OFFICE of
INSPECTOR GENERAL
UNITED STATES DEPARTMENT OF
HOUSING AND URBAN DEVELOPMENT

The Puerto Rico Department of Housing Should Enhance Its Fraud Risk Management Practices

Audit Report Number: 2024-FW-1001

October 27, 2023

To: Claudia I. Monterrosa
Deputy Assistant Secretary, Office of Deputy Assistant Secretary for Grant Programs, DG

//signed//
From: Kilah S. White
Assistant Inspector General for Audit, Office of Inspector General, GA

Subject: The Puerto Rico Department of Housing Should Enhance Its Fraud Risk Management Practices

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our audit of fraud risk management at the Puerto Rico Department of Housing's Community Development Block Grant Disaster Recovery and Mitigation program.

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, as amended, requires that OIG post its reports on the OIG website. Accordingly, this report will be posted at https://www.hudoig.gov.

If you have any questions or comments about this report, please do not hesitate to call Danita Y. Wade, Audit Director, Disaster Recovery Audit Division, at (817) 978-9309.

Highlights

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What We Audited and Why

Fraud poses a significant risk to the integrity of federal programs and erodes public trust in government. For the U.S. Department of Housing and Urban Development's (HUD) disaster recovery programs, fraud results in communities and individuals not receiving needed assistance to recover from and mitigate future disasters. Departments are required by law to develop and maintain governance structures, controls, and processes to safeguard resources and assets. A robust fraud risk framework helps to ensure that programs fulfill their intended purpose and that funds are spent effectively.

We audited the Puerto Rico Department of Housing's (PRDOH) fraud risk management practices to assess the maturity of its antifraud efforts. HUD heavily relies on its grantees to detect and prevent fraud, waste, and abuse[1] and PRDOH is HUD's second largest Community Development Block Grant Disaster Recovery and Mitigation (CDBG-DR and CDBG-MIT) grantee with more than $20 billion in block grant funding. Our objective was to assess PRDOH's fraud risk management practices for preventing, detecting, and responding to fraud when administering programs funded by HUD grants addressing the 2017 disasters.

What We Found

PRDOH's fraud risk management processes to mitigate fraud risks either did not exist or were reactionary in nature. This resulted in the lowest desired maturity goal state -- Ad Hoc --[2] for organizations' antifraud initiatives. PRDOH must improve its fraud risk management practices to adequately protect HUD funding provided for disaster recovery and mitigation efforts. PRDOH's management believed that it was not necessary to take additional actions beyond the minimum requirements because HUD does not require PRDOH to implement a fraud risk management framework that deploys best practices identified by organizations, such as GAO and COSO. In addition, HUD stated imposing these best practices would exceed current requirements and may not be suitable for state and local government grantees.

Because PRDOH does not proactively manage fraud risk and its fraud risk management program is at the lowest state of maturity, it may have missed opportunities to strengthen controls and eliminate fraud vulnerabilities, leaving more than $20 billion in HUD disaster recovery and mitigation funds at increased risk of fraud. Implementing best practices and maturing PRDOH's fraud risk management program will improve HUD and Puerto Rico's ability to prevent and detect fraud and effectively utilize federal funds to support long-term disaster recovery and mitigation needs.

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[1]   HUD OIG Audit report 2023-FO-0001, Improvements Are Needed in HUD's Fraud Risk Management Program, issued October 26, 2022.

[2]   An "ad hoc" maturity level means that fraud risk management processes are disorganized, even chaotic, and antifraud efforts are undocumented and driven in an ad hoc, uncontrolled, and reactive manner.

What We Recommend

We recommend that HUD instruct PRDOH to (1) implement a process to regularly conduct fraud risk assessments and determine a fraud risk profile, and (2) improve its fraud awareness initiatives.

Further, we recommend that HUD (3) evaluate PRDOH's risk exposure and tolerance as part of its program-specific fraud risk assessment for disaster grant programs; (4) coordinate with HUD's Chief Risk Officer to provide training and technical assistance to PRDOH with a focus on the design, implementation, and performance of fraud risk assessments, and establish a fraud risk management framework for the organization; (5) assess whether grantees have mature fraud risk management programs within the disaster recovery and mitigation program; and (6) determine the fraud risk exposure in HUD's disaster recovery and mitigation programs, and work with grantees to implement appropriate fraud mitigation activities.

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Background and Objective

In September 2017, Hurricanes Irma and Maria caused catastrophic damage to Puerto Rico. Although Hurricane Irma's eyewall did not hit Puerto Rico directly, it caused significant damage to the island. Two weeks later, Hurricane Maria, a category 4 hurricane, struck the island directly. It caused flooding and wind damage and destroyed the power grid. From September 2017 to June 2019, Congress appropriated more than $37 billion[3] to assist with the recovery of major declared disasters. From February 2018 to June 2021, the U.S. Department of Housing and Urban Development (HUD) allocated more than $20 billion in Community Development Block Grant Disaster Recovery and Mitigation (commonly known as CDBG-DR and CDBG-MIT) funds to Puerto Rico to help it recover from the hurricanes, as shown in table 1.

Table 1: Funding allocated to Puerto Rico between 2018 and 2021

Public Law	Date Allocated	Allocation amount	Disbursed amount[4]	Purpose
P.L. 115-56	February 9, 2018	$1,507,179,000	$981,623,792	Unmet needs
P.L. 115-123	August 14, 2018	8,220,783,000	1,146,750,588	Unmet needs
P.L. 116-20	January 27, 2020	277,853,230	-	Unmet needs
P.L. 115-123	January 27, 2020	8,285,284,000	12,688,582	Mitigation
P.L. 115-123	June 22, 2021	1,932,347,000	126,887	Electrical power system
	Total	20,223,446,230		

The Puerto Rico Department of Housing (PRDOH) was created on June 10, 1972. The governor of Puerto Rico named PRDOH as the agency responsible for administering the disaster recovery and mitigation program funds.

Fraud Risk Management

Fraud risk management helps ensure program integrity by continuously and strategically mitigating both the likelihood and effects of fraud. When fraud risks can be identified and mitigated, fraud may be less likely to occur. Although the occurrence of fraud indicates there is a fraud risk, a fraud risk can exist even if actual fraud has not yet occurred or been identified. Effectively managing fraud risk helps to ensure that programs fulfill their intended purpose, funds are spent effectively, and assets are safeguarded. The fraud risk management framework can assist agencies in accomplishing these goals.

