United States Government Accountability Office
Report to Congressional Requesters

May 2021

DISASTER RECOVERY

HUD Should Take Additional Action to Assess Community Development Block Grant Fraud Risks

GAO-21-177

GAO@100

Highlights

Highlights of GAO-21-177, a report to congressional requesters

Why GAO Did This Study

In response to a historic string of natural disasters, Congress appropriated approximately $39.5 billion in CDBG-DR grant funds in 2017 through 2019, with most of the funding designated for Texas, Florida, Puerto Rico, and the U.S. Virgin Islands. However, accompanying this unprecedented amount of funding is an increased vulnerability to fraud given that CDBG-DR involves multiple factors.

GAO was asked to review a range of disaster recovery issues following the 2017 disaster season. This report addresses: (1) the fraud risks and risk environment of CDBG-DR and their impacts; and (2) the steps HUD has taken to assess fraud risk agency-wide, and specifically for CDBG-DR, in alignment with leading practices. GAO reviewed DOJ public announcements and HUD OIG enforcement cases to identify CDBG-DR fraud risks. GAO assessed HUD's procedures against leading practices in the Fraud Risk Framework. GAO interviewed HUD officials responsible for CDBG-DR and fraud risk assessment; and conducted site visits to Florida and Texas, selected partly for the amount of CDBG-DR funds they received, among other factors.

What GAO Recommends

GAO makes two recommendations, including that HUD comprehensively assess fraud risks to CDBG-DR and involve relevant stakeholders in the assessment. HUD neither agreed nor disagreed with our recommendations, and instead offered a description of mitigating actions. GAO continues to believe the recommendations are warranted.

View GAO-21-177. For more information, contact Rebecca Shea, (202) 512-6722 or SheaR@gao.gov

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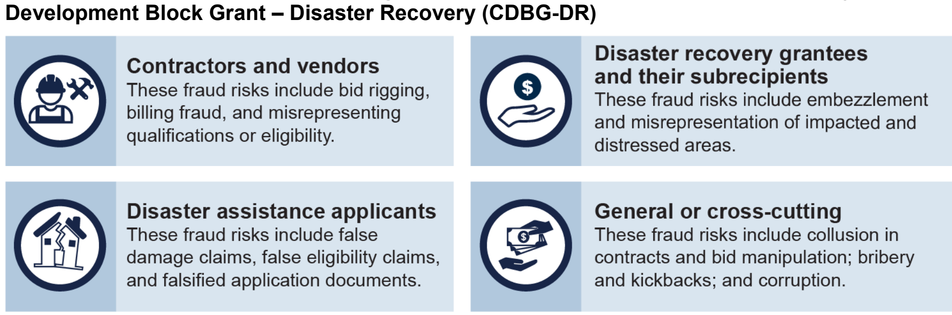
What GAO Found

GAO identified four categories of fraud risks facing the Department of Housing and Urban Development's (HUD) Community Development Block Grant – Disaster Recovery (CDBG-DR) from 2007 to 2020, including risks from contractors, disaster recovery applicants, grantees, and others, as shown below. In total, we identified 78 cases from Department of Justice (DOJ) public announcements and 110 HUD Office of Inspector General (OIG) enforcement cases. For example, in 2012 following Hurricane Sandy, a New Jersey couple applied for disaster assistance and fraudulently received $79,000 in CDBG-DR funds, according to HUD OIG records. The couple was convicted of conspiracy, falsification, and theft and was sentenced to 5 years imprisonment. The funding was for a seaside property they fraudulently claimed was their primary residence, but was later determined to be a summer vacation home that was ineligible for assistance. GAO also found that the CDBG-DR operates in a decentralized risk environment that may make it vulnerable to fraud since CDBG-DR funds flow through a number of entities before reaching their intended beneficiaries. In addition, the risk environment in which CDBG-DR operates may contribute to negative financial impacts, such as improper payments. Fraud can have nonfinancial impacts as well, such as fraudulent contractors obtaining a competitive advantage and preventing other businesses from obtaining contracts.

Fraud Risks of Department of Housing and Urban Development's (HUD) Community Development Block Grant – Disaster Recovery (CDBG-DR)



Source: GAO analysis. | GAO-21-177

HUD has taken some steps to assess fraud risks agency-wide. For example, HUD conducts an agency-wide assessment of risks through a Front-End Risk Assessment, which also considers fraud risks. In 2020, HUD redesigned its agency-level approach to evaluate fraud risks through its Fraud Risk Management Maturity Model. While HUD has taken some steps to assess fraud risks agency-wide, GAO found that HUD has not conducted a comprehensive fraud risk assessment of CDBG-DR, as called for in GAO's Fraud Risk Framework. Further, HUD's current fraud risk approach does not involve relevant stakeholders such as grantees. Leading practices include tailoring the fraud risk assessment to the program and also involving relevant stakeholders responsible for the design and implementation of the program's fraud controls in the assessment process. Ensuring that a fraud risk assessment is completed specifically for CDBG-DR may provide greater assurance that HUD addresses CDBG-DR fraud risks, including ones identified in this report.

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Abbreviations

CDBG	Community Development Block Grant
CDBG-DR	Community Development Block Grant – Disaster Recovery
DEO	Florida Department of Economic Opportunity
DHS	Department of Homeland Security
DOJ	Department of Justice
FEMA	Federal Emergency Management Agency
FERA	Front-End Risk Assessment
FRDAA	Fraud Reduction and Data Analytics Act of 2015
GLO	Texas General Land Office
HUD	Department of Housing and Urban Development
OIG	Office of Inspector General
OMB	Office of Management and Budget
PII	Personally Identifiable Information
SBA	Small Business Administration
USAO	United States Attorney's Office

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441 G St. N.W.
Washington, DC 20548

May 5, 2021

Congressional Requesters

In response to a historic string of natural disasters in the United States, Congress has provided significant sums through the Department of Housing and Urban Development's (HUD) traditional Community Development Block Grant (CDBG) program to help affected communities and disaster victims recover.[1] Specifically, Congress appropriated about $39.5 billion in CDBG Disaster Recovery (CDBG-DR) grant funds in response to natural disasters in 2017 through 2019, with most of the funding designated for Texas, Florida, Puerto Rico, and the U.S. Virgin Islands.[2] This is a significant increase in funding compared to prior periods, according to documents provided by HUD. For example, HUD allocated $18.2 billion for disasters occurring from 2011 to 2016, which included Hurricane Sandy, among other disasters. CDBG-DR grants are intended to help affected communities recover from disasters. Communities are allowed to use their CDBG-DR grants to address a wide range of unmet recovery needs related to housing, infrastructure, and economic revitalization through activities such as home reconstruction, infrastructure repair, relocation of displaced residents, or hazard mitigation.

However, CDBG-DR assistance can take years to reach disaster victims. Due to the lack of permanent statutory authority, CDBG-DR

[1]For example, in 2017, three historic hurricanes made landfall in the United States and its territories, affecting nearly 26 million people. Hurricanes Harvey and Irma marked the first time two category 4 hurricanes hit the continental United States during the same season, and Hurricane Maria was the first category 4 storm to make landfall on the main island of Puerto Rico in 85 years.

[2]The Supplemental Appropriations for Disaster Relief Requirements Act, 2017, Pub. L. No. 115-56, Division B, 131 Stat. 1129, 1137 (2017) appropriated $7.4 billion in CDBG-DR funding for major disasters declared in calendar year 2017. Congress appropriated an additional $28 billion in CDBG-DR funding primarily for major disasters declared in 2017 through the Further Additional Supplemental Appropriations for Disaster Relief Requirements Act, 2018, Pub. L. No. 115-123, Division B, Subdivision 1, 132 Stat. 64, 103 (2018). The act required HUD to allocate in total no less than $11 billion to Puerto Rico and the U.S. Virgin Islands. Further, the Supplemental Appropriations for Disaster Relief Act, 2018, Pub. L. No. 115-254, Division I, 132 Stat. 3186, 3531 (2018) made available $1.68 billion in CDBG-DR funds for major disasters declared in 2018. The Additional Supplemental Appropriations for Disaster Relief Act, 2019, Pub. L. No. 116-20, 133 Stat. 871, 896 (2019) made $2.431 billion in CDBG-DR funds available for major disasters occurring in 2017, 2018, or 2019.

appropriations require HUD to customize grant requirements for each disaster—a time-consuming process that has delayed the disbursement of funds. HUD then generally allows state and local governments—the recipients of CDBG-DR grants—6 years to spend their allocations on disaster recovery initiatives. This long life cycle of CDBG-DR grants—coupled with the growth in these grant appropriations and an expected increase in frequency and intensity of extreme weather and climate-related events—present increased opportunities for fraud.[3]

Given the scope of the recent disasters and subsequent commitment of recovery funds, you asked us to review the federal government's response to the events. As part of wide-ranging disaster-related work we are conducting, this report focuses on the potential for fraud in CDBG-DR. This report examines (1) the fraud risks and risk environment of CDBG-DR and their impacts; and (2) the steps HUD has taken to assess fraud risk agency-wide, and specifically for CDBG-DR, in alignment with leading practices.

To identify the fraud risks and risk environment of CDBG-DR and their impacts, we obtained information on cases from two primary sources illustrating fraud risks that may affect disaster recovery programs or programs with elements similar to CDBG-DR. First, we obtained information on CDBG-DR fraud risks by searching news releases from the Department of Justice's (DOJ) Offices of the United States Attorneys (USAO) website dated May 2017 through February 2020. We reviewed 1,111 news releases using certain key words related to fraud and disaster recovery programs and identified 78 news releases that illustrated fraud risks to disaster recovery programs relevant to CDBG-DR. Second, we

[3]Fraud and "fraud risk" are distinct concepts. Fraud relates to obtaining something of value through willful misrepresentation. Fraud risk exists when individuals have an opportunity to engage in fraudulent activity. Fraud risk factors are highlighted in federal internal control standards. See GAO, *Standards for Internal Control in the Federal Government*, GAO-14-704G (Washington, D.C.: Sept. 10, 2014). In particular, principle eight of the internal control standards requires federal managers to consider the potential for fraud when identifying, analyzing, and responding to risks. This can include considering types of fraud risk factors to agency programs which can provide, among others, opportunities, such as circumstances that exist, such as the absence of controls, ineffective controls, or the ability of management to override controls, that provide an opportunity to commit fraud. Also, according to GAO's Fraud Risk Framework, a "fraud risk factor" describes what conditions or actions are most likely to cause or increase the chances of a fraud risk occurring. See GAO, *A Framework for Managing Fraud Risks in Federal Programs*, GAO-15-593SP (Washington, D.C.: July 28, 2015). Although the existence of fraud risk factors does not necessarily indicate that fraud exists or will occur, they are often present when fraud does occur.

obtained data from the HUD's Office of Inspector General (OIG) on closed cases involving allegations of fraud in CDBG-DR from calendar years 2010 to 2020. We reviewed almost 670 HUD OIG closed fraud cases nationwide. Of those, we identified 110 cases illustrating a fraud or fraud risk relevant to CDBG-DR. After examining these two primary sources, we identified four categories of fraud risks. For more details about the methodology to identify and categorize the fraud risks, see appendix I.

In addition, we interviewed officials and examined documentation from a range of agencies involved in CDBG-DR or disaster assistance generally including: HUD and its Office of Community Planning and Development, which administers CDBG-DR; the HUD OIG; DOJ; and its National Center for Disaster Fraud.[4] We also selected and interviewed officials from four state and local governments in Texas and Florida, which administer program activities under CDBG-DR. We focused our review of CDBG-DR fraud risks in Texas and Florida in part because of their history of natural disasters—including heavy damage following 2017 Hurricanes Harvey and Irma—and the amount of CDBG-DR funds ($2.3 billion and $10.8 billion, respectively, according to documents provided by HUD) allocated by HUD since 2011 to address unmet recovery needs.[5]

To determine the steps HUD has taken to assess fraud risk generally, and specifically for CDBG-DR, in alignment with leading practices, we examined relevant documentation—including policies, procedures, and guidance—and also interviewed HUD officials. We assessed the agency's practices against leading practices identified in GAO's *A Framework for Managing Fraud Risks in Federal Programs* (Fraud Risk Framework)—in particular, component 2, "Plan Regular Fraud Risk Assessments and Assess Risks to Determine a Fraud Risk Profile." We selected the leading practices within the assess component because the identification and assessment of fraud risks are important steps in determining whether HUD's actions identify and address areas at risk for fraud. To the extent

[4]The National Center for Disaster Fraud is a partnership between the U.S. Department of Justice and various law enforcement and regulatory agencies to form a national coordinating agency within the Criminal Division of the Department of Justice to improve and further the detection, prevention, investigation, and prosecution of fraud related to natural and man-made disasters, and to advocate for the victims of such fraud.

[5]Although Puerto Rico was hardest hit from the 2017 hurricane season and was allocated $20.2 billion in CDBG-DR grants, according to HUD, we did not include Puerto Rico or the U.S. Virgin Islands, in the scope of our review in part because neither had prior experience with large CDBG-DR allocations.

we found that HUD's actions were inconsistent with leading practices, we conducted further interviews with program managers from HUD to determine the rationale.

We conducted this performance audit from March 2019 to May 2021 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

History of Community Development Block Grants

The Housing and Community Development Act of 1974 created HUD's CDBG program to develop viable urban communities by providing decent housing and a suitable living environment and by expanding economic opportunities principally for people with low and moderate incomes.[6] According to the Congressional Research Service, the CDBG program is one of the largest and longest-standing federal block grant programs, annually allocating billions of dollars in federal assistance to support local neighborhood revitalization, housing rehabilitation, and community and economic development efforts. Specifically, the CDBG program provides annual block grants on a formula basis to states, territories, Indian tribes, and cities and counties. Because the CDBG program already has a mechanism to provide federal funds to states, territories, and localities, it is widely viewed as a flexible solution to disburse federal funds to address unmet needs in disasters.

Overview of Federal Disaster Response

When a major disaster strikes, federal agencies can respond to a disaster when effective response and recovery are beyond the capabilities of state and local governments. In such cases, the Robert T. Stafford Disaster Relief and Emergency Assistance Act permits the President to declare a major disaster in response to a request by the governor of a state or territory or by the chief executive of a tribal government.[7] Such a

[6]Under the traditional CDBG program, the annual CDBG appropriation is generally allocated to "entitlement communities" and states and territories. Entitlement communities are principal cities of metropolitan statistical areas, other metropolitan cities with populations of at least 50,000, and qualified urban counties with a population of 200,000 or more (excluding the populations of entitlement cities). In most instances, states and territories distribute CDBG funds to localities not qualified as entitlement communities.

[7]42 U.S.C. § 5170.

declaration is the mechanism by which several federal agencies become involved in funding and coordinating response and recovery activities.

- *Department of Homeland Security*—The Department of Homeland Security (DHS) is the federal department with primary responsibility for coordinating disaster response. Within DHS, the Federal Emergency Management Agency (FEMA) has lead responsibility and provides three principal forms of funding for disaster recovery—Individual Assistance, Public Assistance, and Hazard Mitigation.[8]
- *Small Business Administration*—The Small Business Administration (SBA) provides direct loans to help businesses, nonprofit organizations, homeowners, and renters repair or replace property damaged or destroyed in a federally declared disaster.
- *Department of Housing and Urban Development*—HUD's Office of Community Planning and Development administers the traditional CDBG program and CDBG-DR funds, which help cities, counties, states, territories, and Indian tribes recover from presidentially declared disasters, especially in low-income areas. HUD also allocates CDBG-DR funding to affected communities. HUD considers several factors when making CDBG-DR allocations to communities including: the overall damage inflicted on the community, including to both homes and businesses, and contributions from insurance, FEMA grants and SBA loans. This information helps HUD estimate unmet needs or losses not met with insurance or other forms of assistance. CDBG-DR grants may be used to relocate displaced residents, acquire damaged properties, rehabilitate damaged homes, and public

[8]These Federal Emergency Management Agency (FEMA) programs are: (1) The Individual Assistance Program provides financial assistance and, if necessary, direct assistance to individuals and households affected by disasters for necessary expenses and serious needs—including shelter and medical needs—that cannot be met through other means, such as insurance; (2) the Public Assistance Program provides federal disaster grant assistance to state, local, tribal, and territorial governments and certain types of nonprofit organizations for such work as debris removal, emergency protection, and the restoration of damaged facilities; (3) the Hazard Mitigation Program provides grant assistance for measures that substantially reduce the risk of, or increase resilience to, future damage, hardship, loss, or suffering in any area affected by a major disaster.

facilities such as neighborhood centers and roads, and hazard mitigation, among others.[9]

CDBG-DR Grant Funding Process

After the President declares a disaster, Congress may appropriate additional CDBG funding as disaster recovery grants to rebuild the affected areas and provide crucial seed money to start the recovery process. Once Congress appropriates CDBG-DR funds, HUD publishes notices in the *Federal Register* to allocate the funding to affected communities based on unmet need and to outline the grant process.[10] Under the requirements of these appropriations, HUD does not provide CDBG-DR funds directly to disaster victims. Instead, CDBG-DR funds can flow through a number of entities, including grantees, before reaching disaster victims, who may be the intended beneficiaries (see fig. 1).[11]

- *States, territories, and local governments (grantees)*—HUD allocates CDBG-DR grants to states, territories, and local governments, also known as "grantees," which administer disaster recovery programs to assist disaster victims. Grantees are generally required to take a number of steps before entering into a grant agreement with HUD and expending funds, including obtaining approval from HUD for the grantees' financial controls and procurement processes; implementation plans that describe their capacity to carry out the recovery; and action plans for disaster recovery that identify the proposed use of all funds.[12] Once these plans are approved by HUD, states, territories, and local governments generally manage disaster recovery programs themselves or work with subrecipients (described below). Grantees may hire or contract for disaster recovery program staff, or rely on existing state, territory, and local agencies that administer CDBG-DR funds. For example, in Texas, the state General

[9]According to HUD, mitigation is applicable to 2015, 2016, and 2017 disasters, and is defined as activities that increase resilience to disasters, and reduce or eliminate the long-term risk of loss of life, injury, damage to and loss of property, and suffering and hardship. This includes focus on repetitive loss of property and critical infrastructure, building capacity of state and local governments to analyze disaster risks and to update hazard mitigation plans, and supporting adoption of policies that have long-lasting effects on community risk reduction.

