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Audit Report Number	2012-LA-0001
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TO: Milan Ozdinec, Deputy Assistant Secretary for Public Housing and Voucher Programs, PE

David Vargas, Deputy Assistant Secretary for Real Estate Assessment Center, PX

Tanya E. Schulze

FROM: Tanya E. Schulze, Regional Inspector General for Audit, Region IX, 9DGA

SUBJECT: HUD Did Not Adequately Support the Reasonableness of the Fee-for-Service Amounts or Monitor the Amounts Charged

HIGHLIGHTS

What We Audited and Why

We initiated a review of the U.S. Department of Housing and Urban Development's (HUD) oversight of the Housing Choice Voucher program's fee-for-service system because it was included in our annual audit plan, prompted by a prior external audit, during which we noted that a housing agency charged management and bookkeeping fees far in excess of the applicable overhead expense while following HUD's fee-for-service requirements. Our overall audit objective was to determine how HUD arrived at the fee-for-service management and bookkeeping fee limits and whether the methodology and monitoring of these fees appeared reasonable.

What We Found

HUD did not adequately support or reassess the reasonableness of the fee-for-service amounts or monitor the amounts charged. We reviewed three additional housing agencies and found no indication that they defederalized administrative fees in excess of actual costs; however, HUD data suggest that other housing agencies may have overcharged the Section 8 program by more than \$5 million in management fees and more than \$1 million in bookkeeping fees.

What We Recommend

We recommend that the Deputy Assistant Secretary for Public Housing and Voucher Programs in coordination with the Real Estate Assessment Center (Center) establish and implement procedures to reassess the safe harbor percentage and rates periodically to ensure that they are reasonable. HUD should retain the documentation justifying the calculation of the percentage and rates. In addition, HUD should assess the feasibility of requiring the agencies to periodically justify and retain documentation showing the reasonableness of using the maximum rates, or lower them as appropriate. We also recommend that the Deputy Assistant Secretary for Public Housing and Voucher programs and the Center (1) develop and implement automated controls to the Subsystem to check that housing agencies nationwide do not charge excessive management and bookkeeping fees. We also recommend that HUD (2) follow up on the largest discrepancies identified and reassign excessive defederalized funds to the program if the housing agencies cannot provide HUD with a reasonable explanation for the discrepancies.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-4. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We provided a draft report to HUD on October 13, 2011, and held an exit conference with HUD on October 24, 2011. HUD provided written comments on November 14, 2011. HUD generally agreed with our report recommendations.

The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix A of this report.

TABLE OF CONTENTS

Background and Objective	4
Results of Audit	
Finding 1: HUD Could Not Support the Reasonableness of the Housing Choice Voucher Program's Fee Limits	5
Finding 2: HUD Failed To Properly Monitor the Fees Charged to the Housing Choice Voucher Program	9
Scope and Methodology	11
Internal Controls	13
Appendix	
A. Auditee Comments and OIG's Evaluation	15

BACKGROUND AND OBJECTIVES

The U.S. Department of Housing and Urban Development (HUD) published the revision to the Operating Fund program at part 990.280, which provided a new formula for distributing operating subsidies to public housing agencies and established requirements to convert to asset management. HUD issued a supplement to provide guidance to address the changes in financial management and reporting for public housing agencies. The supplement also established that housing agencies would be required to replace cost allocation systems with a series of fees for the Public Housing Operating Fund and Public Housing Capital Fund programs. In addition, it developed guidelines for the fee-for-service allocation system for the Housing Choice Voucher program to assist public housing agencies in determining whether fees are reasonable if an agency chooses to adopt fees voluntarily in lieu of overhead cost allocations.

Under the Operating Fund program, housing agencies with 250 or more units must use a management fee in lieu of allocations for the Operating Fund and Capital Fund programs. However, the change to a management fee approach for the reimbursement of overhead in the Section 8 Housing Choice Voucher program is voluntary.