According to the U.S. Government Accountability Office's (GAO) Standards for Internal Control in the Federal Government[5] and the Committee of Sponsoring Organizations' (COSO) Internal Control-

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[3]   Public Law (P.L.) 115–56 appropriated $7.4 billion on September 8, 2017. P.L. 115–123 appropriated $28 billion on February 9, 2018. P.L. 116–20 appropriated $2.4 billion on June 6, 2019.
[4]   Information retrieved on July 5, 2023, from HUD's Disaster Recovery Reporting System (DRGR).
[5]   On September 10, 2014, GAO updated the Standards for Internal Control in the Federal Government, which sets the standards for an effective internal control system for Federal agencies and provides the overall framework for designing, implementing, and operating an effective internal control system. Originally issued in

Integrated Framework,[6] assessing the risk of fraud is one of many principles for establishing an effective internal control system. In addition, due to the importance of this principle, both organizations have published their own fraud risk management guides with the intention to support organizations in meeting this principle. GAO and COSO make it clear that for a system of internal control to be effective, each of the principles, including "assessing the risk of fraud," must be present, functioning, and operating together in an integrated manner.

GAO has noted that "[f]raud poses a significant risk to the integrity of federal programs and erodes public trust in government." GAO's Standards for Internal Control in the Federal Government defines fraud as obtaining something of value through willful misrepresentation and states that management should consider the potential for fraud when identifying, analyzing, and responding to risks. In July 2015, GAO issued A Framework for Managing Fraud Risks in Federal Programs.[7] The primary audience of the Framework is managers in the U.S. Federal Government, but the leading practices and concepts described in the Framework may also be applicable to State, local, and foreign government agencies, as well as nonprofit entities that are responsible for fraud risk management. The Framework identified leading practices; encompassed control activities to prevent, detect, and respond to fraud; and identified four components – (1) assess, (2) design and implement, (3) evaluate and adapt, and (4) commit – for effectively managing fraud risks.

Similarly, COSO partnered with the Association of Certified Fraud Examiners (ACFE) to create the Fraud Risk Management Guide in 2016, then updated it in 2023. The updated guide provides a comprehensive approach to managing fraud risk including guidance on establishing an overall Fraud Risk Management program. The guide gives organizations, whether large or small, government or private, profit or non-profit, the information necessary to design a plan specific to the risks for the entity. The guide lays out five fraud risk management principles that must be present, functioning, and operating in an integrated manner to be effective. The guide also lays out two approaches that can be followed that would achieve compliance with Principle 8 of the Internal Control-Integrated Framework: (1) Perform a comprehensive fraud risk assessment to identify specific fraud schemes and risks, assess their likelihood and significance, evaluate existing fraud control activities, and implement actions to mitigate residual fraud risks, or (2) Implement the guide as a separate, compatible and more comprehensive process to manage the organization's fraud risks as part of a broader Fraud Risk Management program.

The U.S. Chief Financial Officers Council (CFOC) and the U.S. Department of the Treasury, Bureau of the Fiscal Service (BFS), developed Program Integrity: The Antifraud Playbook in October 2018 (Antifraud Playbook) for use by the entire financial management community, including Federal, State, and local agencies. The Antifraud Playbook contains a maturity model designed to help agencies assess and identify the current state and goal state of their antifraud program and related efforts. The maturity model includes four progressive levels of fraud risk maturity, which are defined below from the lowest to highest desired goal state.

November 1999, the Standards for Internal Control in the Federal Government is known as the Green Book. The Green Book may also be adopted by State, local, and quasi-governmental entities as a framework for an internal control system.

[6] In May 2013, COSO published the Internal Control – Integrated Framework to enable organizations to effectively and efficiently develop and maintain systems of internal control.

[7] GAO-15-593SP, issued July 28, 2015

Ad hoc – Fraud risk management processes are disorganized, even chaotic, and antifraud efforts are undocumented and in a state of dynamic change, tending to be driven in an ad hoc, uncontrolled, and reactive manner. This is not a goal state for agencies with fraud exposure.

Initial – The agency is aware of the need for a more formal fraud risk management approach, and repeatable processes have been developed. Risks are still managed largely in a reactive way.

Operational – Fraud risk management activities across the organization are aligned with controls, and information on fraud risks is aggregated and analyzed and is easily available to the necessary individuals. The goal state for agencies with low fraud risk exposure is an initial to operational maturity level.

Leadership – The agency's focus is on continually improving fraud risk management through both incremental and innovative changes or improvements. Risks are managed largely in a proactive way. The goal state for agencies with high fraud exposure is an operational to leadership maturity level.

Further, the Antifraud Playbook organizes fraud risk management into the following four phases: (1) create a culture, (2) identify and assess, (3) prevent and detect, and (4) insight into action.

Fraud Risk Management in the Disaster Recovery and Mitigation Programs

Legislation providing supplemental funding for disaster recovery and mitigation for Puerto Rico also included a general requirement that "as a condition of making any grant, the [HUD] Secretary shall certify in advance that such grantee has in place proficient financial controls and procurement processes and has established adequate procedures … to detect and prevent waste, fraud, and abuse of funds." HUD, through Federal Register notices, requires grantees to undertake antifraud activities, including certifying to HUD that it has adequate procedures to detect and prevent fraud, waste, and abuse. This includes verifying accuracy of applicant information; monitoring policies[8] saying how, why, and when monitoring will occur; and demonstrating that it has an internal auditor providing programmatic and financial oversight of the grantees' activities. Additionally, HUD monitors its grantees, does a general risk analysis annually for guiding annual monitoring of disaster recovery grantees, and requires grantees to attend antifraud training provided by HUD OIG during the life of the grant.

In its May 2021 audit, "Disaster Recovery: HUD Should Take Additional Action to Assess Community Development Block Grant Fraud Risks," GAO reported that:

> According to HUD officials, the agency's current practice for fraud risk management is to first create a top-level, agency standard, and then apply it to individual units of the agency, such as [CPD], which is the office responsible for CDBG-DR. HUD officials also told us that due to the block grant nature of the CDBG program, HUD does not consider fraud risks in programs managed by grantees to

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[8]   Grantees must report on their monitoring activities to HUD.

be direct risks to HUD itself. Instead, they are fraud risks to the grantees as the "recipients" of CDBG-DR funding.[9]

This places an increased importance on grantees' antifraud measures in detecting and preventing fraud. HUD OIG has previously found weaknesses in these fraud prevention measures in grantees' disaster recovery programs. HUD OIG's memorandum "Lessons Learned and Key Considerations From Prior Audits and Evaluations of the CDBG Disaster Recovery Program" found that grantees inadequately monitoring their programs was the third most common weakness found by OIG over the course of 118 OIG audits of disaster recovery grantees.[10] Further, in HUD OIG's 2020 audit of PRDOH's capacity to administer its disaster recovery grants we found that PRDOH should improve its financial controls, better prevent duplication of benefits, and improve its procurement controls. These findings came after PRDOH had provided information to HUD and HUD had certified the adequacy of PRDOH's policies and procedures. PRDOH has since updated several of its related policies and procedures and has closed 11 of 16 recommendations from that report.