[10]CDBG-DR appropriations generally grant HUD broad authority to waive traditional CDBG program requirements and establish alternative requirements for specific CDBG-DR funds, which are identified in *Federal Register* notices issued by HUD.

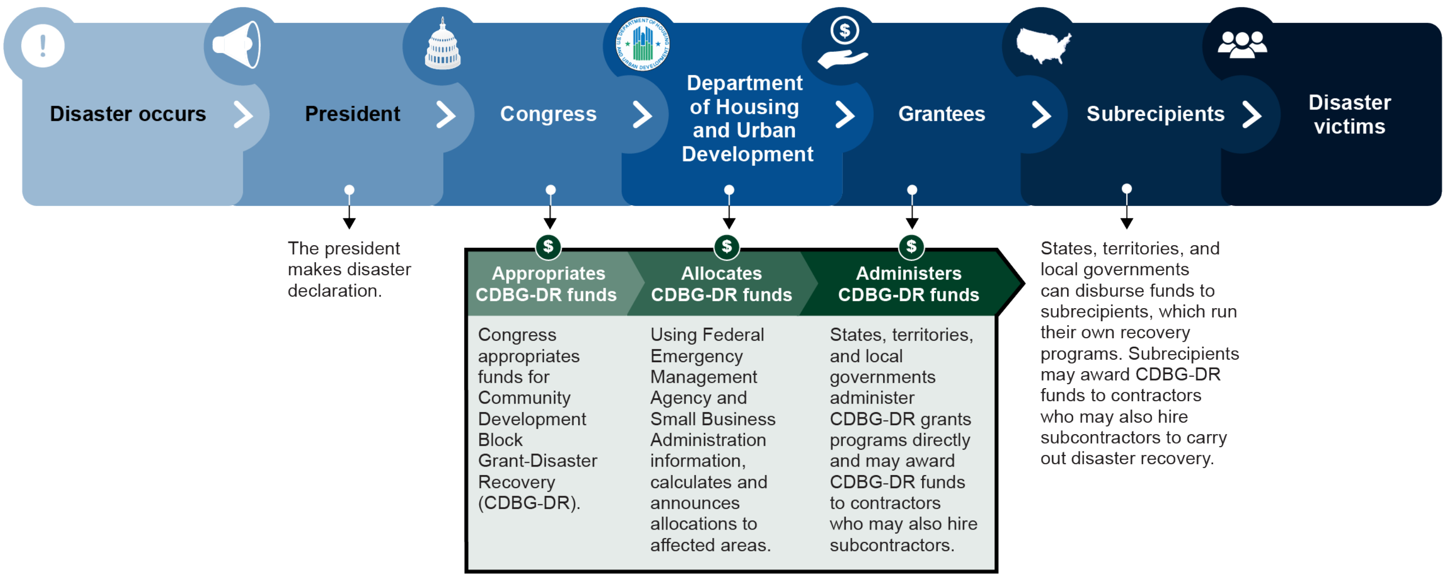
[11]Individuals or businesses impacted by a disaster do not receive CDBG-DR funds directly from HUD. Funds are awarded to states, territories, and local governments, which become grantees.

[12]See, for example, 83 Fed. Reg. 5844 (Feb. 9, 2018).

Land Office (GLO) received CDBG-DR grants from HUD, while in Florida, it was the Department of Economic Opportunity (DEO) that received CDBG-DR grants.

- *Subrecipients*— Subrecipients are generally a public or private nonprofit agency, authority, or organization receiving CDBG-DR funds from a grantee or another subrecipient to undertake disaster recovery efforts. Grantees can enter into agreements with subrecipients to carry out certain disaster recovery activities on behalf of grantees. Grantees are responsible for ensuring that CDBG-DR funds are used in accordance with all programs requirements, even when using subrecipients. Before disbursing any CDBG-DR funds to a subrecipient, the grantee must enter into a written agreement with the subrecipient that includes certain provisions as specified in HUD regulations. Subrecipients may hire disaster recovery program staff who administer CDBG-DR funds. In Texas, two subrecipients—Harris County and City of Houston—received CDBG-DR funds from the Texas GLO.
- *Contractors*—Grantees and subrecipients may award contracts to a prime contractor—a contractor that works directly with the government—for disaster recovery in areas such as: damage assessment, construction/repair, inspection, and management.
- *Subcontractors*—As part of CDBG-DR, contractors can further hire subcontractors to carry out disaster recovery in affected communities. Prime contractors may hire subcontractors, who can then hire more subcontractors.

Figure 1: Flow of Community Development Block Grant — Disaster Recovery (CDBG-DR) Grants to States, Territories, and Local Governments



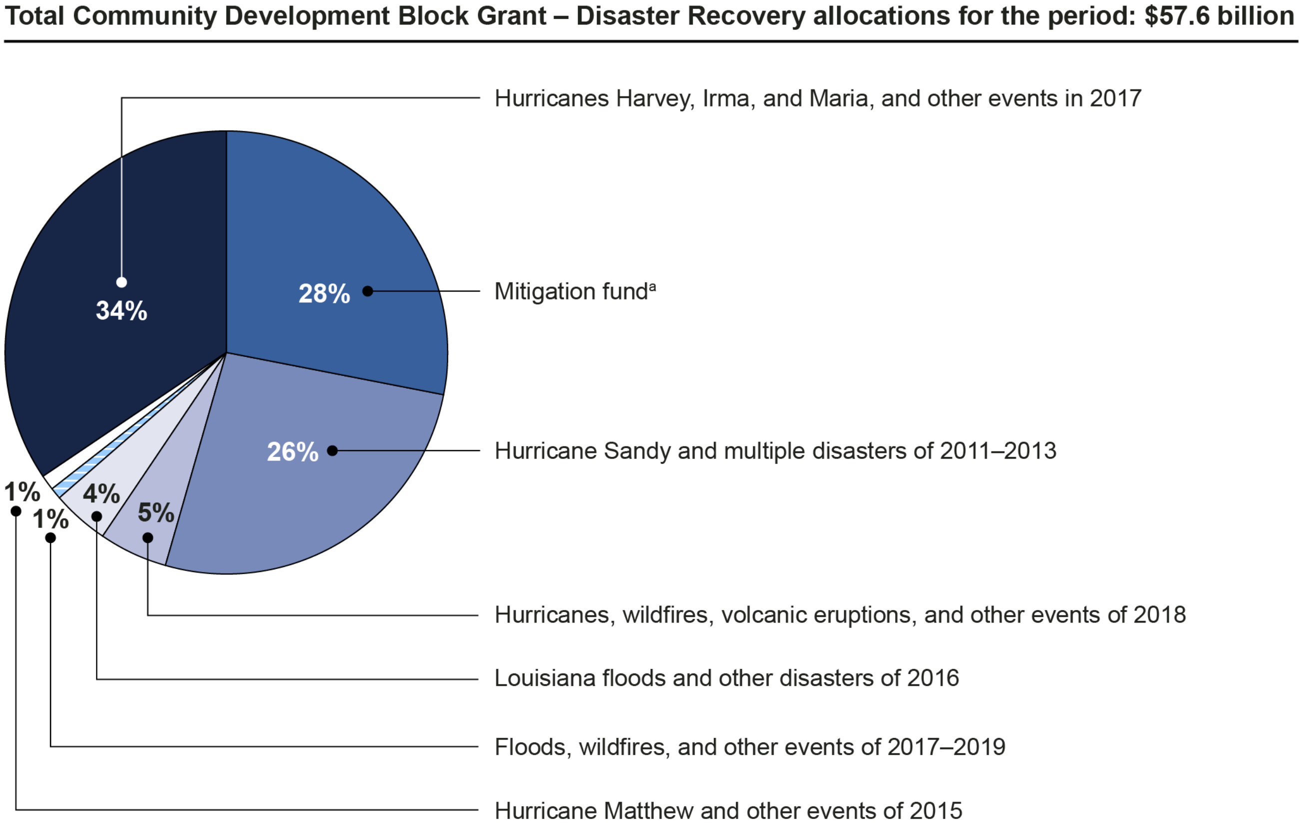
Source: GAO analysis of Department of Housing and Urban Development data. | GAO-21-177

CDBG-DR Grant Allocations

HUD data show that funds for Hurricanes Harvey, Irma, and Maria and other events in 2017 account for the largest share of CDBG-DR grants (34 percent) allocated for events from 2011 to 2019. Figure 2 shows HUD CDBG-DR grant allocations for recent declared disasters, beginning with events at or near the time of Hurricane Sandy in 2012 through 2019.[13] After CDBG-DR allocations for mitigation activities (28 percent), Hurricane Sandy and other disasters from 2011 through 2013 account for the next largest share, at 26 percent.

[13]HUD data are as of March 31, 2020, the most recently available at the time of our review.

Figure 2: HUD Community Development Block Grant — Disaster Recovery (CDBG-DR) Allocations by Disaster Events, 2011 to 2019



Source: GAO analysis of Department of Housing and Urban Development (HUD) data. | GAO-21-177

[a]Mitigation is defined as activities that increase resilience to disasters, and reduce or eliminate the long-term risk of loss of life, injury, damage to and loss of property, and suffering and hardship. This includes focus on repetitive loss of property and critical infrastructure, building capacity of state and local governments to analyze disaster risks and to update hazard mitigation plans, and supporting adoption of policies that have long-lasting effects on community risk reduction. According to HUD, mitigation is applicable to 2015, 2016, and 2017 disasters.

According to our analysis of HUD data, certain states and U.S. territories that suffered major disasters received the largest CDBG-DR allocations from 2011 to 2019 (see table 1). Puerto Rico, in part due to the major damage incurred by Hurricanes Irma and Maria, received the largest CDBG-DR allocation of $20.2 billion followed by the state of Texas ($10.8 billion) from 2011 to 2019.

Table 1: Ten Largest Recipients of HUD CDBG-DR Allocations by State or Territory for Disasters, 2011-2019

State/Territory	CDBG-DR Allocation (dollars in billions)
Puerto Rico	20.2
Texas	10.8
New York	8.8
New Jersey	4.2
Louisiana	3.3
Florida	2.3
U.S. Virgin Islands	1.9
California	1.3
North Carolina	0.95
South Carolina	0.59
Total	**54.4[a]**

Source: GAO analysis of Department of Housing and Urban Development (HUD), *Community Development Block Grant - Disaster Recovery (CDBG-DR) Grant History,* 1992-2020, as of March 31, 2020. | GAO-21-177

Note: These figures show totals at the state/territory level. In some cases, allocations are made to other units of government, such as cities or counties. In this table, any such allocations are consolidated into the state or territory total.

[a]Totals may not sum due to rounding.

As noted earlier, considerable time can elapse before CDBG-DR assistance reaches local communities. For example, grantees have not spent all CDBG-DR funds that were appropriated in response to Hurricane Sandy, the strongest hurricane of the 2012 Atlantic hurricane season. Hurricane Sandy caused significant damage in New Jersey and New York, among other places. Following congressional appropriations in January 2013,[14] HUD allocated $14.2 billion in grants. As of December 31, 2020, New Jersey reported program funds expended under a CDBG-DR grant at $3.4 billion—still 18 percent short of the grant amount of $4.2 billion. In New York City, spending under its CDBG-DR funding reached a peak 5 years after the storm, in the third quarter of 2017, and as of December 2020, 10 percent of a planned $4.2 billion in relief spending still remained outstanding. Overall, among 106 CDBG-DR grants tracked, HUD classified nearly two-thirds (65.1 percent) as “slow spenders” as of February 2020. That designation is based on spending 10 percent less than the monthly pace required to fully use the grants by their target

[14]Pub. L. No. 113-2, 127 Stat. 4, 15 (2013).

close-out dates. Less than one-quarter (22.6 percent) of the grants were designated as "on pace."[15]

Fraud Risk Management

In July 2015, we issued the Fraud Risk Framework, which provides a comprehensive set of key components, overarching concepts, and leading practices that serve as a guide for agency managers to use when developing efforts to combat fraud in a strategic, risk-based way.[16] The Fraud Risk Framework explains the types of internal and external fraud risks programs may face such as fraud related to financial reporting, misappropriation of assets, corruption, and nonfinancial forms of fraud. These broad categories of fraud encompass specific fraudulent schemes related to contracting, grant-making, beneficiary payments, payroll payments, and other areas of government activity.

As referenced in the Fraud Risk Framework, the *Standards for Internal Control in the Federal Government,* commonly known as the Green Book, defines the following types of fraud:

- *Fraudulent financial reporting*—intentional misstatements or omissions of amounts or disclosures in financial statements to deceive users of financial information, such as alteration of accounting records, misrepresentation of transactions, or intentional misapplication of accounting principles.
- *Misappropriation of assets*—theft of an entity's assets, which can include theft of property, embezzlement, or fraudulent payments.
- *Corruption*—bribery and other illegal acts.[17]

Further, according to the Green Book, managers may consider factors that are specific to fraud risks, including incentives, opportunity, and rationalization to commit fraud. The Fraud Risk Framework consists of four components for effectively managing fraud risks, as shown in figure 3.

[15]HUD, Office of Community Planning and Development, Disaster Recovery Grant Reporting System, *Monthly CDBG-DR Grant Financial Report* (Feb. 28, 2020).

[16]GAO-15-593SP.

[17]GAO, *Standards for Internal Control in the Federal Government*, GAO-14-704G (Washington, D.C.: September 2014).

Figure 3: Overview of GAO Fraud Risk Framework

Source: GAO. | GAO-21-177

The Fraud Risk Framework, among other things, includes leading practices related to identifying and assessing fraud risks. Specifically, the second component—assess—includes leading practices for planning and conducting regular fraud risk assessments, including identifying and assessing risks, assessing the likelihood and impact of inherent fraud risks, determining fraud risks tolerance, examining the suitability of existing fraud controls, and documenting the results in the program's fraud risk profile. As noted earlier, given the foundational role of assessment in fraud risk management, this report focuses on the assess component of the framework.

In its Circular No. A-123 guidelines, the Office of Management and Budget (OMB) has directed agencies to adhere to the Fraud Risk Framework's leading practices as part of their efforts to effectively design, implement, and operate an internal control system that addresses fraud risks.[18] The leading practices of the Fraud Risk Framework are also required to have been incorporated into OMB guidelines and agency controls under the Fraud Reduction and Data Analytics Act of 2015[19] and its successor provisions in the Payment Integrity Information Act of 2019.[20]

While executive-branch agency managers are responsible for managing fraud risks and implementing practices for combating those risks, the Fraud Risk Framework notes leading practices related to involving stakeholders in this process that includes individuals responsible for the design and implementation of the program's fraud controls. This could include a variety of internal and external stakeholders such as contractors and other external entities with knowledge about emerging fraud risks or responsibilities for specific control activities.

[18]Office of Management and Budget, *Management's Responsibility for Enterprise Risk Management and Internal Control*, OMB Circular No. A-123 (Washington, D.C.: July 15, 2016).

[19]The Fraud Reduction and Data Analytics Act of 2015 (FRDAA), enacted in June 2016, required OMB to establish guidelines for federal agencies to create controls to identify and assess fraud risks and to design and implement antifraud control activities. Pub. L. No. 114-186, 130 Stat. 546 (2016). The act further required OMB to incorporate the leading practices from the Fraud Risk Framework in the guidelines. Although FRDAA was repealed in March 2020, the Payment Integrity Information Act of 2019 requires these guidelines to remain in effect, subject to modification by OMB as necessary and in consultation with GAO. Pub. L. No. 116-117, 134 Stat. 113 (2020).

[20]Under the Payment Integrity Information Act of 2019, agencies are required to report an estimate of *improper payments.* Fraud is distinct from improper payments, as improper payments are any payments that should not have been made or that were made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements. Improper payments include any payment to an ineligible recipient or ineligible service, duplicate payments, payments for services not received, and any payment for an incorrect amount. However, not all improper payments are fraud. Our prior reports and those of the HUD Office of Inspector General have identified improper payments as an ongoing challenge for HUD and CDBG-DR grantees. For a summary discussion, see GAO, *Disaster Recovery: Better Monitoring of Block Grant Funds Is Needed,* GAO-19-232 (Washington, D.C.: Mar. 25, 2019).

CDBG-DR Faces a Number of Fraud Risks and Operates in a Risk Environment that Result in Financial and Nonfinancial Impacts

CDBG-DR Faces a Wide Range of Fraud Risks

CDBG-DR is at risk of fraud in many ways and from various entities.[21] Specifically, we identified four categories of fraud risks facing CDBG-DR from 2007 to 2020, including risks from:

- Disaster recovery grantees and their subrecipients;
- Contractors and vendors;
- Disaster assistance applicants; and
- General or cross-cutting participants, meaning that the fraud risk is not limited to a single category of CDBG-DR participant as identified above.

Our compilation of fraud risks, detailed in appendix II, may not include all fraud risks facing CDBG-DR, nor does it necessarily indicate a CDBG-DR fraud risk that is unmitigated by controls.[22] Fraud and "fraud risk" are distinct concepts. Fraud involves obtaining something of value through willful misrepresentation and is challenging to detect because of its deceptive nature. Fraud risk exists when individuals have an opportunity to engage in fraudulent activity, have an incentive or are under pressure to commit fraud, or are able to rationalize committing fraud. When fraud risks can be identified and mitigated, fraud may be less likely to occur. Although the occurrence of fraud indicates there is a fraud risk, a fraud

[21]As noted previously, the fraud risks that we identified are based on closed disaster recovery cases obtained from HUD OIG; related cases prosecuted by DOJ USAO; and experiences conveyed by HUD, Texas, and Florida disaster recovery officials.