HUD established the types of fees and limits the amount of fees that public housing agencies may charge to their Housing Choice Voucher programs under the fee-for-service allocation system. The supplement to HUD Handbook 7475.1, REV, CHG-1, Financial Management Handbook, states that “for PHAs¹ that elect to use a fee-for-service methodology for its HCV² Program for overhead/indirect costs, HUD will consider a management fee of up to 20 percent of the administrative fee or up to \$12 PUM³ per voucher leased, whichever is higher, as meeting the requirements for the appropriations act.” The supplement also allows public housing agencies to charge a \$7.50 bookkeeping fee that can be earned for each occupied unit and HUD-approved vacancy.

Audit Objective

Our overall audit objective was to determine how HUD arrived at the fee-for-service management and bookkeeping fee limits and whether the methodology and monitoring of these fees appeared reasonable.

¹ PHA stands for public housing agency.

² HCV stands for Housing Choice Voucher.

³ PUM stands for per unit monthly.

RESULTS OF AUDIT

Finding 1: HUD Could Not Support the Reasonableness of the Housing Choice Voucher Program's Fee Limits

Although HUD provided a partial report justifying the 20 percent safe harbor management fee rate, it was not sufficient to show whether that rate was reasonable. In addition, HUD did not provide adequate justification for the reasonableness of the bookkeeping fee of \$7.50 and management fee of \$12. This condition occurred because HUD either did not adequately support or reassess the Housing Choice Voucher program's fee limits under the fee-for-service allocation methodology or did not believe it was necessary to maintain the justification. Consequently, we identified one housing agency that used the percentage that HUD deemed reasonable and defederalized significant administrative fees and reserves despite having costs far below the reasonable percentage. Although we found no indication that the three Region 9⁴ public housing authorities in our nonstatistical sample defederalized administrative fees in excess of actual costs, HUD may have allowed other housing agencies to defederalize significant amounts of administrative fees in excess of actual costs.

HUD Lacked Sufficient Support To Justify the Fee Limits and Did Not Require Agencies To Retain Records To Justify the Use of Such Fees

HUD did not retain the justification for the fee rates. It provided a contractor's report justifying the management fee of 20 percent of the administrative fee. The report stated that the 20 percent was based on limited research of caps placed on indirect administration in other Federal programs. It also stated that an amount on the higher end of the range would be used due to the unknown in the Housing Choice Voucher program with regard to actual direct versus indirect program administration costs. We were unable to validate the basis for the 20 percent or determine the range that was used since HUD could not produce the limited research or the appendix with the compiled data of the report during our fieldwork.

Moreover, HUD did not provide adequate support to justify the \$12 per unit month per voucher leased management and \$7.50 bookkeeping fee rates. HUD provided Final Consolidated Financial Management and Accounting Handbook, SOW No: 8.1.2.4 and 8.3.3.4, to justify the \$7.50 bookkeeping fee rates, but it only stated "the \$7.50 amount is based on the average bookkeeping fee in HUD's multifamily housing programs of about \$3.50 PUM (2004 data)." HUD did not

⁴ Region 9 is composed of the following states: California, Nevada, Arizona, and Hawaii.

have additional information to show how the multifamily average bookkeeping fee rate of \$3.50 is applicable to the Housing Choice Voucher program rate of \$7.50 or why the bookkeeping fee rate of \$3.50 almost doubled. Further, HUD did not have support to justify the \$12 per unit month per voucher leased management fee rate. Therefore, we could not determine the reasonableness of these rates.

HUD does not require public housing agencies to retain indirect cost allocation records after they have switched to the fee-for-service allocation system and does not require them to justify the reasonableness of fees charged within the established limits. As a result, public housing agencies would not necessarily be able to justify the fee rates charged to the Housing Choice Voucher program or how the amounts were determined. However, based on the housing agencies we reviewed, it appears many public housing agencies maintain indirect cost allocations for their other state or local programs and do have this information available.

