U.S Department of Housing and Urban Development Office of Community Planning and Development Programs Washington, DC

Fraud Risk Inventory for the CDBG and ESG CARES Act Funds

Office of Audit
Washington, DC

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Developed in collaboration with the Pandemic Response Accountability Committee

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MEMORANDUM NO:
2022-FO-0801

Memorandum

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SUBJECT: Fraud Risk Inventory for the CDBG and ESG CARES Act Funds

INTRODUCTION

We conducted this engagement in coordination with the Pandemic Response Accountability Committee (PRAC) to gain an understanding of the U.S. Department of Housing and Urban Development's (HUD) fraud risk management practices and develop an inventory of fraud risks that HUD had not already identified for the funds appropriated by the Coronavirus Aid, Relief, and Economic Security (CARES) Act for the Community Development Block Grant (CDBG) and Emergency Solutions Grant (ESG) programs.

As a result of our engagement, we are providing recommendations to improve the Office of Community Planning and Development's (CPD) and HUD's fraud risk management practices. HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the engagement.

SCOPE AND METHODOLOGY

We conducted our engagement from March 1, 2021, through May 21, 2021. Interviews and discussions were conducted telephonically and virtually. To gain an understanding of HUD's fraud risk management practices and the fraud risks that HUD had already identified for the CDBG and ESG programs, we interviewed officials from HUD's Office of the Chief Financial Officer (OCFO), including the Chief Risk Officer (CRO) and officials from the HUD CARES

Act Compliance Review Team (HCCRT), and officials from CPD headquarters and field offices. We also reviewed relevant CPD notices and monitoring exhibits as well as documentation related to improper payment and enterprise risk management processes.

To identify and develop an inventory of fraud risks, we performed the following:

1. Reviewed the CARES Act and its specific requirements;

2. Reviewed pertinent Federal fraud risk guidance and other criteria for assessing fraud risks, such as the U.S. Government Accountability Office's (GAO) Framework for Managing Fraud Risks in Federal Programs and The Antifraud Playbook developed by the Chief Financial Officers Council and U.S. Department of Treasury, Bureau of Fiscal Service;

3. Interviewed HUD's CRO, the HCCRT, CPD headquarters and field office staff, and grantees;

4. Held brainstorming sessions with subject-matter experts from the Office of Inspector General's (OIG) Offices of Investigation and Audit; and

5. Identified and reviewed HUD OIG audit reports and investigations press releases and reports and press releases from law enforcement agencies, such as the U.S. Department of Justice (DOJ) and other agencies with programs similar to the CDBG and ESG programs.

We note that because CDBG and ESG CARES Act funds were appropriated relatively recently and are still being distributed by grantees, there were no relevant findings from HUD OIG oversight reports or investigations specifically involving CDBG and ESG CARES Act funds as of March 31, 2021. However, the eligible activities for both programs under the CARES Act and the ways the funds are distributed are similar to those under the annual funding provided for the CDBG and ESG programs, so we reviewed HUD OIG audit reports and investigations issued on CPD's programs for the past 5 years. Specifically, we reviewed 118 HUD OIG audit reports issued on any CPD programs between January 1, 2016, and March 31, 2021, and identified and reviewed seven press releases from HUD OIG's Office of Investigation related to CPD programs. We also reviewed GAO's recent report on the CDBG-Disaster Recovery (CDBG-DR) program, to gain insight on identified fraud risks for the CDBG-DR program, which is similar to the non-disaster CDBG program.[1] To gain an understanding of the types of fraud occurring related to CARES Act and other coronavirus Federal funding, we reviewed 114 DOJ press releases related to the coronavirus across various agencies in addition to HUD.

We documented the specific fraud risks and schemes we identified using a fraud risk map.[2]

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[1] GAO-21-177, Disaster Recovery – HUD Should Take Additional Action to Assess Community Development Block Grant Fraud Risks, issued May 2021.

[2] A fraud risk map is a resource that outlines identified potential fraud schemes and other related information for each scheme, such as actor and entry point, for various areas across an organization that can be used across the organization's fraud risk management activities; for example, when performing fraud risk assessments.

We conducted this engagement in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the engagement to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our objective. We believe the evidence obtained provides a reasonable basis for our conclusions based on our objective.

BACKGROUND

The CARES Act and the CDBG and ESG Programs

The CARES Act, signed into law on March 27, 2020, provided $12.4 billion to HUD, including $5 billion for the CDBG program and $4 billion for the ESG program. The CDBG program provides grants to States, cities, and counties to develop viable urban communities by providing decent housing and a suitable living environment and by expanding economic opportunities, principally for low- and moderate-income persons. Examples of eligible activities for CDBG CARES Act funds include constructing facilities for testing, diagnosis, or treatment of the coronavirus; providing short-term working capital assistance to small businesses to enable retention of jobs held by low- and moderate-income persons; increasing the capacity and availability of targeted health services for infectious disease response within existing health facilities; and providing emergency payments for individuals or families impacted by coronavirus for items such as food, clothing, housing (emergency rental assistance or mortgage assistance), or utilities for up to 6 consecutive months. The ESG program focuses on assisting people to quickly regain stability in permanent housing after experiencing a housing crisis or homelessness. ESG CARES Act funds are available to prevent, prepare for, and respond to coronavirus, among individuals and families who are homeless or receiving homeless assistance, and to support additional homeless assistance and homelessness prevention activities to mitigate the impacts created by the coronavirus. Specifically, ESG CARES Act funds can be used to provide emergency shelter, temporary emergency shelter, or rapid rehousing, as well as other crisis response activities and homelessness prevention assistance, such as street outreach and shelter operations.

