



U.S. Department of Housing and Urban Development

**Office of Inspector General**

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Honorable Ricardo H. Hinojosa, Chairman  
United States Sentencing Commission  
One Columbus Circle, N.E.  
Washington, DC 20002-8002

Re: Sentencing Commission Hearing on Enhanced Penalties for Disaster Fraud

Dear Chairman Hinojosa:

It is my understanding that, pursuant to Section 5 of Pub. Law 100-179 (Jan. 7, 2008), the Department of Justice (DOJ) has proposed amendments to Section 2B1.1 of the Federal Sentencing Guidelines, which will enhance the offense level by 2 (with a floor of 14), and will permit the inclusion of the administrative costs of recovery in the calculation of loss, for disaster fraud. This letter expresses the support of the United States Department of Housing and Urban Development (HUD), Office of Inspector General (OIG), for DOJ's proposal. As a consequence of HUD's efforts to respond the September 11, 2001 terrorist attack in New York City, the devastation of the Gulf Coast by Hurricanes Katrina, Rita and Wilma, and other natural disasters, HUD-OIG has become acutely aware of the vulnerability of Federal disaster assistance to fraud. HUD-OIG strongly believes that this vulnerability derives largely from the laudable motivation to quickly provide assistance to those in need during their time of need, not months later, and the unfortunate realities that the volume of assistance payments complicates detection, and that the relatively small dollar amount of the majority of such payments tends to reduce the likelihood of prosecution. HUD-OIG is convinced that DOJ's proposal to enhance the offense level for disaster fraud will improve the likelihood of prosecution of disaster fraud cases and increase deterrence, and, thus, will reduce the vulnerability of disaster assistance to fraud. Additionally, HUD-OIG is encouraged that DOJ's proposal recognizes the substantial resources that the Federal government invests in fraud recoveries associated with disasters. Recovery costs represent real losses to both the government and the intended beneficiaries of the assistance, and they rightly should be treated as losses. Accordingly, HUD-OIG is proud to express our support for the proposal.

Background

When a major disaster occurs, HUD provides critical housing and community development financial resources to aid rehabilitation. HUD also cooperates with other Federal and state agencies to implement disaster recovery efforts. HUD-OIG is responsible to detect and prevent waste, fraud, and abuse in HUD's operations and programs, and to seek administrative

sanctions, civil recoveries and/or criminal prosecutions against those who have committed waste, fraud or abuse.

In response to the events of September 11<sup>th</sup>, Congress appropriated \$3.6 billion for the housing and community development programs in Lower-Manhattan and other areas affected by the terrorist activities. Similarly, in response to the devastation of the Gulf Coast by Hurricanes Katrina, Rita and Wilma, Congress appropriated almost \$20 billion in disaster relief. HUD, via interagency agreements, also has performed various mission assignments for the Federal Emergency Management Agency (FEMA), and in December of 2007, HUD assumed FEMA's responsibility for the provision of long-term rental assistance for approximately 45,000 families affected by the hurricanes.

Through our experience with the events of September 11<sup>th</sup>, the aftermath of the Gulf Coast hurricanes, and the circumstances following prior disasters, HUD-OIG has gained extraordinary insight into combating HUD disaster-related fraud. We have learned that because of the exigent nature of disaster response/recovery, assistance needs to be awarded quickly, and as a consequence many policies and controls normally in place for grant programs are waived or not strictly adhered to. HUD-OIG does not believe that it is realistic to expect that the realities of providing disaster assistance will shift such that increased internal controls and fraud prevention mechanisms may be applied during future disasters. Unfortunately, following each of these disasters HUD-OIG detected substantial cases of fraud, but all cases detected were not prosecuted. HUD-OIG believes that stronger penalties for disaster assistance fraud should improve the likelihood of prosecution and deterrence, and thus counteract some of the inherent susceptibility of disaster assistance to fraud.

### Offense Level Enhancement

#### **Diminished Internal Controls**

Disasters such as September 11<sup>th</sup> and Hurricane Katrina prompt emergency responses, and during these emergency situations internal controls ordinarily attendant to Federal grant programs are mitigated for humanitarian reasons and/or public pressure. The responses of the States of Louisiana and Mississippi to Hurricane Katrina's physical destruction of private real estate reflect a disparity of actions and public reactions to the application of internal controls during emergencies. Both states, using Federal disaster funds, implemented programs designed to assist homeowners to repair damaged homes or to move. Mississippi's program employed less robust internal controls, and as a result it implemented its program more quickly and with less public criticism.