Our objective was to assess PRDOH's fraud risk management practices for preventing, detecting, and responding to fraud when administering programs funded by HUD grants addressing the 2017 disasters.

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[9] GAO report GAO-21-177, HUD Should take Additional Action to Assess Community Development Block Grant Fraud Risks, issued May 2021

[10] HUD OIG audit report 2022-FW-0801, Lessons Learned and Key Considerations From Prior Audits and Evaluations of the CDBG Disaster Recovery Program, issued November 2, 2021

Results of Audit

PRDOH Manages Fraud Risk Reactively and Should Dedicate More Resources Toward Fraud Prevention

PRDOH's fraud risk management processes to mitigate fraud risks either did not exist or were reactionary in nature, resulting in the lowest desired goal state (Ad Hoc) for agencies antifraud initiatives who have fraud exposure. They generally met HUD's requirements that disaster recovery grantees have procedures for fraud prevention and detection set forth in the Federal Register notices[11] and the fiscal controls and accounting procedures requirements set forth in HUD regulations.[12] However, we found that PRDOH (1) had not established a dedicated antifraud component to design and oversee fraud risk management activities, (2) had not performed a fraud risk assessment or developed a process to regularly conduct such assessments, (3) had not developed a response plan for any identified fraud risks, and (4) did not have a process to evaluate the effectiveness of fraud risk management activities. PRDOH's management told us they do not feel taking actions beyond the requirements is necessary since HUD does not require PRDOH to implement a fraud risk management framework. PRDOH's weak fraud risk management practices increased the risk that HUD's disaster recovery and mitigation funds are susceptible to fraud, and that PRDOH will not be positioned to understand how it can best improve its programs to detect fraud or potential fraud. If PRDOH proactively managed fraud risk, strengthened controls, and eliminated fraud vulnerabilities, it would better protect the more than $20 billion in disaster recovery and mitigation funds from the risk of fraud.

PRDOH's Fraud Risk Management Practices Reflected Opportunities To Improve Its Antifraud Efforts

We assessed the current state of PRDOH's fraud risk management practices using the Antifraud Playbook's Program Maturity Model, which organizes the four phases of fraud risk management into the following: (1) create a culture, (2) identify and assess, (3) prevent and detect, and (4) turn insight into action.[13] Our review concluded that PRDOH's overall fraud risk management practices were at the lowest desired state of maturity and that there were opportunities to improve its antifraud efforts to better identify and protect against fraud. To achieve its goal state, PRDOH would need to go beyond the

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[11]   For example, Federal Register 83 FR 5844 establishes that each grantee is required to conduct a risk assessment of its subrecipients, plus conduct monitoring reviews of subrecipients the grantee determines to be high-risk.
[12]   24 CFR 570.489(d)(2) allows states to use fiscal and administrative requirements applicable to the use of its own funds; adopt new fiscal and administrative requirements; or apply the provisions in 2 CFR 200.
[13]   The CFOC's and Treasury BFS's Antifraud Playbook identifies 16 leading practices for effective fraud risk management organized into 4 phases of action. The results of our audit are aligned to match the Antifraud Playbook's four-phased approach.

requirements set forth in the Federal Notices and 24 CFR 570 and follow the best practices, as published by organizations such as GAO[14] and COSO.[15]

Phase 1 – Create a Culture Maturity Level: PRDOH's Antifraud efforts Are Unstructured and Reactive, and It Has Not Established a Program to Combat Fraud.

The Antifraud Playbook encourages agencies[16] to build a culture that is conducive to both integrity efforts and furthering antifraud measures at the agency. GAO's Framework for Managing Fraud Risks in Federal Programs provides that management should create an organizational culture to combat fraud at all levels of the agency and have a dedicated entity to lead the fraud risk management activities. Our assessment of PRDOH's maturity within this phase identified their status as "ad hoc," the lowest desired goal state.

> **PRDOH's current state of antifraud efforts:** PRDOH had not established a dedicated antifraud component to design and oversee fraud risk management activities within the organization and its subrecipients.

PRDOH officials indicated that they had not implemented a fraud risk management program and had not designated a component or individual to design and oversee its fraud risk management activities. In addition, we interviewed officials from PRDOH's subrecipients[17] and confirmed that a fraud risk management program did not exist and that PRDOH had not designated a component or individual to carry out such efforts at their respective entities.

Although PRDOH had not implemented a fraud risk management program, it had developed and implemented certain antifraud controls and activities. For example, PRDOH had established an "Antifraud, Waste, Abuse, and Mismanagement" policy, provided mandatory training to all PRDOH and subrecipient employees to educate them about the policy, and implemented a hotline to process complaints, including those that may involve suspected instances of fraud. In addition, PRDOH had a Monitoring Division and an Internal Audit Office. Thus, PRDOH had shown some level of commitment to combating fraud; however, it had not implemented antifraud measures beyond what was required, such as creating an antifraud entity, regularly conducting fraud risk assessments, developing a response plan to address identified fraud risks by implementing antifraud controls tailored to the identified risks, and regularly evaluating the effectiveness of all fraud risk management controls and activities to constantly adapt and improve them. PRDOH senior leadership said that it did not consider it necessary to take actions beyond its current policy because it considered its current procedures sufficient. As a result,

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[14] 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.

[15] COSO partnered with the Association of Certified Fraud Examiners (ACFE) in 2016 to create the Fraud Risk Management Guide. The joint report is designed to aid organizations in effectively establishing an overall fraud risk management program.

[16] The Program Integrity: The Antifraud Playbook is available for use by the entire financial management community, including Federal, State, and local agencies.

[17] We interviewed subrecipient officials at the Puerto Rico Housing Finance Authority, Puerto Rico Department of Agriculture, and Puerto Rico Economic Development Bank.

PRDOH's management was not proactive in combating fraud, as it did not align its current activities with the best fraud risk management practices published by leading organizations, such as GAO and COSO.

Phase 2 – Identify and Assess Maturity Level: PRDOH Has Not Assessed Fraud Risks that Could Negatively Affect Its Program Effectiveness.

