



Issue Date	July 29, 1997
Audit Case Number	97-SF-203-1005

TO: Beverly Kendrick, Director, Office of Public Housing, 9DPH

FROM: Glenn Warner, District Inspector General for Audit, 9AGA

SUBJECT: Limited Review of Contract Rents - Section 8 Housing Assistance
Payment (HAP) Program
San Diego Housing Commission (SDHC)
San Diego, California

We performed a limited review of SDHC's procedures for approving contract rents for its tenant-based Section 8 HAP program. The purpose of our review was to determine the validity of allegations that SDHC approved contract rents that were higher than rents being charged for comparable unassisted units within the same complex.

We determined that some Section 8 contract rents approved by SDHC since at least 1994 were excessive. SDHC not only approved initial contract rents that were too high but also gave annual adjustments to previously established rents without determining that those adjustments were warranted. This occurred because SDHC did not consistently compare rents it approved for Section 8 units to those rents that project owners charged for comparable unassisted units.

We have provided the auditee with a copy of this report.

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 have any questions, please call Senior Auditor Ruben Velasco at (213) 894-8016.

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Executive Summary

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We determined that some Section 8 contract rents approved by SDHC since at least 1994 were excessive. SDHC not only approved initial contract rents that were too high but also gave annual adjustments to previously established rents without determining that those adjustments were warranted. This occurred because SDHC did not consistently compare rents it approved for Section 8 units to those rents that project owners charged for comparable unassisted units.

We performed our audit at the San Diego Housing Commission. We also visited 19 selected tenant-based Section 8 projects to verify whether contract rents for Section 8 units exceeded rents being charged for unassisted units.

SDHC approved excessive Section 8 rents

We determined that some Section 8 contract rents approved by SDHC since at least 1994 were excessive. It not only approved initial contract rents that were too high but also gave annual adjustments to previously established rents without determining that those adjustments were warranted. As a result, SDHC paid more in Section 8 subsidies to some owners than was allowed by HUD regulations. This occurred because SDHC did not consistently compare rents it approved for Section 8 units to those rents that were being charged for comparable unassisted units as required. In addition, even though HUD had brought this problem to SDHC's attention in 1994, SDHC did not ensure that the problem was adequately addressed. This occurred because SDHC officials had not established necessary management controls to ensure continuance of the proper procedures.

HUD instructed SDHC to strengthen its procedures

Following an investigation by HUD's Office of Inspector General, HUD informed SDHC in April 1994 that its procedure for approving contract rents was inadequate. In its May 1994 response to HUD, SDHC stated that it would require owners to submit rent data for comparable non-Section 8 units within the same complex, in addition to a certification by the owners. SDHC subsequently reverted to the old procedure of relying solely on owners' certifications without verifying the rents being charged for non-Section 8 units within the same complex.

Conditions exist where Section 8 rents can exceed rents paid for non-Section 8 units

We also found other conditions where rents paid for Section 8 units exceeded rents paid for non-Section 8 units. In these cases, even though the Section 8 rents were initially the same as unassisted rents, market rates had declined resulting in a corresponding reduction in unassisted rents. This situation gave the appearance of excessive rents. However, HUD regulations do not allow Section 8 units' current rents to fall below the previously approved initial contract rents even when market rates are going down. Therefore, in this situation, even though Section 8 contract rents may have been higher than rents paid for non-Section 8 (unassisted) units there was no violation of HUD regulations.

Auditee Comments and OIG Evaluation

We discussed the finding with SDHC officials at a July 21, 1997 exit conference. We provided SDHC a copy of the draft finding on May 6, 1997 and received their written response on June 23, 1997. The response and our evaluation are discussed in the finding and the full text of the response is included as Appendix A. SDHC officials generally agreed with the finding except for our recommendation to research excessive payments and repay HUD from non-federal funds. At the exit conference, SDHC officials advised us that Housing Trust Funds and locally generated funds (lease/sales transactions, fees for services) are two sources of non-federal funds. They also informed us, however, that if these funds are to be used to repay the excessive rents, services being paid from these funds would be reduced, therefore, providing lesser benefits to intended beneficiaries.

