Office of Chief Counsel	1	2	3
Legal Division - HQ	10	6	16
Deputy Chief Counsel for Administrative Proceeding Branch	10	0	10
Deputy Chief Counsel for Multifamily Branch	2	0	2
Mortgagee Review Board	0	4	4
IT, Administrative & Management Services Divisions	0	22	22
Satellite Offices	18	4	22
DEC Staff Remaining	<u>0</u>	<u>139</u>	<u>139</u>

The Acting DEC Director could not document management decisions that resulted in the apparent loss of seven positions (132 versus 139). The OGC and DEC need to identify and document authorized changes in the DEC's staff ceiling.

OGC's representative stated that hiring to fill vacant OGC/DEC positions was restricted because OGC had exceeded its fiscal year 2003 staffing ceiling and was only authorized to fill 14 positions OGC-wide in fiscal year 2004. OGC needs to ensure that the DEC can promptly fill key vacant positions and maintain appropriate staffing to fulfill the expectations of the 2020 Management Reform Plan.

OGC/DEC Comments

OGC concurred with recommendation 4A, and portions of recommendations 4B, and 4C. OGC disagreed with the portion of 4B related to establishment of a separate budget

line for the DEC, and in regard to 4C stated that it would provide documentation previously provided to OIG.

OGC provided the following comments:

“We agree that the DEC became subject to OGC’s overall staffing ceiling after the merger. However, the Resource Estimation and Allocation Process and the Department’s Corrective Action Plan have affected staffing for OGC and the DEC staffing numbers by imposing ceiling limitations that have varied from time to time. At other times, hiring freezes have been imposed.

“The DEC’s ability to fill key positions has been hampered by the overall ceiling limitations described above. Since the end of the audit period, the following positions have been filled:

- DEC Director
- Compliance Division Director
- Los Angeles Satellite Office Director
- DEC Deputy Director selection is pending.
- Associate Regional Counsel selections for positions approved under the merger have been made in Chicago, Los Angeles and Fort Worth.

“The merger did result in the DEC losing its autonomous budget, staffing ceiling and independent ability to hire. If the DEC were to have an autonomous budget, this would be contrary to the spirit of the merger. It would also be contrary to how the other areas within OGC are treated. During the exit conference, we discussed that next year each area of HUD will maintain its own staffing ceilings by office or division. Thus, this point will be moot. In terms of independent authority to hire, the most recent personnel delegations of authority give specific authority to the DEC Director, the Deputy Director and the Satellite Office Directors.

“We disagree that the DEC could not provide its staffing ceiling, as this data was provided to the audit team on February 25, 2004. In fact, the ceiling number is cited in the audit.

“As provided to the audit team and discussed at the exit conference, a simple comparison between staffing by position pre- and post-merger is not possible * * *.”

OIG Evaluation of
OGC/DEC Comments

OGC’s comments were responsive to the finding and recommendations. During the exit conference, OIG noted that it was not recommending a formal budget sub-allocation for the DEC, and OGC agreed that its internal budget documentation could identify amounts budgeted and staff ceiling for the DEC. However, based on OGC’s comments, we revised the Finding and Recommendation 4B to delete references to OGC establishing a separate budget line for the DEC. We believe that documenting the DEC authorized staff ceiling in the OGC budget will resolve our concerns. OGC needs to provide documentation of completed actions and details of planned action with target completion dates before OIG can accept their management decisions.

With regard to Recommendation 4C, DEC informed us that its ceiling was 132 positions orally and by email. We worked with DEC officials reviewing staffing report changes in an attempt to document its staff reductions. DEC did not provide documentary evidence of specific management actions that reduced its authorized ceiling to 132 positions. To resolve this recommendation, OGC/DEC needs to provide documentation of Departmental and/or OGC management authorizations that reduced its ceiling from 218 to 132 positions.

Recommendations

We recommend that OGC/DEC:

- 4A. Expediently fill DEC vacancies, particularly the DEC Director, Deputy Director, and other management and supervisory positions.
- 4B. Establish and maintain a staff ceiling for the DEC in OGC’s budget submissions.

- 4C. Document authorized changes in DEC staffing from its pre-merger ceiling of 218 positions to its current authorized ceiling. If more than 132 positions are authorized, the DEC should assess where such additional positions should be assigned.

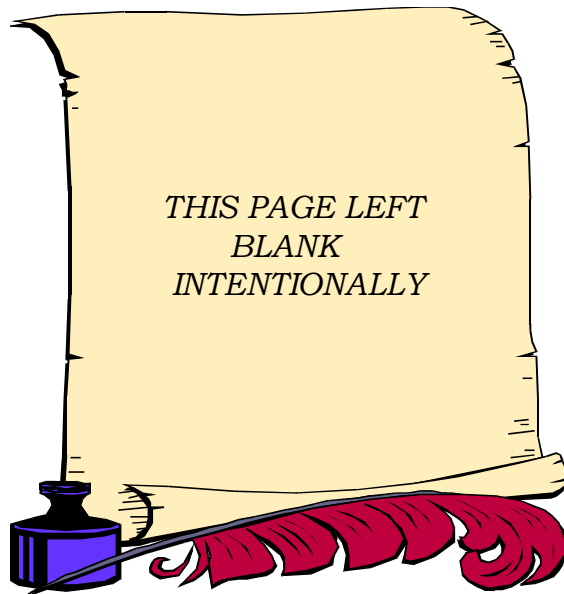
Internal Controls

In planning and performing our audit we considered the DEC's internal controls to determine our auditing procedures. Our review of internal controls was not performed to provide assurance on internal controls. Internal controls include the plan of organization, and methods and procedures adopted by management to ensure that goals are met. Internal controls include the processes for planning, organizing, directing, and controlling program operations.

We assessed the internal controls that we determined to be relevant to our audit objectives, namely controls over program operations, and compliance with laws and regulations.

A significant weakness exists if internal controls do not give reasonable assurance that the entity's goals and objectives are met; that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports.

