



Issue Date	March 30, 2004
Audit Case Number	2004-LA-1002

TO: Cecilia J. Ross, 9DPH  
Director, Los Angeles Office of Public and Indian Housing

*Joan S. Hobbs*

FROM: Joan S. Hobbs  
Regional Inspector General for Audit, 9DGA

SUBJECT: Housing Authority of the City of Los Angeles  
Management of Legal Matters

### INTRODUCTION

We previously completed a review of the Housing Authority of the City of Los Angeles' (HACLA) procurement activities, including ongoing monitoring and management of resultant contracts, as they relate to its Resident Management Corporations/Resident Advisory Councils (RMCs). The review was initiated in response to several citizen complaints alleging irregularities with HACLA's RMCs and related contracting activities. Legal complications have precluded the issuance of a final audit report setting out the results of this review. However, as part of this review, we also identified problems related to HACLA's management of its legal affairs, including failure to advise HUD of significant legal matters. The results of our review, as it relates to this one matter, are set out in this audit memorandum. The audit was performed in accordance with generally accepted government auditing standards.

In accordance with HUD Handbook 2000.06 REV-3, within 60 days please provide us, for each recommendation without a management decision, 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. Additional status reports are required at 90 days and 120 days after report issuance for any recommendation without a management decision. 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 me at (213) 894-0219 extension 3705.

## **SUMMARY**

During a limited review of the Housing Authority of the City of Los Angeles' (HACLA) operations associated with its Resident Management Corporations/Resident Advisory Councils (RMCs) we identified problems with HACLA's management of legal matters. Specifically, HACLA incurred outside legal service fees and also entered into a \$1.8 million litigation settlement agreement to resolve an employee lawsuit without obtaining required prior HUD notification and approval. HACLA also incurred unnecessary and ineligible attorney fees of \$119,440 on behalf of a consultant and \$47,227 in unnecessary attorney fees to monitor information requests and activities of the OIG during our review. In our opinion, these inappropriate actions were a result of inappropriate executive decisions and intentional disregard of HUD requirements on behalf of HACLA management.

## **BACKGROUND**

The Housing Authority of the City of Los Angeles, California (HACLA) was organized as a Public Housing Authority (PHA) in 1938 to provide low-cost housing to individuals meeting criteria established by the U.S. Department of Housing and Urban Development (HUD).

HACLA, one of the largest Public Housing Authorities (PHAs) in the nation, has more than 60 developments with over 8,000 units and 20,000 residents in its conventional public housing program. HACLA also administers Section 8 Programs with over 44,000 units and 95,000 residents. Programs administered by HACLA are designed to enable low-income families, the elderly, and persons with disabilities to obtain and reside in housing that is decent, safe, sanitary, and in good repair.

### **OIG Hotline Complaint**

In July 2001 and September 2001, OIG received two separate complaints alleging similar HACLA contracting irregularities with its RMCs including:

- Kickbacks
- Unfair bidding practices
- Nonprofessional and unethical conduct
- Conflicts of interest

Based on the nature of the OIG Hotline Complaints, OIG initiated a limited review focusing on the allegations received in the complaints. This review has been completed but other ongoing matters have precluded the issuance of our final audit report related to these issues. However, although not part of the original complaint review, we did identify concerns with HACLA's management of its legal affairs. We reviewed this matter and have set out the results of the review in this memorandum.

**FINDING - HACLA DID NOT MANAGE ITS LEGAL AFFAIRS IN COMPLIANCE WITH APPLICABLE REQUIREMENTS AND COST GUIDELINES – INELIGIBLE - \$119,440 AND UNSUPPORTED - \$47,227**

HACLA incurred outside legal service fees and also entered into a \$1.8 million litigation settlement agreement to resolve an employee lawsuit without obtaining required prior HUD notification and approval. HACLA also incurred unnecessary and ineligible attorney fees of \$119,440 on behalf of a consultant and \$47,227 in unnecessary attorney fees to monitor information requests and activities of the OIG during our review. In our opinion, these improper actions were a result of inappropriate executive decisions and intentional disregard for HUD requirements by HACLA management.

