DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

August 24, 2017

The Honorable Christy Goldsmith Romero
Special Inspector General
for the Troubled Asset Relief Program
1801 L Street, NW, 4th Floor
Washington, DC 20036

Dear Ms. Romero:

I write in response to the Special Inspector General for the Troubled Asset Relief Program's (SIGTARP) draft report of August 10, 2017 (the Draft), regarding certain administrative expenses funded through Treasury's Housing Finance Agency Innovation Fund for Hardest Hit Housing Markets (the Hardest Hit Fund, or HHF). Treasury takes very seriously its responsibility as a steward of taxpayer funds, and we appreciate SIGTARP's oversight as we continue to wind down the Troubled Asset Relief Program (TARP).

HHF is a $9.6 billion program created in February 2010 to help struggling homeowners avoid foreclosure and stabilize housing markets in areas hit hardest by the housing crisis. Funding is used by housing finance agencies (together with certain affiliates, HFAs) in 18 states and the District of Columbia, to design and implement HHF programs tailored to the specific needs and conditions of local communities. To date, HFAs have established 88 programs under HHF, which have collectively assisted more than 305,000 homeowners and helped to remove more than 17,000 blighted properties.

Treasury is committed to preventing waste and abuse in HHF and ensuring that taxpayer funds are used responsibly. We appreciate SIGTARP's thorough review of administrative expenses incurred by the HFAs and funded through HHF over the last seven years. In the Draft, SIGTARP recommends that Treasury recover certain of those expenditures and implement a series of controls to prevent unnecessary spending in the future. We agree that Treasury should recover amounts expended in violation of program requirements and take other actions to control administrative spending. With this letter, we describe the steps Treasury has taken to limit administrative expenses based on standards established by the Federal government and enforce those limitations through periodic compliance reviews. We will carefully consider the information and recommendations contained in the Draft and respond to each of SIGTARP's recommendations in a subsequent letter, once we have completed that review.

I. Treasury Requires that HHF Administrative Expenses Comply with Federal Cost Principles.

As SIGTARP's Draft acknowledges, Treasury "set significant limits in its HHF contracts with [HFAs]" in an effort to "ensure that the HHF follows TARP law and funds reach their intended recipients…."[1] These contracts impose a number of requirements with respect to administrative expenses in particular, including that such expenses must comply with standards and principles prescribed by the Office of Management and Budget (OMB Cost Principles). Initially, these cost principles were set forth in OMB Circular A-87 (Cost Principles for State, Local, and Indian Tribal Governments).[2] In December 2016, Treasury updated its contracts to instead adopt OMB's uniform cost principles for Federal awards, the most up-to-date requirements applicable to state and local governments, non-profit organizations, and other non-Federal recipients of Federal funds.[3]

As a basic condition of allowability, the OMB Cost Principles have always required that administrative expenses be necessary for the performance of the HHF contract. Other basic conditions include being reasonable (in nature and amount), allocable to the HHF contract, and adequately documented. The OMB Cost Principles also provide detailed requirements governing the allowability of specific types of expenses. For example, the cost principles recognize that many forms of employee compensation may be allowable—*e.g.*, salaries, wages, health insurance and other benefits, incentive compensation, and severance pay—but only under certain circumstances. These principles also prohibit certain types of expenses which are clearly inappropriate for the Federal government to bear—*e.g.*, tickets to shows, sporting events, or other forms of personal entertainment.

II. Treasury Monitors HFAs' Compliance With HHF Program Requirements.

Treasury evaluates compliance with HHF program requirements—including, but not limited to, the OMB Cost Principles—through regular, on-site compliance reviews. These include reviews of administrative expenses and other program activity on a sample basis. For each sampled administrative expense, Treasury evaluates whether the expense is consistent with the approved budget, supported by an invoice or other documentation, and allocable to HHF, among other things. Last year, Treasury enhanced its testing of administrative expenses in two ways. First, we increased the sample size—*i.e.*, the number of transactions selected for testing—for types of expenses that present a higher risk of non-compliance. Second, we increased our sampling of small-dollar transactions.

States are required to implement internal controls to help ensure that HHF programs are run effectively, efficiently, and in compliance with Treasury's contract. Examples of controls related to administrative expenses include (i) maintaining written policies that describe requirements applicable to administrative expenses, (ii) increased scrutiny of high-dollar transactions or types of expenses which present elevated risks of non-compliance, and (iii) routine reviews of administrative expense payments by internal auditors or quality assurance teams. States' internal controls are evaluated by Treasury during its on-site reviews and independently verified on an annual basis. Treasury has observed that, with these controls in place, states have identified improper expenditures and obtained repayment as needed.

[1] P. 1
[2] These principles were set forth in 2 C.F.R. Part 225 and can be viewed at: https://www.gpo.gov/fdsys/pkg/CFR-2012-title2-vol1/pdf/CFR-2012-title2-vol1-part225.pdf.
[3] 2 C.F.R. §§ 200.400-475.

III. Treasury Recovers Funds Where Appropriate and Takes Other Actions to Enforce the Terms of its Contracts with HFAs.

Treasury requires HFAs to repay HHF when Treasury identifies improper expenditures. This has included, for example: bonuses and other compensation which did not meet applicable requirements; non-business related travel and entertainment; food, beverages, gifts, and other items for employees' personal use; legal expenses not required for the proper administration of HHF; charges not related to HHF; and charges not supported by documentation. Earlier this year, Treasury required states to repay $33,592 to HHF for improper expenditures that SIGTARP later identified in the Draft.

Treasury also requires that HFAs take other corrective actions. For example, where Treasury identifies a potentially systemic error, Treasury requires the HFA to conduct a look-back analysis to ascertain the full impact of the error, and revise its procedures as needed to ensure that the error does not reoccur in the future. In addition, Treasury requires states to establish or improve internal controls around key functions when Treasury identifies a deficiency.

Furthermore, Treasury has worked diligently to analyze expenditures questioned by SIGTARP in the past, and recover funds that we determined were improperly spent. For example, when Treasury received SIGTARP's recommendations regarding its 2016 audit of administrative expenses in the Nevada HHF program, we undertook a thorough analysis that led to HHF recovering more than $80,000. For the reasons set forth in our letter to you on January 19, 2017, Treasury determined that recovery of certain other expenditures was not warranted.[4] We will undertake a similarly thorough analysis with respect to the recommendations in the Draft.

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To facilitate our analysis, we have requested under separate cover that SIGTARP provide us with more specific information for certain of the expenses questioned in the Draft. We note that the Draft provides transaction-level detail for some expenses (*e.g.*, the purchase of a water bottle for $1.81) but describes other expenses on an aggregate basis only (*e.g.*, $330,575 in parking subsidies for employees at one HFA). The expenses referred to in the Draft also span all 19 HFAs, and appear to date back to the outset of the program. We look forward to receiving these important details from you, so that we can move quickly to review the remaining expenses and recover any taxpayer funds that have been improperly spent.

Even as the TARP program nears its end, we remain committed to taking appropriate actions to improve program performance and protect the interests of taxpayers. We look forward to continuing to work with you as we wind down TARP.

Sincerely,

Lorenzo Rasetti

Lorenzo Rasetti
Chief Financial Officer
Office of Financial Stability

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[4] https://www.treasury.gov/initiatives/financial-stability/about-tarp/Pages/Oversight-and-Accountability.aspx.