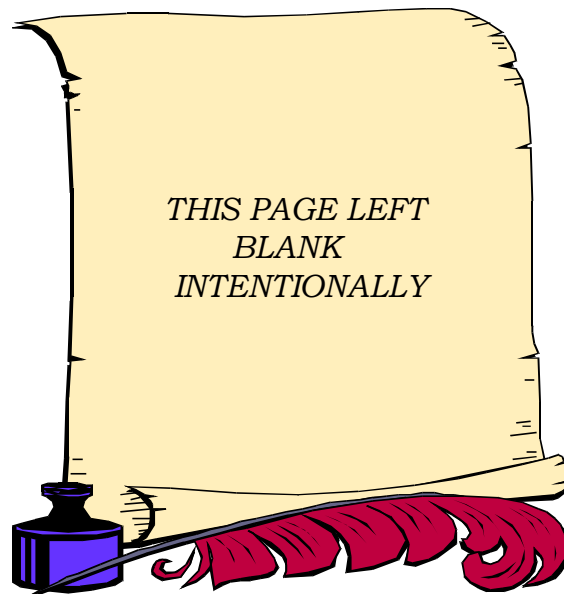
Findings 1 and 2 of this report discuss a significant weakness in internal controls. The DEC had not issued adequate written standards and procedures to ensure consistent enforcement actions on a Department-wide basis and to ensure DEC staff considered all appropriate enforcement actions and referred potentially criminal violations to the OIG.



Follow-Up On Prior Audits

On March 28, 2000, the Office of Inspector General issued Audit Report Number 00-NY-177-0001, detailing results of a nationwide audit of the Enforcement Center's efforts towards achieving the Secretary's strategic objective of restoring the public's trust. The audit reported that the DEC had not fully met the visions of the HUD 2020 Management Reform Plan, and that nearly all of the DEC's focus was on Multifamily programs.

The same conditions continue to exist and are covered in Finding 1 of this report.



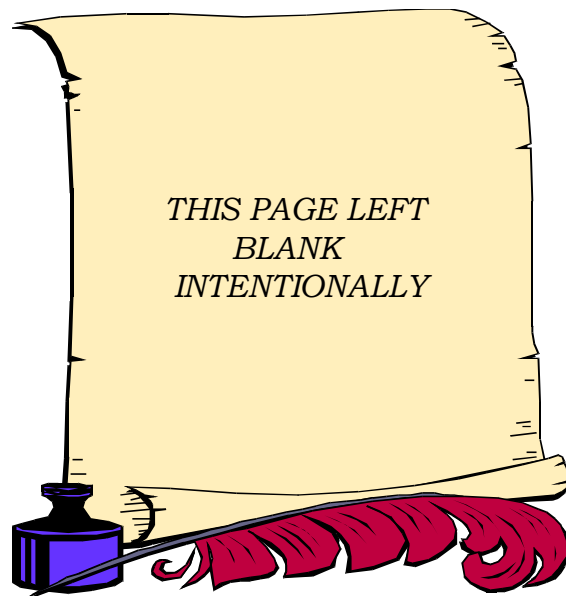
Schedule of Equity Skimming Violations ⁶

DEC Office	Project Name	FY	Amount of Distribution	Prior Year Surplus Cash	Equity Skimming Violation Amount	Referred to OIG	Note
CH	Twin M Nursing Center	2002	\$ 1,310,637	\$ (24,635)	\$ 1,310,637	No	a
AT	Conway Nursing Center	2002	535,000	467,394	67,606	No	d
CH	Cool Creek	2002	286,165	(7,038)	286,165	No	a, e
AT	Lorien Nursing & Rehab Center	2001	175,000	138,992	36,008	No	b
AT	Twin Oaks Personal Care	1999	158,926	(85,738)	158,926	No	c
CH	Spring Creek Towers	2000	176,784	(89,965)	176,784	No	a, e
CH	Spring Creek Towers	2001	122,135	(102,383)	122,135	No	a, e
AT	Branchester Lakes Apartments	2001	121,782	(33,060)	121,782	No	c, e
AT	Southwind Apartments	2001	104,950	(27,104)	104,950	No	d
CH	Glen Courts Apartments	2002	101,000	88,325	12,675	No	b
AT	Baptist Village Phase II	2001	68,275	(35,540)	68,275	No	d
AT	Palm Springs Apartments	2001	56,805	(15,178)	56,805	No	c
CH	Park Place Apartments	2001	42,284	(39,327)	42,284	No	c, e
AT	Hilton Head Gardens	2000	28,343	9,090	19,253	No	d, e
CH	Watertown East Project Phase II	2002	35,500	25,287	10,213	No	b, e
CH	Kaynorth	2002	35,000	6,245	28,755	No	a
CH	Walnut Manor	2001	34,397	-	34,397	No	c, e
AT	Branchester Lakes Apartments	2002	32,307	4,447	27,860	No	c, e
AT	Columbia Gardens, LP	2002	30,000	(163,062)	30,000	No	c
CH	Heritage Place Apartments	2001	27,700	17,575	10,125	No	b
AT	Terraces at Springford Village	2000	15,852	(94,910)	15,852	No	a, e
AT	Gandy Allmon Apartments	2001	13,803	(30,854)	13,803	No	c
AT	Caroline Forest Apartments	2001	10,800	(8,503)	10,800	No	c
AT	Friends Guild House West	2002	<u>10,058</u>	<u>(63,356)</u>	<u>10,058</u>	No	c
Totals			<u>\$ 3,533,503</u>		<u>\$ 2,776,148</u>		

Notes:

- a The DEC only required repayment of the negative surplus cash amount reported in the latest available financial statement at the time of settlement.
- b The DEC did not require repayment of the unauthorized distribution because there was positive surplus cash for the year when the distribution was made.
- c The DEC required repayment in the amount of the unauthorized distribution.
- d The DEC did not require repayment of the unauthorized distribution amounts.
- e The DEC files show the owner made additional improper distributions during the fiscal period immediately before or after our sample case.

⁶ Project names, FY, Unauthorized Distributions, and Prior Year Surplus Cash per DEC case files.



Schedule of Unwarranted Referrals

<u>Number</u>	<u>DEC Satellite Office</u>	<u>Case Category and Project Name</u>
Phantom Referrals ¹		
1	Atlanta	Essex House Apartments
2	Atlanta	Chase on Commonwealth Apartments
3	Atlanta	Crafton Heights Town Homes
4	Atlanta	Vieux Carre Apartments
5	Atlanta	Thomas' Contentment
6	Atlanta	Cherry Village
7	Atlanta	Forrest Acres Apartments
8	Atlanta	Spruce Pine Housing
9	Atlanta	MCSherystown Interfaith Village
10	Atlanta	Somerset Residence
11	Atlanta	Magnolia Manor
12	Atlanta	Philippian Gardens
13	Atlanta	American House of Manassas
14	Chicago	Northwest Chicago Group Homes
15	Chicago	Westshire Care Center
16	Chicago	Forest Ridge Apartments
17	Chicago	Washington Towne Homes
18	Chicago	Cedar Ridge Healthcare Center
19	Chicago	Monticello Village Apartments
20	Chicago	Wooster Housing For The Elderly
21	Chicago	Village Pines of Monroe
22	Chicago	Center Apartments
23	Chicago	Orchard Place of Englewood
24	Chicago	Westwick Square Cooperative 5
25	Chicago	Association Homes
26	Chicago	Propylon Non-Profit
27	Chicago	Dover Place Townhomes
28	Chicago	Abbot's Cove Phase IV
29	Chicago	Prospect Homes
30	Chicago	Logan Vistas
		Subtotal 30 Cases

