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TO: Carol J. Galante, Deputy Assistant Secretary, Multifamily Housing, HT
Joan S. Hobbs

FROM: Joan S. Hobbs, Regional Inspector General for Audit, Region X, OAGA

SUBJECT: HUD's Monitoring of the Performance-Based Contract Administrators Was Inadequate

HIGHLIGHTS

What We Audited and Why

We initiated a review of the U.S. Department of Housing and Urban Development's (HUD) monitoring of the performance-based contract administration contract administrators (PBCA) because of the results of our national internal performance-based contract administration audit issued on June 7, 2007, and our internal audit of the Los Angeles multifamily hub issued on November 5, 2007. These audits, respectively, reported that HUD paid contract administrators \$27.2 million during fiscal year 2006 for work HUD had eliminated and that the Los Angeles multifamily hub did not properly monitor its contractor. Our audit objective was to determine whether HUD's monitoring of the contract administrators nationwide was adequate.

What We Found

HUD did not adequately monitor the PBCAs' performance with respect to the Section 8 performance-based contract administration initiative. Consequently, HUD lacked assurance that Section 8 rental subsidies were correctly calculated and paid, project-based Section 8 housing assistance payments contracts were administered consistently, and it received quality work and the best value for more than \$28 million spent on

administrative fees paid to the PBCAs monitored by the six hubs reviewed. This condition occurred because HUD failed to establish clear, consistent policies and procedures for administering and monitoring the performance-based contract administration program.

What We Recommend

We recommend that the Deputy Assistant Secretary for Multifamily Housing revise the performance-based contract administration initiative guides to (1) clarify inconsistencies or unclear guidance in monitoring the PBCAs, including clarification of PBCA performance that requires issuing incentive fees or the assessment of disincentives, (2) ensure that HUD staff follow the revised guidance when conducting the annual compliance reviews and monthly remote reviews to ensure that it receives quality work and the best value for funds spent on contract administration activities, and (3) reassess the resources allocated to overseeing the contract administrators to ensure that the resources are sufficient to monitor the PBCAs' performance.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We provided a draft copy of this report to the auditee on July 2, 2009, and the auditee provided its written comments on August 19, 2009. The auditee generally disagreed with our report. 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 Did Not Adequately Monitor Its PBCAs' Performance	6
Scope and Methodology	16
Internal Controls	17
Appendixes	
A. Auditee Comments and OIG's Evaluation	18
B. Criteria	22

BACKGROUND AND OBJECTIVE

Project-Based Section 8 Contract Administration

The U.S. Department of Housing and Urban Development (HUD) is authorized to enter into an annual contributions contract (contract) with public housing authorities to provide contract administration services for units receiving project-based rental assistance under Section 8 of the United States Housing Act of 1937. In the late 1990s, HUD had material internal control weaknesses with respect to its administration of project-based Section 8 rental housing.

In May 1999, HUD issued a request for proposals for contract administration services for project-based Section 8 housing assistance payments contracts. During 2000, HUD awarded contracts to only 39 of the 53 contract administrators due to a lack of qualified applicants. HUD then issued a request for qualifications, followed by a request for proposals and awarded an additional five contracts between 2002 and 2003. In 2003, HUD issued an invitation for submission of applications rather than a request for proposals. HUD awarded the remaining nine contracts between 2003 and 2005 under this solicitation.

HUD's objectives for the initiative included calculating and paying Section 8 rental subsidies correctly, administering project-based Section 8 housing assistance payments contracts consistently, and getting the best value for dollars spent on contract administration services using performance-based service contracting. Performance-based service contracting is based on the development of a performance work statement, which defines the work in measurable, mission-related terms with established performance standards and review methods to ensure quality. Performance-based service contracting assigns incentives to reward performance that exceeds the minimally acceptable level and disincentives to assess penalties for unsatisfactory performance. HUD refers to the minimally acceptable level as the acceptable quality level.

Performance-Based Annual Contributions Contract Requirements

The contract includes 10 core tasks for which the contract administrator is responsible:

1. Conduct management and occupancy reviews.
2. Adjust contract rents.
3. Process housing assistance payments contract terminations or expirations.
4. Pay monthly vouchers from Section 8 owners.
5. Respond to health and safety issues.
6. Submit Section 8 budgets, requisitions, revisions and year-end statements.
7. Submit audits of the public housing authority's financial condition.
8. Renew housing assistance payments contracts.
9. Report on public housing authority operating plans and progress.
10. Follow up on results of physical inspections of Section 8 projects.

