



## **U.S. Department of Housing and Urban Development**

### **Section 3 for Public Housing Authorities**



U.S. DEPARTMENT OF  
HOUSING AND URBAN DEVELOPMENT  
OFFICE OF INSPECTOR GENERAL

Issue Date: June 26, 2013

Audit Report Number: 2013-KC-0002

TO: Sara Pratt, Deputy Assistant Secretary for Enforcement and Programs, ED  
Lindsey Reames, Deputy Assistant Secretary for Field Operations, PQ

FROM: Ronald J. Hosking, Regional Inspector General for Audit, 7AGA

SUBJECT: HUD Did Not Enforce the Reporting Requirements of Section 3 of the Housing and Urban Development Act of 1968 for Public Housing Authorities

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of HUD's oversight of Section 3 of the Housing and Urban Development Act of 1968 for public housing authorities.

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 audit.

The Inspector General Act, Title 5 United States Code, section 8L, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at 913-551-5870.



June 26, 2013

## **HUD Did Not Enforce the Reporting Requirements of Section 3 of the Housing and Urban Development Act of 1968 for Public Housing Authorities**

# **Highlights**

**Audit Report 2013-KC-0002**

### **What We Audited and Why**

We reviewed the U.S. Department of Housing and Urban Development's (HUD) oversight of Section 3 of the Housing and Urban Development Act of 1968 due to concerns over HUD's ensuring economic opportunities for low- and very low-income persons. Our audit objective was to determine whether HUD enforced the requirements of the Section 3 program for Recovery Act Public Housing Capital Fund recipients.

### **What We Recommend**

We recommend that HUD (1) implement the new HUD-60002 submission and tracking system, (2) design a method to follow up on missing and inaccurate information in HUD-60002 submissions, (3) publish final regulations, and (4) require housing authorities to support \$26 million in payments. We also recommend that HUD (1) establish policies and procedures that implement a system of escalating administrative measures, including progressive remedies and sanctions, to be applied against housing authorities that do not submit a HUD-60002 and (2) establish a methodology to incorporate Section 3 compliance in risk assessments.

### **What We Found**

HUD did not enforce the reporting requirements of the Section 3 program for Recovery Act Public Housing Capital Fund recipients. Specifically, HUD failed to collect Section 3 summary reports from all housing authorities by the required deadline and verify their accuracy. In addition, it did not sanction housing authorities that failed to submit the required reporting information. As a result, 1,650 nonsubmitting housing authorities may have falsely certified compliance. In addition, they did not provide HUD and the general public with adequate employment and contracting information.

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## BACKGROUND AND OBJECTIVE

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The U.S. Department of Housing and Urban Development's (HUD) Office of Fair Housing and Equal Opportunity (FHEO) administers Federal laws and establishes national policies to ensure that all Americans have equal access to the housing of their choice. In addition, it interprets policy, processes complaints, performs compliance reviews, and offers technical assistance to local housing authorities and community development agencies regarding Section 3 of the Housing and Urban Development Act of 1968.

Section 3 is HUD's policy for providing preference to low- and very low-income residents and the businesses that employ them. Section 3 residents live in the community where applicable HUD funds are spent. Section 3 businesses substantially employ these residents for new employment, training, and contracting opportunities created from the use of covered HUD funds. All public housing funds administered by the Office of Public and Indian Housing (PIH) are subject to Section 3 while certain programs administered by the Office of Community Planning and Development, Multifamily Housing and the Office of Healthy Homes and Lead Hazard control are subject to these requirements within certain limits.

Each recipient (and its contractors, subcontractors, or subrecipients) is required to comply with the requirements of Section 3 to the greatest extent feasible. These requirements include attempting to ensure that a minimum of 30 percent of all new jobs created go to Section 3 residents, 10 percent of all construction contracts are awarded to Section 3 businesses, and 3 percent of all non-construction contracts are awarded to Section 3 businesses. In addition, recipients are required to document their efforts to comply with these thresholds if they fail to meet them and annually submit a summary report to HUD on their Section 3 compliance.

On February 17, 2009, the President signed the American Recovery and Reinvestment Act, which included a \$4 billion appropriation in Public Housing Capital Fund grants to public housing agencies. The first and most important goal of the Recovery Act was to preserve and create jobs and promote economic recovery. Since Recovery Act funding was specifically intended to create jobs and other economic opportunities for those most impacted by the recession, compliance with the requirements of Section 3 was critical. In addition, in fiscal years 2011 and 2012, HUD awarded \$2.04 billion and \$1.875 billion, respectively, in Public Housing Capital Fund grants. These grant funds are available for capital and management activities, including the development, financing, and modernization of public housing projects. These programs are administered by PIH.

FHEO enters into voluntary compliance agreements (VCA) when it concludes that recipients violate Section 3 requirements. These VCA's list all the actions that they must take to come into compliance. FHEO field offices conduct compliance or complaint reviews that lead to the implementation of VCA's.