The CARES Act provided HUD’s Secretary with the authority to waive or specify alternative requirements for any provision of any statute or regulation that the Secretary administers in connection with the use of funds for the CDBG and ESG programs provided by the CARES Act, if it is determined that the waivers or alternative requirements are necessary to expedite or facilitate the use of the funds to prevent, prepare for, and respond to the coronavirus. Requirements related to fair housing, nondiscrimination, labor standards, and the environment cannot be waived. The CARES Act also removed the 15 percent limitation for the use of funds for public services activities to prevent, prepare for, and respond to the coronavirus for CDBG funds provided by the CARES Act and the fiscal years 2019 and 2020 appropriations laws. For CDBG, waivers issued include allowing for expedited citizen participation and virtual hearings; suspending all corrective actions, sanctions, and informal consultations for timeliness for fiscal year 2020; and temporarily removing the requirement for consistency with the consolidated plan when fiscal years 2019 and 2020 CDBG funds are used to prevent, prepare for, and respond to coronavirus. Examples of alternative requirements developed for the ESG program include those that were established to authorize ESG CARES Act funds to be used for installing and maintaining handwashing stations and bathrooms in outdoor locations for people experiencing unsheltered homelessness, the cost of paying incentives to landlords and volunteers, and the cost of a hotel or motel room when no appropriate emergency shelter is available.

Fraud and Fraud Risks

Fraud and fraud risk are distinct concepts. GAO's Standards for Internal Control in the Federal Government defines fraud as obtaining something of value through willful misrepresentation. Whether an act is fraud is a determination to be made through the judicial or other adjudicative system and is beyond management's professional responsibility for assessing risk. Management should consider the potential for fraud when identifying, analyzing, and responding to fraud risks. Specifically, management considers the types of fraud that can occur within the entity to provide a basis for identifying fraud risks. Management should also consider fraud risk factors. Fraud risk factors do not necessarily indicate that fraud exists but are often present when fraud occurs. Fraud risk factors include when (1) individuals have an incentive or are under pressure, which provides a motive to commit fraud; (2) circumstances exist, such as the absence of controls, ineffective controls, or the ability of management to override controls, which provide an opportunity to commit fraud; and (3) individuals involved are able to rationalize committing fraud. Some individuals possess an attitude, character, or ethical values, which allow them to knowingly and intentionally commit a dishonest act. Management uses these fraud risk factors to identify fraud risks. While fraud risk may be greatest when all three risk factors are present, one or more of these fraud factors may indicate a fraud risk. Other information can also be used to identify fraud risks, including allegations of fraud or suspected fraud reported by OIG, internal auditors or personnel, or external parties that interact with the agency. When fraud risks can be identified and mitigated, fraud may be less likely to occur. Although the occurrence of fraud indicates that there is a fraud risk, a fraud risk can exist even if actual fraud has not yet been identified or occurred.

The Payment Integrity Information Act of 2019 repealed and replaced the Fraud Reduction and Data Analytics Act of 2015, leaving in place requirements for (1) conducting an evaluation of fraud risks and using a risk-based approach to design and implement financial and administrative control activities to mitigate identified fraud risks; (2) collecting and analyzing data from reporting mechanisms on detected fraud to monitor fraud trends and using those data and information to continuously improve fraud prevention controls; and (3) using the results of monitoring, evaluation, audits, and investigations to improve fraud prevention, detection, and response. Office of Management and Budget (OMB) Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control (OMB Circular No. A-123), provides implementation guidance and states that management has overall responsibility for establishing internal controls to manage the risk of fraud. An agency's risk profile as required by section II of OMB Circular No. A-123 must include an evaluation of fraud risks and use a risk-based approach to design and implement financial and administrative control activities to mitigate identified material fraud risks. To help managers combat fraud and preserve integrity in government agencies and programs, GAO identified leading practices for managing fraud risks and organized them into a conceptual framework called the Fraud Risk Management Framework. The Framework identifies four components to effectively manage fraud risks, including planning regular fraud risk assessments and assessing risks to determine a fraud risk profile.

RESULTS OF REVIEW

We identified fraud risk factors for the CDBG and ESG CARES Act funds that were not already identified by HUD. During our engagement, we also noted potential areas of improvement to assist HUD in enhancing its fraud risk management practices.

Fraud Risk Factors

We identified five overall risk factors that contribute to the risk of fraud for the CDBG and ESG CARES Act funds. Specifically,

- *Increased funding and volume of payments* – The CARES Act provided a substantial increase in funding for the CDBG and ESG programs, which can draw the attention of nefarious actors looking to take advantage of the programs for personal gain. The increase in funding can also lead to an increased workload for HUD, grantees, and subrecipients who already process a large volume of payments, potentially leading to capacity issues that can increase the risk of a breakdown in internal controls and increased fraud risks.

- *Pandemic environment* – The pandemic environment has limited onsite monitoring by HUD and grantees, which can increase the risk that a breakdown in internal control occurs or goes undetected, increasing the risk of fraud. High unemployment, shortages of goods and services, and other pandemic-related factors can lead otherwise ethical people to rationalize attempting to misappropriate Federal funds.

- *CARES Act provisions* – The CARES Act provided relaxed or altered programmatic requirements and waivers meant to expedite the distribution of funds to those in need; however, they can also increase the opportunity for nefarious actors looking to take advantage of the programs for personal gain. The CARES Act also funded programs at other agencies with goals and objectives similar to those of the CDBG and ESG programs, which increases the fraud risk by increasing the opportunity for nefarious actors to receive duplicate benefits.