Recommendations

We recommended that HUD require SDHC to: (1) obtain information and perform an analysis of non-Section 8 unit rents for apartment complexes that also have Section 8 units; (2) determine whether excessive contract rents were being paid; and (3) repay the total amount overpaid to HUD from non-federal funds.

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Abbreviations

AAF	Annual Adjustment Factor
CFR	Code of Federal Regulations
HUD	Department of Housing & Urban Development
LAAO	Los Angeles Area Office
OIG	Office of Inspector General
PHA	Public Housing Agency
SDHC	San Diego Housing Commission
TBRA	Tenant Based Rental Assistance
U.S.C.	United States Code

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Introduction

BACKGROUND

The San Diego Housing Commission (SDHC) was established in 1979 by the San Diego City Council as the administrative agency for the Housing Authority of the City of San Diego. The Commission consists of seven members who were appointed by the Mayor with the approval of the City Council. SDHC is located at 1625 Newton Avenue, San Diego, California.

SDHC administers eight rental assistance programs including Section 8 Housing Certificate and Voucher Programs. As of September 1996, SDHC was administering 8,821 Section 8 Housing Certificate and Voucher contract units.

The Section 8 rental voucher and certificate programs provide rent subsidies so eligible families can afford rent for decent, safe, and sanitary housing. HUD provides funds to housing authorities for rent subsidy on behalf of eligible families. HUD also provides funds for housing authorities' administration of the programs.

Families select and rent units that meet program housing quality standards. If a Public Housing Agency (PHA) approves a family's unit and lease, the PHA contracts with the owner to make rent subsidy payments on behalf of the family. A PHA may not approve a lease unless the rent is reasonable.

Section 8 assistance may be "tenant-based" or "project-based." In project-based programs, rental assistance is paid for families who live in specific housing developments or units. With tenant-based assistance, the assisted unit is selected by the family. The family with tenant-based assistance may rent a unit anywhere in the United States in the jurisdiction of a PHA that runs a certificate or voucher program. Except for project-based assistance under the certificate program, all assistance under the certificate and voucher programs is "tenant-based."

The Section 8 program is subject to rent reasonableness limitations. "Reasonable rent" is a rent that is not more than either: (1) rent charged for comparable units in the private

unassisted market; or (2) rent charged by the owner for a comparable assisted or unassisted unit in the same building or premises.

PHAs may approve Initial Contract Rents that do not exceed the HUD published Fair Market Rent for the area, with some exceptions. Also, the Initial Contract Rent must meet the previously mentioned "Rent Reasonableness Limitations." Annually, owners may request rent adjustments according to factors established by HUD. The requested annual rent adjustments can go up or down, whichever is appropriate. However, even if the rent for unassisted or other assisted units in the same complex had gone down below the contract rent for the unit being considered, there is no HUD requirement for the owner to lower the rent that the owner already is receiving.

If there has been a drastic drop in market or comparable rents, the PHA in administering its program, although not required by HUD, should negotiate a rent reduction or not renew the contract and require the tenant to move to a more reasonable unit. Other factors such as availability of units, cost of moving, possibility of rents going up again in the near future should be considered.

**AUDIT OBJECTIVES,
SCOPE AND
METHODOLOGY**

Our overall audit objective was to determine the validity of allegations that SDHC approved contract rents that were higher than rents being charged for comparable unassisted units within the same complex. Specifically, we assessed whether SDHC approved initial contract rents that were too high and also gave annual adjustments to previously established rents without determining whether those adjustments were warranted.