HUD Monitoring and Oversight of the Contract

The HUD headquarters Office of Housing Assistance Contract Administration Oversight is responsible for the administration of the outsourcing of project-based Section 8 contract administration and for the administration of subsidy contracts under multifamily rental subsidy programs. The primary responsibility for monitoring and oversight activities of the project-based Section 8 contract administrator (PBCA) rests with the multifamily hubs and the program centers. These offices monitor, oversee, and provide technical assistance to PBCAs and ensure that project-based Section 8-subsidized properties continue to meet HUD's goal of providing decent, safe, and sanitary housing to low-income families.

Current Contract Administration Activity

There are 53 PBCAs with contracts at a cost of approximately \$291 million in 2008. They perform administration for 15,571 housing assistance payments contracts valued at more than \$6.8 billion. The contracts were for an initial three-year period with two one-year renewal options. On average, each project-based housing assistance payments contract cost \$18,706 per year to administer in 2008.

Our audit objective was to determine whether HUD's monitoring of the PBCAs was adequate.

RESULTS OF AUDIT

Finding 1: HUD Did Not Adequately Monitor Its PBCAs' Performance

HUD did not adequately monitor the PBCAs' performance regarding the Section 8 performance-based contract administration initiative. Specifically, HUD's annual compliance reviews and its monthly remote monitoring were inadequate. This condition occurred because HUD's policies and procedures for the initiative were unclear and inconsistent. Consequently, monitoring practices across the nation were not consistent, and HUD lacked assurance that Section 8 rental subsidies were correctly calculated and paid, project-based Section 8 housing assistance payments contracts were administered consistently, and it received quality work and the best value for more than \$28 million spent annually on administrative fees paid to the PBCAs monitored by the six¹ hubs reviewed.

Annual Compliance Review of the PBCAs Were Inadequate

HUD did not adequately review the PBCAs' performance and business practices as required for conducting the annual compliance review. Specifically, HUD's annual compliance review sample sizes did not always meet the requirements of HUD's monitoring guide or its compliance review instructions, and the compliance review checklists were often incomplete, missing, and/or inconsistent with other guidance. In addition, HUD did not always assess disincentives when the PBCAs' actions clearly violated the annual contributions contract (contract).

Inadequate Sample Size

HUD has two sampling methodologies for the compliance review. The monitoring guide focuses on the percentage of the PBCAs' property portfolios to be reviewed, while the compliance review instructions focus on the number of units within the portfolio. We reviewed HUD's sample sizes used for its compliance review of tasks 1, management and occupancy reviews; 2, civil rights compliance; 6, monthly Section 8 vouchers; and 7, corrective actions, for 16 PBCAs for 2007. We determined that HUD's sample sizes did not always meet the requirements of either the monitoring guide or the compliance review instructions.

HUD's monitoring guide states that the compliance review team will review 10 percent of the files of the PBCAs' property portfolio and may review more if a more

¹ Although we reviewed 16 hubs for their selection of sample size under the annual compliance reviews, we reviewed five hubs for the remaining areas under the annual compliance reviews. For monthly reviews, we reviewed four of the hubs we reviewed for annual compliance reviews and one additional hub. Therefore, we reviewed a total of six hubs for the annual and monthly reviews (other than for the selection of sample size).

thorough review is determined to be necessary. In accordance with this methodology, HUD's sample size for the 16 PBCAs reviewed should have ranged from 4 to 103 files. We reviewed the sample sizes and determined that only three hubs' sampling sizes met or exceeded this 10 percent requirement. One hub selected a sample size of less than 2 percent of the PBCA's project files.

The compliance review instructions stated that the review team would sample the files based on the number of units under contract within the PBCA portfolio; i.e., five files would be reviewed if the portfolio included 100 or fewer units, 10 files if the portfolio included 101 to 600 units, 20 files if the portfolio included 601 to 2,000 units, and 25 files if the portfolio included more than 2,000 units. Of the 16 hubs reviewed, 15 were required by this method to select at least 25 files for the annual compliance reviews, and one was required to select 10 files. However, 14 of the hubs that were required to select a sample size of at least 25 files selected sample sizes ranging from 8 to 20 files, and the hub that was required to select a sample size of 10 files only selected five for review. Only one hub complied with the compliance review instruction methodology.