- *Decentralized processes* – HUD uses a decentralized funding process to distribute CDBG and ESG funds. The multiple levels that funds flow through before reaching program beneficiaries increases the opportunity for fraud to occur. It also means that payment-eligibility decisions are made outside HUD, which is a risk factor for improper payments.[3]

- *Self-certification* – Instances in which self-certification is the sole or most significant control for program eligibility increase fraud risks from nefarious actors looking to take advantage of the programs for personal gain.

[3] OMB Memorandum M-21-19, appendix C to OMB Circular A-123, Requirements for Payment Integrity Improvement, lists examples of factors that may impact the level of improper payments and unknown payments within a program.

We used these risk factors and the results of our brainstorming sessions; interviews; and reviews of audit reports, investigations, and press releases to develop a fraud risk map containing 31 fraud schemes that can be used to misappropriate CDBG and ESG CARES Act funds. The schemes we identified fall into the general fraud categories of asset misappropriation and corruption.

Asset misappropriation includes schemes in which an individual or organization steals or misuses HUD funds. The asset misappropriation schemes we identified mainly involved obtaining HUD funds by means of fraudulent disbursements or invoices. These accounted for 23 of the 31 fraud schemes we identified and included purchasing and billing, payroll, reimbursement, and check-tampering schemes. Specifically, these fraud schemes include:

- *Shell companies* – Occur when an individual submits invoices for payment from a fictitious company controlled directly or indirectly by the individual.
- *Pay-and-return* – Occurs when an employee arranges for overpayment of a vendor and pockets the overpayment amount when it is returned to the company.
- *Personal purchases* – Occur when an individual submits an invoice for personal purchases for payment.
- *Ghost employees or beneficiaries* – Occur when an organization or individuals submit requests for reimbursement for employees who are not on their payroll.
- *Overpayment* – Occurs when payroll reimbursements are made based on falsified hours or rates.
- *Ineligible or mischaracterized activities* – Occur when an organization or individuals submit requests for reimbursement for activities they represent as eligible when they are ineligible.
- *Overstated expenses* – Occur when an organization or individuals overstate the costs of their activities.
- *Fictitious expenses* – Occur when an organization or individual invents a cost or activity and seeks reimbursement for it.
- *Multiple reimbursement* – Occurs when an organization or individual submits multiple requests for reimbursement for the same activity or cost.
- *Duplicate benefits* – Occur when an organization or individual receives benefits from multiple programs or agencies for the same activity or cost.
- *Altered payee* – Involves changing the payee designation on the check or payment to the perpetrator or an accomplice.

Corruption schemes occur when individuals use their influence or positions of trust in a business transaction in a way that violates their duty to their employers or the government. Corruption schemes include:

- *Bribery* – Involves the offering, giving, receiving, or soliciting of a thing of value to influence a decision.
- *Kickbacks* – Occur when contractors and vendors make undisclosed payments to employees of subrecipients or grantees to enlist them in overbilling schemes.
- *Bid-rigging* – Occurs when an employee of a subrecipient or grantee fraudulently assists a vendor in winning a contract through the competitive bidding process. Bid-rigging can also involve contractors and vendors working together to ensure that one of them receives a contract in return for payment or being brought on as a subcontractor.
- *Conflicts of interest* – Occur when an individual has an undisclosed ownership or financial interest in an organization or company seeking an award or that already has a contract.
- *Economic extortion* – Occurs when employees demand payment from a contractor or vendor for decisions made in their favor. Refusal to pay the extorter results in harm to the contractor or vendor.

Most of the schemes include risks that are external to HUD, meaning that they occur at the grantee or subrecipient level and may involve contractors, vendors, or beneficiaries. A full listing and the details of the potential fraud risks and schemes we identified can be found in appendix A. We note that while these fraud risks can assist HUD in conducting a fraud risk assessment, they do not replace such an assessment.

Opportunities to Improve HUD's Fraud Risk Management Practices

While gaining an understanding of HUD's fraud risk management practices, we observed that CPD had not completed its own program fraud risk assessment and neither CPD nor OCFO, as part of its enterprise risk management (ERM) process,[4] maintained an inventory of fraud risks for the CDBG or ESG programs. We also noted that the CARES Act funds for the CDBG and ESG programs were not subject to the front-end risk assessment (FERA)[5] process, as they were viewed as additional funds for existing programs and there was a concerted effort to distribute the funds as quickly as possible. Further, the rapid risk assessment performed by the HCCRT

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[4] As defined by OMB Circular No. A-123, ERM is a model for organizations to integrate risk management and internal control activities into a common framework. ERM provides an enterprise-wide strategically-aligned portfolio view of organizational challenges that provide better insight about how to most effectively prioritize resource allocations to ensure successful mission delivery.

[5] A FERA is a risk management function intended to facilitate the identification and management of risks associated with launching a new HUD program or substantially revising a current program. The information required for assessment and evaluation aligns with the ERM framework and will provide program management, risk officers, and program owners with the structure to assess and report on identified risks and plans to address and monitor those risks. The FERA will further aid HUD in identifying and responding to potential risks for fraud, waste, abuse, and mismanagement.

did not contain questions specific to fraud risk. Additionally, the most recent improper payments risk assessments for the ESG and CDBG programs were conducted in fiscal years 2018 and 2019, respectively; however, the questions related to fraud risk included in the improper payment risk assessments were not designed to satisfy a full program-specific risk assessment as described in GAO's Fraud Risk Management Framework. A risk assessment is required in fiscal year 2021 for both programs, due to the increase in funds provided by the CARES Act.