Referral Criteria Not Met²

31	Atlanta	Powell Apartments
32	Atlanta	Greenbrier Manor, Inc.
33	Atlanta	Piney Grove Apartments
34	Atlanta	Franklin Square
35	Atlanta	Washington Grove MCARC
36	Atlanta	East Boros Apartments
37	Atlanta	Beaverwood Homes
38	Atlanta	Reflection Lake Townhomes
39	Chicago	Maple Terrace Apartments
40	Chicago	Logan Vistas
		Subtotal 10 Cases

Referral Criteria Needs Revision³

41	Atlanta	The West 500 Corporation
42	Atlanta	Oakland City / West End Apartments
43	Atlanta	Pine Lake Health Care
44	Atlanta	Sandlewood Apartments
45	Chicago	Elm Center II
46	Chicago	Wexford on The Green
47	Chicago	46th & Vincennes Apartments
48	Chicago	Hebron Townhouses
		Subtotal 8 Cases

Notes:

- 1 The DEC described phantom referrals as automated financial referrals that were erroneously sent when the REAC review of financial statement did not reveal compliance flags that would warrant a referral to the DEC. The DEC stated this condition primarily occurred when the project owners had an open referral for failure to file or timely file annual audited financial statements.

- 2 The DEC received these automatic referrals from REAC even though the referrals did not meet the pre-established conditions agreed to between the DEC and REAC for making the referrals.

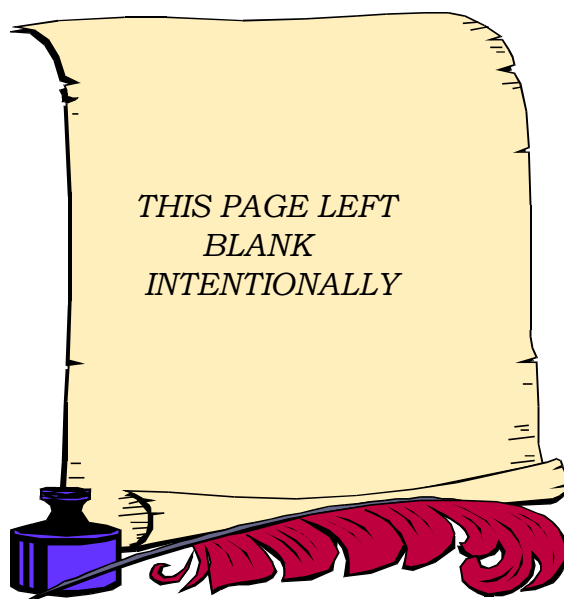
- 3 The DEC received these referrals based on referral criteria that needed to be deleted or modified to eliminate future unwarranted referrals. (See Appendix C for descriptions of proposed revisions to the referral criteria.) The referrals involved servicing issues that required no enforcement consideration and which unnecessarily consumed DEC staff time. The referrals involved issues such as under-funded security deposits, unauthorized withdrawals from residual receipt funds, and financial referrals made only because the project had an open physical referral.

Schedule of Referral Criteria Needing Revision

Automatic DEC Referral Criteria	Change Recommended	Recommended By	DEC's Position	OIG's Position	Note
Disposal of Assets	Delete	DEC		Agree	a
Unauthorized Withdrawals from Replacement Reserve Account	Delete	DEC		Agree	a
Unauthorized Change in Ownership	Delete	DEC		Agree	a
Failure to Make Mortgage Payments	Delete	DEC		Agree	a
Acquisition of Liabilities (Encumbering Project Assets)	Modify	DEC		Agree	b
Unauthorized Loans from Project Funds	Modify	DEC		Agree	c
Unauthorized Distribution of Project Assets	Modify	DEC		Agree	c
Unauthorized Withdrawals from Residual Receipts Account	Modify	OIG	Agree		d
Commingling of Funds	Modify	OIG	Agree		e
Security Deposits	Delete	OIG	Agree		a
Failure to Maintain Property or Cure Deficiencies Noted in Physical Inspections	Delete	OIG	Disagree		f

Notes:

- a The DEC and OIG agree that these referral items should be first considered for servicing action by multifamily housing staff and referred to the DEC only if multifamily officials determine enforcement action is warranted.
- b The DEC recommended adding this compliance flag as an automatic referral. The DEC feels this violation may reflect a major problem with the project.
- c The DEC recommended increasing the referral threshold from \$10,000 to \$25,000. We agree with the DEC's assessment that distributions below this amount should be referred to multifamily housing staff, followed by elective referrals to the DEC if multifamily officials determine that enforcement actions are needed. However, pursuant to Handbook 2000.3, the DEC and Office of Housing are required to refer all cases involving equity skimming to the OIG Office of Investigation.
- d The OIG recommended this compliance flag be modified to include a referral threshold, similar to the \$25,000 threshold recommended for unauthorized distributions of project assets.
- e The DEC agreed with the OIG provided a threshold could be implemented that would result in an automatic referral for commingling project funds. The DEC feels commingling of security deposit or reserve for replacement funds are issues that should be referred to multifamily housing staff followed by a referral to the DEC only if multifamily officials determine a need for enforcement action.
- f These are financial referrals made based solely on outstanding physical referrals. The DEC can obtain financial statements through REMS, without opening and closing a referral. The Acting DEC Director feels the DEC should receive credit for reviewing the financial statements in conjunction with the physical referral. OIG's position is that this flag should be eliminated because it does not identify any compliance issue warranting enforcement action and such referrals inflate caseload statistics.



OGC/DEC Comments



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

OFFICE OF GENERAL COUNSEL
DEPARTMENTAL ENFORCEMENT CENTER

June 16, 2004

MEMORANDUM FOR: James D. McKay, Regional Inspector General for Audit, 4AGA


FROM: Kathleen D. Koch, Acting General Counsel, C

SUBJECT: Draft Audit Report on the Effectiveness of the Departmental Enforcement Center

Please consider this our response to the draft audit report on the effectiveness of the Departmental Enforcement Center (DEC). We appreciate the Office of the Inspector General's (OIG) acknowledgement of the positive impact the DEC has had in the areas of (1) improving the physical condition of HUD's multifamily portfolio, (2) imposing civil money penalties against multifamily project owners who fail to timely submit annual financial statements and (3) implementing debarments against program violators.