Louisiana on the other hand, in coordination with HUD-OIG and the Federal Bureau of Investigation (FBI), implemented extensive internal controls for its Road Home Program. For example, Louisiana and its contractor, ICF International (ICF):

1. Obtains digital photographs of each applicant and co-applicant;
2. Requires each applicant to sign their application, certifying to the truthfulness of the information under penalties of 18 U.S.C. § 1001 (False Statement);

3. Verifies applicant data with information provided to FEMA, the Louisiana Department of Revenue, the Small Business Administration (SBA), and local land records;
4. Internally investigates all applicants who did not possess a FEMA applicant number; and
5. Trains ICF employees in the area of fraud awareness.

Based upon referrals made to HUD-OIG, we believe that Louisiana's internal controls prevented the success of many fraudulent applications. Unfortunately, these internal controls initially delayed program delivery to the ultimate beneficiaries, and the State received tremendous political pressure and media ridicule because of a perception of plodding progress.

In further illustration of this point, the HUD Office of Public and Indian Housing (PIH) recently took over administration of FEMA's Disaster Housing Assistance Program (DHAP). Previously, FEMA had administered the program itself. When PIH took over the program it discovered that 6,771 families, out of the universe of 45,000 families who have been assisted by DHAP, did not reside at the address listed on grant records. Inadequate internal controls appear to factor in causing this problem (e.g., the addresses are examples of data-entry errors or fraud). FEMA received significant criticism for the perceived tardiness of its recovery response during the time period immediately following Hurricanes Katrina, Rita and Wilma, but it has received little if any negative scrutiny regarding its administration of DHAP.

Accordingly, we are concerned that the virulent criticism that Louisiana received and FEMA initially endured will impel future HUD disaster assistance conduits to waive or minimize fraud-prevention controls normally present in grant programs. It is reasonable to conclude that diminished or ineffective internal controls, aggravated by a huge volume of applications, make a grant program easier to defraud. Indeed, as the case examples set forth below reflect, disaster fraud can be surprisingly simplistic and yet successful. Thus, in the absence of preventative measures of this sort, HUD-OIG believes that greater deterrence associated with enhanced penalties is necessary.

## **Disaster Frauds**

### **A. September 11<sup>th</sup> Frauds**

In the aftermath of the terrorist attacks of September 11<sup>th</sup>, Congress authorized HUD to provide the State of New York with approximately \$3.6 billion in disaster assistance to aid recovery and revitalization. Further, Congress insisted that HUD rapidly assist the recovery of Lower-Manhattan, which is the area south of Houston Street that was hardest hit by the attack. Internal controls suffered and frauds were perpetrated, as follows.

Lower-Manhattan Development Corp (LMDC) was created by the State and City of New York to coordinate the rebuilding and revitalization of Lower-Manhattan. To further this goal, the LMDC made HUD-funded Residents Grants and Two-Year Commitment-Based Grants. The Residents Grants were paid to eligible individuals who lived in one of three designated zones in Lower-Manhattan on September 11<sup>th</sup>. The Two-Year Commitment-Based Grants provided money to eligible individuals who made a prospective two-year commitment to live in one of the

zones. Both of these programs experienced fraud. For example, LMDC referred Jobim Rose to HUD-OIG for investigation. Rose, a recipient of the Two-Year Commitment-Based Grant, was found to have sublet 310 Greenwich Street, Apartment 36A, the subject of the two-year commitment, to Richard Scott Marshall. Marshall had been subletting Apartment 36A, from Rose for some time. Indeed, during HUD-OIG's investigation, Marshall showed a HUD-OIG representative a video tape of the Twin Towers collapse that he had captured through the window of Apartment 36A, demonstrating that Rose had not even occupied the apartment on the date of the attack. The investigation further revealed that Rose did not reside in Lower-Manhattan at all. Rose plead guilty and was sentenced to 48 months probation and court ordered restitution.

Allan Klein, a British Citizen, submitted a grant application to LMDC under the Two-Year Commitment-Based Grant. Klein claimed that his then current address was 71 Broadway, Apartment 9F. Several months later, LMDC mailed a letter to Klein at Apartment 9F via the United States Postal Service (USPS). Soon thereafter, USPS returned the letter to LMDC pursuant to its instructions not to forward its correspondence. HUD-OIG investigated and determined that Klein was living in Fort Lauderdale, FL and had been subletting Apartment 9F, in contrast to his commitment. Klein pled guilty and was sentenced to six months imprisonment, \$1,000 fine, and three years supervised release.