Although CPD had not performed fraud risk assessments for the CDBG and ESG programs, they do perform risk assessments as part of their grantee monitoring process, and monitoring reviews of CARES Act funds are planned to begin in 2022. HUD has also implemented and continues to improve its ERM process. However, there is a limited focus on program-specific fraud risks.

While we understand that HUD expects its grantees to be proactive in the identification and remediation of fraud, we believe that HUD can improve its processes to create a more fraud-aware control environment. Specifically, a fraud analytics strategy developed by HUD that leverages grantee and subgrantee data would provide additional assurance that funds are not susceptible to fraud risk factors while simultaneously reducing the amount of resources needed to identify fraud through HUD's current process. Currently, CPD conducts limited analysis of the monitoring exhibits completed by its field office staff during grantee site visits to detect potential red flags for fraud. These exhibits focus on many areas and controls, but none focuses specifically on the identification of potential fraud or fraud risks. Additionally, while we identified that most fraud schemes occur external to HUD, CPD does not collect subrecipient data to conduct data analyses to identify potential instances of fraud that occur across grantees or programs. Due to the pandemic, CPD has been unable to perform its regular site visits to CDBG and ESG grantees, further exposing the agency to potential fraud regarding the CARES Act funds and increasing the need to collect more data to conduct remote monitoring activities.

During our interviews, we also noted some confusion regarding the roles and responsibilities for performing program-specific fraud risk assessments among OCFO's ERM process, the HCCRT, and CPD. Specifically, CPD personnel stated that fraud risk assessments and mitigation efforts for all CPD funding, including CARES Act funding, were addressed as part of HUD's ERM and HCCRT processes. However, the Risk Register developed by the CRO as part of the ERM process did not include program-specific fraud risks and listed only operational risks of the agency at an enterprise level. Similarly, the rapid risk assessment performed by the HCCRT after passage of the CARES Act did not contain questions specific to fraud risks. Additionally, in multiple interviews CPD officials stated that fraud was not a significant issue for the CDBG and ESG programs and that the responsibility for the assessment and mitigation of fraud risks rested primarily with the grantees. The primary focus of CPD's officials is to get the funds appropriated by Congress to the grantees to enable them to start distributing them to subrecipients and program beneficiaries as quickly as possible. Finally, CPD offered training to grantees and literature on other Federal programs administering pandemic-related programs that could result in duplication of benefits. However, trainings on fraud were not recurring, and an emphasis on fraud prevention and detection was not a primary objective. The majority of CPD's training and support for grantees is focused on facilitation and technical support, with limited to no focus on fraud risk identification and reporting.

CONCLUSION

We obtained an understanding of HUD's fraud risk management practices and determined that program-specific fraud risk assessments had not been performed for the CDBG and ESG CARES Act funds. We identified 5 overall risk factors and 31 specific fraud risks, which we detail in our fraud risk map in appendix A. Most fraud risks we identified were external to HUD, occurring at the grantee and subrecipient level; however, OMB Circular No. A-123 states that management has overall responsibility for establishing internal controls to manage the risk of fraud. We note that while our fraud risk map may be informative to HUD in conducting a fraud risk assessment, it does not replace such an assessment.

We also identified opportunities for HUD to improve its fraud risk management practices, including, clarifying roles and responsibilities, performing fraud-specific risk assessments, and raising awareness of fraud and fraud risks. Addressing these opportunities can reduce the risk of fraud occurring and the risk of a loss of trust from the people HUD serves.

RECOMMENDATIONS

We recommend that the Office of the Chief Financial Officer

1A. Coordinate with CPD program staff to clarify the (1) roles and responsibilities of the CRO, HCCRT, and CPD's risk management staff with regard to identifying, assessing, and mitigating fraud risks and (2) purpose and role of HUD's ERM processes and program office risk management processes with regard to identifying, assessing, and mitigating fraud risks.

We recommend that the Principal Deputy Assistant Secretary for Community Planning and Development

1B. Complete a program-specific fraud risk assessment and risk profile for the CDBG and ESG programs, with emphasis on CARES Act funding, and replicate this process to create program-specific fraud assessments and risk profiles for other CPD programs.

1C. Consider OIG's fraud risk inventory to improve CPD's own fraud risk assessments and develop a program-specific fraud risk map and compendium.

1D. Implement efforts to increase the awareness of fraud at all levels (headquarters, field offices, grantees, subrecipients, etc.), including but not limited to regularly publishing articles on known fraud schemes and identified instances of fraud in periodic newsletters or on CPD's intranet website, providing recurring fraud risk trainings to HUD employees and grantees and working with OIG to develop materials to support fraud awareness.

1E. Develop and implement a fraud risk checklist or other instrument as part of CPD's monitoring oversight requirements, to be completed as part of each remote and onsite monitoring review.

1F. Develop and implement a fraud analytics strategy using available data, including but not limited to data and information collected during the grantee risk assessment and monitoring processes, to begin conducting data analyses to identify potential fraud risks for further review.

Appendixes

Appendix A

Fraud Risk Map for the CDBG and ESG CARES Act Funds

CDBG	*ESG*	*Sub-fraud scheme*	*Actor*	*Fraud risk entry point*	*Underlying fraud risk*	*Details*
Asset Misappropriation						
Fraudulent disbursements, expense reimbursement, external						
X	**X**	Shell company-organization	Grantee (grant manager-administrator, local politician)	Expense reimbursement	An individual creates a fictitious organization to funnel funds to his or her personal or an accomplice's account.	The increase in funding due to the CARES Act can challenge the capacity of some grantees, increasing the risk of a breakdown in internal control and providing an opportunity for bad actors to create a fictitious subrecipient or contractor to funnel funds to their personal or an accomplice's accounts.
X	**X**	Shell company-organization	Subrecipient, contractor	Procurement	Individuals pose as service providers or contractors with medical-related expertise and experience but have no intention to perform work.	Individuals can set up a fraudulent organization or vendor claiming to have medical expertise in testing, diagnosis, or treatment to receive awards and claim funds with no intention to perform work or provide services.