Incomplete, Missing, and Improperly Completed Compliance Review Checklists

HUD's review teams did not adequately document the compliance reviews they performed. We performed a detailed review of the compliance review checklists for 5 of the 16 hubs in our sample and determined that four of the five hubs failed to complete the checklists in accordance with the checklist instructions. Fifty-four percent of the checklists (256 of 478) from four of the hubs reviewed for 2007 included one or more of the following deficiencies: (1) blank or "unknown" answers were not explained, (2) exceptions were not explained by the reviewer, (3) the reviewer did not provide a rating, and (4) follow-up notes were not provided by the reviewer on the activities that the PBCAs did not properly perform.

The fifth hub was not able to provide 44 percent of its 2006 and 2007 review checklists for review (81 of 186 checklists not provided). For the missing checklists, we reviewed the PBCA's work, completed the checklists ourselves, and found no errors. Although we found no errors, the hub violated HUD's established monitoring guide by not maintaining important key documents (i.e., detailed records of the files reviewed).

Unassessed Disincentives

The performance requirements summary table (table) in the contract identified the acceptable quality level, incentive fee, and disincentive deductions that would be calculated for each of the required tasks. However, except for performance standard task 3, rental adjustments, the table missed an important element in measuring performance. Except for task 3, the table included metrics only for timeliness or quantity and did not include quality or accuracy metrics for the contracted deliverables. Since the table did not include quality or accuracy metrics, generally,

HUD field staff were reluctant to apply disincentives or cite findings when PBCA work clearly violated the narrative sections of the contract but not the requirements in the performance requirements summary table. Additionally, since there was no monetary consequence for inaccuracy in contracted deliverables, the PBCAs may have been more inclined to deliver the required number of products in a timely manner rather than focusing on submitting quality or accurate products to HUD.

Under the contract, the PBCAs are required to perform management and occupancy reviews at 100 percent of the projects in their portfolios. Under this performance standard, the contract requires that the PBCA select a sample of files to verify owner/agent compliance with HUD regulations and requirements regarding occupancy issues (e.g., resident eligibility and selection, examination and reexamination of family income and assets, and household characteristics) and verify that correct documentation is contained in each resident file to support claims for payment under the owners' housing assistance payments contracts with HUD.

Below are examples of PBCAs that clearly violated the contract requirements under the statement of work or narrative sections of the contract under performance standard task 1, management and occupancy reviews. However, since disincentives identified in the contract were tied only to timeliness or quantity, HUD field staff did not assess disincentives for these deficiencies.

Finding from HUD's Review of PBCA #1

During its 2006 compliance review of the PBCA, one HUD field office reviewed management and occupancy reviews that its PBCA had performed. The field office reviewed only files that the PBCA had reviewed as part of its management and occupancy review of the projects. HUD cited in its report owner/agent deficiencies that had not been noted by the PBCA. The owner/agent deficiencies included the following:

Project A:

- In three tenant files, there were discrepancies between the tenants' move-in dates and the lease effective dates, which may have affected the amount of subsidies. HUD's compliance review further stated that the PBCA had not been able to comment until it received more information from the owner, indicating that it had not identified the discrepancies in its review.
- The PBCA noted in the management and occupancy review report that project management averaged 30 days to prepare a vacant unit for a new tenant. However, on the supporting review forms, the PBCA had calculated the average turnaround time at six weeks.
- Documents were missing from the tenant files for five units (e.g., residents' rights and responsibilities, lead-based paint disclosure, background check, lease agreement, and credit check).

- Information was missing from the rental applications for 11 tenants (e.g., signatures, incomplete forms, and receipt of application dates). Additionally, one file was missing the rental application.

Project B:

- There were discrepancies with subsidy calculations and/or verifications for four units.

Project C:

- There were discrepancies with subsidy calculations and/or verification for four units.

Project D:

- The PBCA closed a finding with an inadequate response from the owner regarding incorrect calculation of income.

Of the 15 projects reviewed by HUD during the annual compliance review for this PBCA, there were eight projects for which the PBCA did not obtain and submit a list of the current project board members to HUD.

According to the contract, since the PBCA's management and occupancy review should have identified these problems, the PBCA should have required the owner to conduct a 100 percent review of the files and report the results. The PBCA should have then tested the review conducted by the owner to determine reliability and accuracy. However, because the timing or quantity of management and occupancy review completions was not affected by these problems, no disincentives were assessed.