Subsequent to our exit conference, we learned of an independent contractor's work for the Office of Multifamily Housing on a risk assessment program. The contractor's study¹ leading to the development of the program involved review of 15,447 insured loans over a four-year period. The draft report states:

“Despite deteriorating conditions, once a property is referred to EC, its likelihood to claim decreases significantly. In particular, an EC referral *reduces* [original emphasis] the log odds to claim by 0.89 – a finding that is statistically significant at five percent. Based on this finding, we conclude that an EC referral is effective in preventing claim.”

The draft report further asserts that the likelihood to claim is reduced regardless of the type of referral to the Enforcement Center. More information from this draft report that correlates to recommendations made in the audit is included under the section relating to “unwarranted referrals”.

In general, we agree with most of the recommendations in the audit report. However, in some cases, we believe you did not consider all relevant factors. We provide specific examples in our attached response. In summary, our response addresses the following.

¹ The report is not included because it was not commissioned by the DEC and it is not yet final.

www.hud.gov

espanol.hud.gov

The DEC is not Functioning Pursuant to Regulatory Plans as the Department's One Enforcement Authority

The audit report opines that the DEC is not functioning in line with a 1997 *Federal Register* notice issued by then Secretary Andrew Cuomo and a 1997 DEC Implementation Plan. The draft audit report does not mention that the Implementation Plan foresaw that the majority of the DEC's referrals could come from one program area. The audit report also does not take into account subsequent *Federal Register* publications that help define (and redefine) the role of the DEC. These include the following.

- Physical Condition Standards and Inspection Requirements
- Uniform Financial Reporting Standards
- Redlegation of Authority to the DEC Regarding Authority to Initiate Civil Money Penalty Actions Under Certain Civil Money Penalty Regulations and to Issue a Notice of Violation of a Regulatory Agreement and a Notice of Default of a HAP Contract.

We do agree, however, that existing published plans can be updated to more accurately reflect what the DEC's mission and role are today.

The DEC Has Had a Positive Impact on the Multifamily Portfolio, but Needs to Improve Its Use of Sanctions

In terms of the draft report, we believe the cases cited by the OIG were handled appropriately. In many cases, it appears the OIG looked at individual audited financial statements in a vacuum without regard to subsequent statements filed or the overall administrative record. Obviously, these items greatly affect the actions taken. In the exit conference, after we explained this, you noted project files could be better documented to demonstrate why certain actions were or were not taken. We appreciate the OIG's offer to provide us with written guidance on matters it believes should be referred to your offices and look forward to working with you on any needed related training.

Improvements are Needed to Reduce Unwarranted Referrals, to Control Workload and to Report Meaningful Accomplishments

As we pointed out during the entrance conference, we are concerned that existing systems create unwarranted referrals when owners subsequently filed late audited financial statements. We provided documents during the audit to show that we were already working with the Office of Housing to correct this issue. We agree that it is important that the DEC receive the more serious cases. It is interesting to note that the draft report referenced above by the Office of Housing's contractor actually recommends increasing the amount of referrals to the DEC because its study of over 15,000 insured properties demonstrates that referred to the DEC are less likely to result in the payment of an insurance claim.

In terms of reporting meaningful accomplishments, while perhaps not intended, the report gives the perception that the DEC willfully tried to overstate its accomplishments. This is not the case. As can be seen in our internal 2002 annual report, the DEC chose not to include financial referrals in its goals due to the problems with the unwarranted financial referrals.

On physical referrals, the DEC established the practice of categorizing cases as “Closed-Monitoring” long ago. Under the old protocol with the Office of Housing, we used this status until the DEC confirmed that an owner had completed repairs under an approved plan. When the new protocol was developed in November 2002, the general consensus between the DEC, Housing and the Real Estate Assessment Center (REAC) was that re-inspections could be done timely; funding issues proved otherwise. The policy decision to leave cases open until the re-inspection was completed was inconsistent with our past practice. It also inappropriately made achievement of our goals dependent on another part of HUD. The Closed-Monitoring status allows DEC management to better gauge the cases being actively worked on at any one time. This is particularly important when shifting workload to our offices with greater capacity.

The Merger with OGC Restricted Hiring for Key DEC Positions

At the exit conference, we provided an update on key positions that have been filled since the draft audit report was prepared – this update is included in our response. We disagree that the DEC could not provide its staffing ceiling, as this data was provided to the audit team on February 25, 2004. In fact, the ceiling number is cited in the audit. (Another copy of what was provided the audit team is attached for your convenience.)

Certain data requested by the team (i.e., specific positions lost) could not possibly be provided because ceiling numbers have never been provided by position. The audit report does not take into account that at one point during the audit period, HUD offices were authorized to hire regardless of their ceilings which further complicates the ability to track ceiling numbers by position for the period of time preceding and following this hiring cycle. Further, the audit report does not reference a current Corrective Action Plan for staffing mandated by Congress that affects hiring ability by all of HUD.

With respect to the recommendation that separate budget and ceiling allocations be established, we discussed during the exit conference, that next year each area within HUD will be responsible for maintaining Congressionally mandated ceiling allocations by office/division. Thus, this will no longer be an issue. We disagree that a separate budget allocation is necessary. Creation of a separate budget allocation for the DEC would result in separate treatment as compared to other OGC offices, which is inconsistent with the intent of the merger, authorized by the Deputy Secretary. During the exit conference, you agreed that our existing annual plan addressing the funding needs of each organization within OGC, including the DEC, satisfies the requirements of this recommendation and that formal sub-allocations are not required. We do also maintain monthly staffing reports, which show the DEC as an identifiable entity within OGC.

We appreciate the courtesy and professionalism extended by the entire audit team. We look forward to working with you to take the necessary steps to ensure proper close out of the audit. Questions regarding this response may be directed to Margarita Maisonet, Director, Departmental Enforcement Center, at 202.708.3856, ext. 3527.

Attachment

Finding 1: The DEC is not Functioning Pursuant to Regulatory Plans as the Department's One Enforcement Authority.

The nature of the work handled by the DEC has evolved as the priorities of the Department and our clients have changed. We disagree that the DEC was created to handle all enforcement matters. In fact, we provided the audit team with documentation supporting the fact that from its inception, the DEC was not to handle fair housing enforcement cases. Rather, such cases are by law the responsibility of the Assistant Secretary for FHEO. Similarly, local field counsels handle limited denials of participation, not the DEC. As another example, the Office of Community Planning and Development has the authority to reduce grants.