The Empire State Development Corp (ESDC) processed the World Trade Center (WTC) Business Recovery Grant (BRG) program. BRG grants were intended to revitalize businesses damaged by the terrorist attacks on the WTC. Prior to the attack, Chang Sheng Yu, an undocumented alien, leased 350 square feet of space at 2 WTC for his company, American McKinley Venture Management, Inc. Yu applied for a BRG, based upon losses allegedly experienced by American McKinley Venture Management, Inc. BRG applicants were required to submit a Federal tax return in support of their applications. Yu prepared a tax return that overstated his business expenses. Yu received a BRG in the amount of \$118,876. Additionally, Yu, using personal data from job applicants that had applied for jobs with American McKinley Venture Management Inc. but who had not been hired, exaggerated the size of his company's staff, in order to qualify for a Small Firm Attraction and Retention Grant Program (SFARG). SFARG is another business grant designed to compensate employers based on the number of employees that they had. Yu pled guilty and was sentenced to 15 months imprisonment, 36 months supervised release, special assessment of \$800, and restitution of \$118,876.

David Zimmer, a resident of Maryland, a Certified Public Accountant, and the president of DZ Investments Inc. DBA Total Business Solutions (DZ), submitted an application for a BRG on behalf of DZ. In connection with the application, Zimmer provided ESDC with a purported copy of DZ's 2000 Federal tax return which showed gross receipts of \$3,327,423. ESDC used this amount to calculate a BRG in the amount of \$270,000, and wired the proceeds of the BRG to DZ. However, a check with the Internal Revenue Service revealed a discrepancy in the tax information provided by DZ, and ESDC referred the matter to HUD-OIG for investigation. HUD-OIG visited 40 Rector Street, New York, NY, which Zimmer claimed on his BRG application was DZ's address, and found that DZ did not occupy space at 40 Rector Street. Further, investigation revealed that DZ was based in Maryland, not NY. Zimmer plead guilty,

and was sentenced to 24 months incarceration, 36 months of probation upon release, restitution, and fines of \$10,200.

Additionally, Alexander Koltovskoy, a/k/a Alexander Kolt (Kolt), applied for and received a BRG on behalf of Alexander Edwards Global Search, Inc. Kolt claimed that Alexander Edwards Global Search, Inc., was located at 2 WTC on September 11<sup>th</sup>. However, HUD-OIG determined that Alexander Edwards Global Search, Inc., moved out of 2 WTC in 1999. Kolt was tried, convicted, and sentenced to 51 months incarceration, three years supervised release, \$373,228 in restitution, and a special assessment of \$1,800.

## B. Hurricane Frauds

In many ways the aftermath of Hurricanes Katrina, Rita and Wilma resembles the September 11<sup>th</sup> recovery, except on a much larger scale in terms of geographic breadth, amount of assistance appropriated, and volume of frauds coming to light. As of January 2008, HUD-OIG has opened 350 investigations of hurricane-related fraud; of these, 115 have resulted in indictment and 74 in conviction. We are also working with the Department of Homeland Security-OIG to address an additional 577 rental assistance disaster fraud cases that involve duplication of assistance payments. Further, HUD-OIG—as alluded to above—anticipates the imminent referral of an additional 6,771 complaints relating to DHAP recipients falsely claiming subsidies for residences that they do not occupy. Examples of HUD-OIG's work follow.

Using Federal disaster assistance, the Mississippi Development Authority (MDA) administered the Mississippi Homeowner's Grant Program (HGP), which was designed to provide financial assistance to homeowners outside of the Federally-designated flood plain whose homeowner's insurance did not cover structural flood damage. Under HGP, homeowners may receive up to \$150,000 or the insured value of their home multiplied by the percentage of damage the home received (whichever is less), less any insurance or FEMA payments received for structural damage. To be eligible for assistance a home had to be a primary residence of the applicant at the time of the hurricane. HUD-OIG has received numerous referrals from MDA concerning applications that they believe are fraudulent. For instance, Phillip A. Winchester applied for HGP assistance with respect to a property located at 111 Oakview Avenue, Long Beach, MS. However, HUD-OIG determined that his actual residence was located at 116 Oakview Avenue, Long Beach, MS, and that 111 Oakview Avenue was a secondary property that Winchester had inherited upon his mother's death. 111 Oakview Avenue suffered significantly greater damage from the hurricane, and was not properly insured. The investigation further revealed that Winchester filed fraudulent applications for FEMA, SBA, and United States Department of Agriculture (USDA) assistance. Winchester pled guilty and was sentenced to five months confinement, restitution, a fine, and 24 months probation.