The Antifraud Playbook encourages agencies to identify fraud risks and develop a path forward for executing, repeating, and expanding a fraud risk assessment that is unique and customizable for the agency. Further, managers who effectively assess fraud risks attempt to fully consider the specific fraud risks the agency faces, analyze the potential likelihood and impact of fraud schemes, and then document prioritized fraud risks. Our assessment of PRDOH's maturity within this phase identified their status as "ad hoc," the lowest desired goal state.

> **PRDOH's current state of antifraud efforts:** PRDOH had not performed a fraud risk assessment or developed a process to regularly conduct fraud risk assessments.

PRDOH officials confirmed that PRDOH had not performed a fraud-specific risk assessment and had not developed a process to plan and conduct fraud risk assessments on a regular basis. Further, subrecipient officials said that fraud risk assessments were not performed at the subrecipient level, as recommended in the Antifraud Playbook.

Senior PRDOH leadership did not consider it necessary to implement risk assessment processes beyond the ones already performed by its Monitoring and Internal Audit Divisions. Our interviews with the Monitoring and Internal Audit Divisions' directors and our review of the Divisions' risk assessments and related documentation showed that those Divisions did not perform fraud-specific risk assessments. While the Monitoring and Internal Audit Divisions performed assessments in preparation for their area's annual work plan, these assessments did not contain all the elements that would constitute a fraud risk assessment, such as detailing inherent risks, likelihood and impact, and fraud risk tolerance. As a result, PRDOH had not (1) performed a fraud risk assessment, (2) designed and implemented a process to regularly conduct such assessments, (3) determined a fraud risk tolerance, (4) examined the suitability of existing controls in mitigating fraud and prioritizing residual fraud risks, and (5) determined a fraud risk profile, as called for in this phase.

Phase 3 – Prevent and Detect Maturity Level: PRDOH's Fraud Management Practices Are Reactive and Not Designed to Develop and Strengthen Antifraud Controls for Its Highest Risk Areas.

The Antifraud Playbook encourages agencies to develop or strengthen antifraud controls that mitigate the highest risk areas and to start or advance a fraud analytics program. Managers who effectively manage fraud risks in this phase design and implement specific control activities, including policies, procedures, techniques, and mechanisms, to prevent and detect potential fraud. Our assessment of PRDOH's maturity within this phase identified their status as "ad hoc," the lowest desired goal state.

> **PRDOH's current state of antifraud efforts:** PRDOH had not developed a response plan for any identified fraud risks that would allow for the design and implementation of specific control activities.

Because PRDOH had not conducted a fraud risk assessment, it had not gotten to the point of developing a fraud risk profile, creating a response plan for the fraud risks identified during a fraud risk assessment,

and developing an antifraud strategy based on the fraud risk profile. Therefore, PRDOH had not reached the stage that would allow management to design and implement fraud-specific control activities to prevent and detect potential fraud tailored to the identified and prioritized fraud risks.

Although PRDOH had developed and implemented antifraud controls and activities that contributed to fraud prevention and detection, it could make improvements. PRDOH had not incorporated fraud-specific data analytics techniques into its antifraud efforts. According to the Antifraud Playbook, data analytics tools are the most effective antifraud controls that can be put into place. Further, the Association of Certified Fraud Examiners' (ACFE) Occupational Fraud 2022: A Report to the Nations[18] found that organizations using data analytics techniques to fight fraud reduced the cost of fraud schemes by 47 percent and reduced the duration of fraud by 56 percent. Therefore, PRDOH should improve its overall preventive and detection activities by developing and implementing fraud-specific data analytics tools.

Phase 4 – Insight Into Action Maturity Level: PRDOH is Not Monitoring or Evaluating the Effectiveness of Its Antifraud Activities.

The Antifraud Playbook encourages agencies to use available information, either within the agency or from external sources, and turning that insight into actionable tasks. Effective management in this phase would involve managers' monitoring and evaluating the effectiveness of preventive activities, including fraud risk assessments and the antifraud strategy, as well as controls to detect fraud and response efforts. Our assessment of PRDOH's maturity within this phase identified their status as "ad hoc," the lowest desired goal state.

> **PRDOH's current state of antifraud efforts:** PRDOH did not have a process to monitor and evaluate the effectiveness of fraud risk management activities.

During our interviews, officials confirmed that PRDOH did not conduct any monitoring or evaluation of its antifraud activities. While PRDOH did conduct monitoring reviews and internal audits using a risk-based approach to oversee its program and operational areas, as well as subrecipients, this risk-based approach was not geared toward monitoring or evaluating the effectiveness of its fraud prevention, detection, and response controls and activities. Because PRDOH did not monitor or evaluate its antifraud efforts, it missed opportunities to use the results to continually improve and adapt its overall fraud risk management.

PRDOH Did Not Consider It Necessary To Implement a Fraud Risk Management Framework

PRDOH's overall fraud risk management was at the lowest desired state because PRDOH's management considered it unnecessary for them to take actions beyond those required in 2 CFR (Code of Federal Regulations) Part 200 and, according to PRDOH, HUD did not require it to implement a fraud risk management framework. To better detect and prevent fraud, PRDOH should align its current antifraud activities and efforts with the industry's best practices published by GAO and COSO.

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[18] ACFE's Occupational Fraud 2022: A Report to the Nations is based on the ACFE 2021 Global Fraud Survey, conducted from July to September 2021. Respondents were presented with 77 questions regarding the details of fraud cases they had investigated. ACFE received 2,110 responses, which were used in developing the report.

HUD officials confirmed that HUD did not require PRDOH to implement a specific fraud risk management framework. They added that the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards at 2 CFR 200.303(a)[19] did not apply to PRDOH. Further, the state CDBG program requirements at 24 CFR 570.489(d)[20] allow states to choose not to adopt 2 CFR part 200 to comply with the grant's fiscal and administrative requirements for spending and accounting for all funds. PRDOH, which is treated as a state and allowed to establish its own policies and procedures to comply with the grant's fiscal and administrative requirements, chose to establish its own policies and not follow 2 CFR part 200. Consequently, PRDOH did not develop or implement a fraud risk management framework under the Uniform Administrative Requirements, which is considered a best practice.