CDBG	ESG	Sub-fraud scheme	Actor	Fraud risk entry point	Underlying fraud risk	Details
X	**X**	Duplication of benefits	Contractor, beneficiary	Expense reimbursement, program application	A contractor or beneficiary receives funds from multiple programs for the same activity or need.	A shelter can claim ESG funds and U.S. Department of Veterans' Affairs or Education funds for providing the same service. Beneficiaries may receive rental assistance from CDBG and the U.S. Department of the Treasury's rental assistance program.
X	**X**	Multiple reimbursements	Subrecipient, contractor	Expense reimbursement	Contractor-subrecipient submits multiple invoices for the same activity or cost.	Contractors or subrecipients can attempt to submit multiple invoices for the same activity or cost. Increased workload at the grantees due to the increase in funds from the CARES Act increases the risk that duplicate billings will be missed.
X	**X**	Fraudulent signatures - authorizations	Grantee (grant manager-administrator, local politician)	Procurement, expense reimbursement	A grantee fraudulently signs-enters into obligations or creates fictitious expenses to avoid losing funds.	The CARES Act provided a substantial increase in funds to many jurisdictions that may not have the capacity or capability to spend the funds in accordance with the required timelines.
X	**X**	Ineligible activities	Subrecipient, contractor	Expense reimbursement	A subrecipient or contractor receives reimbursement for an ineligible expense.	Due to the increased funding from the CARES Act and a potential increase in program activity, grantees and subrecipients can encounter an increase in invoices that challenges their capacity, increasing the risk of a failure of their internal controls leading to

CDBG	ESG	Sub-fraud scheme	Actor	Fraud risk entry point	Underlying fraud risk	Details
						reimbursements for ineligible activities.
	X	Ineligible activities	Beneficiary	Beneficiary, program application	Individuals can forge or manipulate their financial records to appear as at risk homeless to obtain ESG funds that they would otherwise not qualify for.	The CARES Act raised the income limit in the definition of "at risk of homelessness." Bad actors can see this as an opportunity to provide false certification by not reporting all sources of income and presenting themselves as at risk when they are, in fact, not eligible to obtain ESG funds.
	X	Ghost beneficiaries	Subrecipient, contractor	Expense reimbursement	An organization can forge or manipulate its records of homeless people served to obtain additional funds.	A shelter can inflate the number of homeless people served by listing fictitious names or names of people who were not served (manipulate their rolls) to increase the amount they are reimbursed for.
	X	Ineligible activities	Subrecipient, contractor	Expense reimbursement	An individual or organization can lease an existing property and claim to create and operate it as a temporary shelter while using it for ineligible activities.	An applicant can claim that its property is being used as a temporary shelter when it is being used for an ineligible purpose. Because it is temporary and onsite reviews and monitoring have been limited due to the pandemic environment, the applicant can

CDBG	ESG	Sub-fraud scheme	Actor	Fraud risk entry point	Underlying fraud risk	Details
						claim the shelter had shut down if or when monitoring is eventually performed.
	X	Fictitious expenses	Subrecipient, contractor	Expense reimbursement	An organization can falsify records and attempt to receive reimbursement for activities and costs that did not occur.	The ESG CARES Act funds allow for several activities which may be difficult to verify whether they occurred, including transporting homeless persons from a shelter to a test site, housing and quarantining those who test positive, and providing handwashing stations for people in unsheltered situations.
	X	Fictitious or overstated expenses	Subrecipient, contractor	Expense reimbursement	Landlords can inflate the cost of damage and repair or cleaning of program units or appliances or request reimbursement for damage that did not occur.	CPD Notice 20-08 established alternative requirements for the use of ESG CARES Act funds for landlord incentives, including paying the cost to repair damage not covered by a security deposit and paying the costs of extra cleaning or maintenance for a unit or appliance. This practice increases the risk that a landlord housing homeless individuals or families submits claims to be reimbursed for damages or cleaning costs that either inflate

CDBG	ESG	Sub-fraud scheme	Actor	Fraud risk entry point	Underlying fraud risk	Details
						the costs or are for damages and costs that did not occur.
	X	Fictitious or overstated expenses-multiple reimbursements	Subrecipient, contractor	Expense reimbursement	Landlord security deposit scheme. Charge the tenant and charge the program.	CPD Notice 20-08 established alternative requirements for the use of ESG CARES Act funds for landlord incentives, including providing security deposits equal to up to 3 months of rent. There is a risk that a landlord can receive funds from HUD for a security deposit while also improperly demanding security deposits from the homeless person or family being served.
X	X	Fictitious or overstated expenses	Subrecipient, contractor	Expense reimbursement	Service providers create fraudulent invoices for services or goods and request reimbursement.	Individuals operating a non-profit or service provider can submit fraudulent or inflated invoices for goods and services. After being reimbursed they use the funds to pay personal expenses or debts.