Finding from HUD's review of PBCA #2

In 2007, another HUD field office performed a similar compliance review of management and occupancy reviews that its PBCA had performed. This report cited that many owner/agent deficiencies were not noted by the PBCA. These owner/agent deficiencies included the following:

Project A:

- Files did not include documentation showing that criminal/sex offender background checks had been completed.
- The tenant selection plan for the same project listed an eligibility preference for a near-elderly family for which it had not received HUD's prior approval. In addition, the plan did not include the procedures for opening and closing the waiting list.

Project B:

- House rules included an unapproved assessment of charges to the tenants.
- Agreements were made with the tenants that stipulated a “hold harmless” condition for the owner/agent with respect to its fire extinguishers and smoke detectors.
- The project sign did not contain the required “fair housing” statement or logo.

Projects C, D, and E:

- One tenant in each project was overhoused (in a larger unit than required), and the tenant file did not contain documentation to justify the accommodation.

Project E:

- Unapproved and unreasonable lockout fees were charged to the tenants.

The expected outcome identified in the contract for performance standard task 1, management and occupancy reviews, was that the PBCA would identify and resolve areas of owner/agent noncompliance with HUD regulations and other requirements. Although HUD identified various noncompliance issues that the PBCA did not, since the required number of management and occupancy reviews was completed on time, HUD did not assess disincentives.

Monthly Remote Monitoring Was Inadequate

According to HUD’s monitoring guide, remote monitoring is the primary method by which PBCAs will be monitored and evaluated. It is through remote monitoring that most of the issues, problems, concerns, and negative trends in each of the core task areas are identified. This type of monitoring also assists in determining the necessity for a targeted compliance review of a specific area of a PBCA’s work. In addition, the monitoring guide states that review of the monthly invoice is a key tool for remote monitoring and allows HUD to stay informed of PBCA activities. Further, it states that following a review of the monthly invoices and systems reports, HUD should follow up with the PBCA on any areas in which problems were identified. Follow-up activity should be documented and may also result in a targeted review of the PBCA.

We determined that the general policies and procedures for monitoring the PBCAs nationwide were posted on HUD’s intranet. We reviewed these policies and procedures and compared them to the field offices’ monitoring processes, monthly reports, and other monitoring documents for five hubs to determine the monitoring processes practiced by the hubs. During our review, we found the following:

Management and Occupancy Reviews

Our review determined that contrary to HUD's monitoring guide, three of the five hubs did not keep aging reports to track management and occupancy reviews scheduled but not completed each month, and one did not report the management and occupancy issues in the monthly contract administrator oversight monitor (oversight monitor) report.

We also selected five below-satisfactory management and occupancy reviews for one of the PBCAs. Some of these reviews had findings related to a lack of screening for criminal, drug, and sex offender registration; lack of documentation of the former tenant's move-out date; missing rental applications; and incorrect determination of tenant income. Some of the reviews included repeat findings pertaining to annual recertification, missing tenant consent form, missing lease agreement, and missing declaration of citizenship. HUD's monitoring guide states that HUD's oversight monitor will follow up on clearance of management review findings and that the project managers will review all management reviews with a less than satisfactory rating and provide monthly updates to the oversight monitor. However, rather than follow up on these management review findings, the hub relied on the PBCA to follow up with the owner/agents unless the owner/agents filed appeals regarding their ratings.

Voucher Processing

According to the contract, the PBCAs are required to verify and certify the accuracy of monthly Section 8 voucher payments to owners. This verification and certification includes but is not limited to the following:

- Verify, through HUD's tenant rental assistance certification system, that the amount of the housing assistance payment paid on behalf of each resident family is accurate.
- Verify that the owner's payment request does not include covered units for which Section 8 assistance has been abated.
- Determine whether authorized rent or utility allowance adjustments have been implemented accurately and in a timely manner.
- Analyze required adjustments to the prior month's vouchers to determine accuracy and validity.

The monitoring guide requires HUD's oversight monitor to review a random sample of vouchers in HUD's Tenant Rental Assistance Certification System to test for accurate processing by PBCAs each month. It also requires the oversight monitor to review the PBCA's electronic fund transfer request to the bank to confirm the date and the amount of the payment to the owners. The objectives of these steps, according to the monitoring guide, include ensuring that the PBCA conducts a thorough review of the owners' vouchers and makes proper payment to the owners within the required timeframes.