[22]The Fraud Risk Framework recommends that program managers consider the extent to which existing control activities mitigate the likelihood and impact of risks and if the remaining risks exceed managers' tolerance. GAO-15-593SP. An assessment of the effectiveness of controls was outside the scope of our work.

risk can exist even if actual fraud has not yet been identified or occurred. Moreover, while these fraud risks may be informative to HUD's Office of Community Planning and Development in conducting a fraud risk assessment, our work does not supplant such an assessment.[23] Table 2 provides a summary of the fraud risks we identified in the four categories noted above, with direction to appendix II where detailed information on the risks and supporting examples can be found.

[23]The fraud risk assessment is discussed later in this report.

Table 2: Summary of Community Development Block Grant — Disaster Recovery (CDBG-DR) Fraud Risks

Fraud Risks Associated with:	Description of Fraud Risk
 Disaster recovery grantees and their subrecipients	These fraud risks include embezzlement and misrepresenting areas that are impacted and distressed. For example, according to HUD OIG, grantees may attempt to submit false or inflated invoices for reimbursement. *Details of four identified fraud risks in Appendix II, Table 3.*
 Contractors and vendors	These fraud risks include bid rigging, billing fraud, and misrepresenting qualifications or eligibility. For instance, contractors and vendors introduce fraud risk into the CDBG-DR activities if they misrepresent their eligibility to obtain a disaster recovery contract, such as attempting to operate under a new name after having been disbarred elsewhere. *Details of 10 identified fraud risks, including sub-categories, in Appendix II, Table 4*.
 Disaster assistance applicants	These fraud risks include false damage claims, false eligibility claims, and falsified application documents. For example, applicants may misrepresent property ownership or their primary residence in order to obtain unauthorized benefits. *Details of 17 identified fraud risks, including sub-categories, in Appendix II, Table 5*.
 General or cross-cutting	These fraud risks include collusion in contracts and bid manipulation, kickbacks and bribery, and corruption. For example, a homeowner could bribe an appraiser in exchange for an inflated damage estimate that repairs or other program benefits are dependent on. *Details of 11 identified fraud risks in Appendix II, Table 6.*

Source: GAO analysis of CDBG-DR grantees, the Department of Housing and Urban Development Office of Inspector General (HUD OIG), and Department of Justice's Offices of the United States Attorneys (USAO) information. | GAO-21-177

Source: GAO analysis. | GAO-21-177

Disaster recovery grantees and their subrecipients: We identified several fraud risks that relate to HUD grantees—state, territory, and local governments that receive CDBG-DR funding—and subrecipients. This type of fraud risk involves CDBG-DR administration officials that intentionally misuse CDBG-DR funds. For example, embezzlement may involve a grantee employee falsifying invoices, misusing credit cards, and converting payroll checks for personal use.

Source: GAO analysis. | GAO-21-177

Contractors and vendors: Contractors and vendors introduce fraud risk if they misrepresent their eligibility or qualifications and fraudulently become eligible to obtain a disaster recovery contract. For example, contractors may attempt to operate under a new name after having been disbarred elsewhere; or falsely certify as a small or disadvantaged business to increase their chances of obtaining awards.[24] Contractors and vendors may also fraudulently bill for disaster recovery work started but not completed. For example, a contractor may fail to complete work at the end of a job but submit an invoice indicating the work is complete. According to officials from HUD's Office of Community Planning and Development, the procurement process generally presents opportunities for many of the chief fraud risks of CDBG-DR. [See text box illustration of this fraud risk.]

[24]Debarment removes a contractor from eligibility for future contracts with the government for a fixed period of time, while suspension temporarily debars a contractor for the duration of any agency investigation of the contractor or ensuing legal proceedings.

Example: Community Development Block Grant — Disaster Recovery (CDBG-DR) Fraud

DISASTER: Hurricane Sandy, October/November 2012

CASE TYPE: Contractor failure to make agreed repairs.

Two New Jersey construction contractors agreed to make repairs and elevate homes for 23 disaster victims across the state, according to records of the Department of Housing and Urban Development Office of Inspector General (HUD OIG). Instead, the contractors diverted the funds for other purposes, performing little or no work. Some of the victims had received CDBG-DR funding under a program providing grants up to $150,000 for repairs, reconstruction, or elevation. Under the program, homeowners selected contractors and paid them from disaster funds received, as well as other funding sources.

One victim reported paying $54,000 to elevate his home, but found his house had only been moved from the front of his property to the back, with no other work, according to the OIG. The contractors also failed to pay their vendors. Interviews with contractor employees suggested the diverted funds may have gone to gambling. One employee said he believed that out of 60 total jobs started in his recollection, including the 23 Hurricane Sandy fraud victims identified by HUD OIG, none were completed.

OUTCOME: Owners of the two construction companies pled guilty and were sentenced in state court for theft by failure to make required disposition of property received, according to the OIG. Among other penalties, one owner was sentenced to 7 years in state prison and the other to 5 years of probation. The two were ordered to pay approximately $621,000 in victim restitution, with one owner ordered to forfeit a diamond engagement ring. The contractors also were ordered to pay a civil judgement of approximately $1.35 million. Both companies each received a $250,000 anti-money laundering penalty.

Source: GAO. I GAO-21-177

Source: GAO analysis. | GAO-21-177

Disaster assistance applicants: We identified several fraud risks associated with applicants for CDBG-DR disaster assistance. For example, disaster assistance applicants may “double dip” (also known as duplication of benefits) by applying for CDBG-DR assistance and failing to disclose disaster assistance received from other public or private sources. Scenarios include failing to disclose or understating insurance proceeds or aid from nonprofit organizations. Another fraud risk is false damage claims, which occurs when property owners seeking disaster assistance may falsely claim damage to their property that was actually damaged from a prior or subsequent disaster, or intentionally caused by the applicant. HUD OIG officials noted several fraud risks when disaster assistance applicants, such as those who have suffered damage to homes in a disaster, fraudulently seek benefits, such as through misrepresenting their eligibility by falsifying information on applications. [See text box illustration of this fraud risk.]

Example: Community Development Block Grant - Disaster Recovery (CDBG-DR) Fraud

DISASTER: Hurricane Sandy, October/November 2012

CASE TYPE: False claim of damage to primary residence.

A New Jersey couple received $79,000 in CDBG-DR assistance, according to records of the Department of Housing and Urban Development Office of Inspector General (HUD OIG). The aid was for a seaside property they claimed was their primary residence, but which was determined to be a summer vacation home that was ineligible for funding.

The couple moved their family to the summer home after they became aware of an investigation into their application, according to the HUD OIG. Neighbors said the couple had not moved to the vacation property prior to the storm. Toll road records showed no travel to and from the vacation home location to their job, in a city about 80 miles away. School records showed children were enrolled in the community of the actual primary residence, not the vacation home. The investigation also reviewed voter registration and utility records.

OUTCOME: A jury convicted the couple on charges of conspiracy, falsification, and theft, according to the OIG. The couple were sentenced in state court collectively to 5 years imprisonment, 50 hours of community service with 36 months of probation, and ordered to pay jointly approximately $187,000 in restitution to state and federal agencies.

Source: GAO. I GAO-21-177

CDBG-DR assistance also requires applicants to submit various information, and applicants may falsify applications and supporting documents. Examples include fake identification, fictitious lease statements to support rental assistance, and manipulation of repair receipts to obtain greater reimbursement of repair costs.

Source: GAO analysis. | GAO-21-177

General or cross-cutting: We identified many fraud risks occurring across more than one category of CDBG-DR participant—meaning that the same kind of scheme might be conducted by different CDBG-DR participants; or that a scheme might involve one category of participant working with another category of participant. One example is conflict-of-interest, which refers to an undisclosed financial or personal interest in a transaction involving disaster recovery assistance, such as purchasing goods or services from an associate. Such relationships with decision-makers may unfairly influence award of contracts. Thus, such activity would include both a contractor or vendor, as well as a program administrator. Another cross-cutting fraud risk spanning different participant types is identity theft. This may involve, for example, individuals obtaining personally identifiable information (PII) from victims—either through deception or unauthorized use of private or public systems—and then using personal and financial information to fraudulently apply for disaster assistance or for other purposes. When individuals fraudulently pose as someone else by obtaining PII, they willfully misrepresent their true identities to gain access to CDBG-DR funding. [See text box illustration of this fraud risk.]

Example: Community Development Block Grant – Disaster Recovery (CDBG-DR) Fraud

DISASTER: Hurricane Sandy, October/November 2012

CASE TYPE: Identity theft, failure to repair rental units.

A father and son entered into an agreement for a CDBG-DR-funded grant of approximately $519,000 to repair a seaside New Jersey rental property, under a program to help owners rehabilitate, rebuild, and elevate rental properties with up to 25 units, according to records of the Department of Housing and Urban Development Office of Inspector General (HUD OIG). Approximately $295,000 of the grant was disbursed. The son, using his father's personal identifying information, set up a bank account to receive the grant funds, before withdrawing cash and writing cashier's checks to himself, which ended up being cashed at check-cashing businesses.

No building, zoning, or construction permits were ever applied for, or issued, for the damaged property, according to the HUD OIG. A daughter described the father as unable to drive or be transported without a wheelchair or assistance, and that he was unaware of the use of his personal information in the scheme. Upon learning of his son's actions, the father sought to freeze accounts, but by then, most of the CDBG-DR funds had been spent. The son was also being investigated for other CDBG-DR fraud. Total CDBG-DR losses were approximately $445,000.

OUTCOME: The son pled guilty in state court to money laundering, theft by deception, and conspiracy to distribute a controlled substance, according to the OIG. The son was sentenced to 10 years in state prison and ordered to pay victim restitution of approximately $1.02 million.

Source: GAO. I GAO-21-177

CDBG Operates in a Risk Environment that Makes It Vulnerable to Fraud

CDBG-DR operates in a decentralized risk environment that also makes it vulnerable to fraud. The Fraud Risk Framework notes that the risk environment refers to contextual factors, either internal or external to a program, which influence fraud risk management activities.[25] As previously noted, CDBG-DR operates in an environment in which funds do not flow directly to the intended beneficiaries. Instead CDBG-DR funds can flow through a number of entities before reaching their intended beneficiaries and fulfilling intended outcomes—to rebuild the affected areas and provide crucial funding to start the disaster recovery process. Specifically, after the President makes a disaster declaration and Congress appropriates CDBG-DR funding, HUD then allocates funding to

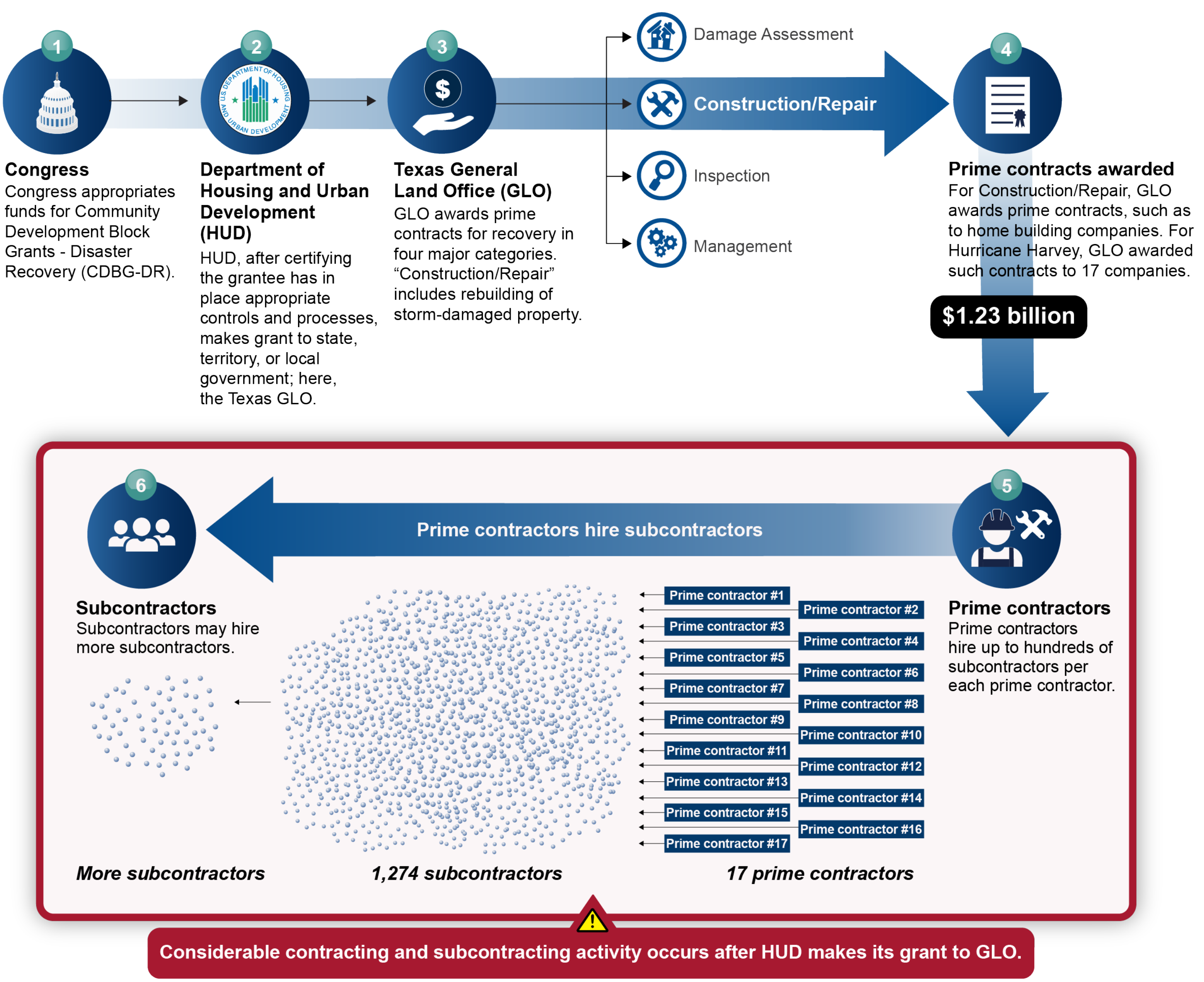
[25] GAO-15-593SP.

its grantees—states, territories, and local governments. After obtaining approval from HUD, grantees may then run their own disaster assistance programs or may disburse CDBG-DR funds to subrecipients, which run their own disaster recovery programs. Further, grantees and subrecipients often use CDBG-DR funds to hire contractors (also known as prime contractors) such as home building companies.[26] Prime contractors may then hire subcontractors to ultimately deliver recovery services to disaster victims. Figure 4 depicts the CDBG-DR grant process for a single grantee receiving CDBG-DR funding—in this case, the Texas General Land Office (GLO)—for a single disaster recovery activity it administers, among others. Considerable contracting and subcontracting activity occurs after HUD allocates CDBG-DR funds to the grantee, increasing opportunities for risk of fraud.[27]

[26]Prime contractors are also known as the general contractors in construction projects and are fully responsible for project delivery and assume the risk of meeting contract requirements. The prime contractor is responsible for managing its subcontractors.

[27]As previously noted, individuals and businesses impacted by a disaster do not receive CDBG-DR funds directly from HUD. Funds are awarded to states, territories, and local governments, which become grantees.

Figure 4: Example of Disaster Recovery Activity Following the HUD Grant



Source: GAO analysis of information provided by HUD, Texas GLO, and industry sources. | GAO-21-177

Notes: As described above, this chart depicts one form of CDBG-DR disaster assistance for one state/local agency. Other programs of this grantee, or other grantees or subrecipients, may operate differently. Of the 17 prime contractors identified in data we reviewed for this example, one subsequently had its contract terminated and another dropped out of the program.

This decentralized process of allocating CDBG-DR funds to grantees makes CDBG-DR vulnerable to fraud in a number of different ways. For example, we identified as a fraud risk misrepresenting areas that are impacted and distressed—when a grantee or a subrecipient claims an area was impacted by the disaster that was not impacted and thereby obtains funding for projects that would not have otherwise been eligible. By misrepresenting the basis of the request for disaster assistance or reimbursement, a grantee or subrecipient may receive and use CDBG-DR funds to repair roads and parking lots that were not impacted by a disaster, for instance.[28]

As CDBG-DR funds are distributed further down the grant chain to contractors and subcontractors, CDBG-DR also becomes vulnerable to fraud. As previously noted, contractors may fraudulently bill for disaster recovery work, including demolition, restoration, or construction, started but not yet completed. This may occur after taking a deposit and receiving CDBG-DR funds. In our analysis of fraud risks, we also identified billing fraud as a CDBG-DR fraud risk. Contractors may collude in contract and bid manipulation, another CDBG-DR fraud risk we identified.

HUD has controls in place to ensure that CDBG-DR funds are used as intended and to prevent fraud, waste, and abuse of those funds. Generally, under the appropriations law enacted by Congress that provides CDBG-DR funding, HUD is required to: (1) certify, as a condition of making a grant, that each grantee has in place proficient financial controls and procurement processes and has established adequate procedures to prevent any duplication of benefits; (2) ensure timely expenditure of CDBG-DR funds; (3) maintain comprehensive websites regarding all disaster recovery activities assisted with these funds; and (4) to detect and prevent waste, fraud, and abuse of funds. Further, prior to the obligation of CDBG-DR funds a grantee must submit a plan to HUD for approval detailing the proposed use of all funds, including criteria for

[28]According to HUD officials, HUD requires that 80 percent of a grantee's CDBG-DR funds be expended in HUD-identified most-impact and distressed (MID) areas. HUD identifies these MID areas based on SBA data and FEMA damage assessments. Grantees may also expend up to 20 percent of their CDBG-DR funds in grantee-identified MID areas. Grantee-identified MID areas must be in counties designated under a Presidentially-declared disaster and covered by the relevant appropriation. Grantees must describe grantee-identified MID areas in their Action Plan, which is subject to review by HUD and through the citizen participatory comment process. HUD then reviews the grantee-identified MID areas to confirm their eligibility for CDBG-DR assistance. For more information, see Appendix IV.

eligibility and how the use of these funds will address long-term recovery and restoration needs in the most impacted and distressed areas.[29]

In implementing these provisions, HUD requires each grantee to demonstrate it has adequate procedures to detect and prevent fraud, waste, and abuse, including demonstrating the grantee had an internal auditor that provides both programmatic and financial oversight of grantee activities, among others.[30] The internal auditor is expected to take an important role in detecting fraud, waste, and abuse within the grantee's CDBG-DR program, according to HUD officials. While HUD has controls designed to ensure grantees use CDBG-DR funds as intended and prevent fraud, waste, and abuse, the risk environment in which CDBG-DR operates still provides fraudsters opportunities to engage in fraudulent activities and makes CDBG-DR vulnerable to fraud.