Our audit objective was to determine if HUD enforced the requirements of the Section 3 program for Recovery Act Public Housing Capital Fund recipients.

## RESULTS OF AUDIT

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### Finding 1: HUD Did Not Enforce the Reporting Requirements of the Section 3 Program

HUD did not enforce the reporting requirements of the Section 3 program for Recovery Act Public Housing Capital Fund recipients. FHEO lacked a collection system able to identify missing and inaccurate reports, and it did not have procedures to follow up on submissions and refer to PIH any noncompliant housing authorities. As a result, 1,650 of 3,102 public housing agencies failed to submit their Section 3 annual summary reports and potentially falsely certified compliance with Section 3. In addition, they did not provide HUD and the general public with adequate employment and contracting information.

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#### Requirements Not Enforced

HUD did not enforce the reporting requirements of the Section 3 program for Recovery Act Public Housing Capital Fund recipients. In addition, it did not sanction housing authorities that failed to submit the required reporting information.

##### HUD-60002 Form Collection

FHEO failed to collect the required Section 3 Annual Summary Reports (form HUD-60002) from all housing authorities by the deadline. It did not fully track housing authorities that had not submitted their reports by the deadline. As of October 23, 2012, HUD had not collected HUD-60002 forms for 2011 from 1,650 of 3,102 (53 percent) housing authorities and had not followed-up with them.

Each housing authority is responsible for submitting form HUD-60002 in accordance with 24 CFR (Code of Federal Regulations) 135.90, which requires housing authorities to submit this form to HUD by January 10 of each year. The requirements of Section 3 apply to all housing authorities regardless of size or the number of units, except those that administer only Section 8 (see appendix C).

##### HUD-60002 Form Verification

FHEO did not verify the accuracy of the forms or follow up on clearly noncompliant information. For example,

- Thirty-six HUD-60002 submissions reported more Section 3 jobs created than the total number of jobs created.
- One housing authority reported 26 total new hires and no Section 3 new hires.
- Another reported 11 total new hires and no Section 3 new hires.

- Another reported that it awarded more than \$170 million in total construction contracts and \$257 million in non-construction contracts, none of which went to Section 3 business concerns. Since the goal for construction contracts is 10 percent and 3 percent for non-construction contracts, it should have awarded at least \$24.71 million in contracts to Section 3 businesses.
- Another reported that it awarded more than \$12.2 million in total construction contracts, none of which went to Section 3 business concerns. It should have awarded at least \$1.22 million in construction contracts to Section 3 businesses.
- Two reported that they each awarded about \$1.5 million in total nonconstruction contracts, none of which went to Section 3 business concerns. Each should have awarded at least \$45,000 in non-construction contracts to Section 3 businesses.

In all these cases, the housing authorities did not provide on their summary reports any justifications for failing to meet minimum Section 3 thresholds. In total, four of the housing authorities awarded more than \$442 million in contracts of which at least \$26 million should have been awarded to Section 3 businesses.

#### Lack of Sanctions for Noncompliance

HUD did not sanction housing authorities that failed to submit the required reporting information. These housing authorities' HUD assessment scores, troubled status, or availability of funding was unaffected by their failure to submit their HUD-60002 reports. They continued to conduct business as usual in spite of their failure to comply with Section 3. PIH has not sanctioned any public housing authority for Section 3 noncompliance as this is not an area they normally enforce. Section 3 is typically viewed as the domain of FHEO.

### **Lack of Appropriate Reporting System and Procedures**

FHEO lacked a collection system able to identify missing and inaccurate reports, and it did not have procedures to follow up on submissions and refer to PIH any noncompliant housing authorities.

#### HUD-60002 Collection System

FHEO lacked an electronic collection system able to identify missing and inaccurate HUD-60002 forms. The system used by FHEO during the audit period had several weaknesses:

- It allowed housing authorities to submit reports that did not indicate efforts to meet the minimum requirements.
- It allowed housing authorities to report logically impossible data such as Section 3 jobs created that were larger than total jobs created.

- It allowed data entry errors in the housing authority name, location, grant number, and grant amount fields.
- It did not allow housing authorities to view their previous HUD-60002 submissions.
- It did not produce immediate reports that let FHEO management know which housing authorities had not submitted their reports.
- It did not notify delinquent housing authorities that they had not submitted their reports.

To determine which housing authorities had submitted HUD-60002 forms, FHEO staff had to download the raw data from the system and then manually determine which ones had submitted and which ones had not yet submitted their reports. FHEO developed a new system, which will address many of the weaknesses in the current system. The system is expected to go live in June 2013. FHEO plans an additional future system enhancement, which will more completely address the weaknesses in the current system.