The five hubs reviewed, as a matter of normal procedures, compared the number of projects paid and the amount paid as shown in HUD's Line of Credit Control System, the number and amount the PBCA claimed to have paid as shown in the PBCA's monthly invoices to HUD, and the amount HUD wired for payment to the PBCA. However, contrary to the requirement in the monitoring guide, the field offices did not randomly sample and test, on a monthly basis for any of the attributes listed above, for accurate processing by the PBCAs. This testing was not conducted until the annual compliance review was performed. During the year, HUD fully relied on the PBCAs' processes and automated voucher submission system instead of performing the required monitoring steps.

Inconsistent Application of Disincentives

As noted above, since the performance requirements summary table did not include quality or accuracy metrics, HUD field staff were generally reluctant to assess disincentives when PBCA work clearly violated the narrative sections of the contract but not the requirements in the table. However, some field staff did assess disincentives in these situations and in an appeal denial letter, HUD's Office of Housing Assistance Contract Administration Oversight stated that there are three key factors to be considered in assessing performance under any performance standard task: quality, timing, and data entry.

One HUD field office applied disincentives, which the PBCA appealed. The disincentives were taken from various billing months, and the deficiencies, as described in the appeal letter, were no worse than the other examples included in our report. However, the appeal was denied, and the disincentives were assessed for the following activities:

- Project 1 – An incorrect date was entered into HUD's Real Estate Management System. According to HUD's appeal denial letter, the PBCA admitted to a "keystroke error."
- Project 2 – The incorrect format was used for a short-term housing assistance payments contract renewal.
- Project 3 – The wrong contract renewal notification, effective date, and code were used.

HUD's Unclear and Inconsistent Policies and Procedures Contributed to Poor Monitoring

HUD's established monitoring and evaluation guide for the performance-based contract administration initiative was created to ensure the PBCAs' compliance with the requirements of the contract. Objectives of this plan included ensuring that Section 8 rental subsidies were correctly calculated and paid, housing assistance payments

contracts were administered consistently, HUD executed contracts only with qualified entities, and HUD received the best value for dollars spent on PBCA services. However, because the policies and procedures were unclear and inconsistent, annual compliance reviews and monthly monitoring were inadequate, and HUD lacked assurance that the initiative met the objectives and that it received the best value for the \$28 million paid for the contracted tasks under management and occupancy reviews, rental adjustment, housing assistance payments contract processing, and voucher processing for six of the hubs.

The monitoring guide states that HUD's on-site review of the PBCA involves both a general review of PBCA policies and procedures and a more specific review of the PBCA's project files for those contracts administered under the contract. In addition, according to the monitoring guide, the annual compliance review team will perform a thorough review of the PBCA's internal policies to ensure that they comply with HUD's guidelines and regulations. Some of the internal policies the monitoring guide included for review but were not on the compliance review checklist were accounting procedures, use of program receipts, general office protocol and chain of command, equal employment opportunity complaints that may have been filed, and PBCA systems. Since these policies were not specifically included on the compliance review checklist, the review teams did not review these policies in the annual compliance review.

Further, HUD allowed the field offices to operate within the parameters of their own business practices. For example, some hubs had developed and compiled their own interpretations of HUD's Section 8 guides and implemented these interpretations in their field offices and with their PBCA. In addition, HUD did not require the oversight monitors to provide monthly reports in a consistent format across hubs, and one hub reviewed did not generate a monthly contract administrator oversight monitor report.

One hub allowed its PBCA to complete the general section of the compliance review checklist rather than completing the document itself. Staff at another hub told us that they did not allow the PBCA fill in the answers for them. This practice not only indicated inconsistencies in the monitoring process by the hubs, but was also an indication of overreliance on and trust in the PBCA's self-reporting. Some of the questions the PBCA answered for the hub were as follows:

“Does the PBCA's fidelity bond provide coverage equal to or greater than one month's HAP [housing assistance payment]?”

“Is HUD listed as the additional loss payee on the fidelity bond?”

“Have the deficiencies [related to any disincentives incurred in the past year] been corrected? What actions were taken? Please explain.”

Each of these questions should have been executed at the PBCA site and verified by HUD rather than allowing the PBCA to self-report.

HUD hired an independent contractor to assess the project-based contract administration program. The contractor provided its report to HUD in February 2007 and noted several inconsistencies among hubs. The report mentioned that specific objectives of each hub and field office differed significantly. One hub focused on the completion of necessary PBCA tasks across multiple PBCAs and worked with the PBCAs and neighboring hubs to create standard processes, procedures, and interpretations of the guidebook. It further noted that the primary objectives of this hub were the creation of standard practices that supported the continual increases in PBCA capabilities. However, it stated that another hub conducted a 100 percent review and monitoring of all PBCA-submitted rental adjustment documentation and documented findings down to the single-dollar rounding error level. Further, the assessment noted that HUD's performance assessment methods were subjective across hubs and field offices and there was a lack of uniformity in HUD's way of assessing the quality of the PBCAs' work.