To accomplish our audit objectives, we performed the following:

- ✓ Reviewed HUD's Public and Indian Housing Handbook 7420.7, Public Housing Agency Administrative Practices Handbook for the Section 8 Existing Housing Program, which was canceled by HUD on January 23, 1995.
- ✓ Reviewed Title 24 of the Code of Federal Regulations pertaining to Section 8 rental assistance programs.
- ✓ Reviewed HUD Notices issued in 1994, 1995, and 1996 relating to the Section 8 rental assistance programs.
- ✓ Reviewed HUD's Los Angeles Area Office (LAAO) and SDHC's files.
- ✓ Interviewed SDHC, HUD Headquarters, and LAAO officials.
- ✓ Reviewed and evaluated recent recertification files for 49 tenants of 16 apartment complexes to compare rent charged for assisted and unassisted units in the same apartment complexes.
- ✓ Visited 19 selected apartment complexes and compared their assisted with unassisted rent amounts.

Our audit covered the period January 1994 through December 1996. We expanded our review to other periods where appropriate. We performed the audit field work from October to December 1996. We conducted the audit in accordance with generally accepted government auditing standards.

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SDHC Approved Excessive Section 8 Contract Rents

Some Section 8 contract rents approved by SDHC since at least 1994 were excessive. It not only approved initial contract rents that were too high but also gave annual adjustments to previously established rents without determining that those adjustments were warranted. As a result, SDHC paid more in Section 8 subsidies to some owners than was allowed by HUD regulations. This occurred because SDHC did not consistently compare rents it approved for Section 8 units to those rents that were being charged for comparable unassisted units within the same complex as required. In addition, even though HUD had brought this problem to SDHC's attention in 1994, SDHC did not ensure that the problem was adequately addressed.

HUD regulations require PHAs to certify that approved rent is reasonable and not more than unassisted rent

Title 24 of the Code of Federal Regulations (CFR), Section 882.106(b)(1), requires housing authorities to 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, quality, amenities, facilities and management and maintenance service of such units, and (ii) not in excess of rents currently being charged by the Owner for comparable unassisted units.

Also, Title 24 of the CFR, Section 882.108 provides that contract rents shall be adjusted upon request to the housing authority by the owner subject to the rent reasonableness limitations stated in 24 CFR 882.106(b).

SDHC approved excessive contract rents and improperly approved rent increases

In some instances SDHC approved excessive Section 8 contract rents and improperly approved requests for annual adjustment factor rent increases. SDHC improperly certified that rents requested were reasonable without determining the owners' comparable rent amounts, despite HUD's requirement for PHAs to ensure that approved rents were reasonable in comparison to surrounding market rents and not in excess of rents being charged for other comparable units within the same complex.

Finding 1

PHA must determine the amount of rent paid by non-assisted units before certifying whether rents are reasonable

HUD Handbook 7420.7, Public Housing Agency Administrative Practices Handbook for the Section 8 Existing Housing Program, paragraph 6-5 required housing authorities to certify and document that approved rents were reasonable in relation to comparable units in the private unassisted market and not in excess of rents currently being charged by the owner for comparable unassisted units.

Paragraph 6-5d(1) of the same handbook also stated that the PHA had to determine the rents for non-assisted units in the same building or other comparable units owned by the owner in order to certify that the contract rents were reasonable.

Seven of 19 apartments selected for review charged higher Section 8 rents

We selected and visited 19 apartment complexes that were participating in SDHC's Section 8 HAP program to determine whether their Section 8 contract rents were higher than rents paid for non-Section 8 units within the same complex. These complexes consisted of 785 Section 8 units. We found that seven of the 19 complexes consisting of 290 Section 8 units, generally charged higher contract rents than non-Section 8 (unassisted) units. A breakdown showing the seven complexes that we reviewed are as follows:

Apartment Complex	Number of Section 8 Units	Total Units
Creekside	41	144
Parkhaven	103	455
Westwood Villa	15	100
Sunset Village	46	144
4949 Logan Avenue	7	38
Euclid Terrace	64	149
Harbor Vista	14	272
TOTAL	290	1,302

Since our audit test only included a portion of the 290 total units, further analysis would be needed to determine the extent of excessive payments.