In accordance with paragraphs 5-2 and 5-3c of HUD Handbook 1530.01 REV 4, Litigation, a Public Housing Authority (PHA) is required to notify HUD of pending litigation and obtain written concurrence prior to accepting a settlement offer arising out of litigation. Additionally, per paragraphs 3-3b(3) and 5-4 of the Litigation handbook, a PHA must obtain Regional Counsel approval prior to entering any litigation services contract with a private attorney(s) where the fee is expected to exceed \$10,000. Costs are not allowable for payment from a Federal award unless they are “necessary and reasonable for proper and efficient performance and administration of Federal awards” (reference Section E of OMB Circular A-87, Cost Principles for State, Local, and Indian Tribal Governments). HACLA failed to adhere to these requirements in the management of their legal affairs as discussed below.

**Prior HUD notification of pending litigation and approval of settlements**

In November 1997 the first in a series of three lawsuits were initiated against HACLA by one of its employees for actions the employee claimed HACLA had taken against her as a result of “whistle blower” type activities reported by her. HACLA did not notify HUD of any of the three lawsuits as required by paragraph 5-2 of HUD Handbook 1530.01 REV 4, nor did it notify HUD prior to entering into agreements to settle the lawsuits. These agreements entered in May 2000 and March 2001 required payment to the employee of \$1,860,000. Additionally, in October 2000 an additional quasi-related lawsuit was filed against HACLA (see below). Again, HACLA did not notify HUD of the lawsuit even though significant attorney fees were incurred.

HACLA claimed that there was no requirement to notify HUD of the lawsuits and settlements as the litigation and settlement was handled by its insurance company. This claim is not valid. The applicable requirements do not differentiate between litigation handled by an insurance company and that handled directly by a PHA. Accordingly, all such litigation must be reported to HUD. This notification is necessary to allow HUD to fulfill its monitoring responsibilities and maintain awareness of significant matters, which could affect both the PHA and HUD. Further, HACLA’s claim that settlement costs were

covered by insurance is not accurate. HACLA was required to pay \$236,586 of the ultimate settlement charges.

**HACLA contracted with private attorneys without HUD concurrence and incurred \$119,440 in ineligible charges and \$47,227 in questionable charges**

HACLA entered into contracts with private attorneys without obtaining prior HUD written concurrence as required by paragraph 5-4 of HUD Handbook 1530.01 REV 4. Further, HACLA incurred \$166,667 in attorney's fees which were not reasonable and necessary and accordingly, ineligible.

In October 2000, a lawsuit was filed against HACLA and a consultant who had done significant business with HACLA and its RMCs. This consultant, who was also a central party in the lawsuits discussed above, asked that HACLA pay his legal fees relating to the lawsuit. HACLA agreed to this and entered a joint defense agreement with the consultant. On November 17, 2000 in accordance with the joint defense agreement, HACLA entered into a contract agreeing to pay an attorney selected by the consultant for an amount not to exceed \$25,000 for the consultant's legal defense. In December 2000, the consultant replaced his attorney with another law firm, wherein HACLA entered into another sole source contract with this firm in an amount not to exceed \$10,000. It should be noted that by the time this contract was executed, charges under the contract already exceeded the maximum price. Accordingly, on February 23, 2001, by which time over \$30,000 in legal fees had been incurred, HACLA's board agreed to a contract amendment increasing the maximum contract price from \$10,000 to \$85,000 (HACLA could not locate this original contract amendment). In March 2002, the contract was again amended increasing the maximum payable to \$135,000. As of September 2002, the total paid by HACLA for the consultant's legal defense under these series of contracts was \$119,440. This includes at least \$3,544 in charges for his attorney's dealings with the OIG during our audit of HACLA's operations.

