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TO: Patricia W. Anderson, Director, Office of Public Housing, Virginia State Office,
3FPH

FROM: Daniel G. Temme, District Inspector General for Audit, Mid-Atlantic, 3AGA

SUBJECT: Virginia Housing Development Authority
Section 8 Certificate and Voucher Programs
Richmond, Virginia

At your request, we performed a review of the Virginia Housing Development Authority (VHDA) Section 8 Certificate and Voucher Programs. Our report contains four findings with recommendations requiring action by your office. The findings address the need for VHDA to administer and monitor its Section 8 Program properly, utilize Section 8 resources fully, improve its recertification procedures, and establish Section 8 utility allowances properly.

Within 60 days please give us, for each recommendation in this report, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Also, please furnish us copies of any correspondence or directives issued because of the audit.

Should you or your staff have any questions, please contact Allen Leftwich, Assistant District Inspector General for Audit at (215) 656-3401.

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Executive Summary

We conducted an audit of Virginia Housing Development Authority (VHDA) Section 8 Certificate and Voucher Programs. The purpose of our review was to determine if VHDA was managing its Section 8 Program efficiently and effectively. Specific audit objectives were to determine whether VHDA:

- established procedures and provided adequate monitoring and oversight of its administrative agents in the areas of Housing Quality Standards (HQS), rent reasonableness, financial management, tenant income verification, family composition, and waiting list administration;
- fully utilized Section 8 resources;
- charged administrative fees according to HUD guidelines;
- had an accounting system that adequately tracked costs associated with its Section 8 programs; and
- provided tenant utility allowances according to HUD requirements.

Generally, we found VHDA effectively manages its Section 8 programs and provides adequate oversight and direction to its 83 administrative agents. However, in our review, we did identify a number of areas in the VHDA's administration of its Section 8 Program that needed to be improved. These areas are summarized below and detailed in the finding section of this report. At the end of our audit, VHDA was in the process of procuring a consultant to perform a comprehensive evaluation of its Section 8 programs to address audit recommendations and areas needing improvement.

VHDA Can Improve Its Administration of the Section 8 Program

We found VHDA can improve its administration of the Section 8 Program along with its compliance with related requirements in the areas of: HQS; rent reasonableness; financial management; tenant waiting list administration; and tenant income verification. We observed problems in these areas because VHDA's monitoring of sub-recipients did not identify existing problems and provide for the uniform and consistent application of program requirements among sub-recipients.

VHDA Did Not Utilize Available Section 8 Resources

VHDA did not utilize \$30 Million of available Section 8 resources. Until recently, VHDA has measured its occupancy based on ACC unit allocations even though HUD revised its Section 8 procedures in 1995, requiring housing authorities to budget resources based on dollars instead of units. VHDA was conservative in its interpretations of HUD budget guidelines, and did not change its leasing benchmarks to recognize dollars instead of units as the relevant leasing measure. Budgeting Section 8 resources based on available dollars as required, would have provided the VHDA with

the opportunity to house significantly more families since it allows a Housing Authority to lease as many units as possible without regard to ACC unit limitations. As a result, VHDA did not fully utilize its Section 8 resources, and HUD recently recaptured over \$30 Million that could have otherwise provided additional rental subsidies to families on VHDA waiting lists.

VHDA Needs to Improve
Its Recertification
Procedures

The VHDA needs to improve its recertification procedures. A computer match of tenants reported income with 1997 Internal Revenue Service (IRS) and Social Security Administration (SSA) information for over 7,000 households reported in HUD's Multifamily Tenant Characteristics System (MTCS) identified over 300 households with potential income discrepancies exceeding \$10,000 and 1,900 households with potential income discrepancies between \$1,000 and \$10,000.

Detailed analysis of 138 active households of the 300 households with potential income discrepancies exceeding \$10,000 appeared to validate the overpayment of Section 8 subsidies in 116 of the cases. The VHDA's recertification procedures contributed to subsidy overpayments because they did not provide for interim recertifications of significant income changes unless the tenant did not report any income on the last certification. Additionally, administrative agents were not always obtaining third party income verifications.

VHDA Did Not Follow
Utility Allowance
Procedures

VHDA did not follow existing policies and procedures in establishing tenant utility allowances. It did not:

- obtain tenant utility consumption data in analyzing utility allowances;
- ensure utility allowances were sufficient to cover minimum provider charges; and
- ensure utility allowance schedules provided to localities were correct.

As a result, VHDA tenants incurred total housing payments in excess of program requirements, since utility allowances were not sufficient to pay actual utility costs. VHDA staff commented that one locality's utility allowances were not raised because gross rents would exceed fair market rents.

Recommendations

We recommend VHDA implement quality control procedures to improve its administration of the Section 8 program. VHDA needs to improve monitoring of localities in the areas of HQS, financial management, rent reasonableness, waiting list administration, and tenant income verification. We also recommend VHDA change its tenant recertification procedures to reduce tenant's under reporting of income, ensure HQS violations disclosed in our review are corrected, and revise utility allowance schedules accordingly when it completes its ongoing utility study.

The findings were discussed with the VHDA during the course of the audit and at an exit conference on January 19, 2000. The VHDA was also given draft findings for comment. VHDA's written comments are contained in Appendix A and summarized elsewhere in the report.

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Abbreviations

AAF	Annual Adjustment Factor
ACC	Annual Contributions Contract
CFR	Code of Federal Regulations
FMR	Fair Market Rent
HA	Housing Authority
HQS	Housing Quality Standards
HUD	Housing and Urban Development
IRS	Internal Revenue Service
OIG	Office of Inspector General
OMB	Office of Management and Budget
PHA	Public Housing Authority
PIH	Public and Indian Housing
SSA	Social Security Administration
VHDA	Virginia Housing Development Authority
VSO	Virginia State Office

Introduction

The Virginia Housing Development Agency (VHDA), is governed by a ten-member Board of Commissioners, chaired by Sam Kornblau. The Executive Director is Susan Dewey. Hunter L. Jacobs is the Director of Multifamily Special Programs which administers the Section 8 Program. The VHDA's offices are located at 601 South Belvidere Street, Richmond, VA 23220.

The VHDA's Section 8 Program has been operating since 1977. A mission of VHDA is to make the Section 8 Subsidy Program available to all localities in Virginia who wish to participate. During Fiscal Year 1998, the VHDA's Section 8 Program administered 86 localities contracting with 83 administrative agents. The HUD's Virginia State Office and the Washington, DC field office contracted with VHDA through an Annual Contribution Contracts (ACC) to provide Section 8 funding. As of June 30, 1998, VHDA administered 9,716 units and expended \$46,233,168 for these units in Fiscal Year 1998.

Audit Objectives

The purpose of our audit was to determine whether the PHA was complying with the provisions of its Section 8 ACC contracts with HUD, as well as applicable regulations, and to determine if they are administering their Section 8 Program efficiently and effectively. The specific objectives were to determine whether VHDA: established procedures and provided adequate monitoring and oversight of its administrative agents in the areas of Housing Quality Standards (HQS), rent reasonableness, financial management, tenant income verification, family composition, and waiting list administration; fully utilized Section 8 resources; charged administrative fees according to HUD guidelines; had an accounting system that adequately tracked costs associated with its Section 8 programs; and provided tenant utility allowances according to HUD requirements.

Audit Scope and Methodology

The audit was conducted between December 1998 and December 1999, and covered the period July 1, 1997 through June 30, 1998. The audit period was extended where necessary. To accomplish the audit objectives, we reviewed procedures and tested compliance as follows:

At VHDA we reviewed:

- administrative fees to determine if the fees were supported.
- disbursements including salaries and indirect costs charged to the Section 8 Program to determine if costs were reasonable.

- monitoring reports of administrative agents to determine if monitoring was adequate.
- utility allowances to determine if allowances were analyzed adequately.
- Section 8 Voucher Payment Standards to determine if standards were established properly.