The draft audit report states that consistent enforcement standards and procedures were not achieved because: *“According to DEC and OGC officials, these conditions occurred because, despite provisions cited in the published implementation plan, the primary aim was for the DEC to handle multifamily housing cases.”* While some varying standards between program offices occurred for the reasons stated, page 6 of the Implementation Plan reviewed by your office, states:

“Department-wide Relationships: The Enforcement Center is a Department-wide operation. It is not associated with any one Program Office even though the majority of its inventory may originate from **one program office** [emphasis added]....”

In the field, the majority of our referrals come from Multifamily field offices. In Headquarters, we receive referrals from various program offices as discussed with the audit team. Therefore, we believe that overall, the DEC is operating as designed.

The draft audit report states that the “Enforcement Authority” will be responsible for taking legal action against all housing authorities that receive a failing score on their annual assessment. However, the report fails to discuss a subsequent *Federal Register* notice placing a moratorium on these types of referrals to the DEC for a period of over three years. The audit report ignores post HUD 2020 publications that further define and redefine the role of the DEC. These include:

- Physical Condition Standards and Inspection Requirements
- Uniform Financial Reporting Standards
- Redelelegation of Authority to the DEC Regarding Authority to Initiate Civil Money Penalty Actions Under Certain Civil Money Penalty Regulations and to Issue a Notice of Violation of a Regulatory Agreement and a Notice of Default of a HAP Contract.

The draft audit report appears locked in time with a *Federal Register* notice that presented the initial DEC formation views of then Secretary Cuomo and seems to find that Secretary Cuomo’s vision has the limitation and effect of law. It does not. Any Secretary must have the latitude to fashion HUD offices to be most effective for current and developing needs. This is what each Secretary has done in the proposed rules, final rules and delegations issued since the DEC was first envisioned in the HUD 2020 Plan.

In support of its findings for the improper variation from the 2020 vision statement, the OIG states that the DEC was not developed into an independent enforcement authority and was under the supervision and control of program offices. Working protocols do not equate to supervision. The DEC, being oriented within the Office of General Counsel, is now aligned within a long-existing, critically necessary, independent authority of the Department. The General Counsel is responsible to the Secretary, not any program office.

Just as other OGC offices provide program office support, the DEC analyzes, supports, recommends, and as needed, implements the office's legal/enforcement needs. These program offices are the DEC's "clients," as any OGC offices would view them. As with any client group, the DEC is appropriately fluid in crafting the actions it recommends, in concert with the program offices, to have the most beneficial HUD-wide result. Additionally, if the DEC feels so strongly that it recommends actions inconsistent with the wishes of the program offices there are venues for pressing its disagreement.

The OIG tends to prescribe its unilateral perspectives with little regard for the consequences of its recommendations (i.e., impact on residents, preservation of housing, etc.). We recognize that this is in line with the charge of the OIG. Respectfully, the DEC takes a bigger picture approach in crafting its recommendations. That is, the DEC provides recommendations to program offices and remains available to support and implement its recommendations. While the current protocol with the Office of Housing allows for closeout of DEC physical referrals after recommendations are made, the practical matter is that we provide daily support to Housing on cases long "closed" and returned to Housing for continued service and implementation of enforcement plans.

Inconsistent Protocols with HUD Offices

In terms of inconsistent protocols with different program offices, we are amenable to revising them if the other program offices so choose. However, the OIG's suggestion that the DEC have uniform enforcement standards for its protocols with each program offices ignores some basic realities:

- First, while there may be some common threads among the responsibilities of the different program offices, it is inappropriate to overlook the unique functions each program provides with one common brush stroke.
- Second, if we were to stroke with such a common brush, the procedures would be so generic that they would have no utility.
- Third, if we attempted to paint this process narrowly, then our procedures would be so specific as to remove needed latitude and discretion in accepting referrals. This would telegraph litigation parameters and strategies to the outside.
- Moreover, the suggestion to have uniform enforcement standards across program areas runs contrary to another finding in the audit opining that the DEC should have the latitude to set referral thresholds because of the inherent differences between programs.

Existing protocols already allow other program field offices to make referrals through their Headquarters offices. The draft audit states that one CPD director had cases he could have referred to the DEC were it not for the protocol restriction; however, the audit does not address whether or not the director followed the protocol and made the referral to his headquarters office. We do not agree that all referrals must be made the same way (i.e., by the field or by headquarters offices, electively or directly). Like the OIG, we accept referrals from different sources and in different formats.

The DEC Deferred Certain Enforcement Decision and Actions to the Office of Housing

As stated to the OIG during numerous conversations and at the meeting where the survey results were presented, the decision to defer final decisions on enforcement matters to Housing was incorporated into the original protocol. This protocol outlined appeal procedures, ultimately up to the level of the Deputy Secretary, if the DEC and Housing did not agree on strategy. It is important to note that these appeal procedures were never needed. During the meeting on your survey results, we also stated that certain enforcement decisions are more appropriately handled by Housing because it has resources the DEC does not. For example, Housing has the ability and resources to order vouchers when relocation of tenants is deemed necessary. The DEC does not. Like the OIG, the DEC makes recommendations and the program offices ultimately decide whether or not to implement them. However, we remain available to assist in the implementation and frequently do so.

The statement in the report that the DEC did not follow up to track actions taken by Housing is inaccurate. During the audit, the DEC advised the OIG that we routinely participated in conference calls Housing held with its offices on physical referral cases. In fact, the audit team was provided with a sample report used by Housing and the DEC on these calls. The DEC communicates daily with the Office of Housing in Headquarters and the field on actions relative to these properties. We do agree that a formal tracking process could be implemented. We do not, however, have a responsibility to monitor our clients.

Office of Housing Controlled Criteria for Referrals to the DEC

The established referral thresholds have, since inception, been negotiated between the DEC, Housing and the Real Estate Assessment Center (REAC). This is because we maintain a collaborative relationship with these offices. As stated in the audit, we have made recommendations to these offices to change the referral thresholds and are following up accordingly. Although the OIG apparently believes the DEC should set its own referral thresholds, the draft report contains the OIG's own opinions on the referrals the DEC should be receiving. Of course, improvements can be made with respect to what matters are referred to the DEC. The DEC agrees that it should have the ongoing discretion to assess all forms of referrals from all program offices. We currently do not have a financial referral protocol with Housing, but the one to be developed will establish new thresholds.