HACLA did not notify HUD of this lawsuit nor request written concurrence to its contracting with private attorneys for the litigation services involved in this lawsuit. In fact, documentation available indicates HACLA actively tried to avoid informing HUD of the suit and obtaining written approval of the contracts. For example, an e-mail between two HACLA employees, which was located in the contract file, states in part, "...does not advise entering into a new contract....entering into a new contract with this law firm would require HUD approval pursuant to HUD REG. 1530.1 Rev., Ch. 5, Section 5-4 as provided for in the HUD Litigation Handbook." This demonstrates that HACLA was fully aware of its obligations to HUD, but chose to disregard them.

When HACLA staff was questioned about paying the consultant's legal fees, they claimed it was in the best interest of HACLA and further stated they had obtained a legal opinion from the City Attorney's office to support their actions. When asked for a copy of this opinion, HACLA could not provide it, but instead provided an opinion dated November 2002, two years after the fact, wherein the City Attorney's office attempted to justify the payments on behalf of the consultant. However, in our opinion, the

justification claimed is not valid. The consultant, under the terms of his contracts with HACLA and its RMCs, was required to have valid professional liability insurance of at least \$1,000,000. Such insurance, if it had been obtained, should have covered the consultant's legal fees and would not have necessitated a joint defense agreement. However, HACLA had not required the consultant to adhere to his contract and obtain liability insurance. In fact, based upon information provided by the consultant, such liability insurance was not obtained until September 2000, five years after he had begun contracting with HACLA. Payment of legal fees by the consultant, which should have been his responsibility, is not a reasonable and necessary expense and accordingly, the \$119,440, and any additional related expenses, are ineligible charges for any federal grant program and must be refunded by HACLA from non-federal funds.

An additional \$47,227 in outside legal fees was incurred by HACLA without obtaining prior HUD notification and concurrence. Further, these fees were, in our opinion, not reasonable and necessary charges. In fact, the charges were for assisting HACLA in dealing with OIG's review, including responding to requests for information deemed necessary for our review. Such interference ended up impeding the efficient conduct of our review without benefiting HACLA's housing programs. HACLA claims the \$47,227 was paid using other non-HUD funds. However, specific documentation needs to be provided to support this claim and if not substantiated, HACLA would be required to refund the \$47,227 to its federally funded housing programs.

#### **AUDITEE COMMENTS**

We provided our draft report to HACLA on January 29, 2004 and discussed this draft with HACLA representatives at an exit conference on February 10, 2004. Additionally, on February 17, 2004 and March 19, 2004, HACLA provided written comments and additional information in response to the draft report and the exit conference. We have included HACLA's March 19, 2004 (final) written comments in Attachment B to the report and have summarized them below.

HACLA stated that the questioned legal costs have now been paid from non-federal funding and provided a schedule to document this claim. Additionally, HACLA stated that it thought that it had tight controls to monitor outside legal services and ensure that contractors meet basic contractual obligations. HACLA stated that it has consistently obtained HUD approval for all substantive legal matters and obtained HUD approval of legal contracts and settlements as appropriate and that its failure to do so for the items discussed in our report was an oversight. However, HACLA had concerns about the report's discussion of management's apparent intentional violation of HUD requirements relating to prior HUD approval of contracts for legal services. HACLA felt that this was not accurate and asked that the conclusions related to this be removed from the report.

HACLA provided additional comments on the defense of a contractor and stated that litigation between the Jordan Downs RMC and the Housing Authority was the result of the contractor stepping forward as a whistleblower and felt it would send the wrong message to the public if they did not defend him.