#### Lack of Procedures

FHEO had not established procedures to follow up on missing or inaccurate information in HUD-60002 submissions or to refer housing authorities to PIH when they fail to make the required submissions or corrections. After conducting on-site compliance reviews or complaint investigations, FHEO negotiates VCAs with housing authorities to resolve the findings. Outside this practice, FHEO lacks procedures for broader follow up and referral. PIH would have to administer monetary sanctions since it administers the capital fund program. In addition, the sanctions available to FHEO, based on interim regulations, only included debarments, suspensions, and limited denials of participation, which were not very effective against housing authorities. These interim regulations have been in place since 1994.

FHEO had developed new draft regulations to establish greater sanctions for noncompliance, including recapturing, ineligibility for, and withholding funding to strengthen the overall effectiveness of Section 3. However, FHEO has been unable to get departmental clearance for the proposed new regulations due to disagreements with HUD's Office of Community Planning and Development on the interpretation of the regulations.

### **False Certification and Inadequate Information**

For 2011, 1,650 housing authorities could be falsely certifying compliance. In addition, they did not provide HUD and the general public with adequate employment and contracting information.

The housing authorities that did not submit their Section 3 annual reports potentially submitted false Certifications of Compliance (form HUD-50077) with

their annual plans. With this form, housing authorities certify that they will comply with all of the requirements of Section 3 as well as many other program requirements for the upcoming year. When housing authorities have not been complying with the Section 3 reporting requirement for prior report periods, they may not comply with the requirements going forward. Additionally, on the form, housing authorities certify that they are in compliance with all applicable Federal statutory and regulatory requirements. Housing authorities submit the form HUD-50077 with their annual plans in order to receive their annual funding. These certifications carry a warning that HUD will prosecute false claims and statements and convictions may result in criminal or civil penalties or both.

In addition, these housing authorities did not provide HUD and the general public with adequate information. HUD needed that information to determine whether Section 3 effectively generated opportunities for economically disadvantaged people and businesses. In addition, the housing authorities deprived the public of information that the Section 3 regulation entitled it to receive.

## Conclusion

HUD did not enforce the reporting requirements of the Section 3 program for Recovery Act Public Housing Capital Fund recipients. It must remedy this situation to ensure that these housing authorities meet Section 3 requirements for their future capital funds. FHEO must have a better system and procedures for tracking, following up on, and referring Section 3 reporting deficiencies. In addition, PIH could develop more effective sanctions that impact housing authorities' scoring and funding. For example, if HUD stops accepting annual certifications from housing authorities that have not submitted their HUD-60002 reports, it will encourage them to submit their forms so they can receive their annual funding.

## Recommendations

We recommend that the Deputy Assistant Secretary, Enforcement and Programs, Office of Fair Housing and Equal Opportunity,

- 1A. Implement the new HUD-60002 submission and tracking system that has been in development as well as the planned system enhancement.
- 1B. Establish procedures to follow up on missing and inaccurate information in HUD-60002 submissions.
- 1C. Establish procedures regarding when to refer to PIH any housing authorities that fail to make the required submissions or corrections.

- 1D. Resolve issues with the Office of Community Planning and Development and complete the process to publish final regulations for 24 CFR Part 135.
- 1E. Require the six housing authorities included in this finding that reported Section 3 noncompliance to provide justification or support that they met the goals. If they cannot show compliance, enter into a voluntary compliance agreement to bring their Section 3 programs into compliance, or refer them to PIH for repayment of the \$26 million that should have been used for Section 3.

We recommend that the Deputy Assistant Secretary, Field Operations, Office of Public and Indian Housing,

- 1F. Establish policies and procedures that implement a system of escalating administrative measures, including progressive remedies and sanctions, to be applied against housing authorities that do not submit a HUD-60002 when noncompliance is reported to PIH by FHEO.
- 1G. Establish a methodology to incorporate Section 3 compliance (based on reporting compliance data from FHEO) in risk assessments for housing authorities that receive capital fund grants.

## SCOPE AND METHODOLOGY

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To accomplish our objective, we

- Reviewed relevant laws, regulations, and HUD guidance,
- Interviewed HUD staff, and
- Reviewed HUD-60002 submissions.

In addition, we reviewed Section 3 compliance review letters of finding issued, complaints processed, and voluntary compliance agreements executed by HUD in 2011 and 2012. We also observed a compliance review in January 2013.

We obtained from FHEO a download of 4,967 records of HUD-60002 submissions. We then sorted by construction contracts, non-construction contracts and jobs created to identify PHAs that had 1) the largest total dollar amount of construction contracts awarded and the lowest amount of Section 3 construction contracts; 2) the largest total dollar amount of non-construction contracts awarded and the lowest amount of Section 3 non-construction contracts; 3) the highest amount of total jobs created and the lowest number of Section 3 hires. We selected two PHAs from each category by sorting and taking the top two that did not list their efforts towards meeting the requirements. We only considered entities that received PIH funding. We then reviewed all the submissions from those PHAs.