When we found a disparity of the rent amounts between Section 8 and non-Section 8 (unassisted) units, it was mostly caused by AAF rent increases for Section 8 units when non-Section 8 unit rents were declining.

SDHC's improper rent approval procedures allowed overcharging

For example, two apartment complexes, Parkhaven and Creekside, generally charged the same initial contract rent for both Section 8 and non-Section 8 (unassisted) units. However, while rent for units occupied by non-Section 8 tenants remained the same, SDHC continuously granted rent increases to Section 8 units using HUD's Annual Adjustment Factor. Had SDHC obtained rental data showing lower rents paid by unassisted comparable units, it may not have approved the rent increases.

SDHC's own review showed it had approved excessive rents

At the time of our audit, SDHC had reviewed about 1,900 of its nearly 9,000 units with Section 8 HAP contracts and found that it had approved excessive Section 8 rents in at least 100 of these units. This resulted in annual rent reduction of over \$90,000. With the exception of Creekside, Parkhaven, Dream Street, and Parkview Robinson Apartments, SDHC limited its review to only those units that Section 8 contracts were due for recertification. If the recertification for a unit was at a future date, SDHC deferred its review of whether rent overpayment had occurred until the recertification date was due. This has resulted in continued excessive rent payment to the owner up until the time of recertification.

We found that this was the case when we reviewed tenant files for units within the same complex that SDHC still had not reviewed. In addition to the 100 units identified by SDHC, we noted another 47 Section 8 units with contract rents that also appeared to be excessive.

We believe that SDHC should review all Section 8 units within the same complex once it identifies overpayment of Section 8 rents rather than waiting for the units' contract recertification date in order to determine if any actual overpayment had occurred.

SDHC's determination of overpayment needs further analysis

SDHC identified overpayment by comparing the current rents for non-Section 8 (unassisted) units against rents paid for Section 8 units. While we believe that this procedure is a good screening device to flag possible overpayment, further analysis needs to be done to determine the extent of any overpayment or even if overpayment actually occurred. For example, to determine if an overpayment actually occurred, SDHC must determine if the initial contract rent was higher than the rent paid by a comparable unassisted unit at the time that the initial contract rent was approved. This determination is critical because current HUD regulations do not permit current rents to fall below the initial contract rent even though rents for non-Section 8 (unassisted) units are lower. In addition, excessive rent payments can also occur if SDHC grants annual adjustments factor rent increases while owners charge comparable non-Section 8 (unassisted) units with lower rents due to declining market rates. As an example, we found that Parkhaven requested and received rent adjustments even though contract rents for Section 8 units already exceeded rents paid by comparable non-Section 8 (unassisted) units.

The overpayment occurred because SDHC did not consistently compare rents it approved for Section 8 units to those rents that were being charged for comparable unassisted units as required. In addition, even though HUD brought this problem to SDHC's attention in 1994, SDHC did not ensure that the problem was adequately addressed.

SDHC did not establish management controls to ensure continuance of the proper procedures

SDHC's effort to correct its procedures to prevent continued payment of excessive rents was inadequate. According to SDHC, it only changed its procedures for a short period and reverted back to relying solely on the owners' certifications rather than verifying what the owners were charging for unassisted units. In May 1994, SDHC changed its procedures for determining rent reasonableness by actually verifying rents paid for non-Section 8 (unassisted) units within the same complex. Although this was effective, it reverted to its old procedure of relying solely on a certification by the owner that rents requested for Section 8 units did not exceed rents charged for comparable non-Section 8 (unassisted) units. This occurred because SDHC did not establish necessary management controls to ensure continuance of the proper procedures.