## **OIG EVALUATION OF AUDITEE COMMENTS**

Documentation supplied by HACLA to support the use of Non-HUD funds was simply a spreadsheet claiming to summarize cost transfers to Fund 401 – Non-HUD Funds. During the course of our audit we documented the use of federal funds for legal costs and HACLA’s documentation does not serve to support their claim that these transfers were actually made nor does it identify the source of funding accounted for in Fund 401. Therefore, additional information and documentation needs to be submitted to substantiate HACLA’s claimed payment of questioned legal fees from non-federal funds. In relation to the sufficiency of HACLA’s controls over legal matters and enforcement of basic contract requirements, it was apparent (as discussed in the finding) that these controls and procedures were not adequate to ensure that legal fees were appropriate, required HUD approval of legal matters was obtained and contractors met basic contract requirements. Accordingly, HACLA needs to establish additional controls and procedures that will ensure future compliance in these matters. Further, we believe that our comments relating to apparent intentional violation of HUD requirements do not warrant change, as they are supported by e-mails in HACLA’s own files, which clearly demonstrated an intentional circumvention of HUD requirements. Finally, with respect to HACLA’s comments regarding the defense of the contractor, the contractor was required to carry professional liability insurance in his position with the Resident Management Corporations and should have provided his own defense. Further, in our opinion, the case was not a simple whistleblower case, but involved serious accusations relating to the contractor’s activities and actions as they related to fulfillment of his contractual obligations. (This whistleblower case was a different case than that which was discussed in the report).

### **RECOMMENDATIONS**

We recommend your office require HACLA to:

- A Repay, using non-federal funds, its conventional low-rent program the \$119,440 in ineligible legal fees incurred in defending its consultant;
- B Provide documentation to your office evidencing that non-federal funds were used to pay the \$47,227 in legal costs relating to our audit and if not substantiated, repay the funds to the applicable program;
- C Establish procedures to ensure that legal fees are incurred only when they are reasonable and necessary for its housing operations and to obtain the required HUD approval for outside legal services and legal settlements; and
- D Implement policies and procedures to ensure that contractors meet basic contract requirements, including obtaining of required liability insurance.

**SCHEDULE OF QUESTIONED COSTS AND FUNDS PUT TO BETTER USE**

<u>Recommendation Number</u>	<u>Type of Questioned Cost</u>		<u>Funds Put to Better Use 3/</u>
	<u>Ineligible 1/</u>	<u>Unsupported 2/</u>	
A	119,440		
B		47,227	

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law, contract or Federal, State or local policies or regulations.

2/ Unsupported costs are costs charged to a HUD-financed or HUD-insured program or activity and eligibility cannot be determined at the time of audit. The costs are not supported by adequate documentation or there is a need for a legal or administrative determination on the eligibility of the costs. Unsupported costs require a future decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of Departmental policies and procedures.

3/ Funds Put to Better Use are costs that will not be expended in the future if our recommendations are implemented.

AUDITEE COMMENTS



**HOUSING AUTHORITY** OF THE CITY OF LOS ANGELES  
AN EQUAL EMPLOYMENT OPPORTUNITY-AFFIRMATIVE ACTION EMPLOYER  
2600 Wilshire Boulevard • Los Angeles, California 90057 • (213) 252-2500  
TTY (213) 252-5313

BOARD OF COMMISSIONERS:  
MICHAEL A. NOGUEIRA, JR. CHAIRMAN

EXECUTIVE DIRECTOR  
DONALD J. SMITH

March 19, 2004

Joan S. Hobbs  
Regional Inspector General for Audit  
U.S. Department of Housing and Urban Development  
611 West Sixth Street, Suite 1160  
Los Angeles, CA 90017

Dear Ms. Hobbs:

This letter is to provide a response to your draft report dated January 29, 2004 and more specifically to the recommendations contained in the draft. The following summary will address and answer the points that are raised:

**SUMMARY**

***A. Repay \$119,440 in ineligible legal fees using non-federal funds***

By letter dated February 13, 2004, to Cecelia Ross, Director of Public Housing, Area Office, the Housing Authority forwarded documents showing that these funds were paid out of non-federal funds (**see attachment A**). HACLA's records show that the amount in question is \$121,462.45, and the attached documents show that these funds were paid from non-federal funds.