The Housing Authority of the County of Los Angeles Charged Excessive Fees to the Section 8 Program

During our audit (audit report # 2009-LA-1009, issued April 24, 2009) of the Housing Authority of the County of Los Angeles, we found that \$5.3 million in management and bookkeeping fees was charged in fiscal year 2008, when total indirect costs allocated to the Section 8 program were only \$1.7 million⁵. As a result, the County accrued significant defederalized funds from its administrative fees, while its administrative fee reserves dropped from \$8 million at the end of fiscal year 2006 to \$2 million in 2008. The established thresholds appeared to be too high in this instance, allowing the County to defederalize its administrative fees and reserves in excess of actual costs.

⁵ Even after the County switched to the fee-for-service allocation system, it maintained an internal record for tracking its indirect costs for the Housing Choice Voucher program as well as its other Federal and non-Federal programs. Based on that record, its actual allocated costs was \$1.7 million; however, \$5.3 million in management and bookkeeping fees was charged to the Section 8 program. Therefore, the fees were \$4 million in excess of actual cost.

There Was No Indication of Defederalized Excess Funds at Three Agencies Sampled

We found no indication that the three public housing agencies in our sample had defederalized significant amounts of administrative fees in excess of actual costs under the fee-for-service allocation system.

- *Housing Agency of the City of Los Angeles* - After it switched to fee-for-service, the City's combined management and bookkeeping fees for fiscal year 2008 were lower than its prior year's indirect cost allocation. Although the fee amounts increased in the following 2 years, the increases were not significant.
- *County of Sacramento Housing Agency* - Sacramento determined its management fees based on budget estimates rather than its actual total administrative fees or unit months leased. Although it could not provide us with documentation to show how these estimates were derived, its fees were within HUD's fee limits, and it charged fees that were significantly less than its total indirect cost immediately before the switch to the fee-for-service allocation methodology.
- *Phoenix Housing Department* - Due to its failure to retain historical records to support its units' months leased, Phoenix was unable to accurately demonstrate how it derived the management and bookkeeping fees that it reported in HUD's Financial Assessment Subsystem. However, after Phoenix switched to fee-for-service, its combined management and bookkeeping fees for fiscal year 2008 were lower than prior years' indirect cost allocations. Although the amounts later increased, they were not significant.

Conclusion

HUD was not able to completely justify its management and bookkeeping fee rates because it did not support or reassess the rates. Although the three public housing agencies sampled had not charged fees significantly higher than their prior indirect cost allocations, indicating the rates appear reasonable for some housing authorities, our prior audit of the County shows this was not always the case. As a result, HUD may have also allowed other public housing agencies nationwide to defederalize significant amounts of Housing Choice Voucher funds in excess of actual expenses. We therefore recommend that HUD establish and implement procedures to evaluate the safe harbor percentages and rates periodically to ensure

that they are reasonable and applicable to all public housing agencies. Further, since our testing showed housing agencies are still internally tracking indirect costs, HUD should also assess the feasibility of requiring the agencies to periodically justify and retain documentation showing the reasonableness of using the maximum rates, or lower them as appropriate.

Recommendation

We recommend that the Deputy Assistant Secretary for Public Housing and Voucher programs in coordination with the Center:

- 1A. Establish and implement procedures to reassess the safe harbor percentage and rates periodically to ensure that they are reasonable. HUD should retain the documentation justifying the calculation of those percentages and rates. In addition, HUD should assess the feasibility of requiring the agencies to periodically justify and retain documentation showing the reasonableness of using the maximum rates, or lower them as appropriate.

Finding 2: HUD Failed To Properly Monitor the Fees Charged to the Housing Choice Voucher Program

HUD did not monitor the management and bookkeeping fees charged to the Housing Choice Voucher program. This condition occurred because HUD did not develop or implement procedures to check for the charging of excessive management and bookkeeping fees. Consequently, there is a risk of public housing agencies' potentially overcharging management and bookkeeping fees and, therefore, defederalizing funds that should be used for the Section 8 program. Public housing agencies nationwide may have charged more than \$5 million in management and more than \$1 million in bookkeeping fees in excess of HUD's established limitations.