HUD determined that SDHC's rent approval process was inadequate

In February 1994, HUD's Office of Inspector General for Investigation reviewed a complaint brought forward by the Housing Commission about a San Diego owner overcharging for Section 8 units. It reported that SDHC apparently approved contract rents requested by the owner for assisted units without verifying whether the rents the owner was charging for unassisted units were comparable. This issue was referred to HUD's Los Angeles Area Office for resolution. In April 1994, the Office Manager, HUD, Los Angeles Area Office, informed SDHC's Acting Executive Director that SDHC erred in approving contract rents without verifying that the requested rents did not exceed rents the owner was charging for his/her comparable non-Section 8 (unassisted) units. HUD requested that SDHC send its policy to HUD showing how it determines rent reasonableness.

In May 1994 the Acting Executive Director replied that SDHC believed it had met the intent of 24 CFR 882.106(b) through the use of the Rent Request Card signed by the owner which stated:

"The undersigned hereby certifies that the rent requested for the above mentioned tenant does not exceed rents being charged for other comparable units in the same complex."

SDHC informed HUD about instituting new procedures

The Acting Executive Director's response further stated that SDHC was instituting additional procedures that would require owners to submit rent data for comparable non-Section 8 (unassisted) units within the complex or for similar units managed by the owner. The forms were to be submitted with the Request for Lease Approval Letter or the Rent Request Card, whichever was appropriate.

SDHC stopped obtaining rent data and relied again on certification

Subsequently, SDHC reverted to the old procedure that HUD had said was in error. This occurred because SDHC officials had not established necessary management controls to ensure continuance of the proper procedures. Also, SDHC officials stated they were unsure whether they had authority to demand rent roll information to verify non-Section 8 (unassisted) rents. SDHC instituted the new procedures in May 1994 to obtain rent amounts that owners were charging for comparable units, but later dropped these procedures and again solely relied on owners' certifications. Some versions of HAP contracts

contained a statement that the owners agree that their signature on the payment checks are considered certification that the rents do not exceed or materially exceed, rents the owner charges comparable non-Section 8 (unassisted) units.

Auditee Comments

Overall, SDHC agreed that some property owners participating in the Section 8 program charged more rents for Section 8 units than for non-Section 8 units within the same complex. SDHC stated, however, that it identified the problem several months before the audit started and had instituted procedural changes to compare requested rents with unassisted unit rents to ensure that the situation does not occur again. According to SDHC, corrective actions taken since July 1996 have resulted in rent reductions on 257 out of 5,258 units examined. SDHC claimed that the total amount of the rent reductions will not exceed 0.5% of their \$52 million program and its determinations were 99.5% accurate.

SDHC also stated that it had relied on property owners' certifications indicating that requested Section 8 contract rents did not exceed rents charged for other comparable unassisted units. SDHC commented that this reliance was not made an issue in prior audits or reviews and that other Public Housing Agencies (PHAs) have used this method to meet regulatory requirements.

SDHC agreed that excessive rents were being charged in some apartment complexes. Until it completes its review of all Section 8 units' rents, however, SDHC believes that it was premature for the audit report to assert that there was an impropriety when a rent difference exists. Also, to research excessive payments back to 1994 would require significant staffing resources and retrieval of needed information may not be readily available or not available at all.

SDHC also stated that even though HUD told SDHC to send its policy showing how it determines rent reasonableness in 1994, HUD neither approved SDHC's proposed changes to its Administrative Plan nor subsequently addressed the issue concerning rent reasonableness again.

SDHC explained that it was staffing changes and ineffective transition of pending issues to new staff that caused SDHC's failure to implement new rent reasonableness determination procedures. SDHC further stated that it made an understandable and inadvertent mistake and did not intentionally ignore or disregard directives from HUD. SDHC believes that repaying the rent overpayments to HUD appears to be punitive and serves no useful purpose.

OIG Evaluation

SDHC's acknowledgement that some property owners charged more rents for Section 8 than for non-Section 8 units confirmed excessive payments of contract rents. While we agree that SDHC's instituted procedural changes to correct the problem is a positive step, we found that it had become aware of this problem as far back as 1994. As pointed out in the finding, although it also made procedural changes in 1994, it failed to establish management controls to ensure continuance of the proper procedures. As a result, overpayment of contract rents continued.