We judgmentally selected four of the largest administrative agents for review of VHDA's administration of its Section 8 Program. The four agents were: Prince William County; City of Virginia Beach; City of Martinsville; and Shenandoah/Page County Department of Social Services. At these localities we:

- conducted physical inspections of 63 units to ensure compliance with HQS. During the inspection, we asked the tenants about their utility costs to determine if utility allowances were adequate.
- examined tenant files to verify: tenants qualified as a family; tenants' income were within income limits; and annual recertifications were performed properly.
- reviewed the use of administrative fees provided by VHDA.
- reviewed rent reasonableness to determine if rents were reasonable and in accordance with regulations.
- reviewed waiting lists to determine if agents maintained lists and selected applicants properly.

We reviewed utilization of Section 8 resources by reviewing documents from VHDA and HUD. Also, with the assistance of HUD Headquarters, we performed a computer match of tenant's income. We used audit related software to analyze computer data maintained by VHDA. During the audit, we interviewed applicable staff from HUD, VHDA, and the administrative agents.

Our audit was conducted in accordance with generally accepted government auditing standards.

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VHDA Needs to Improve Its Administration and Monitoring of the Section 8 Program

VHDA can improve the administration of its Section 8 Program along with its compliance with related requirements in the areas of: housing quality standards; rent reasonableness; financial management; tenant waiting list administration; and tenant income verification. We observed problems in these areas because VHDA's monitoring of administrative agents did not identify existing problems and provide for the uniform and consistent application of program requirements among its administrative agents. As a result VHDA does not have assurance that:

- tenants are occupying units that meet Housing Quality Standards (HQS);
- administrative agents are adequately documenting circumstances regarding rent reasonableness determinations, tenant income verification and over housed tenants;
- administrative agents are efficiently utilizing Section 8 resources; and
- tenants are selected from waiting lists according to HUD requirements.

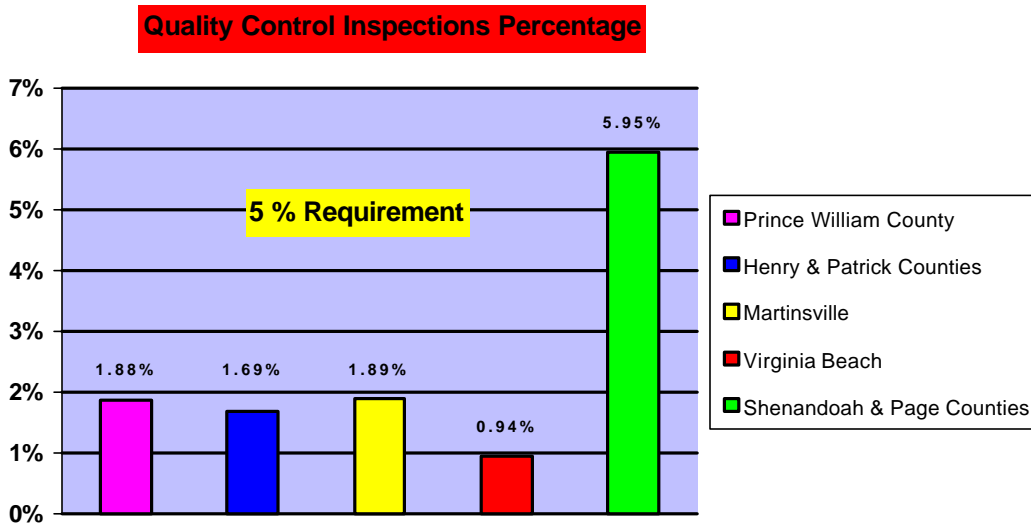
VHDA Did Not Perform Supervisory Inspections According to HUD Requirements

Chapter 5-12 of the Public Housing Authority Administrative Practices Handbook (7420.7) requires housing authorities to establish procedures for reviewing a sample of the completed Section 8 unit inspections. Supervisory re-inspection of a random sample of five percent of the approved units is required.

Our review of VHDA's 1998 locality monitoring reports disclosed that VHDA inspected only 2.72 percent, or about half as many units as provided for in the administrative practices handbook, and inspected at least five percent of the units in only 21 of 72 of its monitoring reviews during 1998.

As illustrated below, VHDA inspected five percent of the housing units in only one of the five localities that we sampled.

Finding 1



VHDA did not inspect five percent of its units because it erroneously believed quality control requirements were satisfied using a combination of quality control inspections and tenant confirmations. VHDA revised this policy in December 1998 and the number of inspections in a locality will now be based on the following sliding scale:

<u>Number of Units</u>	<u>Number of Inspections</u>
0-100	5
101-150	6
151-200	8
201-250	10
251+	12

However, even with this new policy, there is still no assurance the five percent thresholds will be met, especially in larger jurisdictions that have significantly more than 251 units.

Units Did Not Meet HQS

In order to determine if VHDA units met HQS, we judgmentally selected and then inspected 63 of 2,325 leased units in the four localities, and found that 50 units failed HQS. Inspections of the 50 units were provided to VHDA and each applicable locality. Of note was that nine units which previously failed VHDA, HUD and locality inspections were subsequently passed without making sure

the deficiencies were corrected, as we found similar deficiencies during our inspections.

24 CFR, Part 982.401, states that Section 8 housing must comply with HQS, both at initial occupancy of the dwelling unit, and during the term of the assisted lease. To meet HQS, units must :

- be structurally sound;
- provide an alternative means of exit in case of fire;
- provide adequate space and security for each resident and their belongings;
- be free of pollutants in the air at levels that threaten the health of residents;
- provide sanitary facilities that are in proper operating condition;
- have adequate heating and/or cooling facilities;
- have adequate illumination and electricity;
- be maintained in sanitary condition; and
- include a smoke detector on each occupied level.

Rent Reasonableness

Our review of the four localities disclosed that a database for establishing rent reasonableness was lacking at one locality and rent increases were based on an owner's willingness to accept the Annual Adjustment Factor (AAF). We also noted several instances where administrative agent files did not adequately document circumstances when: comparable properties were not used to support rent reasonableness determinations; and tenants were leasing units exceeding their allowable bedroom size.

24 CFR, Part 882.106(b) states that the HA shall certify for each unit for which it approves a lease that the Contract Rent for such unit is:

- (i) Reasonable in relation to rents currently being charged for comparable units in the private unassisted market, taking into account the location, size, type, quality, amenities, facilities and management and maintenance service of such unit, and
- (ii) Not in excess of rents currently being charged by the Owner for comparable unassisted units.

24 CFR, Part 882.108(a), provides that owners can request the HA to annually adjust rents based on the AAF. Paragraph (b) provides that AAF adjustments shall not result in material differences between the rents charged for assisted and comparable unassisted units. Part 982.402(c)(1), provides that the gross rent under the certificate program should not exceed FMR for a bedroom size determined by HA subsidy standards. Paragraph (b)(1) provides that subsidy standards must provide for the smallest number of bedrooms needed to house a family without overcrowding.

In reviewing rent reasonableness determinations at the localities, we selected units that were above the FMRs and checked these units to ensure the number of bedrooms did not exceed the number allowed for the family composition. There was no indication that VHDA's monitoring reviews examined this aspect of rent reasonableness.

In Virginia Beach, the rental database was insufficient to establish the rent reasonableness of some units since it did not include comparables for single-family homes or townhouses. Also the manner in which Virginia Beach provided rent increases to apartment owners was flawed. Virginia Beach asked owners each year if they wanted a rent increase. If the owner said yes, then Virginia Beach would process the rent increase based on the AAF, without any assurance the new rent was reasonable and did not exceed rents charged to unassisted units in the same apartment complex.

Financial Management

VHDA did not reconcile amounts budgeted to its Section 8 program to reflect actual expenditures. Additionally, VHDA did not review the localities accounting of Section 8 funds during its monitoring visits.

Paragraph 1a of OMB Circular A-87 Part C states that costs under Federal awards must be necessary and reasonable for the proper and efficient performance and administration of Federal awards.