Inadequate Resources in Field Offices Contributed to Poor Monitoring

According to HUD staff, they did not have enough oversight resources. The independent assessment of HUD's performance-based contract administration program also stated that the one consistent concern voiced by the staff in the field offices regarding methodology, monitoring tools, and infrastructure was that they lacked the necessary resources to continue to improve and expand the Section 8 program. We also were consistently told that HUD did not have enough staff and travel funds to adequately monitor the PBCAs.

Conclusion

Overall, HUD's oversight of the PBCAs regarding the project-based contract administration initiative was not adequate. Specifically, the field offices' annual compliance review and monthly remote monitoring of the PBCAs were inadequate. The field offices did not select the proper sample size for the annual compliance reviews, did not always have properly completed compliance review checklists, and inconsistently assessed disincentives. In conducting the monthly monitoring, the field offices did not always keep the required aging reports on the management and occupancy reviews that were scheduled but not completed by the PBCAs, did not always report the management and occupancy review issues in the monthly contract administrator oversight monitor report, and did not always follow up on management review findings. Further, during monthly monitoring, as a normal process, the field offices did not test the accuracy of the PBCAs' voucher processing, relied on the PBCAs' own review and transmission in HUD's Tenant Rental Assistance Certification System, and relied on corrective actions reported by the PBCAs.

This condition occurred because HUD's policies and procedures were unclear and inconsistent; the monitoring guide included instructions not included on the compliance

review checklist so these steps were not performed; HUD allowed the field offices to compile, interpret, and implement their own interpretation of the guides; and HUD allowed one field office to support the PBCA's capabilities while allowing another to document findings against the PBCA down to the single-dollar rounding error level. As a result, HUD lacked assurance that Section 8 rental subsidies were correctly calculated and paid, project-based Section 8 housing assistance payments contracts were administered consistently, and it received quality work and the best value for more than \$28 million spent on administrative fees paid to the PBCAs that were monitored by the six hubs reviewed.

Recommendations

We recommend that the Deputy Assistant Secretary for Multifamily Housing

- 1A. Revise the PBCA initiative guides (e.g., the monitoring and evaluation guide and the Section 8 guidebook) to clarify inconsistencies or unclear guidance for monitoring the PBCAs including clarification of PBCA performance that requires issuing incentive fees or assessment of disincentives.
- 1B. Ensure that HUD staff follow the revised guidance when conducting the annual compliance reviews and monthly remote reviews to ensure that it receives quality work and the best value for funds spent on contract administration activities.
- 1C. Reassess the resources allocated to overseeing the PBCAs to ensure that the resources are sufficient to monitor their performance.

SCOPE AND METHODOLOGY

Our review focused on whether HUD adequately monitored its contract administrators' performance with respect to the project-based contract administration initiative. To accomplish this objective, we

- Reviewed applicable federal regulations, HUD handbooks, performance-based contract administration guidebooks, and other HUD requirements related to the Section 8 program;
- Reviewed the field offices' monitoring policies and procedures and their organizations;
- Compared HUD guidelines to the field offices' actual monitoring processes;
- Reviewed the field offices' execution of the annual compliance review and monthly remote monitoring;
- Reviewed HUD's and PBCAs' monthly reports; and
- Interviewed HUD field office staff and met with HUD headquarters officials.

We selected hubs for review using a nonstatistical sample. Our focus was on the hubs for the PBCAs that earned the largest fees and had minimal or no findings reported in the annual compliance reviews of the PBCAs that HUD performed. We found 27 PBCAs that were high earners that had minimal or no findings in their annual compliance reviews. To include a representation of the lower earning group, five hubs were selected from lower earning PBCAs. Therefore, the final number of PBCAs sampled was 32. Of the 32, we selected 16 hubs for sample size review and eight for detailed review of the hubs' monitoring. Six of these eight were reviewed on site.

Our initial audit scope was HUD's monitoring activities from October 2, 2006, through September 30, 2008, and was expanded as necessary to accommodate the latest transactions possible. We performed our audit work from September 16, 2008, through May 1, 2009. We performed our field work in HUD headquarters in Washington, DC, and the field offices in Baltimore, Philadelphia, Boston, Columbus, San Francisco, Chicago, and Seattle.