HUD Did Not Monitor Management and Bookkeeping Fees

Contrary to guidebook requirements, HUD did not monitor public housing agencies' management and bookkeeping fees. HUD Guidebook 7460.7 states that "HUD monitors compliance with requirements through remote monitoring and/or on-site reviews. HUD's objective is to identify situations where funds are endangered and through problem diagnosis/analysis assist PHAs in correcting deficiencies." However, various local HUD field offices told us that they did not actively monitor the management and bookkeeping fees because they believed that the Center was responsible for that function. The Center agreed that it was its responsibility to monitor the management and bookkeeping fees; however, it did not perform the monitoring to identify fee overages, although it had intended to do so when it switched system platforms in 2008. The Center stated that the new platform showed significant developmental issues. Because HUD did not allocate sufficient funds to the Center to correct these issues, it was unable to automate the check functions as was originally planned. The Center also did not have enough staff to manually monitor all the public housing agencies; and therefore, it had not monitored the fees.

Housing Agencies Nationwide May Have Charged Excessive Fees

Our review of data from HUD's Subsystem indicated some public housing agencies may have charged fees to their Housing Choice Voucher programs in excess of the established limits. Based on data from HUD's Subsystem, there

are 467 public housing agencies participating in the fee-for-service system. Of the 467 agencies, 24 entities may have overcharged their management fees and 81 entities may have overcharged their bookkeeping fees. Overall, between fiscal year end 2008 and 2010, public housing agencies nationwide appeared to have charged over \$5 million in management and over \$1 million in bookkeeping fees in excess of HUD's established limitations⁶. Although we have validated data for our 3 survey sample agencies, we did not validate the information submitted to the Subsystem for the agencies that appeared to have overcharged, or contact the respective public housing agencies. As a result, we cannot conclude whether there were other reasonable explanations as to the cause of these deficiencies. At the time of our field work, HUD had not identified or followed up on these potential deficiencies.

Conclusion

HUD has not been monitoring its public housing agencies management and bookkeeping fee charges in Subsystem. This occurred because HUD did not have or implement automated controls to the Subsystem to check for overcharging. Consequently, other public housing agencies nationwide may have overcharged the Section 8 program by more than \$5 million in management and more than \$1 million in bookkeeping fees.

Recommendations

We recommend that the Deputy Assistant Secretary for Public Housing and Voucher programs in coordination with the Center:

- 2A. Develop and implement automated controls to the Subsystem to check that housing agencies nationwide are not overcharging excessive management and bookkeeping fees.
- 2B. Follow up on the largest potential overcharge discrepancies identified in this report and recapture excessive de-federalized funds to the program if the housing agencies cannot provide HUD with a reasonable explanation for the discrepancies.

⁶ We provided HUD with the list of public housing agencies that may have overcharged more than \$5 million in management and more than \$1 million in bookkeeping fees.

SCOPE AND METHODOLOGY

We performed our on-site audit work from June to July 2011, at the City, Sacramento, and Department's facilities located in Los Angeles, CA, Sacramento, CA, and Phoenix, AZ, respectively. The audit generally covered the period from June 30, 2007 to December 30, 2010. We expanded our audit period as necessary.

To accomplish our audit objective, we

- Interviewed HUD headquarters, HUD field offices, the City, Sacramento, and Phoenix staff;
- Reviewed applicable HUD requirements including Public and Indian Housing Notice 2006 – 33, HUD Handbook 7475.1, Financial Management Handbook Supplement, and Office of Management and Budget A-123.
- Analyzed and sorted the audit universe from the Subsystem with ACL. We relied on the information in HUD's Subsystem. Although we did not perform a detailed evaluation of the data, we performed testing with respect to the three housing agencies in our sample and found the data to be adequately reliable for our purposes. Based on the audit universe, we isolated the agencies that have switched over to the fee- for-service system and had charged either management or bookkeeping fees. We then determined the total management fee threshold amount by taking the highest of 20 percent of administrative fees or \$12 per unit monthly per voucher leased. We also calculated the bookkeeping fee threshold by determining \$7.50 per unit monthly per voucher leased. Finally, we compared the management and bookkeeping fees charged to the threshold amounts to arrive at the potential overages.
- Reviewed the 2008, 2009, and 2010 administrative plans for the City and Sacramento. Reviewed the 2009 and 2010 administrative plans for Phoenix.
- Reviewed the City's, Sacramento's, and Phoenix's electronic submissions to the Financial Assessment Subsystem between fiscal years 2008 and 2010.
- Reviewed the City's and Phoenix's internally maintained records of their management and bookkeeping fees. Reviewed Sacramento's internally maintained records of their management fees.
- Reviewed the disbursement listings of administrative fee revenues maintained by the Financial Management Center.
- Verified the units' months leased that were reported in the voucher management system.