Also the ACC, paragraph 11d, provides that program receipts in excess of current needs must be invested. Our review of the Section 8 accounting systems of VHDA and the four localities disclosed the following:

Agency	Deficiency
<u>VHDA</u>	Its system used budgeted amounts in charging indirect costs to the Section 8 Program and did not adjust the amounts to actual costs. For example, Fiscal Year 1998 telephone expense was based on a budgeted amount of \$363,193. Actual costs were \$282,513. VHDA included the cost of installing a new phone system in the budgeted amount. The actual cost was less because the phone system was not installed causing the Section 8 telephone expense to be overcharged. VHDA officials stated that the overcharging was offset by computer, legal, and furniture costs not charged to Section 8 Program.
<u>Prince William County (PWC)</u>	PWC did not earn interest on its Section 8 funds. As of July 1, 1998, Prince William had Section 8 funds totaling \$217,964 on hand which were not earning interest income.
<u>Virginia Beach</u>	Virginia Beach did not maintain separate accounting records for Section 8 units funded by VHDA and directly by HUD. Virginia Beach complained to VHDA that its administrative fee was not sufficient to administer the VHDA units. However, Virginia Beach did not have a system to determine the administration costs of the VHDA units.
<u>Martinsville</u>	Martinsville staff working less than 100% of their time on Section 8, did not prepare time sheets. Additionally, Martinsville commingled funding for Section 8 and Community Planning and Development activities.
<u>Shenandoah County</u>	Shenandoah County did not account for receipts from VHDA totaling \$6,963. County staff stated that the receipts were used for expenses incurred during October 1997. The staff did not provide us an accounting for these expenses.

Since the VHDA did not monitor its administrative agents financial accountability, it is unclear how VHDA determined whether the administrative agents were using their fees to administer the program efficiently.

Waiting List
Administration

We reviewed waiting lists maintained at the four localities and determined Virginia Beach and Martinsville did not administer their waiting lists properly and VHDA's monitoring of these localities did not disclose some of the waiting list problems. Handling waiting lists improperly could lead to improprieties in the admission of tenants into the State's Section 8 Program.

24 CFR 982.204(b) states that the HA will select applicants from the waiting list in accordance with their admission policies. The waiting list at a minimum must contain the following information:

- (1) applicant's name;
- (2) number of bedrooms required based on the family size and make up;
- (3) date and time of the application;
- (4) federal preference qualifications;
- (5) local preference qualifications; and
- (6) ethnic or racial designation of the Head of Household.

Part 982.204(d) states that the order of admission from the waiting list may not be based on family size. In addition VHDA Policy 486, Method of Selection, states that: "The method for selecting applicants from preference categories must have a clear audit trail that can be used to verify that each applicant has been selected in accordance with the method specified." In the following instances the tenant selection process was not documented on the waiting lists.

Virginia Beach

Our review of Virginia Beach's administration of its waiting list disclosed the following:

- No explanations were given for selecting applicants before others who were on the waiting lists longer.
- Two applicants were still on the waiting list even though they were being assisted in the Virginia Beach Section 8 Program.
- One applicant appeared twice on the waiting list.

- Virginia Beach had a waiting list containing one Federal Preference; however, it did not document the date when the applicants requested the preference.

In 1998, the VHDA monitoring report documenting the review of the waiting list only disclosed that Virginia Beach did not verify Federal Preferences.

Martinsville

Martinsville did not maintain waiting lists that documented how selections were made. According to an administrative agent, she selected applicants needing a one bedroom voucher over other applicants even though the other applicants were on the waiting list longer. The agent stated that she was told by a Housing Management Officer from VHDA that these selections from the waiting list were acceptable. The Housing Management Officer denied telling the agent to make selections from waiting list based on bedroom size. The 1998 monitoring reports did not disclose any problems with the way Martinsville was administering its waiting list.

Tenant Income Verification

Three out of four localities did not obtain third party verifications of tenant income, another problem which was not disclosed by VHDA monitoring. These deficiencies were provided to VHDA and each applicable locality. Tenant recertification procedures are discussed in more detail in finding three of this report.

HUD Handbook 7420.7, Chapter 4, paragraph 4-5d.(1) states that the tenant's income must be verified by third parties. Third-party contacts must be transmitted through the mail rather than handled directly by the tenant to ensure valid results.

* * * * *

We discussed the preceding deficiencies with the VHDA and with the applicable communities during our review. We believe the problems need to be corrected by VHDA and their administrative agents. Further monitoring efforts need to be improved to make sure these types of problems are identified when they exist so that corrective action can be

taken and VHDA can provide housing opportunities as efficiently as possible.

Auditee Comments

HQS Inspections

VHDA acknowledged that additional improvements are needed in HQS compliance and enforcement. In that regard, VHDA said it has recently provided its administrative agents with HQS training and will require administrative agents to confirm in writing that repairs have been made and also require photographs and tenant confirmations. VHDA did not agree that it needed to conduct quality control inspections for 5% of units in each administrative agent locality or that units that failed OIG inspections exposed tenants to imminent health and safety hazards. VHDA said its supervisory inspection procedures are in compliance with current HUD requirements. Additionally, VHDA asked the OIG to provide additional support for its position that units were subsequently passed without assurance that deficiencies were corrected.

Rent Reasonableness

VHDA agreed that Virginia Beach did not follow its guidelines for rent reasonableness and that it intends to provide administrative agents with rent reasonableness training. VHDA did not agree that comparable properties were not used to support rent reasonableness determinations since its administrative policies allow for a \$25 - \$50 variance in determining rent reasonableness. Additionally, VHDA said units identified by the OIG as over FMR were allowed pursuant to Over Fair Market Tenancy Option (OFTO), and over housed tenants were paying rents within lesser bedroom FMR guidelines.

Financial Management

VHDA agreed that it needs a financial system that accurately reflects its Section 8 program expenditures and is in the process of implementing an activity based management system which will accurately allocate costs across its programs. However, VHDA did not agree that its administrative agents needed to comply with OMB Circular A-87 since they are paid a predetermined fee, and to require

administrative agents to comply with OMB Circular A-87 will only increase their operating costs and serve as a disincentive to support the Section 8 program. Further, VHDA said OMB encourages agencies to test fee for service alternatives to reduce the burden associated with maintaining systems for charging administrative costs.

Waiting List

VHDA agreed with the discrepancies noted in the finding and will ensure administrative agents maintain file documentation to ensure its ability to determine correct placement and tenant selection.

Tenant Income Verification

VHDA agreed that obtaining independent third party income verification is required and has implemented procedures to confirm appropriate third party verification in its initial and annual reviews.

OIG Evaluation of Auditee Comments

VHDA is to be commended for its commitment towards implementing training and procedures to improve areas of its Section 8 program. Additionally, we have taken VHDA responses into consideration and provided VHDA with additional support and clarification regarding HQS deficiencies and made appropriate revisions to the finding.

Regarding areas of disagreement we respond as follows:

HQS Inspections

We evaluated VHDA's compliance with HUD guidelines for quality control inspections that were in effect during our review and noted the discrepancies accordingly. Additionally, VHDA indicated in its written response, that its supervisory quality inspections will now be based on current HUD regulations, which only requires supervisory quality inspections based on percentages of the total number of units administered by the VHDA and does not distinguish

between its 83 localities. Even though this procedure would meet HUD's new requirement we do not believe it is in the best interest of VHDA's Section 8 programs, as HUD requirements do not consider that State agencies manage Section 8 programs administered by many sub-recipients and therefore, it would not ensure VHDA is providing supervisory quality inspections consistently throughout the State.

Rent Reasonableness

Regarding issues of rent comparability, OFTO tenancy, and over housing, our findings were based on appropriate documentation not being included in the files to justify administrative agents determinations of allowability. The VHDA's policy of allowing a \$25 - \$50 variance in rent reasonableness determinations is appropriate as long as the tenant files contain adequate documentation to support the determination. Regarding Virginia Beach tenants identified as being over housed, we do not agree that their rents were within the applicable FMRs for the bedroom size they were eligible for, as indicated in the VHDA response.

The VHDA did not address other rent reasonableness and over housing discrepancies noted during our review. We will provide the HUD VSO and the VHDA with a complete listing of these discrepancies for their continued review and determination.

Financial Management

We agree it is VHDA's responsibility to ensure its program is operating as efficiently as possible and administrative agents do not necessarily need to maintain financial systems according to OMB Circular A-87. However, VHDA needs to include some level of financial monitoring and assurance that administrative agents are using fees to administer the Section 8 program efficiently.