If a state grantee chooses to follow 2 CFR 200.303(a), it is required to establish and maintain effective internal control over the Federal award. The internal controls should comply with the guidance in "Standards for Internal Control in the Federal Government" issued by the Comptroller General of the United States or the COSO "Internal Control Integrated Framework." According to GAO[21] and COSO,[22] assessing the risk of fraud is one of numerous principles for establishing an effective internal control system. In addition, due to the importance of this principle, both organizations have published their own fraud risk management guides with the intention to support organizations in meeting this principle. GAO and COSO make it clear that for a system of internal control to be effective, each of the principles must be present, functioning, and operating together in an integrated manner. If a principle or component is not effective or the components are not operating together in an integrated manner, an internal control system cannot be effective.

Further, PRDOH considered the antifraud activities it had in place to be sufficient and that establishing additional measures, such as another risk assessment process, was not necessary because no fraud instances or fraud-related findings had been brought to PRDOH's attention. However, not having fraud-related findings or reported instances of fraud may signal just the opposite, that fraud detection controls

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[19]   Regulations at 2 CFR 200.303(a) state that a non-Federal entity must establish and maintain effective internal control over the Federal award that provides reasonable assurance that the non-Federal entity is managing the Federal award in compliance with Federal statutes, regulations, and the terms and conditions of the Federal award. These internal controls should comply with guidance in Standards for Internal Control in the Federal Government issued by the Comptroller General of the United States or the Internal Control Integrated Framework, issued by COSO. However, 24 CFR 570.489(d) allows States to not adopt 2 CFR part 200.

[20]   24 CFR 570.489(d) Fiscal controls and accounting procedures. (1) A State shall have fiscal and administrative requirements for expending and accounting for all funds received under this subpart. These requirements must be available for Federal inspection and must: (i) Be sufficiently specific to ensure that funds received under this subpart are used in compliance with all applicable statutory and regulatory provisions and the terms and conditions of the award: (ii) Ensure that funds received under this subpart are only spent for reasonable and necessary costs of operating programs under this subpart; and (iii) Ensure that funds received under this subpart are not used for general expenses required to carry out other responsibilities of State and local governments. (2) A State may satisfy this requirement by: (i) Using fiscal and administrative requirements applicable to the use of its own funds; (ii) Adopting new fiscal and administrative requirements; or (iii) Applying the provisions in 2 CFR 200.

[21]   On September 10, 2014, GAO updated the Standards for Internal Control in the Federal Government, which sets the standards for an effective internal control system for Federal agencies and provides the overall framework for designing, implementing, and operating an effective internal control system.

[22]   In May 2013, COSO published the Internal Control – Integrated Framework to enable organizations to effectively and efficiently develop and maintain systems of internal control.

may be ineffective and further actions must be taken to improve their effectiveness. Since PRDOH did not have a monitoring or evaluation process in place to test the effectiveness of its antifraud controls, PRDOH management had no assurance of whether its fraud risk management, including its detection activities, were effective.

However, HUD's regulations and requirements identified in the Federal Register Notices do not require PRDOH to establish an effective fraud risk management framework. Without one, HUD and PRDOH are missing a critical control using leading practices that could be detecting and preventing fraud and minimizing fraud risk for over $20 billion in disaster recovery funding. Having a weak fraud risk management framework increases the risk that HUD's Federal funds may be more susceptible to fraud, making it more likely that fraud will go undetected and that HUD and PRDOH will be unable to understand program-specific fraud risks and design corresponding controls to prevent them.

Conclusion

Although PRDOH established several antifraud activities and controls, it should do more to improve its antifraud efforts and mature its fraud risk management practices. Further, due to its low maturity level, PRDOH missed opportunities to reduce the risk of losses to fraud by implementing controls and additional antifraud activities beyond program requirements. For example, PRDOH could create an antifraud entity, regularly conduct fraud risk assessments, develop a response plan to address identified fraud risks by implementing antifraud controls tailored to the identified risks, and regularly evaluate the effectiveness of all fraud risk management controls and activities to constantly adapt and improve them. Because PRDOH did not consider it necessary to take additional actions beyond the requirements, such as aligning its current antifraud activities and efforts with the industry's best practices, and HUD did not require PRDOH to implement a fraud risk management framework, more than $20 billion in disaster recovery and mitigation funds administered by PRDOH will continue to be at a greater risk of fraud. This risk of fraud will remain until PRDOH creates a culture and framework that can regularly detect and prevent fraud, as well as identify, assess, and take corrective action on fraud risks.

Recommendations

We recommend that the Deputy Assistant Secretary instruct PRDOH to:

1A.   Implement a process to regularly conduct fraud risk assessments and determine a fraud risk profile. The fraud risk profile should include key findings and conclusions from the risk assessment, including the analysis of the types of fraud risks, their perceived likelihood and impact, risk tolerance, and the prioritization of risks.

1B.   Improve fraud awareness initiatives, such as participating in organized antifraud conferences, reviewing the OIG's Special Fraud Alerts, Bulletins, and Other Guidance, and attending fraud risk training tailored to the program's fraud risk profile (including subrecipients).

We recommend that the Deputy Assistant Secretary for Grant Programs

1C.   Evaluate PRDOH's risk exposure and tolerance as part of HUD's program-specific fraud risk assessment for disaster grant programs.

1D.   Coordinate with HUD's Chief Risk Officer to (1) provide training and technical assistance to PRDOH with a focus on the design, implementation, and performance of fraud risk assessments, and (2) establish a fraud risk management framework for the organization.

1E.   Assess whether grantees have mature fraud risk management programs within the disaster recovery and mitigation programs.

1F.   Determine the fraud risk exposure in HUD's disaster recovery and mitigation programs and work with grantees to implement appropriate fraud mitigation activities.

Scope and Methodology

We conducted our audit work from November 2022 through February 2023 in San Juan, PR. The audit covered the period from February 9, 2018, through October 31, 2022. All interviews and discussions were conducted remotely. Our audit focused on PRDOH's administration of disaster recovery and mitigation funding related to the 2017 disasters.

To gain an understanding of the fraud risk management environment at PRDOH and adequately conduct our assessment, we performed the following:

- Reviewed pertinent fraud risk guidance and criteria, including GAO's Standards for Internal Control in the Federal Government, CFOC's and DOT BFS's the Antifraud Playbook, GAO's Framework for Managing Fraud Risks in Federal Programs, ACFE's Occupational Fraud 2022: A Report to the Nations, and disaster recovery and mitigation criteria, such as applicable Federal Register notices.

- Interviewed multiple PRDOH officials and contractor staff, including the disaster recovery and mitigation deputy secretary; directors of the Finance, Audit, and Monitoring Divisions; Internal Audit Office director; Legal Division director; and the directors and program managers from the following program areas: Housing, Infrastructure, Economic Development, and Title Clearance.