CDBG-DR's Risk Environment May Contribute to Financial and Nonfinancial Impacts

The risk environment in which CDBG-DR operates may contribute to financial and nonfinancial impacts. As part of its improper payment reporting website—paymentaccuracy.gov—OMB reported $3.4 million in confirmed fraud for CDBG-DR in fiscal year 2020.[31] Further, our prior reports and those of the HUD OIG have identified financial impacts such as improper payments as an ongoing challenge for HUD and CDBG-DR grantees. For example, in May 2017, we reported improper payment estimates by agency and program/activity for fiscal year 2015 based on OMB data.[32] Estimated improper payments from CDBG-DR in fiscal year 2015 were approximately $18.8 million. Improper payments could suggest that a program may also be vulnerable to fraud, although it is important to note that fraud is one specific type of improper payment, and that improper payment estimates are not intended to measure fraud in a

[29]See, for example, the Supplemental Appropriations for Disaster Relief Requirements Act, 2017, Pub. L. No. 115-56, Division B, 131 Stat. 1129, 1137 (2017).

[30]See, for example, 83 Fed. Reg. 5844, 5848 (Feb. 9, 2018).

[31]Paymentaccuracy.gov is a website established to create a centralized location to publish information about improper payments made to individuals, organizations, and contractors. According to OMB, confirmed fraud estimates represent only those fraud cases that have been confirmed by a court and do not represent anything settled out of court with or without admission of guilt.

[32]GAO, *Improper Payments: Additional Guidance Could Provide More Consistent Compliance Determinations and Reporting by Inspectors General,* GAO-17-484 (Washington, D.C.: May 31, 2017).

particular program.[33] Further, in a July 2016 report on CDBG-DR assistance, the Congressional Research Service noted that the availability and timing of disaster assistance from different sources can result in grantees providing duplicative assistance.[34]

In our analysis of CDBG-DR, we identified certain risk factors that could result in financial impacts, such as improper payments, as referenced in the Fraud Risk Framework:[35]

- *New program requirements or procedures each time a disaster occurs*—New program requirements or changes in procedures, which underpin CDBG-DR, could result in negative financial impacts in CDBG-DR. When Congress appropriates CDBG-DR funds, it grants HUD broad authority to customize grant requirements, including the authority to waive certain traditional CDBG requirements and to establish alternative requirements for each individual disaster, essentially creating new CDBG-DR programs.[36] However, the ad hoc nature of CDBG-DR has created challenges for CDBG-DR grantees, such as lags in accessing funding and adhering to varying requirements.

  In a July 2018 report, the HUD OIG found that as of September 2017, HUD used 61 notices to establish requirements for 112 active CDBG-DR grants. At that time, officials from one of the 2017 grantees told us

[33]An improper payment is defined as any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements. For the purpose of producing an improper payment estimate, when the executive agency cannot determine, due to lacking or insufficient documentation, whether a payment is proper or not, the payment shall be treated as an improper payment. In particular, improper payments can be attributed to financial fraud or financial fraud risks that include instances in which beneficiaries intentionally provide misinformation to obtain illegal payments for ineligible recipients; ineligible goods or services; or for goods or services not received. While improper payments may be caused by unintentional error, fraud involves obtaining something of value through willful misrepresentation. Whether an act is fraudulent is determined through the judicial or other adjudicative system. In this report, we use the term "fraud risk" to include existing circumstances that provide an opportunity to commit fraud.

[34]Congressional Research Service, *SBA and CDBG-DR Duplication of Benefits in the Administration of Disaster Assistance: Background, Policy Issues, and Options for Congress*, R44553 (Washington, D.C.: July 1, 2016).

[35]GAO-15-593SP, Appendix IV: Risk Factors for Assessing Improper-Payment Risk.

[36]CDBG-DR appropriations require HUD to customize grant requirements for each disaster in *Federal Register* notices.

that it was challenging to manage the multiple CDBG-DR grants it has received over the years because of the inconsistent rules. According to HUD OIG officials, examples of inconsistent requirements include definition of primary residence and duplication-of-benefits issues.[37]

HUD officials also told us that CDBG-DR requirements have become increasingly complex and the agency remains concerned about grantees' capacity to implement significant disaster recovery programs. HUD OIG officials also noted that grantees may not understand rules and regulations and that such uncertainty may contribute to fraud risks. Moreover, the inconsistent regulatory environment of CDBG-DR may increase the risk of improper payments, as noted in the Fraud Risk Framework. In our March 2019 report, we recommended that Congress consider legislation establishing permanent statutory authority for a disaster assistance program administered by HUD or another agency that responds to unmet needs and directing the applicable agency to issue implementing regulations.[38]

- *Payments or payment-eligibility decisions are made outside the agency*—As previously noted, the decentralized risk environment in which CDBG-DR operates may contribute to negative financial impacts. Once Congress appropriates CDBG-DR funding, HUD then allocates funding to approved grantees—states, territories, and localities—which then submit a plan to HUD detailing the proposed use of the funds. Once approved, grantees use funds to hire contractors and subcontractors to deliver disaster recovery services. While the block grant nature of CDBG-DR is designed to provide federal funds to states, territories, and localities and is viewed as a flexible solution to disburse federal funds to address unmet needs in disasters, the final expenditure of funds is made by grantees and subrecipients, which may contribute to negative financial impacts, such as improper payments.
- *Volume of payments made annually*—The amount of CDBG-DR funds that grantees, contractors, and subcontractors receive can contribute to negative financial impacts. As previously noted, HUD has allocated

[37]According to HUD officials, HUD has taken action to address these inconsistent program requirements. In the case of primary residence, HUD officials noted the issue of concern does not involve definition of primary residence but involves prohibiting assistance for second homes. In its February 2018 *Federal Register* notice, HUD established a second home definition that has been in place for all subsequent grants.

[38]GAO-19-232. A bill introduced and passed by the House of Representatives in the 116th Congress, H.R. 3702, would have permanently authorized the CDBG-DR program, but it was not enacted and would have to be introduced again in the 117th Congress.

CDBG-DR grants totaling $57.6 billion from 2011 to 2019 in response to a number of presidentially-declared disasters including Hurricanes Harvey, Irma, and Maria (2017), Hurricane Matthew (2015), and Hurricane Sandy (2012), among other disasters, according to HUD data. Puerto Rico alone was allocated $20.2 billion in CDBG-DR funds in this same period. By comparison, HUD data show that HUD allocated approximately $9.6 billion in traditional CDBG grants in fiscal years 2017 to 2019, while it allocated $39.5 billion in CDBG-DR grants in that same period.

- *Complexity of the program*—While the overall purpose of CDBG-DR is stated in each appropriations—usually to provide funds for disaster relief, long-term recovery, restoration of infrastructure and housing, and economic revitalization—implementation is complex because CDBG-DR grants are designed and tailored to serve local needs and can result in negative financial impacts. For hurricane recovery, for example, rebuilding damaged homes has been a major goal across state, territorial, and local entities receiving CDBG-DR funds. However, grantees have established a variety of specific housing programs using different methods aimed at reaching that goal including: reimbursement of homeowner-paid repair expenses; assistance in buying a home; legal services to provide title clearance assistance to homeowners; and assistance for landlords.

  To the extent CDBG-DR is tailored to meet local needs, the complexity of the CDBG-DR funded activities could result in financial impacts such as duplication of benefits. In our analysis of fraud risks, we identified duplication of benefits—when disaster victims applying for aid fail to disclose benefits received from other public or private sources or submit multiple claims to circumvent program funding limits—which could result in providing additional CDBG-DR funds to individuals who are not otherwise entitled. This could include disaster victims who apply for CDBG-DR grants, but fail to disclose or understate insurance benefits or fail to report an insurance settlement received after applying for disaster assistance.

- *Levels of experience of CDBG-DR administrators or lack of training*—The levels of experience among grantees and lack of training could also contribute to financial impacts such as improper payments. Grantees' experience levels to manage disaster recovery work in their local environments can vary. Some grantees may have more experience with CDBG-DR than others. For example, local or state government agencies in areas like the U.S. Gulf Coast may frequently receive large amounts of CDBG-DR assistance and have more experience managing CDBG-DR large-scale initiatives, while officials in other locales may have less experience and on a smaller scale. Grantees and staff who administer CDBG-DR grants may lack training, which could lead to financial impacts such as improper payments. For example, in an August 2017 report on the State of New Jersey, the HUD OIG found that the state disbursed $1.7 million of the nearly $16.4 million Hurricane Sandy CDBG-DR funds to homebuyers who did not meet all of the program eligibility requirements.[39] The HUD OIG report cited that the state lacked procedures and its staff lacked training to ensure that homebuyers complied with income eligibility and property ownership requirements.

In addition to the financial impacts described above, we identified several nonfinancial impacts resulting from CDBG-DR's risk environment. Nonfinancial impacts of fraud may not pose a direct financial cost to CDBG-DR, such as improper payments, but they lead to other potentially harmful outcomes. For example, fraud can impact government outcomes, program reputation, and the broader contractor industry. The International Public Sector Fraud Forum, an organization of countries that shares leading practices in fraud management, has identified nonfinancial impacts of fraud that are pertinent to CDBG-DR fraud risks, including:[40]

- *Government outcomes impacts*—Fraud compromises the government's ability to deliver services and achieve intended outcomes. For example, we identified embezzlement—misappropriation of cash or assets entrusted to disaster recovery program administrators and employees—as a fraud risk. A disaster recovery program employee may fraudulently obtain power of attorney to embezzle approved CDBG-DR funds. We also identified as a fraud risk the misrepresentation of impacted and distressed areas—when a grantee or a subrecipient claims an area was impacted by the disaster that was not impacted, and thereby obtains funding for projects that would not have otherwise been eligible. By misrepresenting the basis of the request for disaster assistance or reimbursement, the state,

[39]HUD OIG, *The State of New Jersey Did Not Always Disburse Disaster Funds for Its Sandy Homebuyer Assistance Program To Assist Eligible Home Buyers*, 2017-PH-1005 (Philadelphia, PA: Aug. 14, 2017). The HUD OIG recommended that HUD direct New Jersey to repay HUD from non-federal funds for nearly $1 million disbursed to 21 ineligible homebuyers. As of March 5, 2019, this recommendation remained open.

[40]International Public Sector Fraud Forum, *Guide to Understanding the Total Impact of Fraud*, February 2020. The International Public Sector Fraud Forum consists of representatives from organizations in the governments of Australia, Canada, New Zealand, the United Kingdom, and the United States. The collective aim of the forum is to come together to share best and leading practices in fraud management and control across public borders.

territory, or local government may receive and use CDBG-DR funds to repair roads and parking lots that were not impacted by a disaster. In both examples, fraud may compromise the government's ability to deliver services and achieve intended outcomes.

- *Reputational impact*—Fraud against government programs can result in an erosion of trust in government entities. For example, impersonation or when individuals falsely represent themselves as associated with a disaster recovery program such as CDBG-DR, or to be a government employee or federal law enforcement official may have a reputational impact on CDBG-DR. Florida OIG officials stated that in one complaint, an applicant reported a concern with a contractor who had approached him and said he was part of "Rebuild Florida," a program of the Florida Department of Economic Opportunity (DEO) created to help Florida's long-term recovery efforts from recent hurricanes. The contractor then attempted to pressure the individual into a contract to make repairs. The case was referred to the attorney general as a fraudulent contractor. Representatives from Florida DEO's prime contractor also noted instances of individuals falsely representing themselves by going door-to-door and stating they were affiliated with a disaster recovery program in order to gather PII or other sensitive information, such as Social Security numbers or bank account information. This behavior may affect grantees' reputations by creating doubt about the CDBG-DR and disaster recovery programs administered by the state or locality.
- *Industry impact*—Fraud can result in distorted markets where fraudulent contractors obtain a competitive advantage and drive other businesses out. Officials from HUD, HUD OIG, City of Houston, and Harris County noted bid rigging as a fraud risk where contractors collude and agree among themselves on bid prices, undermining competitive bidding and increasing costs. In our analysis of fraud risks, we also identified misrepresentation of qualifications or eligibility as a CDBG-DR fraud risk. According to HUD OIG, some contractors may falsely certify themselves or obtain legitimate certifications through invalid means. Contractors certified as a small business or a disabled, minority, women, or service-disabled, and veteran-owned businesses are often given preferential treatment related to contract awards. We also identified collusion in contract and bid manipulation as a CDBG-DR fraud risk. For example, a grantee may hire a contractor for consultation or to write a disaster aid action plan; however, the action plan incorporates items favorable to the contractor, who subsequently wins the contract. For each of these fraud risks, contracts awarded to such contractors unfairly may result in fewer contracts available for legitimate small businesses, and these

small businesses then have fewer opportunities to participate in CDBG-DR.

- *Human impact*—While the direct financial impacts are often borne by public entities, behind every story of fraud are the individuals, families, and communities whose lives have been adversely affected. For example, these human impacts can occur through the provision of substandard disaster recovery services—including delays or poor materials used—or unfinished home reconstruction following a disaster. As we previously noted, according to HUD OIG documents, two New Jersey construction contractors failed to make repairs and elevate homes of 23 disaster victims following Hurricane Sandy in October 2012, diverting funds for other purposes and performing little to no work, ultimately leaving these homeowners at increased risk of future disaster damage.

HUD Has Taken Steps to Assess Fraud Risks Agency-wide, But Has Not Comprehensively Assessed CDBG-DR Specific Fraud Risks

HUD Has Taken Some Steps to Assess Fraud Risks Agency-wide

HUD has taken some steps to assess risks, including fraud risks, across the agency.

- *Front-End Risk Assessment*—HUD conducts an agency-wide assessment of risk through a Front-End Risk Assessment (FERA), which also includes a consideration of fraud risks. According to HUD, FERA is a formal, documented review by HUD management to determine the susceptibility of a new or substantially revised program or administration function to waste, fraud, abuse, and mismanagement. Its purpose is to detect conditions that may adversely affect the achievement of program objectives and to provide reasonable assurance that the following goals will be met: safeguarding of assets; effectiveness and efficiency of operations; reliability of financial reporting; and compliance with applicable laws and regulations. HUD program offices use FERA to define the program environment; identify control risks; describe major controls or systems needing additional controls; and document actions needed to reduce these risks to a tolerable or acceptable level.[41] HUD conducted a FERA—under previous assessment requirements—for CDBG-DR in November 2018, which is now outdated. HUD officials told us they plan to complete a FERA update as soon as possible as they are currently managing risks associated with the Coronavirus Disease 2019 pandemic.

HUD's FERA also includes a consideration of fraud and improper payment risks agency-wide. Specifically, the tool uses 20 risk indicators or categories to assess agency-wide risk, which cover internal controls and other areas such as cost-reasonableness and procurement.[42] While FERA does not focus on fraud exclusively—as there is no fraud risk category—HUD indicates which categories may contribute to fraud and improper payments risks. Specifically, the tool designates 13 of the 20 risk categories as ones that could contribute to fraud and improper payment risks, which means that even though FERA does not focus on fraud exclusively with its own risk category, fraud is a consideration of the assessment. A FERA must be conducted if the program meets any of the following criteria: (1) a new program, that once fully implemented, has annual funding greater than or equal to the FERA materiality threshold calculated by the HUD Office of the Chief Financial Officer; (2) a substantially revised program, which is defined as having an increase or decrease in annual funding greater than or equal to the materiality threshold and at least a 5 percent change in the affected budget line item; (3) a new or existing program that doesn't meet either of the above criteria and is deemed to pose a significant risk for fraud, waste, abuse, or mismanagement by the Chief Risk Officer; and (4) a new or existing program that does not meet either of the first two criteria and is determined to exhibit an enterprise-wise or cross-program impact by the Chief Risk Officer.

[41]According to HUD officials, risk-scoring is at the center of the process. Scores ranging from 1-5 are compiled in each of areas of risk based on a number of questions.

[42]The 20 risk indicators of the front-end risk assessment are: Nature of Program Function; Organizational Structure; Goals and Objectives; Internal Controls; Funding; Time and Schedule; Audit Findings; Impact of Errors; Technology; Labor; Training; Political Visibility and External Stakeholder Involvement; Political Visibility and Internal Stakeholder Involvement; Stakeholder Dependencies; Regulatory Involvement; Legislative Risk; Site Characteristics; Project Implementation Health and Safety; Magnitude and Complexity Contamination; and Extraordinary Events and Transactions.