Section 3 rules also apply to community planning development entities such as cities and municipalities. We did not review these entities because it was outside the scope of the audit.

We relied in part on data maintained by HUD's Section 3 Summary Report System. We determined that the computer-processed data were sufficiently reliable for our purpose.

We performed our audit between October 2012 and March 2013 at HUD's office in Washington, DC, as well as at the Orlando Housing Authority at 390 North Bumby Avenue, Orlando, FL. Our audit generally covered the period January 1, 2011, through October 31, 2012.

We conducted the audit 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 objective.

# INTERNAL CONTROLS

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Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

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## Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objective:

- Controls to ensure that all public housing authorities submit form HUD-60002 for Recovery Act Public Housing Capital Fund activities to HUD by January 10 of every year.
- Controls to ensure that all public housing authorities properly and accurately report Section 3 Recovery Act Public Housing Capital Fund activities to HUD.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

## Significant Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- HUD lacked a collection system able to identify missing and inaccurate Section 3 reports and it did not have procedures to follow up on submissions and refer to PIH housing authorities that were not properly reporting.

## APPENDIXES

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### Appendix A

#### SCHEDULE OF QUESTIONED COSTS

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Recommendation number	Unsupported 1/
1E	\$26,025,191

- 1/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

## Appendix B

# AUDITEE COMMENTS AND OIG'S EVALUATION

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### Ref to OIG Evaluation

### Auditee Comments

	U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT WASHINGTON, DC 20410-2000
ASSISTANT SECRETARY FOR FAIR HOUSING AND EQUAL OPPORTUNITY	
MEMORANDUM FOR:	Ronald J. Hosking, Regional Inspector General for Audit, 7AGA
FROM:	Bryan Greene, Acting Assistant Secretary for Fair Housing and Equal Opportunity, E
SUBJECT:	Response to Discussion Draft Audit Report — Section 3 for Public Housing Authorities
<p>This memorandum responds to your May 6, 2013, communication seeking comments from the Office of Fair Housing and Equal Opportunity (FHEO) on the Office of Inspector General's (OIG) Discussion Draft Audit Report concerning the review of FHEO's oversight of Section 3 of the Housing and Urban Development Act of 1968 (Section 3) for Recovery Act Public Housing Capital Fund recipients. FHEO appreciates the opportunity to provide comments.</p> <p>The OIG's Discussion Draft Audit Report concludes that HUD:</p> <ol style="list-style-type: none"><li>1. Did not enforce the reporting requirements of the Section 3 program for Recovery Act Public Housing Capital Fund Recipients;</li><li>2. Lacked a collection system able to identify missing and inaccurate reports;</li><li>3. Did not have procedures to follow up on submissions and refer to PIH any noncompliant housing authorities; and</li><li>4. Failed to ensure that Public Housing Authorities did not make false certifications or provide HUD and the general public with inadequate employment and contracting information.</li></ol> <p>FHEO's comments on each of the OIG's findings are provided below.</p> <p><b>ENFORCEMENT OF REPORTING REQUIREMENTS OF THE SECTION 3 PROGRAM FOR RECOVERY ACT PUBLIC HOUSING CAPITAL FUND RECIPIENTS:</b></p> <p>In recent years FHEO has made significant progress with enforcing Section 3 reporting requirements for all covered recipients of HUD funding. Specifically, in 2006 only 4% of all recipients were complying with the Section 3 reporting requirements. By building strong collaborations with Headquarters and Field staff in the offices of Public and Indian Housing (PIH); Community Development and Planning (CPD); and, Field Policy and Management (FPM), FHEO successfully increased overall reporting rates to approximately 86% in 2010.</p>	

## Ref to OIG Evaluation

## Auditee Comments

As noted in the OIG's Discussion Draft Audit Report, when the investigation commenced on October 12, 2012, only 53% of Recovery Act Public Housing Capital Fund recipients had submitted Section 3 reports to HUD. However, on November 15, 2012, FHEO issued a memo that had been pending release to PIH, CPD, and FPM requesting them to contact grantees regarding delinquent 2010 and 2011 Section 3 reports. As a result, more than 82% of all covered recipients submitted Section 3 annual reports to HUD for the 2011 reporting period, 72% of which are recipients of Recovery Act Capital Funds. Notwithstanding, the timely submission of reports continues to be one of the biggest challenges impacting Section 3 enforcement.

To satisfy OIG's concerns, FHEO will implement OIG's recommendation to establish procedures to refer to PIH any housing authorities that fail to make the required Section 3 annual report submissions or corrections.<sup>1</sup>

Also, the Deputy Secretary recently mandated that the Section 3 revised final rule be fast-tracked within the Department for expedited publication.<sup>2</sup>

### **LACK OF COLLECTION SYSTEM TO IDENTIFY MISSING AND INACCURATE REPORTS**

In recent years FHEO devoted a significant amount of time to providing technical assistance and outreach to PHAs to enable them to submit their Section 3 reports to HUD. Now that reporting rates are increasing, FHEO recently began analyzing the data that is being submitted in Section 3 reports and making appropriate policy decisions.