We do not believe that SDHC's sole reliance on property owners' certifications sufficiently addressed HUD's requirement for ensuring that Section 8 contract rents should not exceed rents paid for non-Section 8 units within the same complex. This requirement was explained by HUD's LAEO in 1994 when it told SDHC to require owners to submit rent data for non-section 8 units within the same complex as a basis for verifying property owners' certifications. We also do not believe that the lack of disclosure in any prior audits or reviews about SDHC's sole reliance on property owners' certifications constituted HUD's approval. First, as previously stated, HUD clarified this issue and informed SDHC about the proper procedures to follow. Second, we believe that in order to properly certify to HUD that requested contract rents do not exceed rents paid for unassisted units, SDHC should first determined the rents for unassisted units. In this case, SDHC's certifications to HUD that were based solely on property owners' certifications does not provide sufficient basis for SDHC to make a proper certification.

Since SDHC also concluded that excessive rents were paid, this in itself is an admission of improper use of HAP funds. SDHC's completion of its review should not only seek to

establish whether HAP funds were properly paid but also to determine the extent of the excessive payments. We acknowledge that to research excessive payments back to 1994 may require staffing resources; however, we were not told how much it would cost. SDHC may choose to consider other options in determining the extent of any overpayments and submit its proposal to HUD, LAAO for its review. We also do not believe that HUD's lack of approval of the Administrative Plan relieves SDHC's responsibility to administer its Section 8 program efficiently, economically, and in accordance with HUD requirements and guidelines.

We do not dispute SDHC's explanation that staffing changes and ineffective transition of pending issues to new staff caused SDHC's failure to implement rent reasonableness determination procedures. However, we do not consider it punitive for SDHC to research rent overpayments from 1994 and repay this amount to HUD from non-federal funds. These overpayments were monies that SDHC should not have paid, had the proper procedures been followed.

Recommendations

We recommend that you require SDHC to:

- 1A. Obtain information on rents for non-Section 8 units within apartment complexes that also have Section 8 units;
- 1B. Use the information obtained in Recommendation 1A above and identify all Section 8 units that appear to have higher contract rents than non-Section 8 (unassisted) units;
- 1C. Perform an analysis for those units identified in Recommendation 1B above to determine whether excessive contract rents were being paid;
- 1D. Determine the total overpayments made since January 1, 1994 to the date that the overpayments were corrected and repay HUD from non-federal funds; and
- 1E. Establish written procedures that will ensure Section 8 rent determinations are properly accomplished on a continuing basis.

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Other Conditions Causing Rent Disparity

We found other conditions where rents paid for Section 8 units exceeded rents paid for non-Section 8 units. In these cases, we noted that rents for comparable non-Section 8 (unassisted) units had declined below the Section 8 units' initial contract rents. However, HUD regulations do not allow Section 8 units' current rents to fall below the previously approved initial contract rents even when market rates are going down. Therefore, even though Section 8 contract rents may have been higher than rents paid for non-Section 8 (unassisted) units, this only gave the appearance of excessive rent payments because there was no violation of HUD regulations.

Current HUD regulations prohibit rent reduction below Initial Contract Rent

After the first year of the lease, contract rents can be adjusted. There is no requirement for the owner to reduce the rent and there is a prohibition against reducing the rent below the Initial Contract Rent under current HUD regulations. Therefore, the owner could be receiving rents on an older HAP contract that are higher than the current rent he/she is charging for unassisted units or for newly assisted Section 8 units.

24 CFR 882.108 provides for rent adjustments "upon request to the PHA by the owner" subject to the unit being in decent, safe and sanitary condition and the owner being otherwise in compliance with the terms of the lease and the HAP Contract. The requested adjustment is also subject to the rent reasonableness limitations stated in 24 CFR 882.106(b). Contract Rents may be adjusted upward or downward, as may be appropriate. However, in no case shall the adjusted rent be less than the Contract Rent on the effective date of the Contract.