***B. Provide documentation that non-federal funds were used to pay legal fees associated with the HUD audit, and repay the funds if not substantiated***

By the same letter dated February 13, 2004, to Cecelia Ross, Director of Public Housing, Area Office, the Housing Authority forwarded documents showing that these funds, in the amount of \$92,276.24 were paid out of non-federal funds (**see attachment A**).

***C. HUD notification and approval for outside legal services and legal settlements***

HACLA has reviewed its procedures and has determined that it routinely notifies and receives approval from HUD prior to entering into any litigation services contract with private attorney(s) where the fee is expected to exceed \$100,000 (**see attachment B acknowledging letters from HUD**). However, there may have been circumstances where it was imperative to commence a defense and notification was inadvertently

**Joan S. Hobbs**  
**Regional Inspector General for Audit**  
**U.S. Department of Housing and Urban Development**  
**March 19, 2004**  
**Page 2**

omitted. The Housing Authority will establish more effective controls to notify HUD prior to entering into any litigation services contract with private attorney(s) where the fee is expected to exceed \$100,000.

In addition, we will notify HUD of any pending litigation and seek HUD's written concurrence prior to accepting a settlement offer arising out of litigation.

***D. Implement policies and procedures to ensure that contractors meet basic contract requirements, including obtaining of required liability insurance***

The Housing Authority does have policies and procedures to insure that contractors meet basic contract requirements, including required liability insurance. It is the Housing Authority's policy that contractors meet basic contract requirements, including required liability insurance. Following receipt of your draft audit letter, and the example referenced, the Housing Authority has instituted a review of its contracting policies and procedures, including required liability insurance, in order to tighten its procedures.

***FURTHER DISCUSSION***

In the management of its operations, HACLA carries insurance to cover claims in, among other matters, employment practices and liability areas. By carrying appropriate insurance, and abiding by the terms of the insurance policies, the Housing Authority provides prudent management of its resources and saves taxpayers hundreds of thousands, and potentially millions, of dollars in public funds.

As part of its insurance coverage, HACLA, as any other insured, must abide by the terms of the insurance policy or risk curtailment of coverage. As the lawsuit in question was in fact covered by insurance, HACLA's defense and settlement of the litigation, was appropriately directed by the carrier. Furthermore, the \$1.8 million case referenced in your letter resulted from a judgment awarded by a jury, upheld by the court of appeal and ultimately settled by HACLA's insurance carrier.

Although HACLA will institute procedures to notify HUD of all litigation and seek approval from HUD for litigation settlement, the Housing Authority is mindful that this be done without jeopardizing the insurance coverage or HACLA's liability.

HUD references that HACLA agreed to pay the legal fees for a consultant, Dwayne Williams, who was a central party to certain lawsuits that were filed. HUD also asserts that under the terms of Mr. Williams' contracts with HACLA and the RMC's, he was required to have valid professional liability insurance of at least \$1,000,000, which would have covered the consultant's legal fees and would not have necessitated a joint defense.

**Joan S. Hobbs**  
**Regional Inspector General for Audit**  
**U.S. Department of Housing and Urban Development**  
**March 19, 2004**  
**Page 3**

At the time of the lawsuit in question, Mr. Williams was under contract with several Resident Management Corporations (RMC's), and not with HACLA. It was the RMC's, not HACLA, who were responsible for determining whether Mr. Williams had the requisite Professional Liability Insurance.

Additionally, with respect to whether or not Mr. Williams' attorney costs should be paid by HACLA, a determination was made that it would be in HACLA's best interest to pay the attorney costs, because of Mr. Williams' role in the matter. The confrontation between the Jordan Downs RMC (JDRMC) and the Housing Authority, and the subsequent litigation, took place because Mr. Williams stepped forward and served as a whistleblower with respect to attempts by the JDRMC to embezzle public funds. It was determined that not to provide Mr. Williams with a defense, regardless of insurance, would be to send a wrong message to the public – that whistleblowers would be left to provide their own defense - and that course of conduct by a public entity would have a chilling effect on future whistleblowers. These determinations along with the actions approving the funds for Mr. Williams defense, were publicly stated and publicly approved by the Housing Authority's Board of Commissioners in open, publicized meetings.