- Interviewed officials from the following disaster recovery and mitigation subrecipients: Puerto Rico Housing Finance Authority, Puerto Rico Economic Development Bank, and Puerto Rico Department of Agriculture.

- Reviewed PRDOH's policies and procedures, as well as other relevant documentation.

- To determine the maturity level of PRDOH's fraud risk management practices, we used the Antifraud Program Maturity Model contained in the Antifraud Playbook. We followed GAO's A Framework for Managing Fraud Risks in Federal Programs and the CFOC's Antifraud Playbook guidance to perform our assessment and identify areas for improvement.

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 objective(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Appendix

Appendix A – Auditee and HUD Comments and OIG's Evaluation

Ref to OIG Evaluation – Auditee Comments

Comment 1

Comment 2

GOVERNMENT OF PUERTO RICO
DEPARTMENT OF HOUSING

September 6, 2023

Danita Y. Wade
Auditor Director, Disaster Recovery Audit Division
Office of Inspector General
U.S. Department of Housing and Urban Development
451 7th Street SW
Washington, DC 20410

Via email: dwade@hudoig.gov

RE: **PRDOH Response to HUD OIG Draft Report No. 2023-FW-XXXX**

Dear Ms. Wade,

On August 28, 2023, the Puerto Rico Department of Housing (**PRDOH**) received a Draft Audit Report No. 2023-FW-XXXX from the U.S. Department of Housing and Urban Development – Office of Inspector General (**HUD OIG**), which includes draft recommendations from its review of PRDOH's Fraud Risk Management (**FRM**) practices. PRDOH hereby submits its response to the Draft Audit Report.

In the Draft Audit Report, HUD OIG recognizes PRDOH's diligence in establishing several anti-fraud activities and controls to properly identify and mitigate fraud and that in fact, these activities and controls have contributed to fraud prevention and detection. However, HUD OIG recommends that HUD require PRDOH and other grantees to incorporate additional best practices for fraud risk management that go beyond what is required in the applicable Federal Registers.

After reviewing the Draft Audit Report, although PRDOH acknowledges that the Chief Financial Officers (**CFO**) Council's Antifraud Playbook provides additional guidance to identify, assess, prevent, and detect fraud, PRDOH reaffirms its compliance with the fraud risk management requirements established in the applicable Federal Registers as required by HUD. PRDOH's policies and procedures have been demonstrated to be effective in preventing and detecting fraud, waste, abuse, and misconduct, as we have been able to detect and stop potential acts of fraud and mismanagement before disbursing funds. Moreover, PRDOH's policies and procedures also align with the following Committee of Sponsoring Organization's (**COSO**) Integrated Framework Components: 1) Control Environment, 2) Risk Assessment, 3) Control Activity, 4) Information and Communication, and 5) Monitoring Activities.

Barbosa Ave. #606 , Building Juan C. Cordero Dávila, Río Piedras, PR 00918 | PO Box 21365 San Juan, PR 00928-1365
Tel. (787) 274-2527 | www.vivienda.pr.gov

Comment 3

In alignment with COSO's Integrated Framework, PRDOH has established policies for monitoring subrecipients, contracts, and vendors, and provides extensive training on policies such as the Antifraud, Fraud, Waste, Abuse, or Mismanagement (**AFWAM**) Policy, Conflict of Interest (**COI**) Policy, and COSO's ERM Capacity Trainings, among many others. In terms of risk assessment, we maintain internal controls across various divisions like Procurement, Finance, and Monitoring, using policies, guidelines, and standard operating procedures. We actively track duties and processes to identify gaps and discrepancies. Likewise, PRDOH's control activities are robust, with segregation of duties built into their internal control activities.

Comment 3

PRDOH has established mechanisms for reporting potential fraud, as well as procured external services to enhance risk management and internal controls. Also, PRDOH generates relevant information through QA/QC reviews, recordkeeping, hotline reports, and application activity monitoring. We promptly address irregularities, conducting interviews and preparing reports when needed. Furthermore, we proactively monitor and evaluate the activities of the subrecipients, vendors, Project Managers (**PM**s), and other partners, to not only detect, but to prevent fraud, waste, abuse, and mismanagement. If an irregular activity is detected, the staff documents the evidence, prepares findings reports, and notifies the Legal Department and pertinent federal Agencies.

Comment 4

It is important to note that HUD OIG agrees that the industry's best practices go beyond HUD requirements for fraud risk management. In light of the comprehensive distinction that HUD OIG has outlined between regulatory requirements and aspirational criteria, we propose a dialogue focused on aligning the assessment methods employed by HUD OIG with those established in the Federal Register notices. PRDOH appreciates HUD OIG's guidance and insightful perspectives regarding PRDOH's fraud risk management practices and will consider the additional guidance when reviewing existing policies and procedures.

Should you have any questions about the submitted response, please feel free to contact me.

Sincerely,

William O. Rodríguez Rodríguez, Esq.
Secretary
Puerto Rico Department of Housing

Ref to OIG Evaluation – HUD Comments

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

OFFICE OF COMMUNITY PLANNING
AND DEVELOPMENT

Kilah S. White
Assistant Inspector General for Audit
HUD Office of Inspector General, GA
Office of Inspector General
451 7th Street SW, Room 8180
Washington, DC 20410

Re: Discussion Draft Report - The Puerto Rico Department of Housing Should Enhance its Fraud Risk Management Practices

Dear Ms. White:

The Department of Housing and Urban Development (HUD) received a draft audit report from the HUD Office of Inspector General (OIG) on the Puerto Rico Department of Housing's (PRDOH) fraud risk management practices for review.

The report offers three recommendations for HUD. The OIG recommends that HUD evaluate (1) PRDOH's risk exposure and tolerance as part of its disaster recovery and mitigation program fraud risk assessments and (2) whether the issues identified in this report are systemic within the disaster recovery and mitigation programs. Further, the OIG recommends that HUD require grantees to implement a fraud risk management framework that aligns with the best practices published by leading organizations, such as the U.S. Government Accountability Office and the Committee of Sponsoring Organizations of the Treadway Commission.

The Department offers the following comments on the draft report.

1. The draft report's recommendations fall outside the scope presented at the start of the OIG's audit engagement. The original scope conveyed to the Department consisted of an external audit of a Community Development Block Grant Disaster Recovery (CDBG-DR) grantee, the Puerto Rico Department of Housing. The initial findings outline that the OIG shared with the Department included several recommendations directed at the auditee and one recommendation directed at HUD. HUD concurred with the recommendation directed at the agency, which concerned grantee training on fraud risk management. The draft report, however, directs no recommendations to the auditee and instead provides three new recommendations directed at HUD. This departure from the original scope and initial findings outline at the draft audit stage, without discussion or notification, is highly unusual and the basis for the change is unclear. Furthermore, the draft audit does not describe the methodology used to reach those recommendations that are directed at the entire CDBG-DR portfolio and that are based on the audit of a single CDBG-DR grantee.