Recommendations

We recommend that HUD require VHDA to:

- 1A. Ensure HQS violations are corrected at properties that failed HQS inspections during our review.

- 1B. Establish and implement quality control procedures to improve its administration of the Section 8 Program. Specifically:
- assure that quality control HQS inspections include a representative sample of units from all of its administrative agents.
 - ensure HQS inspections are performed according to HUD requirements, and units failing HQS inspections are performed to ensure cited deficiencies are corrected; and
 - provide all localities with HUD guidelines for the assessment of rent reasonableness; family composition; financial management; tenant selection and maintaining waiting lists; and verification of tenant income, and determine if the guidelines are being followed during monitoring visits.

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VHDA Did Not Utilize \$30 Million of Available Section 8 Resources

Until recently, VHDA has measured its occupancy based on ACC unit allocations even though HUD revised its Section 8 procedures in 1995, requiring housing authorities to budget resources based on dollars instead of units. Budgeting Section 8 resources based on available dollars as required, would have provided the VHDA with the opportunity to house significantly more families since it allows a Housing Authority to lease as many units as possible without regard to ACC unit limitations. VHDA was conservative in its interpretations of HUD budget guidelines, and did not change its leasing benchmarks to recognize dollars instead of units as the relevant leasing measure. VHDA said its interpretations of HUD guidelines were prudent since HUD has now revised its guidelines going back to using units as the relevant leasing measure. Additionally, HUD budget reviews and program guidance did not effectively communicate the significant program changes, as VHDA budgets were approved even though it was not fully utilizing its resources. As a result, VHDA did not fully utilize its Section 8 resources, and HUD recently recaptured over \$30 Million that could have otherwise provided additional rental subsidies to families on VHDA waiting lists.

HUD Recaptured \$30.7 Million From VHDA

In November 1997, HUD recaptured Section 8 reserves based on Public Law 105-18. The Public Law instructed HUD to recapture \$5.8 Billion in Section 8 reserves to provide funding for disaster relief activities from the spring floods. \$30.7 Million was recaptured from unused VHDA resources.

In a Federal Register dated July 3, 1995, HUD required the Housing Authorities (HA) to manage Section 8 Program funds based on dollars instead of units. Also, the Register stated that HUD cannot guarantee that the funding that is appropriated by Congress and obligated by HUD to a specific HA's admission of families without regard to unit size.

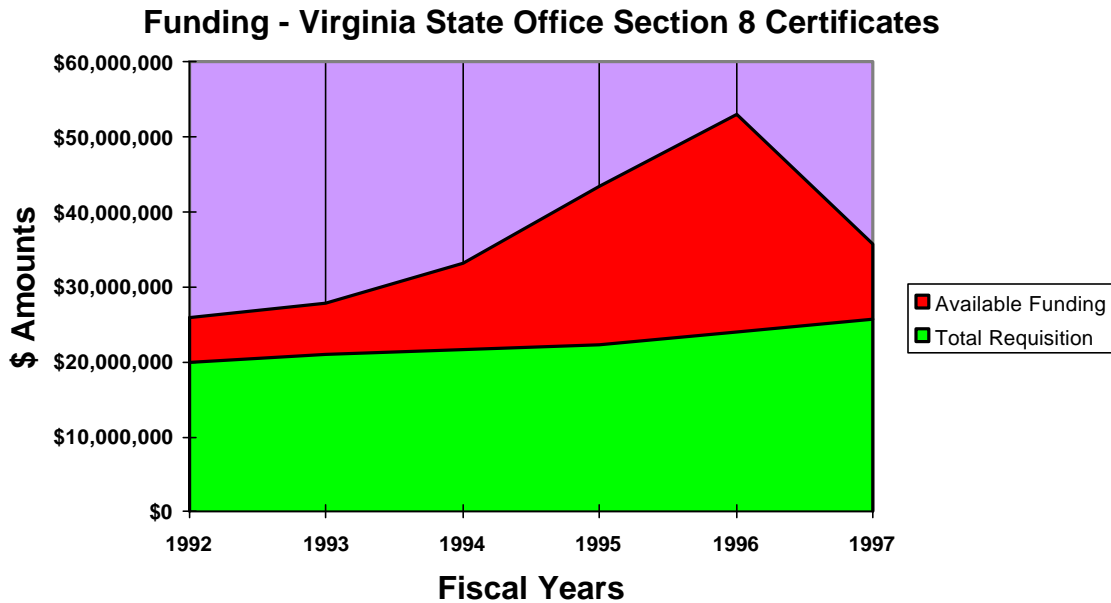
VHDA continued to use ACC unit allocations as its leasing benchmark and was conservative in its leasing of Section 8 units because:

- HUD guidelines overemphasized penalties associated with over utilizing Section 8 resources (PIH Notice 97-

59 states, The cost of over-leasing must be absorbed by the HA through the Section 8 operating reserve or other funding sources. The Section 8 Certificate and Voucher programs will not absorb the cost of HA over-leasing.); and

- Although, HUD budget reviewers encouraged VHDA to lease additional units, they still approved budgets that VHDA anticipated spending significantly less than authorized.

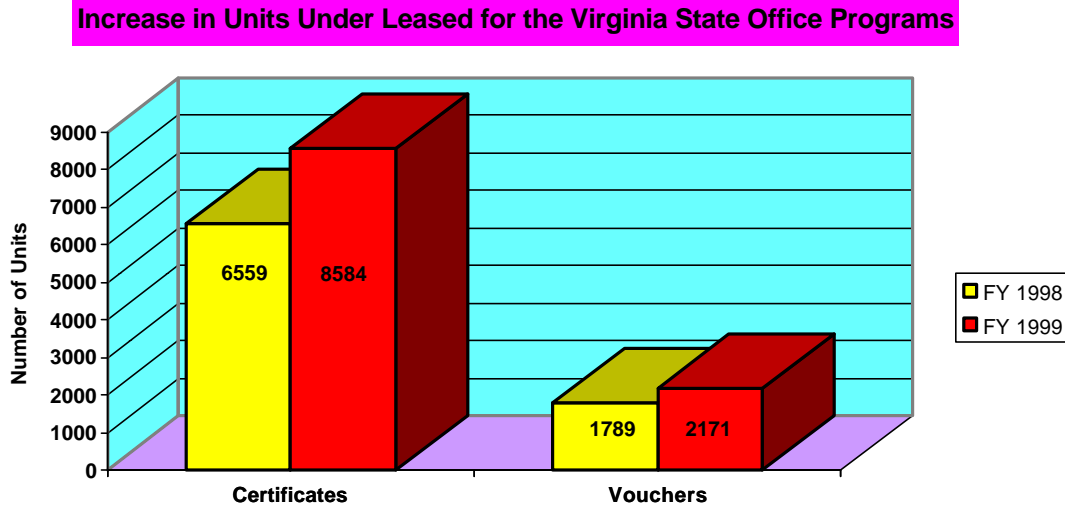
As shown below, VHDA Section 8 resources continued to increase until they were recaptured in 1997.



The HUD Virginia State Office (VSO) did not support VHDA’s request for additional administrative fees and considered the agency to be “at risk” based on its under-utilization of program resources. The VHDA protested these actions and HUD Headquarters overturned the earlier determination and VHDA was awarded \$600,000 of additional administrative fees. It appears the VSO actions were ultimately effective in getting the VHDA to initiate a more rapid leasing strategy.

Since July 1998, VHDA has responded to VSO recommendations and successfully leased over 2,400

additional Section 8 units, and significantly improved its utilization of Section 8 resources as shown below.



* * * * *

In our opinion, better communication between the VHDA and HUD’s Virginia State Office (VSO) can increase housing opportunities for needy families and result in a more efficient use of program resources. The VHDA should continue to seek clarification and guidance to ensure its program is operating as efficiently as possible and meeting its mission of providing low-income housing for needy families in Virginia.

Auditee Comments

VHDA indicated the recapture of program resources represented only one half of one percent (.00529) of the National recapture, and was due in large part to: HUD’s methodology for calculating renewal funding; a HUD internal reconciliation that added \$9.5 Million in subsidy after the end of Fiscal Year 1996; and FMR reductions in 1993 and 1994.