CDBG	ESG	Sub-fraud scheme	Actor	Fraud risk entry point	Underlying fraud risk	Details
X	**X**	Overstated expenses	Subrecipient, contractor	Expense reimbursement	A contractor or vendor increases the costs of goods or services and pockets the excess amount (price gouging).	The pandemic environment created shortages of goods and services, including cleaning and medical supplies. Individuals can overstate the cost of such goods and services and claim that there were supply shortages when requesting reimbursement and pocket the excess.
X	**X**	Overstated expenses	Subrecipient, contractor	Expense reimbursement	A contractor or vendor substitutes unauthorized, cheaper materials during construction or rehabilitation.	CARES Act funds are available for many construction and rehabilitation activities, including converting, or renovating properties for use as a hospital, shelter, or testing site. Shortages of materials and bad actors seeing an opportunity to personally profit increases the risk that cheaper or unauthorized materials are used during construction or rehabilitation, allowing the perpetrator to pocket the excess.
X	**X**	Overstated expenses	Subrecipient, appraiser, underwriter, lender	Expense reimbursement	Individuals coordinate to overstate the cost of real property before acquisition.	CARES Act funds can be used to acquire and rehabilitate properties for use as group living facilities for patients undergoing treatment or to expand the capacity of hospitals. Individuals, including appraisers, underwriters, and lenders, can coordinate to inflate the cost of a

CDBG	ESG	Sub-fraud scheme	Actor	Fraud risk entry point	Underlying fraud risk	Details
						property before acquisition and pocket the excess.
	X	Fictitious expenses	Subrecipient, contractor	Expense reimbursement	Service providers use fraudulent volunteer incentive schemes such as kickbacks, ghost volunteers, or skimming to misappropriate funds.	CPD Notice 20-08 established alternative requirements for ESG CARES Act funds used to provide incentives to volunteers who help with street outreach, emergency shelter, essential services, and housing relocation and stabilization services during the coronavirus outbreak. Bad actors can use this opportunity to misappropriate funds by requesting reimbursement for non-existent volunteers or splitting reimbursements with accomplices who do not perform volunteer activities. They can also overstate the amount of the incentives provided to actual volunteers and pocket the excess.

CDBG	ESG	Sub-fraud scheme	Actor	Fraud risk entry point	Underlying fraud risk	Details
	X	Overstated expenses	Subrecipient, contractor	Expense reimbursement	A landlord increases rent to increase its profit.	CPD Notice 20-08 waived the requirement that prohibits rental assistance when the rent for the unit exceeds the fair market rent established by HUD, so long as the rent complies with HUD's standards of rent reasonableness. This can provide an opportunity for bad actors to raise rents solely to increase their profit.
X	X	Pay-and-Return	Grantee, subrecipient	Expense reimbursement	Program staff members arrange for an overpayment of a reimbursement request or vendor invoice and pocket the overpayment when it is returned.	An employee or program official, especially those at smaller grantees and subrecipients which have less resources for internal controls, can circumvent internal controls to overpay a vendor invoice or reimbursement request. When the vendor or subrecipient returns the excess amount, he or she funnels the funds into a personal account.
X	X	Misrepresentation, Identity Theft	Subrecipient, contractor	Procurement	Individuals falsely claim to represent a legitimate organization or contractor to direct payments to their personal accounts.	Individuals can claim to represent an actual organization or contractor to claim awards and reimbursement for fictitious expenses, when they have no relation to the organization or contractor.
Expense reimbursement, external-internal						

CDBG	ESG	Sub-fraud scheme	Actor	Fraud risk entry point	Underlying fraud risk	Details
X	X	Ineligible beneficiary	HUD-grantee-subrecipient employee, program applicant-beneficiary	Expense reimbursement	Program staff members collude with outside accomplices to assist them in fraudulently obtaining funds.	Program staff members with knowledge of the CDBG and ESG CARES Act requirements can coordinate with an ineligible organization or applicant (a grantee can coordinate with a subrecipient or a subrecipient can coordinate with a program applicant) so that the organization-applicant appears eligible for funds and receives a portion of the benefits in return.
Check and payment tampering, external-internal						
X	X	Altered Payee/Forged Endorsement	Grantee (grant manager-administrator), subrecipient	Disbursements	An employee at a grantee or subrecipient diverts funds to his or her personal account.	Due to the substantial increase in funds from the CARES Act, employees can see an opportunity to attempt to redirect vendor payments to their own or an accomplice's account.
Payroll, external						
	X	Falsified Wages	Grantee, subrecipient, contractor	Expense reimbursement	An organization can seek reimbursement for hazard- pay for individuals who did not put their own health at risk.	The CARES Act allows recipients and subrecipients to provide hazard pay to their staff members who put their own health at risk to continue to provide necessary services. An organization can request reimbursement for hazard pay for employees whose health was not at risk (teleworkers) and pocket the difference.

CDBG	ESG	Sub-fraud scheme	Actor	Fraud risk entry point	Underlying fraud risk	Details
Corruption						
Bribery, external						
X			Developer-contractor	Procurement-awards	Developers offer bribes to obtain redevelopment or rehabilitation agreements or the rights to purchase and redevelop city or county owned properties	Local officials can be offered and receive bribes to use their positions and influence to assist them in obtaining properties for redevelopment or rehabilitation and/or status as a designated developer.
Bribery, external-internal						
X	X		Subrecipient, contractor-vendor	Procurement	Contractors-subcontractors offer bribes to obtain contracts	A contractor can offer payment in the form of cash, favors, or gifts to a contracting officer in exchange for being awarded a contract.
Kickbacks, external						
X	X		Contractor-vendor	Expense reimbursement	Contractors offer kickbacks to subcontractors for inflating costs.	A contractor can instruct a subcontractor to inflate costs, ensures payment is made on a false invoice, then provides a portion of the profit to the subcontractor.
X	X		Contractor-vendor	Procurement	Contractors-subcontractors offer kickbacks to program staff in exchange for overstated or fictitious expense schemes.	A contractor can offer a kickback to a program administrator to be determined qualified for program funds or to look the other way when the contractor over-charges for activities or costs.
Kickbacks, external-internal						