- *Risk appetite statement*—HUD assesses agency-wide risks by issuing "risk appetite statements," which broadly assess the amount and type of risk the agency is willing to accept in seeking to achieve its mission to create "strong, sustainable, inclusive communities and quality affordable homes for all."[43] While not exclusively fraud-focused, the risk appetite statement creates three categories to guide the agency's approach to risk. In particular, for the purposes of designing and implementing policies to advance economic opportunities through HUD programs, the risk appetite statement calls for a "high-risk appetite" which means that HUD has a "preference to disciplined risk-taking" when it determines potential benefits outweigh potential costs.[44] In addition to high-risk appetite, the statement also creates categories for medium-risk appetite (areas in which HUD must constantly strike a balance between the potential upside benefits and potential downside costs of a given decision) and low-risk appetite (areas in which HUD avoids risk, or acts to minimize, or eliminate the likelihood that risk will occur, because the department has determined that the potential downside costs are intolerable). According to HUD officials, this agency-level risk appetite statement is intended to be an umbrella approach that covers HUD program-level statements. HUD officials noted that the agency is developing a risk appetite statement for CDBG-DR, but did not provide timelines.
- *Fraud risk assessment*—HUD has taken steps to assess agency-wide fraud risks more exclusively. In addition to the agency-wide FERA, in 2020, HUD redesigned its agency-level approach to evaluate fraud risks across the agency. HUD's Fraud Risk Management Maturity Model, known as FRM3—which includes fraud risk assessment activities—is consistent with the overall approach of GAO's Fraud Risk Framework. For example, the new approach adopts the same four major elements of the Fraud Risk Framework—commit, assess,

[43]*Risk tolerance* and *risk appetite* are both concepts in risk management that describe the amount and type of risk an organization is willing to accept in pursuit of its objectives. GAO's Fraud Risk Framework focuses on fraud risk tolerance, and managers of federal programs will generally have a low risk appetite for fraud, regardless of the circumstances. For this reason, the Fraud Risk Framework does not address the concept of risk appetite in its discussion of risk tolerance. Relatedly, the Committee of Sponsoring Organizations of the Treadway Commission describes the related concepts this way: "Risk tolerance relates to risk appetite but differs in one fundamental way: risk tolerance represents the application of risk appetite to specific objectives. … While risk appetite is broad, risk tolerance is tactical and operational." See Committee of Sponsoring Organizations of the Treadway Commission, *Enterprise Risk Management—Understanding and Communicating Risk Appetite* (January 2012).

[44]HUD, *Risk Appetite Statement*, version 1.0, Dec. 19, 2019.

design and implement, and evaluate and adapt—as described earlier.[45] HUD plans to institute this agency-wide, risk-based approach to evaluate risks for fraud, waste, and abuse, and to prioritize control activities in response to identified risks.[46] In October 2020, HUD officials told us that the agency completed a pilot fraud risk assessment consistent with the Fraud Risk Framework for a HUD office other than CDBG-DR in June 2020.[47] According to the officials, HUD plans to adapt the pilot process for use across the agency.

HUD Has Not Conducted a Comprehensive Fraud Risk Assessment for CDBG-DR

The second component of the Fraud Risk Framework—assess—calls for federal managers to plan regular fraud risk assessments and to assess risks to determine a fraud risk profile. A fraud risk profile is an essential piece of an overall antifraud strategy that informs the design and implementation of specific fraud control activities.

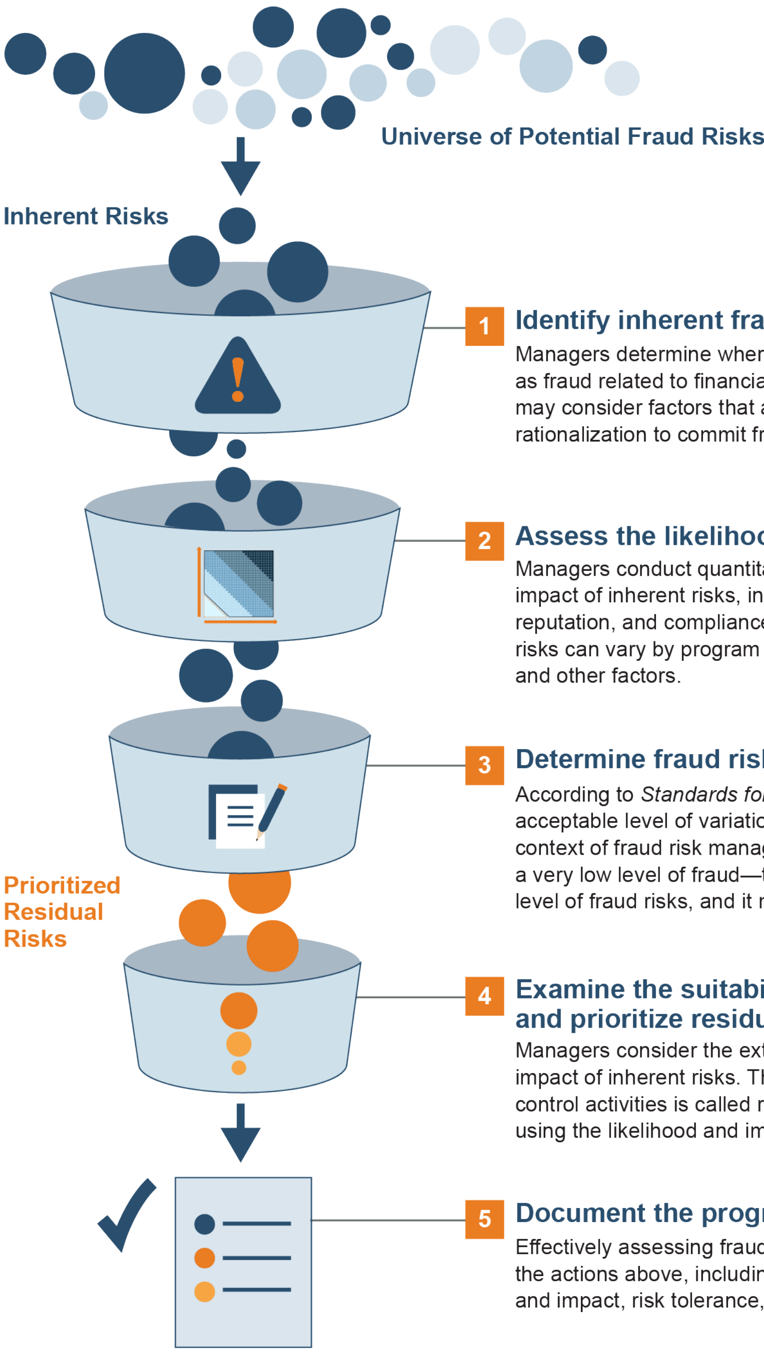
The Fraud Risk Framework also identifies leading practices for conducting a fraud risk assessment to determine a fraud risk profile. Fraud risk assessments that align with the Fraud Risk Framework involve (1) identifying inherent fraud risks affecting the program, (2) assessing the likelihood and impact of those fraud risks, (3) determining fraud risk tolerance, (4) examining the suitability of existing fraud controls and prioritizing residual fraud risks, and (5) documenting the results, as illustrated in figure 5.

[45]In particular, HUD officials told us the agency's approach aligns with GAO's Fraud Risk Framework, GAO's Green Book, OMB's *Circular No. A-123*, and the Payment Integrity Information Act of 2019.

[46]However, HUD officials noted that this agency-wide, risk-based approach to evaluate fraud, waste, and abuse does not identify proven cases of fraud.

[47]The pilot fraud risk assessment was not for CDBG-DR, as will be discussed later in this report.

Figure 5: Key Elements of the Fraud Risk Assessment Process



1 Identify inherent fraud risks affecting the program

Managers determine where fraud can occur and the types of fraud the program faces, such as fraud related to financial reporting, misappropriation of assets, or corruption. Managers may consider factors that are specific to fraud risks, including incentives, opportunity, and rationalization to commit fraud.

2 Assess the likelihood and impact of inherent fraud risks

Managers conduct quantitative or qualitative assessments, or both, of the likelihood and impact of inherent risks, including the impact of fraud risks on the program's finances, reputation, and compliance. The specific methodology managers use to assess fraud risks can vary by program because of differences in missions, activities, capacity, and other factors.

3 Determine fraud risk tolerance

According to *Standards for Internal Control in the Federal Government*, risk tolerance is the acceptable level of variation in performance relative to the achievement of objectives. In the context of fraud risk management, if the objective is to mitigate fraud risks—in general, to have a very low level of fraud—the risk tolerance reflects managers' willingness to accept a higher level of fraud risks, and it may vary depending on the circumstances of the program.

4 Examine the suitability of existing fraud controls and prioritize residual fraud risks

Managers consider the extent to which existing control activities mitigate the likelihood and impact of inherent risks. The risk that remains after inherent risks have been mitigated by existing control activities is called residual risk. Managers then rank residual fraud risks in order of priority, using the likelihood and impact analysis, as well as risk tolerance, to inform prioritization.

5 Document the program's fraud risk profile

Effectively assessing fraud risks involves documenting the key findings and conclusions from the actions above, including the analysis of the types of fraud risks, their perceived likelihood and impact, risk tolerance, and the prioritization of risks.

Source: GAO. | GAO-21-177

While HUD has taken some steps to assess fraud risks agency-wide, as previously noted, it has not conducted a comprehensive fraud risk assessment of CDBG-DR, as called for in the Fraud Risk Framework. HUD officials we spoke to acknowledged that the agency has yet to assess CDBG-DR fraud risks and has not developed a fraud risk profile for the program. Further, HUD's current fraud risk approach is not tailored specifically for CDBG-DR and does not involve relevant stakeholders. Leading practices in the Fraud Risk Framework include tailoring the fraud risk assessment to the program and involving relevant stakeholders responsible for the design and implementation of the program's fraud controls in the assessment process.[48] This could include a variety of internal and external stakeholders such as general counsel, contractors, or other external entities with knowledge about emerging fraud risks or responsibilities for specific control activities. In addition, HUD's current fraud risk approach does not consider sources, such as grantees, that could provide information about fraud risks, including data on fraud schemes and trends from monitoring and detection activities.[49] In some programs, for example, it may be possible to conduct focus groups or engage relevant stakeholders in one-on-one interviews to identify fraud risks affecting the program, as noted in the Fraud Risk Framework.

According to HUD officials, the agency's current practice for fraud risk management is to first create a top-level, agency standard, and then apply it to individual units of the agency, such as the Office of Community Planning and Development, which is the office responsible for CDBG-DR. HUD officials also told us that due to the block grant nature of the CDBG program, HUD does not consider fraud risks in programs managed by grantees to be direct risks to HUD itself. Instead, they are fraud risks to the grantees as the "recipients" of CDBG-DR funding. However, the Green Book notes that managers should design an internal control system to provide reasonable assurance regarding prevention or prompt detection and correction of unauthorized acquisition, use, or disposition of an entity's assets and to serve as a first line of defense in safeguarding assets.[50] Further, HUD's current practice of assessing fraud risks does not involve the relevant stakeholders—such as the grantees that are responsible for the design and implementation of the fraud controls—in

[48] GAO-15-593SP.

[49] HUD officials told us that in some cases, HUD asks grantees to provide pre-grant information as part of its financial certifications to identify criteria for subrecipient fraud.

[50] GAO-14-704G.

the assessment process that could provide knowledge about emerging fraud risks, as noted in the Fraud Risk Framework.

During our review, we asked HUD officials when they plan to perform a fraud risk assessment focused specifically on CDBG-DR. HUD officials told us that HUD's Office of Community Planning and Development, which administers the traditional CDBG program and CDBG-DR funds, would decide when and whether such a fraud risk assessment will be conducted. During our review, HUD officials noted that work on a CDBG-DR-specific fraud risk assessment with the corresponding fraud risk profile and fraud risk tolerance had been in progress, but was delayed due to the Coronavirus Disease 2019 pandemic.

While the agency has not conducted a comprehensive fraud risk assessment of CDBG-DR, HUD conducts an annual risk analysis of each grantee, which is used to guide annual monitoring of CDBG-DR grantees.[51] In our March 2019 report, we reported this process is undertaken during the first quarter of each fiscal year.[52] HUD guidance states that the purpose of this analysis is to provide the information needed for HUD to effectively target its resources to grantees that pose the greatest risk to the integrity of CDBG-DR, including identification of the program areas to be covered and the depth of the review. As part of its risk analysis of grantees, HUD also assesses which grantees may require onsite or remote monitoring. However, in the March 2019 report, we found that the risk analysis is of limited usefulness for new CDBG-DR grants, because the risk analyses do not formally incorporate information HUD gleaned from its reviews of grantees' financial processes and capacity assessments.[53] For example, the risk analysis worksheet does not include questions about the extent to which HUD's review of a grantee's procurement processes and procedures raised any concerns.

[51]See, for example, 83 Fed. Reg. 5844, 5846 (Feb. 9, 2018).

[52]GAO-19-232.

[53]GAO-19-232. In March 2019, we recommended that HUD require staff to document the basis for their conclusions during reviews of grantees' financial controls, procurement processes, and grant management procedures and capacity and unmet needs assessments. In response to this recommendation, HUD acknowledged the need for this documentation and stated that it would require staff to better document their analysis. Specifically, HUD revised the checklists used for the disasters in 2018 and 2019 to require grant managers to indicate the basis for their conclusions used to review financial controls, procurement processes, grant management procedures, and capacity and unmet needs assessments. HUD also noted that it plans to continue to use the checklists that track HUD staff feedback on reviews and provided an example of the checklists used for a subsequent disaster.

Further, HUD's annual risk analysis of grantees does not include questions about the extent to which HUD's review of a grantee's procedures to detect and prevent fraud, waste, and abuse raises any concerns.

In addition to HUD's annual risk analysis, HUD must certify, in advance of signing a grant agreement, that the grantee has procedures in place to detect fraud, waste, and abuse of funds before receiving a CDBG-DR allocation, including: procedures indicating how the grantee will verify information provided by applicants; a monitoring policy; and procedures requiring the grantee and subrecipients to attend any fraud-related training provided by the HUD OIG. Each grantee is also required to conduct a risk assessment of its subrecipients, plus conduct monitoring reviews of subrecipients the grantee determines to be high-risk. HUD officials told us staff from HUD's Departmental Enforcement Center are also involved in reviewing grantee certification of procedures to prevent and detect fraud. For highest-risk grantees, the Departmental Enforcement Center reviews requests for payment of grant funds to grantees for program work performed. In addition to HUD's grantee certification procedures and the Department Enforcement Center's review of grantee certification procedures noted above, we identified examples of controls all of which may be pertinent as CDBG-DR examines the suitability of its existing fraud controls given the fraud risks we previously identified. The examples of controls that may be pertinent to CDBG-DR are discussed in appendix III.

As noted in the Fraud Risk Framework, by comprehensively assessing fraud risks—by identifying and assessing the likelihood and impact of inherent fraud risks that affect the program; determining fraud risk tolerance; examining the suitability of existing fraud controls; and documenting the fraud risk profile—HUD would have a greater assurance as to whether current control activities are efficiently and effectively addressing CDBG-DR fraud risks within an established tolerable level. By involving relevant stakeholders—such as grantees that administer CDBG-DR funds—HUD would also ascertain whether additional fraud controls or adjustments are needed to help mitigate the disbursement of potentially fraudulent CDBG-DR funding.

Conclusions

CDBG-DR provides valuable assistance to people and communities that have suffered catastrophic damage from natural disasters. The sums involved in CDBG-DR assistance are considerable—$39.5 billion in CDBG-DR funds in response to natural disasters from 2017 through

2019. However, as our review identified, CDBG-DR is inherently vulnerable to fraud. Further, CDBG-DR operates in an environment in which funds flow from HUD in Washington; to grantees across the country awarded CDBG-DR grants; to subrecipients who receive a portion of those grants; and to commercial contractors and their subcontractors, which increasingly are the vehicle by which disaster assistance actually reaches disaster victims.

HUD is responsible for assessing fraud risks and implementing antifraud controls tailored to CDBG-DR and involving relevant stakeholders, such as grantees. While HUD has taken some steps to assess fraud risks agency-wide, the agency has not yet performed a fraud risk assessment specifically tailored for CDBG-DR, which sets the stage for design of program-specific antifraud controls. Further, HUD's current practice of assessing fraud risks does not involve the relevant stakeholders in the assessment process, which are grantees that ultimately design and implement fraud controls, or solicit information from grantees to identify fraud risks. Understanding the wide-ranging fraud risks CDBG-DR faces could help HUD and its grantees better identify and assess ways to prevent fraud, waste, and abuse. Such prevention is preferable to the alternative of experiencing fraud and seeking to reclaim financial losses given the scope and size of CDBG-DR. In this review, we have provided a compilation of CDBG-DR fraud risks, which should assist HUD as it undertakes its planned fraud risk assessment, as well as provide guidance to CDBG-DR grantees and others, as they implement disaster assistance programs and weigh fraud risks of their activities, in today's environment of expanding natural disasters.

Recommendations for Executive Action

We are making two recommendations to HUD:

The Assistant Secretary for Community Planning and Development should comprehensively assess fraud risks to CDBG-DR, including identifying inherent fraud risks affecting it, assessing the likelihood and impact of inherent fraud risks, determining fraud risk tolerance, and examining the suitability of existing fraud controls. The assessment should also consider CDBG-DR's risk environment and be informed by the fraud risks identified in this report. (Recommendation 1)

In comprehensively assessing fraud risks to CDBG-DR, the Assistant Secretary for Community Planning and Development should involve relevant stakeholders in the assessment process, including CDBG-DR grantees (states, territories, and local governments) that design and implement fraud controls. (Recommendation 2)

Agency Comments and Our Evaluation

We provided a draft of this report to HUD for comment. In written comments, which are summarized below and reproduced in appendix IV, HUD neither agreed nor disagreed with our two recommendations.