Recommendations:

1A. Revise the DEC’s operating procedures to bring them into compliance with the published HUD 2020 Management Plan and the DEC Implementation Plan, or obtain written authorization for changes in the DEC mission and plans. If material changes are made, OGC should determine whether Departmental policy calls for a revised Federal Register Notice. Significant changes from the published plan would include as a minimum: (a) leaving separate enforcement functions in some program offices, (b) changes in the enforcement responsibilities specifically cited in the Federal Register Notice, and (c) deferring enforcement decisions to program offices.

Response: Concur. We will revise published plans to reflect our current operating environment.

1B. Establish written enforcement standards and procedures for use by all HUD program offices and DEC staff. Such standards and procedures should be designed to ensure consistent enforcement actions for common compliance issues that impact two or more HUD offices. Examples would include annual financial statement requirements, common requirements for grant and loan fund accountability, and physical condition of housing properties. The standards should provide guidance to all HUD program managers. Such guidance should address when to consider enforcement actions, enforcement procedural requirements such as issuing a Notice of Violation and timeframes allowed, reference to the various available sanctions such as debarments and civil money penalties and their applicability to common violations, and information on making referrals to or seeking guidance from OGC/DEC. (See also Recommendation 2B for other improvements in written guidance.)

Response: Do not concur. This recommendation should be deleted. It is inconsistent with Recommendation 1A that states the DEC should either establish operating procedures to ensure greater consistency between program offices or revise its mission and plans. It assumes the DEC will not revise its mission and plans. We do agree to make some changes to written guidance as noted in our response to Recommendation 2B.

Finding 2 – The DEC Has Had a Positive Impact on the Multifamily Portfolio, but Needs to Improve Its Use of Sanctions

Positive DEC Impacts

We appreciate the OIG’s acknowledgement of our positive impact on the multifamily portfolio. The survey of physical referrals reviewed by the audit team indicated **53%** of properties improved their physical inspection score to meet or exceed HUD standards. We are pleased to report that currently **68%** of all properties referred due to physical condition are showing improvement. In the areas of non-filer referrals and suspension and debarments, we are working to further improve the progress noted by the OIG. We hope to increase the number of suspension and debarment referrals from the Satellite Offices, however, it should be noted that these fact-based cases are more difficult to prove than those generated through other referral means (i.e., indictments and convictions).

Physical Condition Referrals

We previously addressed the reasons why certain enforcement actions have been deferred to Housing. In short, this decision was made at the inception of the DEC and incorporated in a protocol that provided appeal procedures. The appeal process was never used. While formal appeal procedures are not contained within this protocol, we have had numerous discussions with Housing field and Headquarters offices where we have been able to resolve differences in our recommendations versus the strategy implemented.

Financial Referrals

The audit reports that for 58 of 97 cases, the DEC functions as a “loan servicer,” recovering portions of misspent funds, versus functioning as an enforcement organization. The OIG misses the point that achieving compliance and establishing a record upon which to pursue repeat violations is an enforcement action. Instead it improperly concludes that only equity skimming cases, debarments and civil money penalties are measurable enforcement actions. Compliance and future program violation deterrence, achieved through strength and action, is the goal of enforcement.

As referenced in our transmittal memorandum, an independent assessment of over 15,000 insured loans over a four-year period, by a contractor hired to develop a risk assessment program for the Office of Housing, was recently completed. We were aware a contractor was hired to develop this program – we were unaware that they would also focus on the impact DEC referrals have on increasing or decreasing insurance claims. The contractor’s report concludes that DEC referrals are effective in decreasing the likelihood of claims.

The contractor also reviewed internal documentation and determined that compliance violations eligible for referral to the DEC “correspond to significant financial and physical deterioration as measured by the FASS and PASS scores.” Based on this statement, one might reasonably conclude that DEC referrals would result in an increased likelihood of an insurance claim but the regression analysis performed by the contractor proves otherwise.

We view the DEC’s obtaining compliance on these 58 cases as a success, not a failure. To the extent that the program offices could have handled some of these cases, we do not disagree. This is why we have been working with Housing and the Real Estate Assessment Center to revise referral thresholds. However, we have often been able to achieve compliance where the Office of Housing has not, as evidenced by the number of elective referrals we have received from them in the past.

Because the independent study was based on a greater scale than the sample used by the OIG and indeed, our own analysis, it is imperative that we consider the results of this study in revising the existing thresholds for referral.

In terms of the 24 cases the OIG feels should have been referred to its offices for equity skimming or double damages violations, we believe we are being held to a higher standard than the OIG sets for itself. We also believe there is adequate justification for each of our actions. In fact, the DEC’s practice of settling improper distributions for an amount of surplus cash deficiency or recognizing subsequent positive surplus cash, has at times, been employed by the OIG. In an examination of numerous OIG audits, at times the OIG required owners to repay the entire amount of unauthorized distributions or just the negative surplus cash amount, yet did not pursue equity skimming or double

damages. This was true in cases where projects had less than satisfactory physical inspections and/or mortgages in financial default. For brevity's sake, only a few are included below.

Audit 2001-KC-1002. The OIG did not recommend repayment of funds, as the improper distribution was a "timing issue that self-corrected" when new surplus calculations were made.

Audit 98-SF-212-1002. The OIG recommended the owners repay the project for improper disbursements up to the current surplus cash deficiency.

Audit 98-CH-211-1820. The OIG did take this case to the Assistant US Attorney's Office, but the referral was declined due to workload. A follow up audit found that the surplus cash deficiency had decreased to \$4,700 and the OIG recommended that the owner reimburse the project the surplus cash deficiency. (The OIG also recommended the imposition of civil money penalties.)

Audit 97-BO-219-1801. No referral was made to the Assistant US Attorney's Office because the owners agreed to repay the funds in question.

The OIG report criticizes the "netting"² of excess surplus cash distributions to achieve compliance. Like the OIG, we have done this where there are timing issues that caused premature distributions and the owners subsequently had positive surplus cash or we required the repayment of the surplus cash deficiency only. The draft audit report states that all distributions, netted, repaid or not, are equity skimming cases that require action. They are not. Accordingly, we feel that the OIG's list of cases that were improperly "netted" is an invalid audit finding, to which we take exception.

In looking at the list of cases in Chicago identified as type "e" for which unauthorized distributions were taken after referral to the DEC, the audit's impression is that the DEC took no action on these matters, and the owners again made unauthorized distributions and the DEC did nothing. This is inaccurate. The audit focuses on a single year's referral without noting the results of the DEC's combined review of subsequent referrals and the fact that the DEC made decisions on the basis of the entire administrative record.