CDBG	ESG	Sub-fraud scheme	Actor	Fraud risk entry point	Underlying fraud risk	Details
X	X		Contractor-vendor	Procurement	Contractors-subcontractors offer kickbacks to program staff in exchange for overstated or fictitious expense schemes.	A contractor can offer a kickback to a program administrator to be determined qualified for program funds or to look the other way when the contractor over-charges for activities or costs.
Bid-rigging, external						
X	X		Contractor-vendor	Procurement	Contractors coordinate with each other to ensure that one of them obtains an award.	Contractors can conspire to avoid competitive bidding controls by agreeing on bid prices to ensure that a specific contractor receives the award. The contractor can use the other bidders as subcontractors to funnel funds to them for their participation.
X	X		Contractor-vendor	Procurement	A contractor or vendor submits fake quotes.	A contractor or vendor can submit fake quotes from other purported vendors to give the false impression that its bid is the best to ensure that it receives an award.
Conflicts of interest, external						
X	X		Grantee, subrecipient	Procurement	An official at a grantee or subrecipient has an ownership or financial interest in a contractor or vendor seeking an award.	An official at a grantee or subrecipient can steer contracts to a company he or she owns or has a financial interest in. This can also lead to other fraud schemes, such as fictitious or overpayments.
Economic extortion, extortion, external						

CDBG	ESG	Sub-fraud scheme	Actor	Fraud risk entry point	Underlying fraud risk	Details
X	**X**		Grantee, subrecipient	Procurement, expense reimbursement	An official at a grantee or subrecipient demands payment or other benefits from a contractor for a decision made in their favor.	A procurement official at a grantee or subrecipient can demand payment or financial benefits from a contractor or vendor in exchange for an award. Refusal to pay can result in the contractor losing an award they were best qualified to receive.

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation	Auditee Comments

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

MEMORANDUM FOR: Kilah S. White, Assistant Inspector General for Audit, OIG

FROM: James Arthur Jemison II, Principal Deputy Assistant Secretary, D JAMES JEMISON Digitally signed by JAMES JEMISON Date: 2021.09.28 18:00:42 -04'00'

George Tomchick Digitally signed by George Tomchick Date: 2021.09.28 19:48:29 -04'00'
George J. Tomchick III, Deputy Chief Financial Officer

SUBJECT: Management Response to Draft Report, "Fraud Risk Inventory for the CDBG and ESG CARES Act Funds"

DATE: 09/28/2021

Thank you for providing the Department of Housing and Urban Development (HUD) the opportunity to review and comment on the Office of the Inspector General's (OIG's) Draft Report, *Fraud Risk Inventory for the CDBG and ESG CARES Act Funds* (FO 21 0001). We appreciate the OIG's review of HUD's fraud risk management practices for the $9 billion in funding appropriated by the Coronavirus Aid, Relief, and Economic Security (CARES) Act to the Community Development Block Grant (CDBG) and Emergency Solutions Grant (ESG) programs. The CARES Act funding has provided critical support to prevent, prepare for, and to respond to housing needs resulting from the COVID-19 pandemic. Upon review of the OIG's draft report, we are providing additional clarity on HUD's fraud risk management activities for these programs.

Comment 1

The OIG states that the CARES Act provided relaxed or altered programmatic requirements and waivers to expedite distribution of funding. In response to the increase in funding from CARES Act, the Community Planning and Development (CPD) program office has instituted controls over the use of waivers to mitigate the increased risk of fraud resulting from these flexibilities. For example, to exercise the waiver flexibility provided under key waiver memorandums, grantees must notify the CPD Field Office Director via email no less than two days prior to use. Grantees are responsible for updating program records to document the specific conditions justifying waiver use, consistent with the guidelines outlined in the related program notices. Further, CPD Field Offices have established a dedicated email address for receiving waiver requests, which are tracked in a spreadsheet. As part of the Fiscal Year (FY) 2022 grants monitoring process, CPD anticipates leveraging this tracking mechanism to evaluate the completeness and accuracy of the supporting documentation retained by a sample of waiver recipients. In addition, CPD has deployed robust duplication of benefits controls and internal and external training programs to respond to the risk presented by other Agencies and programs with potentially overlapping goals and objectives that also received CARES Act funding.

Ref to OIG Evaluation	Auditee Comments

Comment 2

Although CPD temporarily suspended its onsite visits to CDBG and ESG grantees, it continues to perform monitoring procedures remotely; and established the CARES Act Administrative Review (CAAR) process in February 2021 to supplement existing compliance monitoring processes. The CAAR is used to document technical assistance provided to CARES ACT grantees to assist in addressing current issues and includes specific steps to monitor the disbursement status of grant recipients, ensure that supporting activity detail within CPD's systems is adequate, and confirm quarterly reporting is submitted on schedule to further mitigate the risk of fraud.

Comment 3

As a further method of governance and control over the CARES Act funding, HUD established the HUD CARES Act Compliance Response Team (HCCRT) within the Office of the Chief Financial Officer (OCFO) to specifically assess and address the impact of the CARES Act on HUD people, processes, and technology. The HCCRT conducted a series of Rapid Risk Assessments on all program offices receiving CARES Act funding and aligned resources to targeted initiatives to address the risks facing the program offices resulting from the funding surge. This included looking at the ability to scale the programs' internal controls to mitigate the risks associated with fraud, waste and abuse. To address this risk the OCFO performed A-123 internal control assessments in FY 2021 across all programs that received CARES Act funding. After completion of the Rapid Risk Assessments, HCCRT continued to engage with programs to strengthen and monitor internal controls and other mitigating activities related to overseeing and disbursing CARES Act funds and establish next steps accordingly. These discussions held with the program offices will inform the FY 2022 internal controls evaluation strategy and other risk mitigation strategies. OCFO will consider how the OIG fraud risk map and the summaries of common fraud activities that OIG has identified through brainstorming sessions with OIG investigators could be used to help inform HUD programs of potential threats and ongoing fraud risks.