One of FHEO's main conclusions is that the current Section 3 reporting system does not have the capacity to track missing reports or to prevent recipients from submitting inaccurate data. Unfortunately, the current Section 3 reporting system was built in the 1990's and operates on outdated software which caused FHEO staff to carry out manual tracking processes that were inefficient and ineffective. Further, the system lacks quality control features to prevent recipients or hackers from submitting erroneous and inaccurate information that compromises the overall integrity of all of the data collected.

In FY 2012, FHEO developed a new Section 3 reporting system that addresses these issues and significantly improves the management and oversight of covered recipients. The new Section 3 reporting system is automatically populated with data from existing HUD systems to reduce recipient burden and eliminate user errors. For instance, this system uploads real-time data from HUD's Line of Credit Control System (LOCCS) showing the actual dollar amount of HUD funds that covered recipients have drawn down during each fiscal year. The new Section 3 reporting system also prevents recipients from entering invalid outcome data and will enable FHEO to immediately identify noncompliant recipients so appropriate actions can be taken.

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<sup>1</sup> See recommendation #1C in OIG Discussion Draft Report.

<sup>2</sup> See recommendation #1D in OIG Discussion Draft Report.

**Ref to OIG Evaluation**

**Auditee Comments**

**Comment 1**

This new Section 3 reporting system is currently pending release upon approval by the Office of the Chief Information Officer (OCIO). FHEO believes that this system will implement the recommendation set forth in the OIG's Discussion Draft Audit Report.<sup>3</sup>

Anticipated Completion Dates:

- New Section 3 reporting system operational: June 21, 2013
- Training for PHAs and other covered grantees: July-September 2013
- Section 3 reports submitted by recipients of Recovery Act Capital Funds for the 2013 reporting period: January 10, 2014

**FAILURE TO HAVE PROCEDURES TO FOLLOW UP ON SUBMISSIONS AND REFER TO PIH ANY NONCOMPLIANT HOUSING AUTHORITIES**

**Comment 2**

While FHEO has not followed up with PHAs regarding their Section 3 reports or referred any Recovery Act Public Housing Capital Fund recipients to PIH to be penalized for their failure to comply with the Section 3 reporting requirements in recent years, our office shares the OIG's concern that the lack of penalties for failing to submit timely Section 3 reports gives PHAs the false impression that there are no consequences for noncompliance. Unfortunately, FHEO is often at a disadvantage for enforcing Section 3 requirements upon PHAs because our office does not provide funds to these entities and does not have the direct authority to impose penalties upon them.

In the coming weeks FHEO will be implementing OIG's recommendation to develop procedures to follow up on missing and inaccurate information submitted by PHAs on faint HUD-60002.<sup>4</sup> Since developing appropriate procedures will require management decisions, FHEO is unable to provide an anticipated completion date at this time.

Additionally, as previously mentioned, FHEO is currently implementing the Deputy Secretary's directive to take steps to expeditiously enter a revised Section 3 final regulation into departmental clearance. The revised Section 3 final regulation will also include any subsequent management decisions that are directly related to the findings of the OIG's Discussion Draft Audit Report.

**FAILURE TO ENSURE THAT PUBLIC HOUSING AUTHORITIES DID NOT MAKE FALSE CERTIFICATIONS OR PROVIDE HUD AND THE GENERAL PUBLIC WITH INADEQUATE EMPLOYMENT AND CONTRACTING INFORMATION**

Generally, FHEO agrees with the OIG's finding and supports any efforts that will ensure that PHAs do not make false certifications to HUD or that will ultimately improve our ability to provide adequate information about Section 3 covered employment and contracting opportunities.

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<sup>3</sup> See recommendation #1A in OIG Discussion Draft Report.

<sup>4</sup> See recommendation #1C in OIG Discussion Draft Report.

**Ref to OIG Evaluation**

**Auditee Comments**

**Comment 3**

To satisfy OIG's concerns, FHEO will work with PIH to implement OIG's recommendation to require the six PHAs identified in the Discussion Draft Audit Report that reported Section 3 noncompliance to HUD to provide justification or evidence demonstrating that they met the minimum numerical goals<sup>5</sup>. If these PHAs are not able to show compliance, FHEO will take steps to enter into voluntary compliance agreements (VCAs) to address our concerns.