VHDA said the recaptured funds were used as a contingency reserve to be used in the event of unforeseen economic events, and in funding shortfalls, such as VHDA faces this

year. Further VHDA said the fact that HUD has returned to its old policy of funding the Section 8 program on the basis of ACC unit allocations makes a strong argument that PHA's should use prudence in managing these programs.

OIG Evaluation of
Auditee Comments

As stated in the finding narrative, we acknowledge Section 8 resources were recaptured throughout the Nation, and HUD regulations could have contributed to VHDA's conservative leasing approach. However, we do not agree that VHDA's leasing strategy was prudent considering HUD guidelines have mandated using program dollars as the relevant leasing measure since 1995. Clearly, the VHDA continued to use units as the relevant leasing measure and could have provided additional rental subsidies to Virginia households as demonstrated by its recent success in increasing program utilization.

Recommendations

We recommend the:

- 2A. VHDA administer its Section 8 Programs according to the most current HUD guidelines.
- 2B. VHDA fully budget the Section 8 resources provided by HUD, and monitor its administrative agents to ensure full leasing is maintained.

The VHDA Needs to Improve Its Recertification Procedures

We compared the income tenants reported to the VHDA with income they reported to the IRS and SSA and found significant discrepancies. The discrepancies resulted in the potential overpayment of Section 8 subsidies, in 116 of 138 tenant cases in our review. The VHDA's recertification procedures contributed to income reporting discrepancies since its requirements did not provide for interim recertifications of significant income changes unless the tenant did not report any income on the last certification. Additionally, administrative agents did not always obtain third party income verifications.

24 CFR 982.516 states, Housing Authorities are responsible for reexamination (recertification) and interim examinations of tenant income. The Housing Authority must obtain third party verification of income and adopt policies identifying the time and the circumstances under which tenants must report a change in family income or composition.

Our computer matching project consisted of comparing tenant income data for over 7,000 households reported in HUD's MTCS with the tenants' 1997 IRS and SSA information. This automated comparison identified over 300 households with potential income discrepancies exceeding \$10,000 and 1,900 households with potential income discrepancies between \$1,000 and \$10,000.

We performed a detailed analysis of 138 households that were still active in VHDA's program, of the 300 households with computer generated discrepancies greater than \$10,000 to determine why they existed. Detailed analysis of 138 active households appeared to validate the overpayment of Section 8 subsidies in 116 of the cases. As detailed below, many of the discrepancies existed because of weaknesses in VHDA's tenant income recertification and verification procedures. This warranted tenant and VHDA notification according to PIH computer matching procedures. Additionally, we also referred 11 egregious cases to HUD-OIG's Office of Investigations.

Income Recertification Procedures

We noted numerous instances where the tenant reported child support or public assistance on the annual recertification, but shortly after obtained a job with a material increase in income. However, VHDA's recertification procedures do not require any interim recertification for changes in a tenants' income as long as the tenant had reported some income on the previous certification. These procedures are too lenient and could encourage tenants to avoid paying their share of rent by manipulating their employment schedules around annual recertifications.

Income Verification Procedures

VHDA’s sub-recipient agencies were not always obtaining third party income verifications to support annual recertifications. Instead, they relied on pay stubs to verify tenant income. VHDA’s verification requirements only allow sub-recipients to use pay stubs as a last resort. However, it appears that the sub-recipients used them too frequently and they did not adequately document their calculation of annual income. For example, in some cases sub-recipients incorrectly calculated frequency of pay which caused the potential income discrepancies. Additionally, sub-recipients did not have adequate documentation that could verify if certain tenants were live-in aides or whether the head of households’ children were full-time students.

* * * * *

In summary, the VHDA could reduce Section 8 overpayments and improve tenant income reporting by strengthening its interim recertification requirements and ensuring its sub-recipient agencies obtain independent income verifications and maintain complete file documentation.

Auditee Comments

VHDA said it has redesigned its compliance monitoring protocol and is more closely monitoring administrative agents to ensure they properly calculate tenant income and obtain third party verifications. VHDA did not agree its interim recertification procedures were too lenient since the requirement to report interim increases in income imposes a strong disincentive upon participating families to improve their financial status and places an additional administrative burden on the VHDA and its administrative agents.

OIG Evaluation of Auditee Comments

Notwithstanding the disincentives of earning additional income and the extra paperwork associated with interim recertifications, the VHDA’s recertification procedures in our opinion are too lenient. By requiring tenants to report material income changes the VHDA could ensure tenants are paying their share of rent and limited Section 8 resources are used more efficiently.

Recommendations

We recommend the VHDA:

- 3A. Change its interim reporting requirements. Specifically, require tenants to report all material increases or changes in source of income within 30 days of receiving the income regardless of whether they reported income or not on the prior recertification.

- 3B. Implement procedures that will closely monitor sub-recipients to ensure they properly calculate tenant income.

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VHDA Did Not Properly Establish Section 8 Utility Allowances

VHDA did not follow existing policies and procedures in establishing tenant utility allowances. It did not:

- obtain tenant utility consumption data in analyzing utility allowances;
- ensure utility allowances were sufficient to cover minimum provider charges; and
- ensure utility allowance schedules provided to localities were correct.

As a result, VHDA tenants incurred total housing payments in excess of program requirements, since utility allowances were not sufficient to pay actual utility costs. VHDA staff commented that one locality's utility allowances were not raised because gross rents would exceed Fair Market Rents.

24 CFR 882.214(a) states that, at least annually, the PHA shall determine whether there has been a substantial change in utility rates or other charge of general applicability, and whether an adjustment is required in the allowance of utilities and other services. If the PHA determines that an adjustment should be made, the PHA shall establish a schedule of adjustments taking into account size and type of dwelling units and other pertinent factors. Paragraph (c) provides that if a PHA finds that utility cost changes are causing substantial difficulties in leasing decent, safe and sanitary housing within the existing Fair Market Rent limitations, then the PHA shall furnish appropriate documentation to HUD with a request for consideration of the need for a change in the Fair Market Rents.

We tested utility allowances by asking tenants what their average utilities were costing during HQS inspections, and verifying monthly minimum charges with utility providers. We compared this information with the VHDA utility allowances. It appears the utility allowances were inadequate in two of the four localities reviewed as follows:

Tenant Utility Costs
Exceeded Utility
Allowances

Prince William County

Tenant utility costs exceeded utility allowances in 25 of 25 tenants interviewed. Water and sewer utility allowances for Manassas Park, Virginia, did not even cover minimum monthly service charges. Additionally, VHDA made an error in preparing Prince William County's utility allowance for heating a unit with two exposed walls as shown below:

<u>Exposed Walls</u>	<u>Monthly Dollar Allowances</u>					
	<u>0 BR</u>	<u>1 BR</u>	<u>2 BR</u>	<u>3 BR</u>	<u>4 BR</u>	<u>5 BR</u>
1	17	19	21	22	24	25
2	10	11	12	15	18	21
3	22	24	27	28	30	33

Logically, utility allowances for units with two exposed walls should have been between the allowances for one and three exposed rates, not less than the one exposed rate. VHDA agreed to correct these rates and sent the revised rates to Prince William County. VHDA instructed Prince William County to adjust the tenant rent retroactively for the applicable tenants.

Virginia Beach

Tenant utility costs exceeded allowances for 17 of 18 tenants' accounts we tested. Based on tenant surveys it appears actual water and sewer costs significantly exceeded the utility allowances provided.

VHDA updated its utility allowance schedules effective July 1, 1998 by analyzing changes in utility rates without considering tenant utility consumption data or utility provider minimum charges. VHDA's policy for updating utility allowance schedules did not require VHDA to obtain utility consumption data or use utility minimum charges. Without using consumption data or utility minimum charges, VHDA did not update utility allowance schedules adequately.

* * * * *

VHDA is in the process of updating its utility allowances to follow HUD guidelines by obtaining actual utility data from tenants. VHDA sent a memorandum dated January 25, 1999 to all of its administrative agents requesting tenant releases so that VHDA can request tenant's utility records including consumption data for the past 12 months. VHDA expects to complete this study shortly and will use this data to revise their utilities' allowances.