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

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are achieved:

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

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. They 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 controls were relevant to our audit objective:

- HUD's policies and procedures for monitoring the PBCAs' performance to ensure that HUD made accurate assessments of the PBCAs' performance in accordance with the annual contributions contract, laws, and regulations.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

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

- HUD's controls did not ensure adequate monitoring of the PBCAs' performance in administering and monitoring the Section 8 housing assistance program under the performance-based contract administration initiative.


Appendix A

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation


Auditee Comments

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 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

OFFICE OF HOUSING AUG 19 2009

MEMORANDUM FOR: Joan S. Hobbs, Regional Inspector General for Audit, OAGA

FROM:  Carol J. Galante, Deputy Assistant Secretary for Multifamily Housing Programs, HT

SUBJECT: Draft Audit Report – HUD's Monitoring of the Performance Based Contract Administrators (PBCA) was Inadequate

This response is in follow-up to your memorandum dated July 2, 2009, transmitting the subject draft report and the subsequent exit conference addressing the same on July 30, 2009. We are providing formal written comments to the draft report for your consideration as provided and supporting documentation requested at the exit conference.

Page 6 of the draft, paragraph 3, Inadequate Sample Size

There are two sampling methodologies for the annual compliance review. The original framework was provided in the Monitoring and Evaluation Policies and Procedures Guide. The Annual Compliance Review Checklist was subsequently developed and has been revised several times since the inception of the program due to program changes and the need to improve the effectiveness of the documentation review. The most recent revision was dated October 1, 2008, this included recommendations by IG in a previous audit. The framework presented in the Annual Compliance Review Checklist supersedes the aforementioned guide. Therefore, HUD staff sampling size should follow the contract sample size on the annual compliance review form to the extent there is sufficient activity in the category reviewed to meet the sample size criteria. The instructions on the form specifically note the following:

"If the number of contracts that had IBPS activity is less than the same size above, the CRT (compliance review team) should review the total number of contracts having activity."

The supporting documentation did not detail review by task and incorrectly referenced sample size by unit when the sampling is based on the number of contracts in the PBCA's portfolio. This reference and the documentation should be revised to accurately reflect the sampling strata.

Page 7, Unassessed Disincentives

The PBCA ACC has both a quantitative and qualitative component. The quantitative component is provided in the Performance Requirement Summary. The qualitative definition and detail is provided for each IBPS in the SOW in Appendix A of the ACC. As stated in the ACC definition section:

www.hud.gov espanol.hud.gov

Comment 1
Comment 2

Comment 3

Comment 4

“Statement of Work (SOW). The description of core contract administration tasks to be performed by the PHA under the ACC (Section 3 of Exhibit A).”

Disincentives should be assessed when the PHA’s performance does not meet the acceptable quality level quantitatively and or qualitatively. The calculation of the assessment would be based on the deductions include on the Performance Requirement Summary.

Page 8, Finding from HUD’s Review of PBCA #1

The statement that the field office reviewed only files that the PBCA had reviewed is appropriate. The intent is for the field office to follow behind the PBCA and review the same documents to determine whether the PBCA’s review of the tenant files adequately documented owner compliance with existing subsidy requirements. The CRT should be documenting any deficiencies found when conducting the follow-up tenant file review and if appropriate assess disincentives as a result of inadequate performance.

Page 13, Paragraph 2

Conduct of the annual compliance review is based on the annual compliance review checklist which superseded the monitoring policy guide. The checklist does include and direct the reviewer to management/operation functions, financial management, certifications, quality control, and system security.

If you have any questions, please contact Deborah Lear, Director at (202) 402-2768.