With respect to OIG's recommendation to refer to PIH any of the six noncompliant PHAs that do not enter into VCAs with HUD to resolve outstanding areas of noncompliance to PIH for appropriate action, FHEO will have to coordinate with appropriate persons in PIH to make management decisions. At this time, FHEO is waiting to receive contact information from the OIG to implement this recommendation. Therefore, FHEO is not able to provide an anticipated timeframe for carrying out this portion of OIG's recommendation. However, FHEO can provide the following anticipated actions and completion dates:

- Contact the six PHAs referenced in the OIG report to request either a justification for their failure to comply with the Section 3 requirements or evidence demonstrating their compliance: June 14, 2013
- PHA responses due to FHEO: June 28, 2013
- Assess responses and supporting materials received: July 1-26, 2013
- Notify PHAs about outstanding areas of noncompliance: August 16, 2013
- FHEO Field office staff will coordinate with PHAs to enter into VCAs to address areas of noncompliance: September 30, 2013

**CONCLUSION:**

FHEO should have monitored timely reporting requirements of the Section 3 program for Recovery Act Public Housing Capital Fund recipients. As indicated in our response, FHEO shares the concerns identified by the OIG and has been taking proactive steps to address them since FY 2010. Notwithstanding, FHEO believes that implementing the recommendations set forth in the OIG's Discussion Draft Audit Report will ultimately strengthen the overall effectiveness of Section 3.

FHEO will keep the OIG apprised of our progress as we work to implement your recommendations. If you have any questions or need any additional information, please contact Charles Montgomery, FHEO Audit Liaison Officer, at (202) 402-6916, or Staci Gilliam, Director, Economic Opportunity Division, at (202) 402-3468.

**Ref to OIG Evaluation**

**Auditee Comments**



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
WASHINGTON, DC 20410-5000

OFFICE OF PUBLIC AND INDIAN HOUSING

MEMORANDUM FOR: Ronald J. Hosking, Regional Inspector General for Audit, 7AGA

FROM: Lindsey S. Reames, Acting Deputy Assistant Secretary for Field Operations, PQ

SUBJECT: Audit of Section 3 in the Public Housing Capital Fund

This memorandum is in response to the draft audit report provided by the Office of the Inspector General (“OIG”) containing the findings of its audit of public housing agency (“PHA”) compliance with Section 3 requirements in the administration of the Public Housing Capital Fund American Recovery and Reinvestment Act grants. The Office of Field Operations appreciates the opportunity to provide its opinion before the issuance of a final audit report and has prepared these comments in conjunction with the program office, the Office of Public Housing Investments, which administers the Capital Fund. Based on the facts, as relayed in the draft audit report and in discussions with OIG staff, PIH suggests the following changes be made before the issuance of the final audit report.

As discussed with OIG staff, PIH suggests alternative recommendations. PIH and OIG agreed that combining 1F and the former 1G resulted in a workable outcome that realized program oversight objectives within the purview of PIH’s authority. Upon further analysis, PIH suggests that the former 1H (now 1G) also be incorporated into this recommendation. As discussed, the new 1F would require PIH commit to developing a set of policies and procedures that would involve an escalating series of actions designed to bring PHAs into compliance with the Section 3 reporting requirement. PIH suggests: “Establish policies and procedures that implement a system of escalating administrative measures to be applied against housing authorities that do not submit a HUD-60002 when noncompliance is reported to PIH by Fair Housing and Equal Opportunity.”

Based on a comment made previously, OIG agreed that Section 3 compliance would be a useful factor in the risk assessment tool PIH is currently developing and refining. PIH is committed to developing its risk assessment tool with an aim to identifying potential management weaknesses before an incident of noncompliance. PIH hopes that the risk assessment Section 3 indicator would serve as an alert that will prevent the need for any programmatic remedies or sanctions, with the goal of providing technical assistance to avoid the failure to report. PIH suggests: “After the testing and implementation of FHEOs tool is completed and upon receipt of reporting compliance data from FHEO, establish a methodology to incorporate Section 3 compliance in risk assessments for PHAs that receive capital fund grants.”

**Ref to OIG Evaluation**

**Auditee Comments**

**Comment 4**

PIH requests additional changes to the audit report be made consistent with the new recommendations. Specifically, PIH requests that references to the Department’s not penalizing PHAs for noncompliance be revised to reflect that PIH’s role is to engage the PHAs in order to improve compliance. As discussed, it’s not clear what penalties PIH could impose for a failure to submit the form. PIH suggests references to penalizing PHAs be changed to “take administrative measures.” Consistent with that recommendation, PIH recommends that “administer monetary sanctions” on page six be amended to “provide technical assistance and encourage compliance through programmatic measures.”

**Comment 5**

Finally, PIH suggests the paragraph on the top of page seven be revised to reflect the shared view of PIH and OIG that an historical failure to report on Section 3 is a good prospective risk indicator. PIH believes that the form HUD-50077 certification of future compliance may provide the appropriate prompt for PIH to engage historically noncompliant PHAs, but it is the risk assessment that will lead to PIH action. PIH suggests that references to potentially false certifications be omitted and the focus of the paragraph centered on the identification of PHAs at heightened risk of noncompliance. Accordingly, PIH also suggests the final sentence of the conclusion paragraph be struck.