Likewise, William and Deane Palmer's primary residence was in Lakeland, FL, when Hurricane Katrina struck the Gulf Coast. The Palmers also owned two rental properties in MS. Following the storm, the Palmers applied for an HGP for a rental property they owned in Ocean Springs, MS. The Palmers also filed fraudulent applications for FEMA and SBA assistance. William Palmer pled guilty, and was sentenced to 18 months incarceration, three years of supervised release, restitution, and a fine.

Louisiana's corollary to Mississippi's HGP program is its Road Home Program. At the time of Hurricane Rita, Barbara Robicheaux was employed by the Louisiana Department of Motor Vehicles. Immediately after the storm, the Louisiana State Police temporarily suspended the issuance of new State identification cards and driver's licenses, anticipating attempts to misrepresent residential information. Robicheaux asked a co-worker to create a new State identification card for her, displaying the address of a property that she owned at the time of Hurricane Rita but that was not her primary residence. Robicheaux then presented the new fraudulent State identification card as proof of residency, when applying for assistance under the Road Home Program. An investigation also revealed that Robicheaux filed fraudulent applications for FEMA, SBA, and USDA assistance. Robicheaux has entered a guilty plea, but has not been sentenced yet.

Nonetheless, these cases do not necessarily represent the likelihood of disaster fraud prosecutions in general. Many of disaster fraud referrals that we have received following September 11<sup>th</sup> and along the Gulf Coast do not involve multiple frauds exceeding \$120,000 (see Section 2B1.1(b)(1)(F) of the Federal Sentencing Guidelines) against multiple agencies as the majority of the above-referenced cases did, and, thus, they have not been and will not be prosecuted, among other reasons, because of the low dollar loss to the government or because an alternative trigger for an offense level enhancement is not present.

#### The Costs of Fraud Recovery

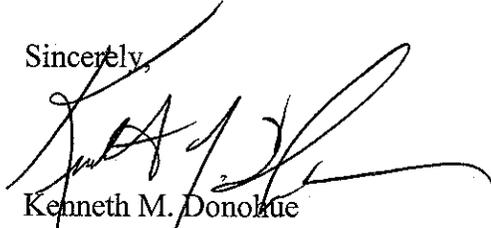
On the basis of Congressional directions, the HUD Office of Community Planning & Development, Office of Community Development Block Grants (CDBG), has obligated \$13.25 million for oversight of billions of dollars of community development and disaster recovery funds destined for the Gulf Coast. CDBG has been concentrating on the States of Louisiana and Mississippi, which received 80% of the funds. CDBG conducts oversight through an electronic reporting system, monitoring reviews, and the use of a risk analysis contractor. To carry out this effort the CDBG Disaster Division increased its staff from two to 11 persons. Similarly, as discussed above, PIH administers FEMA's DHAP program, under a \$565 million interagency agreement. Over \$14.75 million of the DHAP agreement funding covers administration and oversight. Additionally, HUD-OIG has received \$16 million in supplemental appropriations to augment HUD-OIG's resources in the Gulf Coast and defray operating costs associated with monitoring the nearly \$20 billion in HUD disaster assistance circulating there. Currently, HUD-OIG has 33 auditors and investigators dedicated to detecting disaster fraud in Louisiana and Mississippi. The Gulf States have also devoted a significant portion of the HUD disaster assistance—approximately 5%—for fraud prevention and detection.

The costs of CDBG, PIH, HUD-OIG, and the states' fraud prevention and detection efforts are considerable, and failing to recognize them undervalues the relative impact of disaster fraud.

Conclusion

As a consequence of the September 11<sup>th</sup> terrorist attack, Hurricanes Katrina, Rita and Wilma, and other natural disasters, HUD-OIG has become increasingly concerned about the vulnerability of Federal disaster assistance to fraud. HUD-OIG is convinced that DOJ's proposal to enhance the offense level for disaster fraud will improve the likelihood of prosecution of disaster fraud cases and increase deterrence, and accordingly will reduce the vulnerability of disaster assistance to fraud. Additionally, HUD-OIG is encouraged that DOJ's proposal recognizes the substantial resources that the Federal government invests in fraud recoveries associated with disasters. These funds represent real losses to both the government and the intended beneficiaries of the assistance, and they rightly should be treated as losses.

Sincerely,



Kenneth M. Donohue  
Inspector General