With one exception, none of the Chicago matters were "repeat offenders." The DEC obtained compliance in these cases and netted during the combined working of multiple unresolved referrals. The exception involved a claim for \$5,000. At the Office of Housing's request, the DEC worked with the owner to attain compliance, as Housing had not had any similar violations with this owner on any other properties.

Further, the DEC is working on repeat offender matters (improper distributions after notice and cure of a first offense) with more aggressive tools, such as pursuing civil money penalties and/or double damages referrals as supported by the administrative record. One matter is being referred to the

² Netting is the practice of taking into account subsequent year(s) surplus cash position when determining whether or not to require repayment of unauthorized distributions and how much the repayment should be.

OIG Investigations for criminal equity skimming. Four matters have been referred to OIG Audit. Three matters are pending in the DEC with the Court of Federal Claims. No matter has been closed without action, except the one matter noted.

Over the last several years, we have referred numerous cases to your offices. Conversely, we have received referrals from your offices to resolve audit findings when auditees have not complied with their requirements to restore funds or comply with other terms of the audit. We have also assisted your offices in the past on cases with the Department of Justice that required legal input from HUD on settlement discussions or litigation. The DEC provides a support service to OIG offices. We are pleased to continue working with your offices and believe we have a good working relationship with your field offices. It should be noted, however, that many times it has taken the OIG months, if not close to a year, to assign staff to commence work on our cases.

Like the OIG, we consult with Assistant US Attorney Offices to determine if certain cases meet their referral thresholds. We also discuss cases with OIG offices for the same reason. We do agree that our files could be better documented to provide evidence of these conversations.

Recommendations

2A. Revise DEC's procedures for handling physical condition cases to require DEC staff to handle enforcement actions rather than closing the cases and recommending actions to the Office of Housing. DEC should coordinate with Housing as needed to implement actions requiring Housing's involvement such as abatements and foreclosures.

Response: Do not concur. This recommendation should be deleted. It is inconsistent with Recommendation 1A that allows for changes in published plans versus a change in operating procedures.

2B. The written standards proposed in Recommendation 1B should include procedural steps for DEC staff to (1) consider the use of available sanctions and civil actions, (2) determine whether violations must be referred to OIG, (3) determine amounts to be repaid when HUD regulated funds are improperly disbursed and restrictions to prevent project owners from subsequently withdrawing the repaid funds, and (4) documenting these assessments and decisions in DEC case records.

Response: Concur. We are currently updating our procedures on civil money penalty referrals for late or non-submission of audited financial statements. Upon completion, we will also update our procedures for physical and financial referrals. We look forward to receiving the guidelines you agreed to provide on when cases should be referred to the OIG and will incorporate them in our procedures.

2C. Provide training to DEC staff on implementation of the new standards and procedures.

Response: Concur for standards developed as a result of 2B.

Finding 3 – Improvements are Needed to Reduce Unwarranted Referrals, to Control Workload and to Report Meaningful Accomplishments

As the audit report demonstrates, the DEC has initiated efforts to reduce unwarranted referrals. We believe the system had been fixed in October 2003 but continue to receive some financial referrals when an owner files an audited statement after we received a non-filer referral for the late submission. These are what we define as “phantom” referrals. Lack of funding resources to ensure systems corrections make it difficult to determine when the final fixes will take place. We agree that it is important for the DEC to focus on the highest priority cases.

We take exception to the statement that we are not reporting meaningful accomplishments and further address this issue below. We have strived to identify appropriate accomplishments. We have qualified accomplishments in external and internal reports or completely eliminated them from Departmental goals. Specifically, we provided the audit team with a copy of our fiscal year 2002 report that clearly articulates that the DEC elected not to include financial cases in its Departmental Management Plan Goals because of the “phantom” referrals.

Footnote 5 on page 19 of the audit report states:

“DEC caseload statistics have been cited in HUD’s Annual Performance and Accountability Reports, which are available as public information and are shared with the Congress and Office of Management and Budget. The 2002 annual report included the DEC’s accomplishments on physical condition, financial, and non-filer case referrals and the 2003 report included the DEC’s accomplishments on physical referrals.”

This footnote is misleading. Our goals as included in the reports are cited below, along with our basis as to why the footnote is misleading.

Goal # 1: Close 80 percent of MF cases in DEC as of 9/30/2001. Those financials would not include any “phantoms” as the phantom issue did not arise until we started receiving financial submissions of late AFS non-filer referrals. Thus, the claim of inflated numbers has no bearing on this goal accomplishment.

Goal # 2: This goal was focused on closing 75 percent of all cases (physical and financial) received in FY 2002 that had been in the DEC for 180 days. The number of referrals received in FY 2002 that were over 180 days old would have only been determined as of April 1, 2002. It was around that time that the DEC first realized the consequences of the “phantom” referrals and took immediate steps toward correcting that concern.

We disagree that we have premature case closure practices. Several years ago, we created a DEC status of “Closed-Monitoring” to reflect when active processing was not taking place on a given referral, but future actions might be required. For example, this status was used on the prior physical referral protocol with Housing when owners were under approved repair plans. Once repairs were confirmed, either through a subsequent REAC inspection, or a confirmatory review by the DEC, its contractor or Multifamily staff, the status would be changed as needed.

When the November 2002 protocol was developed, repair plans were for the most part, eliminated. The DEC, REAC and Housing were under the assumption that the second inspections could be performed according to the 60-day time frame in the protocol. In anticipation that re-inspections would be done timely, we revised our policies to use the “Closed” status after the re-inspection was completed instead of our longstanding practice of using “Closed-Monitoring”. Due to REAC and Housing budgetary constraints, re-inspections have taken longer than anticipated.

The decision to return to “Closed-Monitoring” was two-fold. First, the use of this status allows DEC management to effectively determine which cases are actually being worked on at any given time. This is especially critical when shifting workload between offices based on capacity. This is good business sense that is consistent with the Department’s own Resource Estimation and Allocation Process that seeks to align human resources and workloads. Second, we recognized that it is inappropriate for the DEC to rely on another part of HUD to determine whether or not we achieve our goals. Using the analogy of the OIG’s finding in this report that the DEC allowed Housing to control referral thresholds, one could readily foresee a future audit finding that the DEC allowed REAC to determine whether or not the DEC met its goals.

The audit report’s reference to the then Acting Director’s statement that she needed additional staff to handle the high volume of work is incorrect or perhaps, taken out of context. The then Acting Director commented more than once that she agreed critical vacancies should be filled. In fact, it was the then Acting Director who first raised the issue of the considerable number of unwarranted (phantom) referrals at the entrance conference. It is inconsistent that she would then state she needed additional staff without qualification as implied by the audit report.