HUD did not specify whether it agreed or disagreed with the report's first recommendation to develop a comprehensive fraud risk assessment for CDBG-DR, including identifying fraud risks, assessing the likelihood and impact of those risks, determining risk tolerance, and examining the suitability of existing controls. HUD stated that its overall approach to managing fraud and fraud risk in CDBG-DR is to focus on oversight, relationship management, and building capacity. HUD noted several measures as part of its effort to mitigate fraud risk to CDBG-DR, including: (1) performing Front-End Risk Assessments to determine the susceptibility of a new or revised policy to fraud, waste, and abuse; (2) risk maturity modeling to identify key indicators and activities that facilitate a risk management program; (3) internal control plans for addressing improper payments, including fraud, in accordance with OMB guidance; (4) visits by senior HUD management and program staff to grantee offices to maintain a working relationship; and (5) coordinating investigative efforts at multiple levels. While HUD stated that these measures mitigate fraud risk in CDBG-DR, the agency acknowledged the current absence of a comprehensive risk assessment.

In the report, we acknowledged and discussed in detail each of the above steps that HUD has taken to assess risks, including fraud risks, across the agency. We also noted that HUD officials told us that the agency has yet to assess CDBG-DR fraud risks specifically, which HUD confirmed in its written comments. Further, we found that HUD's current fraud risk approach is not tailored specifically for CDBG-DR, which as we noted in the report, is one of the leading practices described in the Fraud Risk Framework. In light of these ongoing issues, we continue to believe that our first recommendation is warranted.

Similarly, HUD neither agreed nor disagreed with our second recommendation to include relevant stakeholders in the fraud risk assessment process, including CDBG-DR grantees (states, territories, and local governments) that design and implement those controls. HUD stated that current departmental risk programs that assess enterprise and fraud risks do not include activities at the grantee level, and that the agency views fraud risks in programs managed by grantees as fraud risk to the grantee. HUD went on to note several requirements aimed at protecting HUD's assets and enhancing grantee capacity to detect and prevent fraud, including: (1) introducing a pre-award risk assessment tool to identify and address fraud risks; (2) requiring grantees to provide their policies and procedures for preventing fraud, waste, and abuse as part of the financial management and grant compliance certification process; (3) publishing *Federal Register* notices requiring grantees to hire an internal auditor with specific responsibility for detecting and preventing fraud; (4) starting in 2017, requiring grantees and subrecipients to attend fraud-related training provided by HUD OIG; and (5) annual monitoring of grantee activities to ensure compliance with CDBG-DR policies and regulations.

While HUD has controls designed to ensure grantees use CDBG-DR funds as intended and prevent fraud, waste, and abuse, the risk environment in which CDBG-DR operates still provides fraudsters opportunities to engage in fraudulent activities, which make CDBG-DR vulnerable to fraud. During our review, HUD officials told us that the agency does not consider fraud risks in programs managed by grantees to be direct risks to HUD itself. However, the Green Book requires that managers design an internal control system to provide reasonable assurance regarding prevention or prompt detection and correction of unauthorized acquisition, use, or disposition of an entity's assets and to serve as a first line of defense safeguarding assets.[54] As we note in the report, that assurance may be partly achieved by involving relevant stakeholders responsible for the design and implementation of the program's fraud controls as part of the assessment process—a leading practice in the Fraud Risk Framework. Relevant stakeholders may include general counsel, contractors, grantees, or other entities knowledgeable about emerging fraud risks across different spheres of responsibility for CDBG-DR implementation. Accordingly, we continue to believe that our second recommendation is warranted.

In our report, we identified intentionally misrepresenting areas that are impacted by a disaster in order to secure approval for funding as a fraud risk. For example, a grantee or subrecipient may intentionally misrepresent that roads were impacted by the disaster in order to secure the approval of funding for unrelated infrastructure repairs. HUD stated that misrepresentation of most-impacted and distressed (MID) area designations by the grantee or subrecipients is not a fraud risk. HUD then lists its requirements for identifying and allocating CDBG-DR grant funds to MID areas. As demonstrated by two examples in the report, misrepresentation of MID areas in order to secure approval for funding is a fraud risk that we identified from our review of closed fraud allegations provided by HUD OIG. Furthermore, although misrepresentation of MID

[54]GAO-14-704G

areas may not always result in fraud, it remains an inherent risk to federal block grant programs that should be considered as part of HUD’s comprehensive fraud risk assessment. However, we revised the report to include the additional information regarding HUD’s requirements for identifying and allocating CDBG-DR grant funds to MID areas.

HUD also provided technical comments, which we incorporated as appropriate.

We are sending copies of this report to the appropriate congressional committees, the Secretary of Housing and Urban Development, and other interested parties. In addition, the report is available at no charge on the GAO website at http://www.gao.gov.

If you or your staff have any questions about this report, please contact me at (202) 512-6722 or shear@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix V.

Rebecca Shea
Director, Forensic Audits and Investigative Service

List of Requesters

The Honorable Gary C. Peters
Chairman
The Honorable Rob Portman
Ranking Member
Committee on Homeland Security and Governmental Affairs
United States Senate

The Honorable Ron Johnson
Ranking Member
Permanent Subcommittee on Investigations
Committee on Homeland Security and Governmental Affairs
United States Senate

The Honorable Rand Paul, M.D.
Ranking Member
Subcommittee on Emerging Threats and Spending Oversight
Committee on Homeland Security and Governmental Affairs
United States Senate

The Honorable Maxine Waters
Chairwoman
Committee on Financial Services
House of Representatives

The Honorable Bennie Thompson
Chairman
Committee on Homeland Security
House of Representatives

The Honorable Carolyn B. Maloney
Chairwoman
The Honorable James Comer
Ranking Member
Committee on Oversight and Reform
House of Representatives

The Honorable Nydia Velázquez
Chairwoman
Committee on Small Business
House of Representatives

List of Requesters Continued

The Honorable Peter DeFazio
Chairman
The Honorable Sam Graves
Ranking Member
Committee on Transportation and Infrastructure
House of Representatives

The Honorable Emanuel Cleaver, II
Chair
Subcommittee on Housing, Community Development, and Insurance
Committee on Financial Services
House of Representatives

The Honorable Marco Rubio
United States Senate

The Honorable Al Green
House of Representatives

The Honorable Jim Jordan
House of Representatives

The Honorable Michael McCaul
House of Representatives

The Honorable Gary J. Palmer
House of Representatives

The Honorable Ann Wagner
House of Representatives

Appendix I: Objectives, Scope, and Methodology

This report examines (1) the fraud risks and risk environment of Community Development Block Grant – Disaster Recovery (CDBG-DR) and their impacts; and (2) the steps the Department of Housing and Urban Development (HUD) has taken to assess fraud risk agency-wide, and specifically for CDBG-DR, in alignment with leading practices.

To address both our objectives, we reviewed relevant laws, regulation, and guidance, including the Housing and Community Development Act of 1974; *Federal Register* notices allocating the CDBG-DR funds; and HUD policies and guidance on internal controls. We also reviewed relevant documentation and interviewed officials from HUD headquarters, including HUD's Office of Community Planning and Development, which administers the traditional CDBG program and CDBG-DR funds; the HUD Office of the Inspector General (OIG); and the Department of Justice (DOJ) and its National Center for Disaster Fraud. The 2017 hurricanes caused the most damage in Puerto Rico, Texas, the U.S. Virgin Islands, and Florida. We visited Florida and Texas and included in our scope two state government entities (Florida Department of Economic Opportunity and Texas General Land Office) that administer CDBG-DR activities known as "grantees" and two local government entities that received CDBG-DR funds from grantees known as "subrecipients" to further carry out activities (Harris County and City of Houston).

We focused our review of CDBG-DR fraud risks on the states of Florida and Texas, in part because of their history of natural disasters—including heavy damage following 2017 Hurricanes Harvey and Irma—and the amount of CDBG-DR funds ($2.3 billion and $10.8 billion, respectively) allocated by HUD since 2011 to address unmet recovery needs.[1] Although Puerto Rico was hardest hit from the 2017 hurricane season and was allocated $20.2 billion in CDBG-DR grants, we did not include Puerto Rico or the U.S. Virgin Islands in the scope of our review in part because neither had prior experience with large CDBG-DR allocations.

To identify the fraud risks and risk environment of CDBG-DR and their impacts, we interviewed officials and obtained documentation from HUD and HUD OIG, as well as the four state and local entities responsible for administering CDBG-DR grants (named above), inquiring about examples of fraud risks specific to CDBG-DR. We also interviewed officials and reviewed documentation from other entities in Florida and Texas involved

[1]Unmet recovery needs are losses that have not been met with insurance or other forms of assistance, including federal disaster assistance.

in disaster recovery work including: state consumer protection and oversight agencies, county governments, community and business groups, and a private sector contractor engaged by a grantee in Florida to administer local implementation of CDBG-DR assistance. In addition to conducting interviews and reviewing documentation, we examined information from two sources to create a compilation of CDBG-DR fraud risks. The fraud risk examples that we identified related to case events that occurred from calendar years 2007 to 2020.

- *DOJ Offices of the United States Attorneys (USAO)*—We obtained 60,000 news releases dated May 2017 through February 2020 from DOJ's USAO website to identify cases illustrating fraud risks that may affect disaster recovery programs or programs with elements similar to CDBG-DR. We established search terms reflecting our reporting objectives, including "hurricane," "disaster," "HUD," and "community development block grant." Ultimately, we identified 1,111 news releases that contained at least one of our search terms. We also further focused on selected news releases that contained terms such as "fraud," "fraudulent," and "defraud." We reviewed all selected news releases and identified 78 news releases that illustrated fraud risks to disaster recovery programs also relevant to CDBG-DR. We did not intend this compilation of USAO news releases to be exhaustive of all fraud risks facing disaster relief generally or CDBG-DR in particular. Our purpose in performing this work was to identify examples of types of fraud risks relevant to our objective, by means of cases prosecuted to completion by U.S. attorneys across the nation.
- *HUD OIG*—We also obtained data from HUD OIG on closed cases involving allegations of fraud in CDBG-DR from calendar years 2010 to 2020. We reviewed almost 670 HUD OIG closed fraud cases nationwide. Of those, we identified 110 cases illustrating a fraud or fraud risk relevant to CDBG-DR for inclusion in the fraud risk compilation. Our goal was to identify a small number of cases to serve as illustrative examples of CDBG-DR fraud. Using this approach, we identified fraud risks in a broader fashion that would have otherwise been overlooked had we focused solely on closed enforcement cases in which fraud was determined to have taken place. We elected to use this approach due to several considerations: (1) the existence of a particular fraud risk may not necessarily culminate in an enforcement action or judicial determination of fraud; (2) enforcement actions or judicial determinations in cases initially begun on the basis of suspected fraud may not ultimately conclude with a formal finding of fraud; and (3) prosecutors, using their discretion, may decline to bring suspected fraud cases to court for adjudication. Thus, taken together,

we concluded that reliance only on closed enforcement cases in which fraud was determined to have taken place would understate the true extent of fraud risks.

As part of our analysis, we reviewed the evidence collected to identify descriptive information such as key case or summary points and impacted entity in order to create descriptive fraud risk examples. We then assessed and analyzed all examples to identify themes and categories based on (1) the specific parties mentioned in the fraud risk example, and (2) whether the fraud risk example involved two or more parties. Based on our assessment, we developed the following four categories of CDBG-DR fraud risk:

- *Disaster recovery grantees and subrecipients*—local or state governments, including their employees, administering disaster recovery funds after receipt of CDBG-DR grants;
- *Contractors and vendors*—entities hired by grantees and subrecipients to perform disaster recovery work on their behalf;
- *Disaster assistance applicants*—ultimate beneficiaries of program funds and resources (as distinct from government entities that seek and receive CDBG-DR grant funding from HUD); and
- *General or cross-cutting*—fraud risks associated with at least two of the three categories noted above.

We then summarized the different underlying fraud risk examples in each category to create the fraud risk, sub-type, and descriptions presented in appendix II. Because our analysis relied on our professional judgement, we took additional steps to ensure that the results were reliable. Specifically, we had two analysts sequentially review all of the examples and proposed CDBG-DR fraud risk category designations. Any disagreements in the descriptive example information and proposed designation were resolved through discussion or, if needed, a final determination was made by a third analyst.

The specific focus of this work was to identify examples of fraud risks that may affect CDBG-DR. We did not conduct work that would allow us to draw conclusions about prevalence of these risks or other population characteristics. Therefore, our analysis is limited to descriptive characteristics regarding the fraud risk examples that we identified during our review. We also identified examples of controls that could help to mitigate or address some of these fraud risks (see appendix III). For example, we noted that CDBG-DR is not a single, uniform program, but instead has rules established on a disaster-by-disaster basis.

To identify the impacts of CDBG-DR fraud risks and its risk environment, we assessed documentary and testimonial evidence obtained during our review and identified certain risk factors that could result in negative financial impacts, such as improper payments, as referenced in GAO's *A Framework for Managing Fraud Risks in Federal Programs* (Fraud Risk Framework), Appendix IV.[2] To identify nonfinancial impacts, we assessed documentary and testimonial evidence and leading practices from the International Public Sector Fraud Forum, an organization of countries that shares leading practices in fraud management.[3] We organized the impacts of CDBG-DR's risk environment in general categories identified by International Public Sector Fraud Forum.

To determine the steps HUD has taken to assess fraud risk generally, and specifically for CDBG-DR, in alignment with leading practices of the Fraud Risk Framework, we reviewed HUD's rules, policies, processes, tools, responsibilities, and guidance related to fraud risk assessment. We also analyzed documentation and interviewed HUD officials regarding HUD's risk assessment processes, including efforts to assess fraud risks agency-wide and for CDBG-DR specifically. We assessed the information gathered to determine the extent to which HUD had implemented selected leading practices contained in the Fraud Risk Framework.[4] Our assessment focused on the leading practices contained in the second component "related to assessing fraud risks. We selected the leading practices within the assess component because the identification and assessment of fraud risks are important steps in determining whether HUD's actions identify and address areas at risk for fraud. To the extent we found that HUD's actions were inconsistent with leading practices, we conducted further interviews with program managers from HUD to determine the rationale.

We conducted this performance audit from March 2019 to May 2021 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain

[2]GAO, *A Framework for Managing Fraud Risks in Federal Programs*, GAO-15-593SP (Washington, D.C.: July 28, 2015).

[3]International Public Sector Fraud Forum, *Guide to Understanding the Total Impact of Fraud*, February 2020. The International Public Sector Fraud Forum consists of representatives from organizations in the governments of Australia, Canada, New Zealand, the United Kingdom and the United States. The collective aim of the forum is to come together to share best and leading practice in fraud management and control across public borders.

[4]GAO-15-593SP.

sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Community Development Block Grant — Disaster Recovery Fraud Risks

In compiling fraud risks to Community Development Block Grant – Disaster Recovery (CDBG-DR), we organized fraud risks into four categories:

- Disaster recovery grantees and their subrecipients;
- Contractors and vendors;
- Disaster assistance applicants; and
- General or cross-cutting fraud risks, meaning that the fraud risk is not limited to a single category of CDBG-DR participant as identified above.

An identified fraud risk does not necessarily mean there has been a judicially determined finding of fraud in all instances cited. Rather, we identify *fraud risks* generally, in reflection that it is fraud risks that can ultimately lead to cases of *fraud.*[1] In addition to fraud, other forms of misconduct can occur, such as waste and abuse.[2] Waste and abuse do not necessarily involve fraud or illegal acts; however, they may be an indication of potential fraud.[3] For example, misuse of applicants' personal or financial information, such as selling applicant information to contractors may indicate abuse, potential fraud, or other illegal activity.

Table 3 presents fraud risks related to CDBG-DR grantees and their subrecipients—state and local governments that administer CDBG-DR program services—may be most likely to facilitate. Table 4 presents fraud risks we identified for procurement—in which grantees and subrecipients obtain goods and services from contractors and vendors in order to deliver CDBG-DR program services. According to HUD, fraud risks may arise at various points throughout the procurement process under CDBG-DR grants. Procurement involves often complicated rules and

[1]Fraud and fraud risk are distinct concepts. Fraud—obtaining something of value through willful misrepresentation—is challenging to detect because of its deceptive nature. Fraud risk (which is a function of likelihood and impact) exists when people have an opportunity to engage in fraudulent activity, have an incentive or are under pressure to commit fraud, or are able to rationalize committing fraud. Whether an act is in fact fraud is a determination to be made through the judicial or other adjudicative system.

[2]GAO, *Standards for Internal Control in the Federal Government*, GAO-14-704G (Washington, D.C.: Sept. 10, 2014). Waste is the act of using or expending resources carelessly, extravagantly, or to no purpose. Abuse involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary operational practice given the facts and circumstances. This includes the misuse of authority or position for personal gain or for the benefit of another.

[3]GAO-14-704G.

procedures, which can be exploited if grant recipients do not have sufficient capacity to manage recovery programs. Table 5 presents fraud risks or related issues we identified for CDBG-DR disaster assistance applicants. These types of fraud risks arise through the misrepresentation of pertinent financial or non-financial information by disaster assistance applicants to satisfy qualification requirements and obtain an unauthorized benefit. Table 6 presents general or cross-cutting CDBG-DR fraud risks or related issues we identified. For additional information on our methodology for identifying fraud risks, see appendix I.

Table 3: Fraud Risks Related to Community Development Block Grant — Disaster Recovery (CDBG-DR) Disaster Recovery Grantees and Their Subrecipients

Disaster recovery grantees and their subreceipients

These fraud risks include embezzlement and misrepresentation of impacted and distressed areas.

Source: GAO. | GAO-21-177

Fraud Risk	Description
Embezzlement	Misappropriation of cash or assets entrusted to disaster recovery program administrators and employees. Examples include: • A disaster recovery program employee fraudulently obtains power of attorney, in order to embezzle approved applicant grant funds. • Falsifying invoices and misusing credit cards. • Hiring “ghost” employees and converting their payroll checks for personal use.
Falsified invoices	Submission of false or inflated invoices for reimbursement. According to the Department of Housing and Urban Development Office of Inspector General, grantees may attempt to submit false reimbursement requests.
Misrepresentation of impacted and distressed areas	When a grantee or subrecipient intentionally misrepresents the area impacted by the disaster in order to secure approval for funding. For example: • A city may intentionally misrepresent that roads were impacted by the disaster in order to secure the approval of funding for unrelated infrastructure repairs. • Grantees could provide false information in their application for funds by stating that an area needed to be rehabilitated, when in fact the area was allegedly not affected by the disaster.
Unauthorized program fee	When a disaster recovery program administrator charges unknowing applicants a fee for what is actually a free disaster aid application process and keeps the money.