2. The audit of this grantee's fraud risk management program duplicates previous efforts to address this issue. In previous audits, the OIG identified weakness in the Department's broader fraud risk management efforts and accepted a management decision to address the

Comment 5

Comment 6

OIG's concerns. Issuing additional recommendations on the subject of fraud risk management while agreed upon corrective actions are underway appears to distract from the steps that HUD is taking to improve its fraud risk management practices.

Comment 7

3. The draft report suggests that individual programs within HUD should develop fraud risk management frameworks. By contrast, the Department has conveyed its position that fraud risk management is appropriately a component of agency-wide Enterprise Risk Management. Accordingly, HUD has developed an agency-wide risk management program and an FY24 implementation plan to address this issue.

Comment 8

4. Draft Recommendation 1C recommends that HUD require CDBG-DR grantees to adopt fraud risk management frameworks that are designed for federal agencies, including leading practices recommended by the U.S. Government Accountability Office (GAO) and the Committee of Sponsoring Organizations of the Treadway Commission. Imposing such a requirement on grantees of a federal agency would exceed the requirements of 2 CFR 200 and impose requirements that may not be suitable for state and local government grantees.

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

Sincerely,

CLAUDIA MONTERROSA
Digitally signed by CLAUDIA MONTERROSA
Date: 2023.09.26 10:56:28 -04'00'

Claudia I. Monterrosa
Deputy Assistant Secretary
    for Grant Programs

OIG Evaluation of Auditee and HUD Comments

Comment 1   The Puerto Rico Department of Housing (PRDOH) commented on HUD OIG's recognition of it establishing antifraud activities and controls but believed our recommendations go beyond applicable Federal Register notice requirements.

We recognize PRDOH's efforts in developing and implementing antifraud controls and activities. However, based on our assessment, the current state of PRDOH's fraud risk management practices were at the lowest desired state of maturity and there were opportunities to improve PRDOH's antifraud efforts to better identify and protect against fraud. We reiterate that to better detect and prevent fraud, PRDOH should align its current antifraud activities and efforts with the industry's best practices published by GAO and COSO. For example, PRDOH could be performing regular fraud risk assessments or having a dedicated antifraud unit that would help identify new or emerging fraud risks. Doing so is in the best interest of Puerto Rico's ability to effectively and efficiently utilize federal funds to support its long-term disaster recovery and mitigation needs. In addition, having a robust and fully functioning fraud risk management framework helps HUD in ensuring efficient and effective program administration.

Furthermore, as explained in the report's background section, according to GAO and COSO, assessing the risk of fraud (Principle 8) is one of 17 principles for establishing an effective internal control system. Due to the importance of Principle 8, both organizations published their own fraud risk management guides with the intention to support organizations in meeting this principle. GAO and COSO make it clear that for a system of internal control to be effective, each of the 17 principles must be present, functioning, and operating together in an integrated manner. If a principle or component is not effective or the components are not operating together in an integrated manner, an internal control system cannot be effective. As a result, following the fraud risk management guides would enable PRDOH to improve not only fraud prevention and detection, but also the effectiveness of its internal controls as a whole. We did not revise our finding or conclusions.

Comment 2   PRDOH acknowledged that the Antifraud Playbook provides additional guidance to identify, access, prevent and detect fraud. However, it reaffirmed its compliance with applicable Federal Register fraud risk management requirements and asserted that its effective policies and procedures have allowed it to stop potential acts of fraud and mismanagement before disbursing funds. PRDOH also asserted that its policies and procedures align with COSO's five Integrated Framework Components.

Based on our assessment using the GAO Framework and the CFO Council's Antifraud Playbook, PRDOH's fraud risk management practices were at the lowest desired state of maturity level. The guidance and criteria in the GAO Fraud Risk Management Framework directly relate to Principles 1, 2, 3, and 5 in COSO's Fraud Risk Management Guide, which indicates an immature fraud risk management state

under the COSO standards as well. In addition, PRDOH could improve its efforts in meeting Principle 8 of the COSO Internal Control Framework, as explained in our response to Comment 1. We did not revise our finding or conclusion that PRDOH's overall fraud risk management practices were at the lowest desired state of maturity and that there were opportunities to improve its antifraud efforts to better identify and protect against fraud.

Comment 3   PRDOH discussed its monitoring policies, the training it conducts, and its internal control activities. It asserted that it tracks duties and processes to identify gaps and discrepancies and that its control activities are robust, with built in segregation of duties. Further, it discussed procuring external services to enhance risk management and internal controls along with its processes to detect and prevent fraud, waste, abuse, and mismanagement.

We recognize PRDOH's effort in developing and implementing antifraud controls and activities. However, PRDOH could not demonstrate how its activities achieved the spirit of principle 8, which at a minimum included performing a fraud risk assessment and evaluating PRDOH's fraud risk exposure and tolerance in administering its disaster recovery program. To better detect and prevent fraud, PRDOH should align its current antifraud activities and efforts with the industry's best practices published in GAO's *A Framework for Managing Fraud Risks in Federal Programs* or COSO's *Fraud Risk Management Guide*.

Comment 4   PRDOH noted HUD OIG's agreement that industry best practices go beyond HUD's requirements for fraud risk management and proposed focusing on aligning OIG's assessment methods with the Federal Register notices. It committed to considering the additional guidance when reviewing existing policies and procedures.

We acknowledge PRDOH's openness to improving its fraud risk management activities. We encourage PRDOH to fully implement a fraud risk management program in accordance with GAO or COSO's frameworks. Doing so is in the best interest of Puerto Rico's ability to effectively utilize federal funds to support its long-term disaster recovery and mitigation needs. Doing so also provides assurance to HUD that PRDOH is operating its disaster program efficiently and effectively.

Comment 5   HUD commented that the draft report's recommendations fall outside the scope presented at the start of the OIG's audit engagement and that it concurred with the recommendation directed at grantee training on fraud risk management. HUD called what it characterized as a departure from the original scope and initial findings outline highly unusual with an unclear basis for the change.   Further, it stated the draft audit did not describe the methodology used to reach the recommendations directed at the entire CDBG-DR portfolio that are based on the audit of a single grantee.