The VHDA reiterated its commitment to updating its utility allowance schedules based on actual tenant consumption data by March 2000.

Auditee Comments

Recommendations

We recommend HUD to:

- 4A. Monitor the progress of VHDA in updating their utility allowances to ensure that the allowances meet HUD guidelines.

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Management Controls

In planning and performing our audit, we obtained an understanding of the management controls that were relevant to our audit. Management is responsible for establishing effective management controls. Management controls, in the broadest sense, include the plan of organization, methods, and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Management Controls

We determined the following management controls were relevant to our audit objectives:

- utilizing Section 8 budget authority fully
- calculating administrative fees properly
- implementing a financial management system to administer the Section 8 Program
- monitoring of administrative agents by VHDA
- updating utility allowances adequately
- determining payment standard and rent reasonableness of Section 8 units adequately
- complying with Section 8 requirements including income verification
- maintaining units under Housing Quality Standards (HQS)
- selecting applicants from waiting lists properly

We assessed all of the relevant controls identified above.

It is a significant weakness if internal controls do not give reasonable assurance that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports.

Significant Weaknesses

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

- VHDA did not administer and monitor Section 8 program properly in the areas of (1) HQS, (2) Financial Management System, (3) rent reasonableness, (4) waiting lists, and (5) tenant income verification
- VHDA did not fully utilize Section 8 resources
- VHDA did not adequately update utility allowances

Follow Up On Prior Audits

This was the first Office of Inspector General's audit of VHDA Section 8 Certificate and Voucher Programs.

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Auditee Comments



January 6, 2000

Mr. David J. Niemiec
Acting District Inspector General for Audit
U.S. Department of Housing &
Urban Development
Wanamaker Building, Suite 1005
100 Penn Square East
Philadelphia, PA 19107-3380

Dear Mr. Niemiec:

I enclose our response to the OIG review of the Section 8 Program administered by VHDA. I appreciate this opportunity to address the findings that were contained in the draft report dated December 10, 1999, and look forward to the exit conference that is scheduled for January 19, 2000.

Please also be advised that VHDA will be issuing a Request for Proposal within the next 30 days to engage a consultant to review our administration of the Section 8 Program and to address all issues included in the OIG report, including our relationship with the Virginia State Office.

Sincerely,

Susan F. Dewey
Executive Director

SFD:HJ:sh



Virginia Housing Development Authority
601 South Belvidere Street • Richmond Virginia 23220-6504 • 804-782-1986 • VTDD 804-783-6705

RESPONSE TO THE OIG DRAFT FINDINGS ON THE VHDA SECTION 8 PROGRAM

JANUARY 6, 2000

Finding: VHDA needs to improve its administration and monitoring of the Section 8 Program.

HQS Inspections

OIG: Supervisory reinspection of a random sample of five percent of the approved units is required.

Response: The requirement that supervisory reinspection of five percent leased Section 8 units be performed annually is no longer applicable since publication of the Technical Amendment to the Section 8 Management Assessment Programs on July 26, 1999. The SEMAP standard under 24 CFR, Part 985.3(e) for Housing Quality Standards (HQS) quality control inspections requires samples of the same minimum sample size as required for other supervisory quality control reviews.

OIG: VHDA inspected five percent of the housing units in only one of the five localities that we sampled.

Response: VHDA determines its HQS quality control inspection sample size on the basis of the entire universe of units under HAP contract for the last completed PHA fiscal year, not on the basis of the size of each individual locality program. VHDA also conducts additional quality control inspections to supplement, to the extent needed, the internal quality control measures implemented by each locality. This methodology was confirmed through an e-mail with Sue Loritz at HUD Headquarters as an acceptable protocol under the SEMAP regulations.

OIG: Inspections of the 50 units were provided to VHDA and each applicable locality

Response: The inspections were not provided to VHDA.

OIG: Of note was that units which previously failed VHDA, HUD, and locality inspections were subsequently passed without making sure the deficiencies were corrected, as we found similar deficiencies during our inspections.

Response: To support this statement the draft report references units that were inspected in Martinsville and had previously failed but recently passed inspections by HUD, VHDA, or the locality. Four of the nine units that failed the OIG inspections were inspected by HUD during their review of the Martinsville program in September 1998. Results of those inspections, however, were not made available to VHDA until April 29, 1999. Upon receipt of the inspections from HUD, VHDA transmitted the information to our agent in Martinsville at the same time that the OIG was conducting inspections of the same units, and of course, finding the

same deficiencies. Neither Martinsville nor VHDA was afforded the opportunity to respond to the HUD inspections because the findings were not reported to the locality. Accordingly, the OIG inspections overlapped HUD's inspections resulting in the "similar deficiencies". OIG's claim that units recently passed inspections by HUD, VHDA, or the locality is not supportable by the facts. On the contrary, most of the units inspected by the OIG were not recently inspected as defined in the HUD regulations at 24 CFR Part 985.3(e) (1), i.e. performed during the three months preceding reinspection.

OIG: Units failing HQS exposed Section 8 tenants to health and safety hazards.

Response: The above statement implies that health and safety hazards were prevalent and widespread. While acknowledging that there were some HQS issues identified, most of the units inspected did not pose a danger to the inhabitants.

Additional Comments: VHDA acknowledges that additional improvements are needed in both HQS compliance and enforcement. VHDA provided its Administrative Agents with HQS training presented by Nan McKay & Associates, Inc., on October 7-8, 1999. In addition to requiring Administrative Agents to confirm in writing that repairs have been completed, VHDA will also require photographs and tenant acknowledgements, when applicable, of completed repairs.

Rent Reasonableness

OIG: Comparable properties were not used to support rent reasonableness determinations.

Response: VHDA's rent reasonableness policy (Policy 633) allows its agents to utilize a \$25 to \$50 variance to gross rents in determining rent reasonableness.

This policy has been a part of the HUD approved VHDA Administrative Plan since as early as 1985. Allowing such a variance is reasonable given the variations in the factors affecting the market rental value of a given property. These factors include location, square footage, quality/condition, age, amenities, etc. Establishing rent comparables is a significant challenge in the more rural areas of the state where comparability data is often lacking, and must be developed through whatever sources are available, e.g. phone surveys, newspaper advertisements, etc. We believe that an extremely restrictive interpretation of comparability that permits no variance beyond the gross rent of a subject property would unduly restrict the availability of affordable housing units. We further believe that a strict comparison of gross rents fails to consider that comparability reviews are being conducted by individuals that are not trained and licensed as real estate appraisers as is required in the Section 8 New Construction/Sub Rehab Programs. (See also our response to contract rents exceeding FMR below.)

OIG: Contract rents to property owners exceed Fair Market Rents (FMRs)

Response: A review of six cases identified by the OIG as being in excess of the FMR in the Martinsville program reveals that the participating families are OFTO tenancies (Over FMR

Tenancy Option). OFTO was designed and implemented by the final Conforming Rule to allow tenants to utilize a Section 8 certificate to rent a unit that exceeds the FMR. The six families are listed below with the rent comparables that were used in the rent reasonableness determination:

	<u>Gross Rent*</u>	<u>Comp #1</u>	<u>Comp #2</u>	<u>Comp #3</u>	<u>FMR</u>
Pamela Martin	\$ 370	\$ 344	\$ 329	\$ 344	\$ 355
Joshlyn Hairston	417	465	446	446	417
Latasha Hairston	443	410	446	465	417
Mitzi Graves	442	420	461	466	423
Candis Hairston	442	519	408	420	423
Desiree White	429	421	426	444	417

*Note that gross rents are within the parameters set by Policy 633 and are rent reasonable.

Other cases that were cited as over the FMR have been explained in correspondence submitted to the OIG as being due to decreases in the FMR; increases in the utility allowance; as well as one family with an incorrect certified bedroom size (1BR rather than 2BR - Louise G. Hairston).

OIG: Tenants leased units exceeding allowable size based on their family composition.