**Comment 6**

PIH appreciates OIG’s engaging it to design recommendations that will further the Department’s objectives. PIH suggests the recommendations be revised as follows.

- 1F. Establish policies and procedures that implement a system of escalating administrative measures to be applied against housing authorities that do not submit a HUD-60002 when noncompliance is reported to PIH by Fair Housing and Equal Opportunity.
- 1G (old 1H). After testing and implementation of FHEOs tool is completed and upon receipt of reporting compliance data from FHEO, establish a methodology to incorporate Section 3 compliance in risk assessments for PHAs that receive capital fund grants.

**Comment 7**

Again, PIH believes the new language for 1F and 1G could feasibly be incorporated into one recommendation because the risk assessment and early intervention would be just one component of the larger strategy for enhancing compliance.

For further information, please contact Scott Shewcraft, Office of Public Housing Investments, at (202)402-6421 or scott.a.shewcraft@hud.gov.

## OIG Evaluation of Auditee Comments

- Comment 1** FHEO must ensure that it implements not just phase 1 of its new Section 3 reporting system but also phase 2 that will grant each user a unique ID and password as well as other system enhancements to address the issues identified in the audit report.
- Comment 2** FHEO and PIH must fully implement all recommendations in this report to ensure PHAs do not have the false impression that there are no consequences for noncompliance.
- Comment 3** We have now provided the contact information for the appropriate person in PIH to make management decisions.
- Comment 4** We believe that sanctions for noncompliance are required to ensure adherence. We've changed the term from penalty to sanction in order to ensure consistency throughout the body of the report.
- Comment 5** As discussed with PIH earlier, we believe that it can hold up funding PHAs by challenging their annual HUD-50077 submission if they have failed to submit their Section 3 form. Item 22 on HUD-50077 states that the PHA certifies that it is in compliance with all applicable Federal statutory and regulatory requirements. Failure to submit the HUD-60002 form is classified as non-compliance with Section 3 regulations. Therefore we conclude that there are penalties that can be imposed for failure to submit the HUD-60002 form.
- Comment 6** We believe that references to potentially false certifications should not be omitted from the report because PHAs are certifying to current compliance with item 22 (comment 5) and future compliance with item 11 of HUD-50077.
- Comment 7** We combined recommendations 1F and the former 1G into the current 1F. However, we believe that recommendations 1F and 1G need to be separate because we are recommending that PIH take two separate actions.

## Appendix C

### CRITERIA

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#### **24 CFR 135.3 – Applicability**

- (a) *Section 3 covered assistance.* Section 3 applies to the following HUD assistance (Section 3 covered assistance): (1) *Public and Indian housing assistance.* Section 3 applies to training, employment, contracting and other economic opportunities arising from the expenditure of the following public and Indian housing assistance:
- (i) Development assistance provided pursuant to section 5 of the U.S. Housing Act of 1937 (1937 Act);
  - (ii) Operating assistance provided pursuant to section 9 of the 1937 Act; and
  - (iii) Modernization assistance provided pursuant to section 14 of the 1937 Act.
- (3) **Thresholds—**(i) No thresholds for Section 3 covered public and Indian housing assistance. The requirements of this part apply to Section 3 covered assistance provided to recipients, notwithstanding the amount of the assistance provided to the recipient. The requirements of this part apply to all contractors and subcontractors performing work in connection with projects and activities funded by public and Indian housing assistance covered by Section 3, regardless of the amount of the contract or subcontract.

#### **24 CFR 135.30 - Numerical goals for meeting the greatest extent feasible requirement**

- (a) General.
- (1) Recipients and covered contractors may demonstrate compliance with the “greatest extent feasible” requirement of Section 3 by meeting the numerical goals set forth in this section for providing training, employment, and contracting opportunities to Section 3 residents and Section 3 business concerns.
  - (2) The goals established in this section apply to the entire amount of Section 3 covered assistance awarded to a recipient in any Federal Fiscal Year (FY), commencing with the first FY following the effective date of this rule.
  - (3) For recipients that do not engage in training, or hiring, but award contracts to contractors that will engage in training, hiring, and subcontracting, recipients must ensure that, to the greatest extent feasible, contractors will provide training, employment, and contracting opportunities to Section 3 residents and Section 3 business concerns.
  - (4) The numerical goals established in this section represent minimum numerical targets.