Comment 5

**Comment 2
Comment 6**

OIG Evaluation of Auditee Comments

- Comment 1** Our audit period was October 2, 2006 through September 30, 2008 and we used the checklist and monitoring guide in effect at that time. Although the checklist instructions state that the sample size is to be based on the number of contracts, the table in the instructions in effect during our audit period shows that the selection should be based on units and is specific as to the number of files to review for the number of units in a PBCA's portfolio. For PBCAs whose portfolios include 100 or fewer units, 5 files would be sampled, for 101-600 units, 10 files would be sampled, for 601-2,000 units, 20 files would be reviewed and for PBCAs that have more than 2,000 units in their portfolios, 25 files would be reviewed. Further, the OIG recommendation referred to in HUD's response related to monitoring the use of interest-bearing accounts not selecting a sample for the annual compliance review.
- Comment 2** On December 10, 2008, we discussed the differences between the checklist and the monitoring guide with the director of the Office of Housing Assistance Contract Administration Oversight and we were told that HUD is allowing the field offices to decide their own business practices that meet the needs of their local operations and the PBCAs' operations. We were also told that the field offices should not deviate from any guidelines in the HUD handbooks. However, we were not told that the checklist instructions supersede the monitoring guide. In addition, neither the checklist nor the monitoring guide states that the checklist supersedes the monitoring guide. Regardless, although HUD states that, "...HUD staff sampling size should follow the contract sample size on the annual compliance review form..." our testing of sample sizes disclosed that of the 16 hubs reviewed, only one hub complied with this methodology.
- Comment 3** Although the supporting documentation we provided did not include detailed information as to sample size by task number, the report identified that we reviewed tasks 1, management and occupancy reviews; 2, civil rights compliance; 6, monthly Section 8 vouchers; and 7, corrective actions, for sample size. We selected these tasks for review since these were tasks that would require the review team to meet the sampling requirement. Even so, most of the hubs did not select an adequate sample.
- Comment 4** Qualitative components are included in the narrative section of Exhibit A to the annual contributions contract. However, with the exception of task 3, the IBPS Performance Requirements Summary table, in which the calculations for disincentives are explained, does not include qualitative components. The defined acceptable quality level for each of the tasks, with the exception of task 3, is based on quantity or timeliness, not quality. We were told that the guidelines were not clear and the annual contributions contract was not specific on quality requirements. As a result, contract monitors felt there was not enough support in the contract to assess a disincentive based on quality of work so disincentives were not assessed.

Comment 5 We understand that it was appropriate for the field office staff to review only files that the PBCA had reviewed and to document deficiencies found. However, because the deficiencies found were not of a quantitative or timeliness nature but were deficiencies of quality of work, disincentives were not assessed. This supports our statements in Comment 4.

Comment 6 We agree the latest checklist includes the review of activities related to management/operations functions, financial management, certifications, quality control, and system security. However, it does not include the review of accounting procedures, use of program receipts, general office protocol and chain of command, equal employment opportunity policies and any related complaints that may have been filed, and PBCA systems. Each of these is specifically noted as an item for review in the monitoring guide. As a result, as we stated in our report, since these items were not specifically included in the checklist, the review teams did not review these policies during the annual compliance reviews.

Appendix B

CRITERIA

- A. Office of Management and Budget (OMB) Circular A-123 states that federal employees must ensure that government resources are used efficiently and effectively to achieve intended program results. Management must ensure that contracting out is fiscally responsible and effective.
- B. OMB Circular A-133, subpart C, 300 (Auditees) (b), states that the auditee shall maintain internal control over federal programs that provides reasonable assurance that the auditee is managing federal awards in compliance with laws, regulations, and provisions of contracts or grant agreements that could have a material effect on each of its federal programs.
- C. Housing Act of 1937, section 2(a)(1)(C), states that it is the policy of the United States to promote general welfare of the nation by employing the funds consistent with the objectives of this title to vest in public housing agencies that perform well the maximum amount of responsibility and flexibility in program administration with appropriate accountability to public housing residents, localities, and the general public.
- D. The annual contributions contract is the contract between HUD and the contract administrators. This is the controlling document in the performance-based contract administration initiative.
- E. The Guidebook for Section 8 Contract Administration Initiative, dated March 15, 2001. This guidebook was issued around the time of HUD's award of contracts under the 1999 request for proposals for contract administrators for project-based Section 8 housing assistance payments contracts. Following contract awards, HUD entered into annual contributions contracts with the contract administrators. This guidebook outlines a uniform process for contract administrators to follow in administering and overseeing project-based subsidy contracts. Users of this guidebook may include contract administrators, HUD multifamily housing and other HUD staff, property owners, management agents, and property residents.
- F. The Proposed Monitoring and Evaluation Policies and Procedures, dated August 2000. The objective of this document is to establish HUD's monitoring and evaluation plan for how it will monitor Section 8 housing assistance payments contract administrators to ensure compliance with the requirements of the annual contributions contract. It is also designed to ensure that all payments made to contract administrators are accurate and justified.
- G. The annual compliance review checklist is used during HUD's annual compliance review of the contract administrators to answer monitoring questions. There is a specific checklist for each performance-based annual contributions contract task.