We disagree that our draft report recommendations fell outside the scope of our audit. This audit is part of our comprehensive strategy for oversight of HUD's disaster recovery portfolio, which includes assessing how multiple factors and

external entities impact the Department's overall fraud risk exposure. Further, it is important for HUD to evaluate the significance of potential fraud risks from one of its largest grantees, which received more than $20 billion in response to Hurricanes Irma and Maria, and what effects that may have on HUD's overall fraud risk exposure for its entire disaster recovery portfolio.

After consideration of HUD's comments, we reinstated 2 of 5 PRDOH recommendations from our draft finding outline that both PRDOH and HUD previously received. These recommendations most directly contribute to improving PRDOH's fraud risk maturity. In addition, we (1) reintegrated the finding outline training recommendation that HUD concurred with because our prior fraud risk work found that the training HUD program offices provided to grantees were not focused on fraud risks, how to conduct antifraud activities, or what to do when suspected fraud is identified; and (2) revised draft report recommendation 1C (now recommendation 1F) that was directed at the entire disaster recovery portfolio.

We provided the recommendations to PRDOH and HUD, and discussed them with HUD. HUD shared our concerns regarding fraud risks and the overall risk posture of the disaster recovery program. Additionally, HUD stated that its goal is to provide the necessary resources and tools to PRDOH and other disaster recovery grantees so they can effectively evaluate their fraud prevention programs and proactively mitigate potential fraud. HUD suggested (1) additional revisions to recommendations 1A, 1B and 1D and (2) the removal of recommendation 1E.

We appreciate HUD's continued efforts to collaborate with our office to identify reasonable and actionable recommendations. We carefully considered each of its suggested revision requests and we revised recommendation 1B. In that recommendation, we did not limit fraud risk training to only HUD OIG-provided training because it is not incumbent solely on HUD OIG to provide fraud training.

We did not make any other revisions to our recommendations.

We maintain our position that (1) PRDOH needs to implement a fraud risk assessment process to regularly conduct fraud risk assessments and determine a fraud risk profile (recommendation 1A) and (2) HUD needs to assess whether its disaster grantees have mature fraud risk management programs (recommendation 1E). These recommendations are the minimum requirements for any entity to have an adequate integrated internal control framework that includes addressing fraud risks.

Comment 6   HUD stated this audit duplicates previous efforts to address the fraud risk management issue and that issuing additional recommendations while agreed upon corrective actions are underway distracts from steps HUD is taking to improve its fraud risk management practices.

We disagree that issuing these fraud risk recommendations distracts from HUD's steps to improve its fraud risk management practices. This report and

recommendations complement and enhance HUD's fraud risk management efforts. We are making these recommendations to HUD for its consideration while implementing corrective actions to improve its own fraud risk management practices. A robust fraud risk management framework is not only beneficial to PRDOH's disaster recovery programs, but if properly implemented, it also benefits HUD's entire disaster recovery portfolio. As discussed in OIG report 2023-FO-0001, *Improvements are Needed in HUD's Fraud Risk Management Program,* program offices believed that after HUD disbursed the funds to recipients, the recipients were responsible for fraud detection and fraud risk management until the Federal funds reached the final beneficiary. This report illustrates potential weaknesses at the recipient (grantee) level, and we revised recommendation 1C (now recommendation1F) for HUD to determine the fraud risk exposure to the Department from its disaster recovery grantees and to implement appropriate mitigation activities. This recommendation is particularly important because fraud primarily occurs at the grantee or subgrantee levels.

Comment 7   The Department conveyed its position that fraud risk management is appropriately a component of agency-wide Enterprise Risk Management and that it has developed an agency-wide risk management program and an FY24 implementation plan to address the issue.

We recognize HUD's development of an agency-wide risk management program and FY24 implementation plan. Fraud risk is an element of a broader Enterprise Risk Management assessment. However, GAO's Fraud Risk Framework requires risk assessments to be conducted at a program level. This is supported by audit report 2023-FO-0001, recommendation 1A, where the Department has agreed to implement fraud risk assessments at the program level. Further, in audit report 2022-FO-0801, *Fraud Risk Inventory for the CDBG and ESG CARES Act Funds,* recommendation 1B, which is a priority open recommendation, CPD agreed to develop program-specific fraud risk assessments. These reports also included discussion of HUD's program offices' controls and monitoring processes that focused mostly on program facilitation or fraud which would occur only at the enterprise level, without drawing attention to the specific areas within the program where fraud could occur, primarily at the grantee or subgrantee levels.

Comment 8   HUD disagreed with draft recommendation 1C, which it believed was designed for Federal agencies. In addition, it stated imposing the recommendation on grantees would exceed 2 CFR 200 requirements and impose requirements that may not be suitable for state and local grantees.

The Office of Management and Budget (OMB) Circular A-123 speaks to addressing fraud risks and developing risk tolerance in disaster situations. Moreover, GAO recently issued report GAO-23-104382, *Disaster Recovery: HUD Should Develop Data Collection Guidance to Support Analysis of Block Grant Fraud Risks,* which reported similar audit conclusions regarding grantee fraud risk management responsibilities and HUD requirements to consider grant risk management as part of its overall risk management approach. Specifically, in response to HUD's position that grantees are

not required to undertake specific action to support fraud risk management, GAO stated, "… a provision of the Payment Integrity Information Act of 2019 (PIIA), codified at 31 U.S.C. § 3357, requires OMB to maintain guidelines for agencies to establish financial and administrative controls to identify and assess fraud risks and that incorporate leading practices from GAO's *Fraud Risk Framework*."

GAO also discussed OMB Circular A-123 directing Federal agencies to follow the leading practices outlined in the *Fraud Risk Framework* and HUD's own *Departmental Policy on the Implementation of OMB Circular A-123, Management's Responsibility for Enterprise Risk Management (ERM) and Internal Control,* which specifies that HUD management has the responsibility to design, implement, and operate processes with embedded internal controls that mitigate the risk of fraud, waste, and abuse in grant programs. Lastly, GAO quoted OMB Circular A-123, "the Federal Government has a number of complex inter-dependencies with State and local governments, and other recipients of Federal funding. From an ERM [enterprise risk management] perspective, these inter-dependencies—called the "extended enterprise" impacts the Agency's risk management, and give rise to certain additional risks, which need to be considered in the Agency's risk profile." GAO's position is applicable to the findings included in this report.

We revised draft recommendation 1C (now recommendation 1F) to provide HUD flexibility in determining the appropriate actions it should take to manage the fraud risk exposure from its disaster recovery grantees.