- (b) Training and employment. The numerical goals set forth in paragraph (b) of this section apply to new hires. The numerical goals reflect the aggregate hires. Efforts to employ Section 3 residents, to the greatest extent feasible, should be made at all job levels. (1) Numerical goals for Section 3 covered public and Indian housing programs. Recipients of Section 3 covered public and Indian housing assistance (as described in § 135.5) and their contractors and subcontractors may demonstrate compliance with this part by committing to employ Section 3 residents as:
- (i) 10 percent of the aggregate number of new hires for the one year period beginning in FY 1995;
  - (ii) 20 percent of the aggregate number of new hires for the one period beginning in FY 1996;
  - (iii) 30 percent of the aggregate number of new hires for one year period beginning in FY 1997 and continuing thereafter.
- (c) Contracts. Numerical goals set forth in paragraph (c) of this section apply to contracts awarded in connection with all Section 3 covered projects and Section 3 covered activities. Each recipient and contractor and subcontractor (unless the contract or subcontract awards do not meet the threshold specified in § 135.3(a)(3)) may demonstrate compliance with the requirements of this part by committing to award to Section 3 business concerns:
- (1) At least 10 percent of the total dollar amount of all Section 3 covered contracts for building trades work for maintenance, repair, modernization or development of public or Indian housing, or for building trades work arising in connection with housing rehabilitation, housing construction and other public construction; and
  - (2) At least three (3) percent of the total dollar amount of all other Section 3 covered contracts.
- (d) Safe harbor and compliance determinations. (1) In the absence of evidence to the contrary, a recipient that meets the minimum numerical goals set forth in this section will be considered to have complied with the Section 3 preference requirements. (2) In evaluating compliance under subpart D of this part, a recipient that has not met the numerical goals set forth in this section has the burden of demonstrating why it was not feasible to meet the numerical goals set forth in this section. Such justification may include impediments encountered despite actions taken. A recipient or contractor also can indicate other economic opportunities, such as those listed in § 135.40, which were provided in its efforts to comply with Section 3 and the requirements of this part.

## **24 CFR 135.32 – Responsibilities of the Recipient**

Each recipient has the responsibility to comply with Section 3 in its own operations, and ensure compliance in the operations of its contractors and subcontractors. This responsibility includes but may not be necessarily limited to:

- (a) Implementing procedures designed to notify Section 3 residents about training and employment opportunities generated by Section 3 covered assistance and Section 3 business concerns about contracting opportunities generated by Section 3 covered assistance;
- (b) Notifying potential contractors for Section 3 covered projects of the requirements of this part, and incorporating the Section 3 clause set forth in § 135.38 in all solicitations and contracts.
- (c) Facilitating the training and employment of Section 3 residents and the award of contracts to Section 3 business concerns by undertaking activities such as described in the Appendix to this part, as appropriate, to reach the goals set forth in § 135.30. Recipients, at their own discretion, may establish reasonable numerical goals for the training and employment of Section 3 residents and contract award to Section 3 business concerns that exceed those specified in § 135.30;
- (d) Assisting and actively cooperating with the Assistant Secretary in obtaining the compliance of contractors and subcontractors with the requirements of this part, and refraining from entering into any contract with any contractor where the recipient has notice or knowledge that the contractor has been found in violation of the regulations in 24 CFR part 135.
- (e) Documenting actions taken to comply with the requirements of this part, the results of actions taken and impediments, if any.

## **24 CFR 135.90 – Reporting**

Each recipient which receives directly from HUD financial assistance that is subject to the requirements of this part shall submit to the Assistant Secretary an annual report in such form and with such information as the Assistant Secretary may request, for the purpose of determining the effectiveness of Section 3. Where the program providing the Section 3 covered assistance requires submission of an annual performance report, the section3 report will be submitted with that annual performance report. If the program providing the Section 3 covered assistance does not require an annual performance report, the Section 3 report is to be submitted by January 10 of each year or within 10 days of project completion, whichever is earlier. All reports submitted to HUD in accordance with the requirements of this part will be made available to the public.

### **HUD Section 3 Guidance for Recipients of Public and Indian Housing Assistance**

Each submission of form HUD-60002 should indicate the following:

- The total dollar amount of HUD funding that was received by the housing authority during the specified reporting period.
- The total number of new employees that were hired by the housing authority or its contractors, subcontractors, and subrecipients.
- The number of new employees that were hired by the housing authority or its contractors, subcontractors, and subrecipients, that met the definition of a Section 3 resident.
- The total number of Section 3 residents that participated in training opportunities that were made available by the housing authority, its contractors, subrecipients, or other local community resource agencies.
- The total dollar amount of construction and/or non-construction contracts (or subcontracts) that were awarded with HUD funding received by the housing authority.
- The dollar amount of the housing authority's construction or non-construction contracts (or subcontracts) that were awarded to Section 3 business concerns.
- Detailed narrative descriptions of the specific actions that were taken by the housing authority, covered contractors, subcontractors, subrecipients, or others to comply with the requirements of Section 3 and/or meet the minimum numerical goals for employment and contracting opportunities.

FHEO considers housing authorities to be in compliance with Section 3 if they meet the minimum numerical goals listed at 24 CFR Part 135.30iii:

- 30 percent of the aggregate number of new hires are Section 3 residents;
- 10 percent of the total dollar amount of all covered construction contracts are awarded to Section 3 business concerns; and
- 3 percent of the total dollar amount of all covered non-construction contracts are awarded to Section 3 business concerns.