- Compared the fee-for-service allocation expenditures with cost allocation expenditures from before the switch to the fee-for-service allocation methodology.

We nonstatistically selected one public housing agency from three of the four Region 9 hubs or program centers. We selected the largest agency from each hub or program center (based on total Section 8 units) that had switched to the fee-for-service allocation methodology and was not a part of the Moving to Work program.

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

INTERNAL CONTROLS

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

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

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

Relevant Internal Controls

We determined that the following internal control was relevant to our audit objective:

- Controls to ensure that HUD assesses or reassesses fee rates periodically to ensure that they are reasonable.
- Policies and procedures designed to ensure that HUD monitors management and bookkeeping fees for excessive charges.

We assessed the relevant controls identified above.

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

We evaluated internal controls related to the audit objective in accordance with generally accepted government auditing standards. Our evaluation of internal controls was not designed to provide assurance on the effectiveness of the internal control structure as a whole. Accordingly, we do not express an opinion on the effectiveness of HUD's internal control.

Significant Deficiencies

Based on our review, we believe that the following items are significant deficiencies:

- HUD could not support the reasonableness of fee limits (see finding 1).
- HUD lacked monitoring procedures to adequately assess whether public housing agencies nationwide charged the correct fees (see finding 2).

APPENDIXES


Appendix A

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

Comment 1


U.S. Department of Housing and Urban Development
Washington, D.C. 20410

NOV 14 2011

OFFICE OF PUBLIC AND INDIAN HOUSING


MEMORANDUM FOR: Tanya E. Schulz, Regional Inspector General
for Audit, Region IX, 9DGA

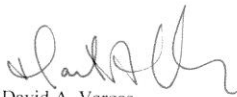
SUBJECT: Office of Public and Indian Housing Response
to Office of Inspector General Discussion
Draft Report: Section 8 Housing Choice Voucher
Program's Fee for Service

In response to Recommendation 1A, page 8, of the Discussion Draft, the Office of Public and Indian Housing submits the Comment outlined below.

We recommend that the following sentence be deleted: "In addition, HUD should assess the feasibility of requiring the agencies to periodically justify and retain the documentation showing the reasonableness of using the maximum rates, or lower them as appropriate."

The purpose of establishing the HCV program's fee for service fixed amounts based on reasonable and defensible costs is to reduce the administrative burden on PHAs while maintaining cost controls at the federal level. The same goes for safe harbor percentages. If the federal government is able to analyze and document the reasonableness of these fees, that should be the threshold used by PHAs. This is the process we have used for years successfully in determining HCV administrative fee levels.


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OIG Evaluation of Auditee Comments

Comment 1 We understand that safe harbor percentages were established to reduce the administrative burden on public housing agencies and to maintain costs controls at the federal level. We agree that if HUD is able to analyze and show the reasonableness of these fees as they apply to each public housing agency, then public housing agencies should be allowed to use the established threshold. However, as an added control, HUD should also determine whether the public housing agencies should periodically show the reasonableness of using the maximum rates. As we saw during our review at HACoLA, even though it was charging rates at the maximum amounts that were established and approved by HUD, it was collecting fees significantly more than actual cost. This additional step, if feasible, would help ensure that Housing Choice Voucher funds are not being unnecessarily defederalized.