Source: GAO analysis. | GAO-21-177

Table 4: Fraud Risks Related to Community Development Block Grant — Disaster Recovery Contractors and Vendors[a]

Contractors and vendors

These fraud risks include bid rigging, billing fraud, and misrepresenting qualifications or eligibility.

Source: GAO. | GAO-21-177

Fraud Risk	Sub-type (if any)	Description
Bid rigging		When contractors conspire to influence the purchase of goods or services to avoid competitive bidding controls. Often involves contractors agreeing among themselves on bid prices and submitting bids reflective of that agreement to ensure a specific contractor wins the contract. According to the Department of Housing and Urban Development (HUD) Office of Inspector General (OIG), bid rigging usually occurs in the pre-solicitation, solicitation, or evaluation phases. In some instances, the winning contractor may further conspire with other bidders and use those contractors as subcontractors in order to siphon funds to them in facilitation of the fraud.
Billing fraud	**Double billing**	Contractors may attempt to fraudulently bill multiple contracts or submit invoices for the same work or services more than once. This could be of increased risk if a contractor has multiple contracts for the same type of services in a state or locality.
	False status report	Specific to progress payments, contractors misrepresent project's status, in order to continue receiving disaster recovery funds released according to contract requirements for progress toward project completion.
	Incomplete work	Contractors may fraudulently bill for or request additional funds for disaster recovery work that may have been started but not completed, including demolition, restoration, or construction. For example, a contractor may fail to complete work at the end of a job but submit an invoice indicating the work is complete.
	Overbilling	Contractors may fraudulently bill for work not related to the contract or inflate the cost of the work. For example, a contractor bills a disaster recovery program for employees working at a separate business.
	Poor quality work	Contractors may intentionally perform poor quality work that does not meet contract specifications but bill as though the work was performed to contract specifications. This type of fraud risk may be difficult to identify through inspections but after job completion, major defects may become apparent, such as a newly repaired house beginning to lean. A contractor may further compound the fraud risk by submitting an additional invoice to make needed repairs.
	Substandard materials	Contractors may deliberately substitute unauthorized or inferior materials for approved materials, where the unauthorized materials do not meet contract terms and invoice for the materials. For example, rebuilding homes using materials that do not meet building codes, such that the homes remain unfit for occupancy.

Fraud Risk	Sub-type (if any)	Description
Billing fraud	**Wage or subcontractor payments**	Contractors may falsely certify they paid their employees or subcontractors when they did not, either by not paying or paying rates lower than stipulated in the contract. For example: • Contractor is paid based on false certifications of payments to subcontractors. This can cause further challenges when unpaid subcontractors place liens on the properties of disaster victims. These subcontractor liens could be detrimental to property owners. • Contractor may deliberately misclassifies employees as independent contractors in order to circumvent fair wage requirements. • According to HUD OIG officials, a known issue in South Florida is when contractors employ undocumented workers. This practice may indicate that some contractors pay lower wages in violation of their contracts, while submitting invoices for reimbursement at full labor costs.
	Work not performed	Contractors may bill for disaster recovery work not performed at all. For example: • Submission of false invoices and timesheets showing work that was not actually performed. • Debris removal often is a critical task before rebuilding can begin and where fraud is known to have occurred in previous disasters. Specifically, false invoices are submitted indicating debris was removed that was not actually removed.
Misrepresentation of qualifications or eligibility		False certification of qualifications or eligibility that may be relevant for certain disaster recovery contracts. For example: • Contractor falsely certifies itself to be a small or disadvantaged business in order to increase chances of obtaining contracts. • Contractor falsely represents using minority-owned businesses for substantive work, but actually uses these companies as pass-through entities, in order to increase chances of obtaining contracts. • False or defective performance bonds. • After having been debarred such as for performance issues elsewhere, contractors may attempt to operate under a new name.

Source: GAO analysis. | GAO-21-177

[a]Sometimes this fraud risk includes procurement officials. See, for example, Table 6, “collusion in contract and bid manipulation” for additional information.

Table 5: Fraud Risks Related to Community Development Block Grant — Disaster Recovery Disaster Assistance Applicants

Disaster assistance applicants

These fraud risks include false damage claims, false eligibility claims, and falsified application documents.

Source: GAO. | GAO-21-177

Fraud Risk	Sub-type (if any)	Description
False attestation of reoccupancy		An applicant may submit falsified proof of reoccupancy following purported property repairs, in order to retain disaster assistance funds for ineligible purposes. For example, an applicant who received a grant to repair a damaged property may not repair or reoccupy the property following the disaster, but submit falsified utility bills in an effort to prove occupancy.
False damage claim	**Damage unrelated to eligible disaster**	This type of fraud risk can present in several ways including when applying for disaster aid for damage caused intentionally by applicants; damage that existed before the disaster (including damage from prior disasters); and damage that occurred after the disaster that benefits are being applied for (including damage from subsequent disasters). Applicants could falsely report this type of damage in their application in order to have unrelated damage repaired. Some damage, such as wind or mold damage, is more difficult to verify as related to the particular disaster, creating a vulnerability to false damage claims.
	Failure to disclose damage	Understating or failing to disclose certain types of property damage, such as contamination, which may be more expensive to remediate. This risk may occur in buyback programs where applicants do not want to be responsible for contamination clean-up and hide the damage so as not to be excluded from the program.
	Undamaged property	Property owner falsely reports damage that never occurred. For example: • Claiming critical need and rental assistance, after purportedly having been displaced by disaster damage, when no damage actually occurred.
False eligibility claim	**Claiming second property as primary residence**	Homeowners falsely claim damaged property as their primary residence when the damaged property was a second property. Potential ineligible second properties include rental, vacation, or investment property, home received through inheritance that is not primary residence, second home under construction at the time of the disaster, or properties that were abandoned at the time of the disaster or are currently unoccupied.
	Commercial property	Applicant falsely claims a commercial property as primary residence in order to obtain residence-based benefits. For example, an applicant attempts to make it appear as though they live at their place of business.
	Deceased beneficiary	A false claim for disaster relief made on behalf of a deceased person. While this could occur in other ways, examples include: • A child of a recently deceased applicant intentionally continues with rebuilding of a damaged home. • Individual applies as a co-applicant for deceased parent's property.

Fraud Risk	Sub-type (if any)	Description
False eligibility claim	**Fictitious address**	Applicant falsely reports damage to a nonexistent residence or location, such as a vacant lot or a residence that does not exist at the specified location.
	Legal residency status	Applicant files a false claim attesting to U.S. citizenship or legal resident status, in order to qualify for program aid when citizenship or legal resident status is an eligibility requirement. For example, an ineligible foreign citizen uses the identification of a legal resident to submit an application.
	Misrepresenting property ownership	Applicants apply for assistance for properties in which they have no ownership. For example: • Seeking assistance for property destroyed in a disaster that does not actually belong to them, or for a property previously owned. • Seeking financial assistance for a business in which they have no true ownership by submitting a fictitious application. • When an applicant applies for benefits on a prior residence and where the applicant did not live during the disaster event.
	Overstating household size	Applicants may falsely overstate household size, in order to qualify for more disaster aid or for larger property replacement. This could include falsely claiming more children or grandchildren as household members. For example: • Rebuilding may be based on current household size. For larger properties, this could mean a replacement structure is smaller than the damaged property. Applicants thus may overstate household size in order to support rebuilding at the original, larger property size, when they would otherwise qualify for a smaller rebuilding project. • Claiming larger household size in order to meet household size-based income eligibility requirements—either to qualify initially or to obtain a greater amount of assistance.
	Rental property	CDBG-DR rental assistance can be based on tenant income levels. A landlord, either alone or in collusion with tenants, may falsely claim that low-income tenants reside at the property, in order to obtain such aid as a forgivable disaster repair loan. A landlord may also pressure a tenant to apply for aid under an affordable rental program, in order that the landlord can qualify for disaster assistance. • When a legal tenant sublets an apartment without permission or authority to do so and subsequently intentionally applies for and receives disaster assistance even though the tenant is no longer the resident.
	Unauthorized claim on behalf of another person	A false claim for disaster aid made on behalf of another person without authorization. For example, a person may apply for aid on behalf of an eligible elderly disaster victim without the victim’s knowledge or permission and pocket the funds.

False eligibility claim	**Understating income**	Applicants may intentionally understate income on applications in order to meet low- and moderate-income requirements for disaster assistance, or to obtain additional aid. Examples include: • Providing falsified or incomplete household income information on applications. • Manipulating the timing of reported income for self-benefit, such as failing to report pre-disaster income. • Excluding income from all relevant household members, such as working adult children living at home. • Failing to report rental income. • Failing to report or exclusively reporting cash income that can be a challenge for verification, especially for “unbanked” applicants without a bank account or electronic paper trail.
Falsified application documents	**Destroyed documents**	Program applicant falsely claims that proof of property ownership—a condition of eligibility—or other documentation necessary for the application was lost or destroyed in the disaster event.
	Duplication of benefits	A key area of concern for the Department of Housing and Urban Development (HUD), HUD Office of Inspector General, and state and local disaster recovery program offices. Disaster victims applying for aid and failing to disclose benefits received from other public or private sources, resulting in CDBG-DR funds to which they are not otherwise entitled. Scenarios include: • Failure to disclose aid from non-profit or philanthropic organizations. • Failure to report an insurance settlement received after applying for disaster assistance. • Acknowledging other aid, but understating actual assistance received.
Falsified application supporting documents		Falsified supporting documents are a fraud risk to disaster recovery programs, which rely on accurate documentation to establish eligibility to substantiate otherwise self-reported information by applicants. Examples of potential falsified supporting documents that may be submitted include: • Fake identification. • Fictitious lease statements and payment receipts submitted to support rental or transportation assistance. • Providing falsified documents such as utility bills as purported proof of occupancy or ownership for a property. • Manipulation or falsification of repair receipts to obtain greater reimbursement. • A false certificate attesting to a property’s elevation, submitted as part of an elevation grant application, in order to satisfy eligibility requirements. • Falsified income documentation such as pay stubs or tax forms. • For CDBG-DR funded reimbursement programs, applicants may submit altered receipts for expenses not incurred, made in cash, or for more than incurred expenses.

Source: GAO analysis. | GAO-21-177

Table 6: General or Cross-cutting Community Development Block Grant — Disaster Recovery Fraud Risks

General or cross-cutting

These fraud risks include collusion in contracts and bid manipulation; bribery and kickbacks; and corruption.

Source: GAO. | GAO-21-177

Fraud Risk	Description
Benevolent fraud	When disaster recovery program staff help or steer otherwise ineligible applicants to meet program eligibility requirements, such as by instructing applicants to falsify applications or approving assistance, using their inside knowledge. For example, a state's disaster assistance contractor assists otherwise ineligible applicants whose trailer homes were not located in the disaster area at the time of the event but were moved into the eligible area post-disaster, during the application process. In some instances, this may be done without the applicant's involvement. Instead, this could happen when disaster recovery program staff purposefully falsify information on applicant document(s) to make the applicant eligible when they otherwise would not have been.

Fraud Risk	Description
Bribery and Kickbacks	When a person offers, gives, receives, or solicits something of value as payment in order to influence an official act. Payments may take the form of money, goods, or services, and may be given directly to the bribe-taker or to someone designated by the bribe-taker. For example: • A contractor pays a contracting officer in exchange for being awarded a contract. • An official accepts favors, such as personal vehicle use, hotel accommodations, airfare, personal security services, or use of a credit card. Acceptance of favors would be in exchange for making an official decision or determination to the benefit of the person offering providing the favors. This risk could indicate fraud if the official did not properly disclose gifts or approved an official decision in writing without proper disclosure. • Homeowner bribes an appraiser, which can be a program employee or contractor, in exchange for inflated damage estimates that repairs or other program benefits are dependent upon. • Homeowner bribes a program administrator in exchange for being determined qualified for a program. • A program administrator secures employment for an associate at a company in exchange for a contract award. Kickbacks are a form of bribe where a portion of gains derived from an arrangement is given to a bribe-taker for arrangements made. Payment may take the form of money, goods, services, or anything of value. For example: • A contractor instructs a subcontractor to inflate the cost of materials and ensures payment is made on the false invoice, and then provides a portion of the profit to the subcontractor. • Homeowner offers a kickback to an appraiser for inflated cost estimates, which can increase the amount of the homeowner’s disaster assistance. • Homeowner offers a kickback to program administrators, in order to be determined qualified for program funds. • Contractor overbills disaster funds for work on a property, then shares the proceeds with the owner. • Inspector could inflate the value of repairs deemed necessary, or increase the cost of planned repairs, and then receive a portion of the higher spending from the contractor doing the work.
Collusion in contract and bid manipulation	A procurement employee and contractor acting together can manipulate the bidding process to benefit a favored contractor or supplier. For example: • A contractor hired by a grantee or subrecipient for consultation or to write a disaster aid action plan incorporates items favorable to itself and subsequently wins a contract. • A grantee employee changed the minimum financial requirements of a request-for-proposal solicitation, in order to qualify one contractor over others. • A request-for-qualifications notice tailored to benefit a particular vendor of a specific item.

<table>
<tr><th>Fraud Risk</th><th>Description</th></tr>
<tr><td>Conflict-of-interest</td><td>An undisclosed financial or personal interest in a transaction involving disaster recovery aid. According to the Department of Housing and Urban Development Office of Inspector General, a criminal conflict may occur when an employee substantially participates in a matter in which they have a financial interest. For example:
Misrepresentation by contractors or consultants, such as intentionally not identifying subcontractors with relationships with decision-makers in contract offers or bids.
When a contracting official intentionally approves a contract with a former employee based on a prior relationship and not the contractor’s ability to meet procurement requirements.
When a government official is a relative or friend of the recipient of a disaster recovery contract and intentionally approves the application for benefits, knowing the application is false or misleading.
When program administrators inappropriately use their position to approve inflated reimbursement requests for family members.
When a program official purchases or approves the purchase of goods or services from an associate without disclosing the relationship, to the extent required.
Utilizing a position as program administrator or other program official to not provide assistance to a qualified applicant due to a personal grudge by rejecting an otherwise qualified applicant.
An entity receiving funds to repair homes is also involved in evaluating damage to those properties. In this dual role, officials in the entity could falsify damage reports to overstate needed repairs and then invoice for repairs not needed or completed based on the initial damage report.</td></tr>
<tr><td>Falsified appraisals</td><td>Several parties—including appraisers, code enforcement officials, and applicants—may attempt to overstate or understate property values or structural damage, depending on the situation. For example:
Applicant intentionally underreports property damage, so that the amount does not exceed the maximum allowed for repair—vs. replacement—in order to retain the original property size. (With full replacement, the replacement structure may be smaller than the original, based on household size.)
Appraiser or code enforcement official inflates the value of structural damage, in order to obtain greater assistance.</td></tr>
<tr><td>Falsified results</td><td>Falsification of test or inspection results needed to evaluate contractor reimbursement eligibility under disaster recovery program rules. For example, disaster program staff may submit false checklists showing completion of environmental assessments necessary to release program reimbursements.</td></tr>
<tr><td>Identity theft</td><td>Individual obtaining personally identifiable information (PII) such as dates of birth or social security numbers, or other sensitive information, either through deception or unauthorized use of private or public systems, and then using that information to fraudulent apply for disaster assistance or for other unauthorized purposes.</td></tr>
<tr><td>Misuse of funds</td><td>Intentional use of disaster recovery funds for ineligible goods or activities (i.e., diversion of such funds). For example:
Using recovery funds for unqualified expenses such as mortgage payments, as a gift to a relative or other associate, renovations, property acquisitions, pre-disaster expenses, alcohol, debt relief, and entertainment.
Contractors intentionally using funds to buy supplies from a country determined ineligible under international trade agreement while still certifying supplies were allowable.</td></tr>
</table>

Fraud Risk	Description
Public corruption	When elected officials, grantees, other government employees, or contractors abuse their position for personal gain or the improper gain of others. For example, elected officials may intentionally steer or authorize contracts to companies from which they have received political donations or have a known or unknown financial relationship. Alternatively, participants may use their official position to authorize disaster assistance funds for ineligible family members and friends; authorizing an application for which the applicant is not eligible or falsifying documentation as part of an application.
Redirecting payments	Redirection of vendor payments, such as by computer hacking of a vendor payment system to change where vendor payments are sent.
Theft involving misrepresentation	The disaster may create greater incentives or opportunities for theft involving misrepresentation. For example: • An attorney fraudulently obtains disaster recovery assistance on behalf of a client without the client's authorization and keeps the financial proceeds for themselves. • An individual intercepts disaster assistance checks issued to a relative and negotiates the check and keeps the proceeds for their own personal gain. • A contractor deposits checks twice and shortly thereafter withdraws funds in cash. • An employee of a company performing a demolition fraudulently uses the contractor's license to obtain disaster recovery funds owed to the company for the work performed.

Source: GAO analysis. | GAO-21-177

Appendix III: Controls to Address Community Development Block Grant — Disaster Recovery Fraud Risks

As described in the report and in appendix II, our work has identified a range of fraud risks, both within Community Development Block Grant – Disaster Recovery (CDBG-DR), as well as the broader disaster recovery portfolio. Through our review, we also identified examples of controls and initiatives to mitigate or address some of these fraud risks. We identified examples of controls based on interviews with and documentation from Department of Housing and Urban Development (HUD), the HUD Office of Inspector General, and Department of Justice's Offices of the United States Attorneys website, as well as four state and local entities responsible for administering CDBG-DR grants. Table 7 below lists examples of controls that may limit opportunities for fraud in CDBG-DR. This is not a complete list of controls that may be needed to remediate risks to CDBG-DR.