We agree that elimination of unwarranted referrals would allow the DEC to be more productive in other areas. We note, however, that while the audit report acknowledges the accomplishments of the DEC in reducing the non-filer workload in the beginning portion of the report, this section of the audit stresses that the DEC could make better use of its resources by reducing unwarranted referrals and focusing on the backlog of non-filer referrals. This section gives the impression the DEC has not been proactive (let alone successful) in implementing a strategy to reduce the backlog.

In this section of the audit, the term “phantom” as used by the OIG appears to include all financial referrals for which there are no DEC compliance flags. In actuality, this phrase was developed by the DEC to include only those financial referrals received simply because of an existing open non-filer referral. Since the initial stages of the DEC’s implementation, the DEC and Housing agreed that the DEC would receive all subsequent referrals when it had an existing open referral. The thought was that this would allow greater control of the overall administrative record.

We agree that the above practice should continue when the DEC has an open physical or financial referral. We do not agree that this practice should continue solely because of an open non-filer referral. It has been our experience that most owners do not file timely for numerous reasons other than significant compliance issues. As you are aware, the system is already set up to refer those financial statements with DEC compliance issues. Housing also retains the ability to make elective referrals even if an automated referral is not generated.

In this section of the audit, the OIG draws conclusions based on workload data on financial referrals. We feel it is practical for us to consider the previously mentioned independent contractor's study when making final decisions on revised thresholds. This is practical given the OIG reviewed data pertaining to 97 cases over a 26-month period versus the contractor's review of 15,447 loans over a four-year period. While the OIG analysis of a DEC report indicates 89% of 12,869 cases were closed with no enforcement action or monetary restitution from the owner, this does not take into account work the DEC may have done to invalidate findings by working with owners on questionable entries or practices they may have. We raised this issue with the audit team.

We believe the contractor's study verifies the point we made to the Senior Auditor that the mere fact that a property has been referred to the DEC has had a positive effect on properties not referred to the DEC. We initially found this to be true when meeting with owners with multiple properties who had only one referral with the DEC. Often, they would inform our Satellite Office Directors that they did not want their other properties referred to the DEC.

Recommendations:

3A. Complete actions to prevent future unwarranted referrals from inflating the DEC's workload and closed case accomplishments. This includes resolution of the problems with phantom referrals and implementation of the revised REAC referral criteria presented in appendix C of this report.

Response: Concur. The resolution of the phantom referrals is impacted by the availability to make changes to systems that are primarily being funded for maintenance only at this time. As stated previously in this response, our recommendations to Housing on revised thresholds will change based on the independent contractor study done. Please recognize that our prior agreement on the changes suggested by the OIG may be impacted by any additional information we receive relative to the contractor's study.

3B. Revise the policy of counting physical condition referral cases that are pending re-inspection by REAC as closed cases. If the DEC desires to identify the pending status of these cases, a status classification of "pending re-inspection" would be appropriate.

Response: Do not concur. We had considered revising the types of DEC statuses, but we have been informed that system changes would again take at least a year to effectuate due to funding constraints. Again, it is important to remember that we often continue work on "Closed" cases and this work is not reflected in our quantified accomplishments.

Finding 4: The Merger with OGC Restricted Hiring for Key DEC Positions

The draft audit states that: (1) the merger of the DEC into the Office of General Counsel has, at least temporarily, had a negative impact on DEC staffing, (2) the DEC has been unable to fill key positions, (3) the merger resulted in the DEC losing its autonomous budget, staffing ceiling and independent authority to hire and (4) the DEC could not provide documentation to support reductions in its staffing ceiling following the merger.

In order, we offer:

(1) Impact on Staffing

We agree that the DEC became subject to OGC's overall staffing ceiling after the merger. However, the Resource Estimation and Allocation Process and the Department's Corrective Action Plan have affected staffing for OGC and the DEC staffing numbers by imposing ceiling limitations that have varied from time to time. At other times, hiring freezes have been imposed.

(2) Key Positions

The DEC's ability to fill key positions has been hampered by the overall ceiling limitations described above. Since the end of the audit period, the following positions have been filled:

- DEC Director
- Compliance Division Director
- Los Angeles Satellite Office Director³
- DEC Deputy Director selection is pending.
- Associate Regional Counsel selections for positions approved under the merger have been made in Chicago, Los Angeles and Fort Worth.

(3) Loss of DEC Autonomous Budget, Staffing Ceiling and Authority to Hire

The merger did result in the DEC losing its autonomous budget, staffing ceiling and independent ability to hire. If the DEC were to have an autonomous budget, this would be contrary to the spirit of the merger. It would also be contrary to how the other areas within OGC are treated. During the exit conference, we discussed that next year each area of HUD will maintain its own staffing ceilings by office or division. Thus, this point will be moot. In terms of independent authority to hire, the most recent personnel delegations of authority give specific authority to the DEC Director, the Deputy Director and the Satellite Office Directors. To date, each new internal or external hire that they have selected within their delegated authority has been hired.

(4) DEC Could Not Provide Documentation to Support Reductions

As provided to the audit team and discussed at the exit conference, a simple comparison between staffing by position pre- and post-merger is not possible for the following reasons:

- a. We have never been provided staffing ceiling numbers by position. In fact, we don't know of any office within HUD that receives allocations by positions.
- b. While the DEC had overall ceiling numbers prior to the merger during the Staffing 9-30 hiring initiatives, offices were authorized to hire irrespective of current ceiling numbers. Therefore, positions that did not exist at the time of the merger were added during the 9-30 initiative. So, no valid comparison can be made.

³ We received a roster for the Senior Enforcement Analyst, however no selection was made. We expect to re-advertise the position once the job requirements are more clearly delineated.

Recommendation: We recommend that the OGC/DEC:

4A. Expediently fill DEC vacancies, particularly, the DEC Director, Deputy Director and other management and supervisory positions.

Response: Concur. The DEC Director, Compliance Division Director and Los Angeles Satellite Office Director have been filled. A selection has been made for the Deputy Director position.

4B. Establish separate budget and staff ceiling lines for the DEC within OGC's budget.

Response: Concur on separate ceiling as this will be required for all program areas for fiscal year 2005. Do not concur on the budget as this will inappropriately differentiate the DEC from other OGC offices and is contrary to the intent of the merger.

4C. Document changes in authorized DEC staffing from its pre-merger ceiling of 218 positions to its current authorized number of positions. If more than 132 positions are authorized, the DEC should assess where such additional positions should be assigned.

Response: Concur to provide documentation that was previously provided to the audit team. It is not possible to provide a position-by-position analysis for the reasons previously mentioned.