Response: Tenants may lease units larger than their certified bedroom size if the gross rent falls within the FMR of the certified bedroom size or the applicable payment standard. Additionally, remaining members of the tenant family may remain in a larger unit as per Policies 803 & 804 of the VHDA Administrative Plan. In reference to findings of over-housed families in Virginia Beach, the following explanations were provided to the OIG:

<u>Tenant</u>	<u>Cert Size</u>	<u>Unit Size</u>	<u>FMR/PS Applied</u>	<u>Explanation</u>
Doris Miles	1	2	1	Not over-housed, reasonable accommodation, gross rent within 1 Bdrm FMR
Ella Williams	2	2	2	Not over-housed, gross rent within 2 Bdrm FMR
Ella Whitaker	2	3	2	Not over-housed, gross rent within 2 Bdrm FMR
Patricia Johnson	2	2	2	Not over-housed

Virginia Beach has acknowledged that non-comparable dwelling units were used in past rent reasonableness determinations. To correct this situation the agent has implemented control measures to insure that the Request for Lease Approval is completed with all the necessary data to identify the type of dwelling unit that is to be leased under the program. Additionally, the agent intends to expand the rent comparability data base to include all dwelling unit types by market area. With regard to the rent increase procedures utilized by Virginia Beach, the agent asked property owners whether they want a rent increase at the same time that the annual

recertification was processed, so that the recertification paperwork could include the rent increase.

VHDA intends to provide additional training in the spring of 2000 regarding rent reasonableness. Also, VHDA is adding a question to its initial and annual file review section of the "VHDA Review of Local Operations" that will identify whether the correct payment standard was applied.

Financial Management

OIG: VHDA and its sub-recipient localities did not have systems to adequately account for the cost of operating the Section 8 Program or adequately invest related funds. Further, VHDA did not review a localities' accounting of Section 8 funds during its monitoring visits.

Response: VHDA contracts with 75 Administrative Agents to carry out program activities at the locality level. These activities include selection and admission of applicants, verification of income, recertification of income, HQS inspections and enforcement, rent reasonableness determinations, and complaint investigation. These agents, or subcontractors, consist of units of local government such as Departments of Social Services and local housing authorities, not-for-profit organizations such as CAP Agencies, Community Services Boards, and Centers for Independent Living and private real estate companies. Each agent is paid a negotiated fee for their services. There are no cost reimbursement contracts. The Administrative Agents do not receive federal awards or sub-awards, nor do they receive, administer, disburse, account for, or otherwise deal with Section 8 funds. Accordingly, we do not believe that Circular A-87 is applicable to our Administrative Agents. To require each of our agents to comply with the provisions of Circular A-87 will increase their operating costs and will thereby serve as a disincentive to many agents to continue their support of this program. Furthermore, we invite your attention to Attachment A, Part A, paragraph 2b of Circular A-87 which states, "Federal agencies should work with States or localities which wish to test alternative mechanisms for paying costs for administering federal programs. The Office of Management and Budget (OMB) encourages Federal agencies to test fee-for-service alternatives as a replacement for current cost-reimbursement payment methods in response to the National Performance Review's (NPR) recommendation. The NPR recommended the fee-for-service approach to reduce the burden associated with maintaining systems for charging administrative costs to federal programs and preparing and approving cost allocation plans. This approach should also increase incentives for administrative efficiencies and improve outcomes." The telephone expense allocated to the Section 8 Program for fiscal year 1998 was \$68,613. While we do not know the source of the \$282,513 telephone expense referenced in the draft report, we believe that it was an estimate that was budgeted to support the data links that would have been required to support an automated payment processing system that was not installed. Expenses that were incurred by the Section 8 Program but were not charged back to the Special Programs Department totaled \$345,372 (Attachment 1). VHDA is implementing an activity based management (ABM) system which will allow us to accurately allocate costs to each of our lines of business. Cost allocations will be reconciled from budgeted to actual costs identified under ABM.

Waiting List Administration

OIG: We reviewed waiting lists maintained at the four localities and determined Virginia Beach and Martinsville did not administer their waiting lists properly and VHDA's monitoring of these localities did not disclose some of the waiting list problems.

Response: VHDA's Administrative Agents will be required to retain copies of the waiting list at times families are selected in order to ensure our ability to determine correct placement and selection. VHDA's Administrative Plan per Policy 486 requires that the method of selection must leave a clear audit trail that can be used to verify that each applicant has been selected correctly. Agents will also be required to produce adequate documentation for families that were denied admission. We are in the process of revising our locality review methodology in order to fully implement the SEMAP sampling procedures for the waiting list indicator.

Tenant Income Verification

OIG: Three out of four localities did not obtain third party verifications of tenant income, another problem which was not disclosed by VHDA monitoring.

Response: In years past, income verifications were required to be submitted by the Administrative Agent to VHDA with the HUD 50058, Family Report. Gradually, this requirement was dropped in the interest of increased efficiency as each locality demonstrated that it was complying with income verification requirements. With the adoption of the revised monitoring protocol for FY '99, VHDA incorporated the SEMAP performance indicators including "Determination of Adjusted Income". Both our initial and annual file review protocol now requires confirmation of appropriate third party verification procedures. Additionally, Policy 515 of the VHDA Administrative Plan incorporates the HUD requirements for tenant income verification, a copy of which is provided to each agent.

Finding: VHDA did not utilize \$30 million of available Section 8 reserves.

OIG: VHDA did not fully utilize its Section 8 resources, and HUD recently recaptured over \$30 million that could have otherwise provided rental subsidies to thousands of families on VHDA waiting lists.

Response: The \$30.7 million recapture represented slightly more than one-half of one percent (.00529) of the total funding recaptured from housing authorities throughout the country in 1997. The accumulation of excess funds in the project reserve account was due in large part to HUD's methodology for calculating renewal funding. Since the inception of the VHDA statewide Section 8 Program in 1977 until FY 1998, HUD calculated renewal funding at 100% of the Fair Market Rents (FMRs). This methodology resulted in over-funding of Section 8 renewal increments and led to the accumulation of reserves at PHAs throughout the country. HUD has acknowledged that PHAs receiving renewal funding based on 100% of the FMR, on average, do not use all the budget authority set aside for new and renewal contracts. Additionally, the

increase in subsidy funding for FY '96 that is depicted in the chart which appears in the draft report was the result of a HUD internal reconciliation that added approximately \$9.5 million in subsidy to that fiscal year. That subsidy was not available for expenditures, however, since it was added after the fiscal year-end. These funds became part of the project reserve and represented approximately 1/3 of the funds recaptured in 1997 (Attachment 2). Until the recapture, these funds had served as a contingency reserve to be used in the event of unforeseen economic events, and in shortfalls in funding for the programs, such as VHDA faces this fiscal year. Until the recapture, VHDA had built its reserve to an amount that would have sustained the program for approximately 10 months.

VHDA is one of many housing authorities administering the Section 8 Program along with members of Congress that have viewed over-leasing with much skepticism. Nevertheless, VHDA did allow over-leasing in localities which were able to absorb additional units. Additionally, VHDA has previously advised the Virginia State Office of HUD that our agency was unable to lease-up available ABA because of actions taken by the Congress and HUD, most notably the 90-day delay in reissuance of certificates and vouchers that was in effect between FY 1996 and FY 1998; and the reductions in Fair Market Rents that were implemented by HUD in 1993 and 1994. VHDA enforced the 90-day delay in reissuance while HUD encouraged housing authorities to skirt the statute by renumbering and reissuing the certificate or voucher. The FMR reductions resulted in landlords leaving the program and led to a reduction in housing stock available to families that were issued Section 8 certificates and vouchers. The FMR reductions also resulted in reduced administrative fees paid by HUD which had a negative impact on the capacity of VHDA's Administrative Agents to support lease-up activities. Furthermore, HUD policy on administrative fees rewards local housing authorities for leasing their HUD direct units in preference to VHDA Section 8 units because of the higher fees that are earned. Fees paid by HUD on their direct units ranged in FY 1997-98 from 34% to 62% higher than the corresponding fees paid on VHDA units assigned to the locality. The result of this disincentive in fees paid by HUD was a typical under-utilization of VHDA's Section 8 units by local housing authorities participating in its program.