Finally, you also reference one email between two HACLA employees that allegedly "demonstrates that HACLA was fully aware of its obligations to HUD, but chose to disregard them." The e-mail between two lower-level employees does not demonstrate that HACLA chose to disregard its obligations to HUD. It is unclear whether the persons who were copied on the email ever opened it, read it, or even received it. In any case the employee who sent the email should have sought further counsel regarding this matter from their supervisor. Additionally, the contract increase required Board approval and was duly noted on the public agenda. There was no attempt to hide the contract from either the public or from HUD.

We look forward to a favorable response and continued partnership with HUD. If you have any questions or wish to discuss the matter further, please feel free to contact me at (213) 252-1810.

Sincerely,



Donald J. Smith  
Executive Director

Attachments



**HOUSING AUTHORITY** OF THE CITY OF LOS ANGELES

AN EQUAL EMPLOYMENT OPPORTUNITY-AFFIRMATIVE ACTION EMPLOYER

2600 Wilshire Boulevard • Los Angeles, California 90057 • (213) 252-2500

TTY (213) 252-5313

EXECUTIVE DIRECTOR

DONALD J. SMITH

BOARD OF COMMISSIONERS:  
MICHAEL A. NOGUEIRA, JR. CHAIRMAN

February 13, 2004

Cecilia Ross  
Director, Public Housing Division  
U.S. Department of Housing and Urban Development  
611 West Sixth Street, Suite 800  
Los Angeles, CA 90017

**Re: OIG DRAFT AUDIT**

Dear Ms. Ross:

Thank you for meeting with me and my staff to discuss the draft audit on litigation matters. As we indicated in the meeting, all the funds in question have been paid from non-federal funding sources, and documentation to this effect is enclosed.

We also indicated during the meeting that we believed we had tight controls in place to monitor outside legal services and to ensure that contractors meet basic contractual obligations such as maintaining appropriate insurance.

We agreed to inform HUD of all substantive legal matters and to seek its approval in compliance with the HUD Litigation Handbook and pertinent HUD Notices. I pointed out that I was unaware of these requirements until recently, despite my 32 years in the industry. I also expressed my concern that the requirements for HUD prior approval would prove impractical and may have a chilling effect in the relationship between PHAs the insurance industry.

Lastly, I expressed my concern that the draft audit implied that the Authority's management made conscious attempts to avoid compliance with HUD requirements. I respectfully request that those conclusions be deleted from the draft audit.

If you have any questions regarding this matter, please call me at (213) 252-1810.

Sincerely,

Donald J. Smith  
Executive Director

c: Joan Hobbes, Regional Inspector General

**CONSOLIDATED LEGAL FEES CHARGED TO FUND 401**

Fund/ Major Account	Sub Account	Cost Center	Location	Amount	Month	Department #	DeptName	Vendor
401 413000	000000	100	010	\$121,462.45	12/31/2003	9100		Hughes and Dunstan LLP
401 143002	003500	200	020	\$27,351.18	12/31/2003	9200	Design & Construction Svcs.	Stephan, Oringher, Richman & Theodora
401 143002	000000	200	020	\$23,576.15	12/31/2003	9200	Design & Construction Svcs.	Stephan, Oringher, Richman & Theodora
401 413000	000000	200	402	-\$402.21	12/31/2003	9200	Design & Construction Svcs.	Stephan, Oringher, Richman & Theodora
401 413000	000000	200	402	\$41,751.12	12/31/2002	9200	Design & Construction Svcs.	Stephan, Oringher, Richman & Theodora
<b>TOTAL:</b>				<b>\$213,738.59</b>				

Fund 401 is a non HUD fund or money received from sources other than HUD.