Table 7: Examples of Controls that May Help to Address Community Development Block Grant — Disaster Recovery (CDBG-DR) Fraud Risks

Control	Description	Examples
Application information verification	Application processes with comprehensive validation procedures throughout the program life cycle may reduce the risk of applicant fraud, by ensuring acceptance of valid applicant information and documentation.	• Inquiring about prior aid. • Verifying assistance from other agencies with disaster recovery responsibilities, such as Small Business Administration or Federal Emergency Management Agency (FEMA). • Establishing a process to check for duplicate benefits and recapture excess funds.
CDBG-DR contingency preparedness	Inexperience in new recovery program areas; turnover among experienced program staff; and insufficient management capacity to run programs can lead to missed opportunities for assessing, mitigating, and responding to fraud risks. Programs that account for new disaster recovery delivery activities and turnover of experienced staff may help ensure program stability during periods of transition.	• In the event that funding is earmarked for a particular purpose, such as energy infrastructure, for which the disaster recovery program lacks experience in that sector, procedures allow for exploration of options to fill the knowledge gap, such as partnering with agencies or consultants with the desired subject matter expertise. • Staffing plan that accounts for the departure of managers or experienced staff in key areas, such as development of the local action plan or program details.
CDBG-DR continuity	CDBG-DR's ad hoc nature can create confusion and provide opportunities for exploitation. Having a unified oversight process in place that allows program staff to compare data across the CDBG-DR portfolio would help to both reduce opportunities for fraud that target multiple grantees and subrecipients, as well as aid in detecting such fraud schemes when they do occur.[a]	• Applying to multiple CDBG-DR programs across municipal or state lines in an attempt to obtain additional aid for which applications would not be eligible.

Control	Description	Examples
Coordinated public outreach	Current communications capabilities allow disaster fraud schemes to extend nationally. While fragmented public outreach may undercut efforts to reduce fraud, coordinated efforts to ensure public awareness of disaster fraud may curb opportunities for fraud.	• Antifraud public service announcements available in web, video, and audio versions. • Partnerships among law enforcement and groups such as attorneys general, in order to bring more awareness of anti-fraud efforts.
Coordinated response effort	CDBG-DR is not a single, uniform program, but instead has rules established on a disaster-by-disaster basis. The ad hoc nature of these grants may lead to fragmented response efforts when fraud is uncovered, and thus heighten fraud risk. A more comprehensive response effort could include law enforcement and other stakeholders, as appropriate, in order to effectively investigate, prosecute, or seek administrative and civil remedies for cases of established disaster fraud.	• Creating working groups comprised of representatives from all levels of law enforcement in response to a particular disaster event. • Establishing joint investigative efforts of inspectors general from different agencies to address fraudulent claims for disaster assistance.
Current and reliable data	CDBG-DR relies on timely, complete, and accurate information, such as FEMA assistance data, to validate applicant information. Outdated, incomplete, or inaccurate data limits CDBG-DR's capacity to mitigate and respond to fraud risks.	• As related by one grantee/subrecipient, FEMA data—used to check for duplication of benefits with CDBG-DR assistance—were found by program staff to be inconsistent and unreliable. Program staff were instructed to accept the applicant-provided data over the FEMA data if the information conflicted.
Fraud risk management guidance	Written procedures for verifying information throughout the CDBG-DR process for indications of fraud strengthens opportunities for assessing, mitigating, and responding to fraud risks.	• Written procedures for preventing, detecting, and responding to fraud, waste, and abuse. • Planning and performing a formal fraud risk assessment for CDBG-DR. • Fraud risk training that includes specific issue areas, such as duplicate benefits, proper income documentation, and identifying fake applicant documents. • Written procedures for meeting regulatory requirements, such as to check for contractor/vendor suspensions and debarments.
Fraud risk training for CDBG-DR staff	Formal, accessible, and routine staff training on CDBG-DR fraud risk indicators may strengthen opportunities for assessing, mitigating, and responding to fraud risks.	• Fraud risk training is offered to program staff from either a central location or using virtual connectivity tools. • Training materials are accessible to all staff. • Program staff receive timely responses to questions about training sessions and materials.
Oversight of disbursed funds	Applicants who are otherwise eligible may take advantage of fragmented disaster relief program enforcement capabilities to profit off disaster assistance. Having oversight mechanisms for disbursed funds could help mitigate such opportunities.	• In order to obtain aid, applicants must cooperate with inspection of repairs, and provide access to documentation of repair progress, or expenditures made, as defined by program guidelines. • Program system includes a validation mechanism that prevents an applicant from being inadvertently paid twice by a disaster relief program, such once by wire and once by check.

Control	Description	Examples
Separation of duties	Separating job functions ordinarily serves as a check and balance on fraud opportunities for program staff, by ensuring that job responsibilities do not cross multiple steps involved in overseeing program funds.	• Contractors cannot access disaster recovery program information. • Independent employees handle accounts receivable, accounts payable, and payroll to minimize the risk of a staff using these overlapping roles to steal program funds.

Source: GAO analysis. | GAO-21-177

[a]See GAO, Disaster Recovery: Better Monitoring of Block Grant Funds Is Needed GAO-19-232 (Washington, D.C.: Mar. 25, 2019). We recommended that Congress consider permanently authorizing a disaster assistance program that meets unmet needs in a timely manner.

Appendix IV: Comments from the Department of Housing and Urban Development

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

PRINCIPAL DEPUTY ASSISTANT SECRETARY
FOR COMMUNITY PLANNING AND DEVELOPMENT

Ms. Rebecca Shea
Director
Forensic Audits and Investigative Service
Government Accountability Office
441 G Street, NW
Washington, DC 20548

Re: The Office of Community Planning and Development (CPD) Response for Draft report entitled "HUD Should Take Additional Action to Assess Community Development Grants Fraud Risk" [GAO-21-177]

Dear Ms. Shea:

In April 2021, the Government Accountability Office (GAO) issued the draft report to HUD's CPD Office for advance review and agency comment. As part of the GAO review of a range of disaster recovery issues following the 2017 disaster season, this draft report addresses: 1) the fraud risks and risk environment of Community Development Block Grant disaster recovery (CDBG-DR) and its impacts and 2) the steps that HUD has taken to assess fraud risk agency-wide, and specifically for CDBG-DR in alignment with leading practices.

The GAO draft report provides two Recommendations, including that HUD comprehensively assess fraud risks to CDBG-DR in accordance with leading practices and that HUD involve relevant stakeholders in its approach.

This letter provides agency comment on the draft report and describes the specific actions that the Department has implemented to mitigate fraud risk in the implementation of CDBG-DR funds. This letter also identifies future steps that the Department is considering to further enhance and strengthen its existing fraud-related internal controls.

GAO Recommendation 1: The Assistant Secretary for Community Planning and Development should comprehensively assess fraud risk to CDBG-DR, including identifying inherent fraud risk affecting it, assessing the likelihood and impact of inherent fraud risks, determining fraud risk tolerance, and examining the suitability of existing fraud risk controls. The assessment should also consider CDBG-DR's risk environment and be informed by the fraud risks identified in this report.

Fraud risks are currently considered by CPD and CDBG-DR staff as a routine part of the annual enterprise risk management process overseen by the Department's Chief Risk Officer (CRO). The CRO function is located within the Office of the Chief Financial Officer (CFO).

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Fraud risk is currently considered in several ways: First, in the design and deployment of all disaster recovery programs. Second, as part of the routine refresh of the CPD risk profile and declarations of significant risks in the broader HUD departmental risk profile. Third, through the internal control review and validation processes for CDBG-DR, administered by CFO.

The Disaster Recovery and Special Issues (DRSI) Division participated in a program-level enterprise and fraud risk maturity assessment (based on Committee of Sponsoring Organizations, International Organization for Standardization, Green Book, and GAO Anti-fraud Framework standards) and has implemented strengthening activities. DRSI has committed to further participation in enterprise-wide risk assessment and risk management measures, including the creation of a Fraud Risk Assessment template.

The Department took initial steps to create a Fraud Risk Assessment template in 2019, but the effort was delayed due to the Coronavirus pandemic. While this effort remains in the CFO's work plan, current contracting issues have delayed forward momentum on the development of the template. Consistent with the Department's approach to enterprise-wide risk management, individual program offices look to the CFO and the CRO to coordinate risk management and provide training on a consistent approach to risk assessment.

In the interim, the Department continues to deploy risk management tools and controls designed to mitigate fraud risk. HUD's overall approach to managing fraud and fraud risk in the CDBG-DR program is focused on oversight, relationship management, and building capacity. The addition of 2017 disaster grants to the CDBG-DR portfolio expanded this overall approach to include additional pre-award risk assessments; expanded technical assistance to build grantee capacity; and additional fraud and fraud risk mitigation measures. Risk management tools at the program and grantee level include:

1. **Front-End Risk Assessment (FERA)**: A FERA is a formal, documented review by HUD management to determine the susceptibility of a new or substantially revised program or administrative function to fraud, waste, and abuse. A FERA is required for any substantially revised program where a funding revision results in an increase that is greater than $10 million, and the revision is equal to a change of five percent or more in the budget line item. (HUD Handbook 1840.1 Rev. 3, Chapter 8). FERAs are reviewed by HUD's CFO to help the agency allocate resources to manage any additional risk, including fraud. The CDBG-DR FERA identifies additional risks associated with HUD's oversight and management of CDBG-DR grants, including limited resources for on-site monitoring. The FERA process includes reviews of HUD's internal controls, staffing, and requirements of the appropriation to evaluate the risk associated with the implementation of the appropriation.

2. **Risk Maturity Model**. A Risk Maturity Model outlines key indicators and activities that comprise a sustainable, repeatable, and mature enterprise risk management program. The Department has completed a risk maturity self-assessment of CPD with a strong focus on DRSI, allowing it to compare its current risk management practices with key indicators to promote a standardized approach to identify and manage risks in our operations and programs.

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3. **Internal Control Plans:** The Office of Management and Budget (OMB) directed each federal agency receiving an appropriation of CDBG-DR funds under Public Laws (P.L.) 113-2 and 115-56 to develop and implement internal control plans. The plans address additional internal controls to be established to manage funds, the agency's planned protocol for addressing improper payments, including fraud. The core of HUD's internal control plans is an annual risk assessment conducted for all CDBG-DR grantees. The Department also engaged in testing of internal controls for CDBG-DR as part of annual Accountability, Integrity and Risk reviews to satisfy the A-123 requirements and the Department's compliance efforts with Payment Integrity (formerly Improper Payment) reviews.

4. **Senior HUD Staff Presence**: Frequent visits by senior HUD management and program staff to grantee offices ensure a closer working relationship with grantee decision-makers. HUD also believes that the frequency of a high-level HUD presence may serve as a fraud deterrent. HUD field offices also include senior management staff in reviews or technical assistance provided to CDBG-DR grantees.

5. **Investigation Coordination:** To proactively prevent fraud, HUD participates in coordinating investigation efforts at multiple levels. There is routine coordination among the HUD disaster recovery program director, the HUD Regional Inspectors General for audits and investigations, State auditors and investigations staff, and the U.S. Attorney's Office. HUD also initiated quarterly conference calls with its HUD's Office of Inspector General (OIG) to identify monitoring plans and activities and any issues or areas of shared concern.

Taken together, these measures represent a robust effort to mitigate fraud risk in CDBG-DR, even in the current absence of a comprehensive risk assessment.

Recommendation 2: In comprehensively assessing fraud risks to CDBG-DR, the Assistant Secretary for Community Planning and Development should involve relevant stakeholders in the assessment process, including CDBG-DR grantees (states, territories, and local governments) that design and implement fraud controls.

Current Departmental risk programs assessing enterprise and fraud risks do not include activities at the grantee level. Evaluation of a grantee's fraud-related internal controls is part of standard disaster grant oversight, including the single audit process and deployment of monitoring and technical assistance resources and personnel.

The Department emphasizes that in the appropriation of CDBG-DR supplemental appropriations, Congress has recognized the block grant nature of CDBG-DR funding. Consistent with the block grant framework of the Housing and Community Development Act, CDBG-DR grantees are responsible for the design and implementation of programs that respond to their specific recovery needs. HUD's role is to make a determination that these programs are operated in compliance with CDBG-DR rules, policies, and requirements, based on HUD's review of a grantee's Action Plans, Action Plan Amendments, Quarterly Performance Reports, voucher submissions to support grant payments, and through routine monitoring.

While CDBG-DR grantees are responsible for fraud prevention and detection of fraud within their programs, the Department employs a range of mitigation techniques and requirements aimed at protecting the Department's assets and enhancing grantee capacity to detect and prevent fraud. These techniques include:

1. **Pre-Award Risk Assessment**: The Department introduced a pre-award risk tool for its 2017 CDBG-DR grantees that is used to identify unmitigated risks, including fraud, and to establish grant conditions to address those unmitigated risks.

2. **Financial Certifications:** As part of the Financial Management and Grant Compliance Certification process, the Department requires grantees to provide their policies and procedures to prevent fraud, waste, and abuse as a basis for the required certification. The Department monitors grantees for adherence to these policies and procedures.

3. **Internal Auditor:** The *Federal Register* Notices that govern CDBG-DR funds require each grantee to hire an internal auditor with specific responsibilities to detect and prevent fraud. The internal audit function must provide both programmatic and financial oversight of grantee activities. As part of the above financial certification process, the grantee must include a document signed by the internal auditor that describes his or her role in detecting fraud, waste, and abuse. Additionally, as a special grant condition, grantees may be required to submit internal audit reports directly to HUD. HUD monitors grantee implementation of the internal audit function.

4. **OIG Fraud Training:** Starting with the 2017 CDBG-DR grantees, HUD requires CDBG-DR grantees and subrecipients to attend fraud-related training provided by the OIG. This training has been delivered to all CDBG-DR grantees who attended the 2018 CDBG-DR Grantee Clinic in Atlanta and the 2019 CDBG-DR Grantee Clinic in Kansas City. The HUD OIG also delivers targeted fraud training for the 2017 CDBG-DR grantees in each of the grantee locations (Texas, Florida, U.S. Virgin Islands, and Puerto Rico).

5. **Monitoring:** The Department conducts annual monitoring of grantee activities to ensure compliance with CDBG-DR rules and regulations, and requirements

While the Department views fraud risks in programs managed by grantees as fraud risk to the grantee, HUD deploys numerous controls designed to mitigate risk and prevent fraud, waste. and abuse in CDBG-DR.

Technical Corrections and Clarifications:

1. On page 14 (Table 2) and page 21, the report identifies misrepresenting areas that are impacted and distressed as a fraud risk. HUD requires that 80 percent of a grantee's CDBG-DR funds be expended in HUD-identified Most-Impacted and Distressed (MID)

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areas. HUD identifies these MID areas based on Small Business Administration data and Federal Emergency Management Agency damage assessments. Grantees may expend up to 20 percent of its CDBG-DR funds in grantee-identified MID areas. Grantee-identified MID areas must be in counties with a Presidentially declared disaster covered by the relevant appropriation. Grantees must describe grantee-identified MID areas in their Action Plan, which is subject to review by HUD and through the Citizen Participation process. HUD reviews grantee-identified MID areas to confirm that they constitute areas eligible for CDBG-DR assistance. Misrepresentation of MID area designations by the grantee or subrecipients is not a fraud risk.

2. On page 23, the draft report states, “OMB reported that improper payments from CDBG-DR in Fiscal Year 2020 were $3.4 million based on confirmed fraud cases”. This figure is inconsistent with the annual improper payments estimates provided to OMB by HUD. HUD is required to provide an estimate of improper payments for grants made under P.L. 113-2 and 115-56. HUD prepares improper payment estimates according to a methodology approved by OMB. According to the OMB-approved methodology, HUD did not report any improper payments in CDBG-DR for FY2020 for the two appropriations on which HUD is required to provide an improper payment estimate. The Department is aware that improper payments encompass a wide array of, ranging from clerical errors to inadequate documentation available at the time of review, to ineligible use of funds, and notes the report’s comment that “improper payment estimates are not intended to measure fraud in a particular program” (page 23). Please clarify the source for the reported $3.4 million in improper payments from “confirmed fraud cases.

3. On page 33, the report incorrectly states that grantees are “beneficiaries” of CDBG-DR funding.” Grantees are “recipients” of CDBG-DR funding awarded in a block grant program. The statement is correct in noting that “due to the block grant nature of the CDBG program, HUD does not consider fraud risks in programs managed by grantees to be direct risks to HUD itself.” Fraud risks in programs managed by grantees are fraud risks to the grantees.

4. On page 34, the report references the “Coronavirus Disease 2019 pandemic”. The Coronavirus pandemic, however, affected HUD operations beginning in calendar 2020.

Thank you for the opportunity to comment on this draft report.

Sincerely,

James Arthur Jemison II

Digitally signed by James Arthur Jemison II
Date: 2021.04.16 15:31:17 -04'00'

James Arthur Jemison II
Principal Deputy Assistant Secretary
for Community Planning and Development

Appendix V: GAO Contacts and Staff Acknowledgments

GAO Contact

Rebecca Shea at (202) 512-6722 or SheaR@gao.gov

Staff Acknowledgments

In addition to the contact name above, Heather Dunahoo and April Gamble (Assistant Directors), Christopher H. Schmitt and Tina Paek (Analysts-in-Charge), Mariana Calderón, and April Van Cleef made key contributions to this report. Also contributing to the report were Colin Fallon, Barbara Lewis, Maria McMullen, Brenda Mittelbuscher, James Murphy, Joseph Neumeier, Cory Ryncarz, and Mike Silver.

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Strategic Planning and External Liaison

Stephen J. Sanford, Acting Managing Director, spel@gao.gov, (202) 512-4707
U.S. Government Accountability Office, 441 G Street NW, Room 7814, Washington, DC 20548