The fact that HUD has returned to its old policy of funding the Section 8 Program on the basis of the number of units reserved under the Annual Contributions Contract rather than units supported by the budget authority; and is requiring PHAs to reduce over-leased units through attrition makes a strong argument that PHAs should use prudence in managing these programs. Moreover, VHDA is currently owed \$2.9 million by HUD and is facing a shortfall in funding for FY 2000 in an amount that is expected to total \$4 million or more. Additionally, Deborah Hernandez, Acting Director, Section 8 Finance Division at HUD Headquarters, has stated that it has never been HUD's policy to require housing authorities to spend all their ABA, and would not consider a housing authority at risk for having annual expenditures below the ABA.

VHDA recognizes that it needs to keep HUD informed on the utilization of its subsidy funds and will be providing the Virginia State Office with monthly reports. Additionally, VHDA intends to approach the Virginia State Office with a proposal that we employ mediation to address any outstanding issues or concerns that may exist between the organizations.

Finding: The VHDA needs to improve its recertification procedures.

Income Recertification Procedure

OIG: We noted numerous instances where the tenant reported child support or public assistance on the annual recertification, but shortly after obtained a job with a material increase in income. However, VHDA's recertification procedures do not require any interim recertification for changes in a tenants income as long as the tenant had reported some income on the previous certification. These procedures are too lenient and could encourage tenants to avoid paying their share of rent by manipulating their employment schedules around annual recertifications. HUD Handbook 4350.3 Change 21 which applies to Project-Based Section 8 more appropriately requires interim reporting when household income changes by \$40 or more per month

Response: VHDA's experience in administering the Project-Based Section 8 Programs indicates that the requirement to report interim increases in income imposes a strong disincentive upon participating families to improve their financial status and to seek self-sufficiency. This provision has been widely criticized within the affordable housing industry as fostering dependence upon public assistance.

On the other hand, the flexibility permitted by HUD in the Tenant-Based Section 8 Program enables families to improve their economic position without having to almost immediately forfeit the rewards that come with a better job, full employment, or a pay raise. We believe that incorporating such an incentive in the Section 8 Program is likely to produce subsidy savings that will far outweigh any cost to the federal government that would result from a delay in the family's recertification to its annual anniversary date.

Furthermore, we believe that significant cost savings can be realized by subsidy contract administrators in eliminating these interim recertifications where the sole reason for conducting the review is an increase in income. Many families that are required to report interim increases in income, have unstable employment and experience numerous and repeated job changes. Consequently, there exists for these families a great potential for future reductions in income which require yet another recertification. Our experience has shown that an excessive amount of time and money is spent by both our agency and our Administrative Agents in determining whether or not a family failed to report interim income charges, as well as, in monitoring accounts receivable and repayment agreements which result from the interim recertifications.

Accordingly, we believe that our policy reduces "red tape" and costs normally associated with the administration of Section 8 subsidies. We believe such efforts are in keeping with the overall goals of both the federal and state government including, maintaining program integrity, promoting family self-sufficiency, and reducing administrative costs at a time when HUD is reducing administrative fees.

Income Verification Procedures

OIG: VHDA's sub-recipient agencies were not always obtaining third party income verifications to support annual recertifications. Instead, they relied on pay stubs to verify tenant income. VHDA's verification requirements only allow subrecipients to use pay stubs as a last resort.

Response: As reported under Tenant Income Verification above, VHDA redesigned its compliance monitoring protocol with the inception of its fiscal year 1999 to conform with the SEMAP performance indicators. While we continue to seek improvements in the methodology employed in our locality reviews, as well as in the manner in which the SEMAP data is collected and reported, we believe that our compliance monitoring reviews have been strengthened with the adoption of the new protocol, and that we are more closely monitoring our agents to ensure they properly calculate tenant income and obtain third-party verifications.

Finding: VHDA did not properly establish Section 8 Utility Allowances.

OIG: VHDA did not follow existing policies and procedures in establishing tenant utility allowances. It did not:

- obtain tenant utility consumption data in analyzing utility allowances
- ensure utility allowances were sufficient to cover minimum provider charges; and
- ensure utility allowance schedules provided to localities were correct.

As a result, VHDA tenants incurred total housing payments in excess of program requirements, since utility allowances were not sufficient to pay actual utility costs.

Response: As stated in the OIG draft report, VHDA began to obtain tenant releases in January, 1999, so that we could request tenant utility records which include consumption and cost data for a 12 month period. Since that time, VHDA has obtained tenant utility records and corresponding utility rate schedules directly from utility providers, and is in the process of compiling and analyzing the data. We anticipate completing this process by March 2000.

The draft report states that VHDA tenants incurred total housing payments in excess of program requirements, since utility allowances were not sufficient to pay "actual" utility costs. CFR 982.517 provides that the utility allowance schedule must be determined based on the "typical" cost of utilities and services paid by energy-conservative households that occupy housing of similar size and type in the same locality. The PHA must use normal patterns of consumption for the community as a whole and current utility rates. As early as November, 1979, HUD Handbook 7420.7 provided that the dollar amount established by the PHA for utilities and other services are to be based on the "typical" cost of utilities and services paid by occupants of housing of similar size and type in the same locality.

The OIG tested utility allowances by asking tenants what their average utilities were costing during HQS inspections, and verifying monthly minimum charges with utility providers. This information was compared with the VHDA utility allowances. We are not clear as to what tenants were basing this information on, or for what period of time. We question the reliability of the utility allowance data gathered from tenants that is based on an accurate recollection of utility costs over a 12 month period even if the tenant was on a budget plan. As stated above, we have obtained actual utility records directly from utility providers, and will be using this information to see if our utility allowance schedules need to be adjusted.

The report states that VHDA updated its utility allowance schedules effective July 1, 1998 by analyzing changes in utility rates without considering tenant utility consumption data or utility provider minimum charges. Without using consumption data or utility minimum charges, VHDA did not update utility allowance schedules adequately. CFR 882.214 provides that the PHA shall determine whether there has been a substantial change in utility rates or other charge of general applicability. In its annual review of utility allowances for July 1, 1998, VHDA did a utility provider survey to assess any substantial increases in applicable utility rates, and does not feel that a retroactive adjustment to July 1, 1998 is warranted.

SFD:HJ:sh

Expense Items Provided by VHDA, Not Charged Back To Special Programs

1. IT - provide a PC and network connection

Total out-of-pocket expense avg./yr. 94/95/96 \$5,962,226 *
 Divided by 3 years /3

Expense per year to maintain workstations \$1,987,408
 Percentage of total authorized positions x11%

IT to provide PC and network connections \$ 218,614 (Indirect)

2. IT direct support for HMSP Statewide Network \$ 52,687 (Direct)

3. Furniture and Equipment (97/98 Actual)

Depreciation \$331,883
 Maintenance \$ 22,413
 Expensed \$ 74,456
 \$428,752

 x11%

\$ 47,163 (Indirect)

4. Cafeteria/Health Center Subsidy (97/98 Actual)

Cafeteria \$166,937
 Health Center \$ 77,684
 \$244,621

 x11%

\$ 26,908 (Indirect)

5. Other Support Not Included (Direct and Indirect)

- Administrative Services management support,
- IT Programmer support,
- Human Resources function and staff support,
- Support Services function and staff support,
- Finance/Accounting Management and staff support,
- Executive Division management and staff support,
- Legal management, staff and contracted support.

Total \$ 345,372

- Network Cost Study, October 1996

Rev 12/29/99

Attachment 1

Distribution

Executive Director, Virginia Housing Development Authority, 601 South Belvidere Street,
Richmond, VA 23220-6504

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Deputy Chief of Staff for Operations, S (Room 10226)

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Office of Policy Development and Research, R (Room 8100)
Assistant Secretary for Community Planning and Development, D (Room 7100)
Government National Mortgage Association, T (Room 6100)
Assistant Secretary for Fair Housing and Equal Opportunity, E (Room 5100)
Chief Procurement Officer, N (Room 5184)
Assistant Secretary for Public and Indian Housing, P (Room 4100)
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Assistant Deputy Secretary for Field Policy and Management, SDF (Room 7108)
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