Additionally, the OCFO designed and distributed a risk assessment questionnaire inclusive of specific fraud risk factors in connection with the payment integrity evaluation processes. These fraud risk factors included whether a fraud risk assessment has been conducted in the last three years, if there are adequate training programs around fraud prevention and detection, if there is adequate segregation of duties and oversight in grant management processes, and the effectiveness of senior leadership's tone at the top related to fraud. The CPD CDBG and ESG programs were both assessed following this method in FY 2021 and the results of this assessment will be used to further refine the payment integrity planning and scoping in FY 2022.

Comment 4

Within the *Conclusion* section of the draft report, the OIG reported one recommendation for the Office of Chief Financial Officer (OCFO). The OIG recommendation is that OCFO should work with the CPD program office to define roles and responsibilities for identifying fraud risk and to define the purpose and role of HUD's ERM processes and program risk management process for identifying, assessing and mitigating fraud risk. HUD concurs with the OIG's recommendation to further define the roles and responsibilities across HUD to identify and mitigate fraud risks.

Ref to OIG Evaluation	Auditee Comments
Comment 5	CPD's Office of Block Grant Assistance does not fully agree that CARES Act Provisions and Decentralized Processes are contributing to increased risk for CDBG-CV. Regarding CARES Act Provisions, the waivers and alternative requirements were not complicated or significant deviations from the annual CDBG program. The scope of the waivers and alternative requirements is closer to the Recovery Act program CDBG-R than it is to CDBG-DR or NSP. CDBG-R posed very little additional risk over the main annual CDBG program, leading HUD to the conclusion that existing risk controls would be largely sufficient.
Comment 6	HUD continues to be committed to fulfilling its mission of creating strong, sustainable, inclusive communities and quality affordable homes for American families and individuals, while also responding to the impacts of COVID-19 on housing. HUD recognizes the value of the information provided by OIG and see opportunities to further enhance fraud risk management across the Department.

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OIG Evaluation of Auditee Comments

Comment 1	We recognize HUD's efforts to implement controls to mitigate the risk of fraud from the flexibilities granted by the CARES Act and duplication of benefits. However, we note that the implementation of control activities is only part of a robust fraud risk management program as defined by GAO's Framework for Managing Fraud Risks in Federal Programs. To build such a program, HUD needs to continue its efforts to implement the four components for effectively managing fraud risks as detailed in the Framework, including committing to combating fraud, planning regular fraud risk assessments and determining a fraud risk profile, designing and implementing a strategy to mitigate fraud risks, and evaluating outcomes using a risk-based approach and adapting activities to improve fraud risk management. These steps must be done not only at the agency level, but also at the program level in order to have a robust fraud risk management program.
Comment 2	We appreciate HUD's efforts to provide technical assistance and monitor its CARES Act grantees; however, we note that there is a substantial risk of fraud that exists outside HUD and its grantees at the subrecipient and beneficiary levels, as detailed in many of the fraud schemes in our fraud risk map. Based on our observations, HUD placed much of the responsibility for managing fraud risks at the subrecipient and beneficiary levels on its grantees; however, according to OMB Circular A-123, Management's Responsibility for Enterprise Risk Management and Internal Control, HUD has the overall responsibility for managing the risk of fraud.
Comment 3	We recognize and appreciate HUD's efforts to design and implement controls over the CARES Act funding, which include establishing the HCCRT and designing a risk assessment questionnaire that is inclusive of fraud risk factors. However, the controls described are only at the agency level. As discussed in our report, the majority of fraud risks identified in our inventory occur at the subrecipient level, and therefore antifraud activities should be developed to mitigate the fraud risks at that level. We look forward to working with HUD as it continues its efforts to implement further best practices.
Comment 4	We acknowledge OCFO's concurrence with our recommendation to work with CPD program offices to define roles and responsibilities for the identification of fraud risk and to define the purpose and role of HUD's ERM's process for identifying, assessing, and mitigating fraud risk factors.
Comment 5	We recognize that the CDBG program as funded by the CARES Act is similar to the annual CDBG program; however, we disagree that very little additional risk was created. We believe that altering or waiving programmatic requirements can increase the risk of fraud. For example, removing the 15 percent limitation for the use of funds for public services can increase the risk that bad actors may attempt to obtain HUD funds by falsely claiming that they performed activities classified

as public services or through other willful misrepresentations. We also note that the decentralized process used to distribute the CDBG and ESG CARES Act funds leads to eligibility decisions being made outside HUD, which is a risk factor for improper payments specifically mentioned in appendix C to OMB Circular A-123, Requirements for Payment Integrity. Every level funds flow through to reach the beneficiary creates more distance from HUD's direct oversight and increases the opportunity for fraud schemes to occur as more parties become involved. Accordingly, we reiterate our assessment that CARES Act provisions and decentralized processes are overall fraud risk factors for the CDBG and ESG CARES Act funds, which contribute to multiple fraud schemes identified in our fraud risk map, and the importance of improving HUD's fraud risk management practices.

Comment 6 We appreciate HUD's cooperation during our review. We also recognize HUD's continued efforts to design and implement an effective enterprise risk management program and system of internal controls, including those to prevent and detect fraud.