If owner decreases unassisted rents, new HAP contracts may not be higher

The rules were written presupposing that market rents would rise, not fall. The theory would be that the initial contract rents could not exceed the market rents at that time and could not be adjusted higher than market rents in the future. However, they could become higher than market rents because the market fell and the owner was not required to lower rents. Rents are adjusted at the request of the owner, not because the Housing Authority determines that market rents changed and therefore the owner should also change his rents. If an owner decreases his non-assisted (unassisted) rents, all new HAP contracts he/she executes could not exceed those new unassisted rents, even though an older HAP contract could have a higher rent. In this example, the owner

Several reasons why rents may vary

could not get a rent increase for the older HAP contract because of the rent reasonableness limitation.

There are numerous allowable reasons why rents may vary from unit to unit within an apartment complex such as: (1) an owner requesting an approvable rent increase on one assisted unit, but not on another comparable assisted unit in the same building; (2) a downturn in the local housing market could result in the rents for unassisted and newly assisted comparable units being lower than an older HAP contract rents; (3) an owner may choose to increase the rents on some of the owner's non-Section 8 (unassisted) units while not increasing the rents for other comparable non-Section 8 (unassisted) units-creating disparate rents for unassisted units on which to make a comparison to a comparable assisted unit; (4) a voucher assisted tenant may agree to pay a higher rent than the PHA would approve for a certificate assisted tenant; (5) tenants living at the complex for varying lengths of time may have had their rents increased by annual adjustment factors whereas the asking rent for new tenants did not change; (6) apparently similar units (such as 2 bedroom units) may differ in size, location, view, newly decorated or not, amenities, varying move-in specials; and (7) other possible scenarios that can arise under the Section 8 rental certificate regulations when they are applied in their entirety. These reasons may not result in excessive Section 8 contract rents, but each case may have a different circumstance.

The determination concerning the actual occurrence of excessive rent payments, therefore, is not always clear cut. While it appears that Section 8 contract rents improperly exceed rents paid by non-Section 8 (unassisted) units, additional analyses, such as those explained above, may tend to prove otherwise.

Since this portion of the report is not considered a deficiency, recommendation for corrective action is not required.

Internal Controls

In planning and performing our audit, we considered internal controls used for handling approval and adjustment of Section 8 tenant-based rents after January 1, 1994 to determine our auditing procedures and not to provide assurance on internal control. Internal control is the process effected by an entity's management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

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

In each of these three categories of objectives, organizations will establish their own specific control objectives and control procedures aimed at achieving these broad objectives. If organizations are to meet these control objectives, five components of internal control--control environment, risk assessment, control activities, information and communication, and monitoring--must be present. That is, the control objectives in each category are inextricably linked with the five supporting components.

We evaluated pertinent internal control categories

We determined that the following internal control categories were relevant to our audit objectives:

- Rent reasonableness determination of initial contract rents.
- Approval of AAF rent increases.

We assessed the categories identified above. For the assessments, we obtained an understanding of the design of relevant policies and procedures and whether they had been placed in operation, and we evaluated control risk.

A significant weakness exists if internal control does not give reasonable assurance that all three control objectives are met. Based on our review, we believe the following was a significant weakness:

- SDHC did not establish controls to ensure that initial contract rents and rent adjustments did not exceed rents paid for comparable non-Section 8 (unassisted) units within the same apartment complexes.

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Auditee Comments

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 Office of Comptroller, Texas State Office, 6AF Attn: K.J.Brockington
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 Audit Liaison Officer, Barbara Burkhalter, PF (Room 5156) (3)
 Director, Economic Market Analysis Division, REE, Room 8222)
 Acquisitions Librarian, AS (Room 8141)
 Chief Financial Officer, F (Room 10164) (2)
 Deputy Chief Financial Officer for Finance, FF (Room 10164)(2)
 Elizabeth Morris, Executive Director, San Diego Housing Commission,
 1625 Newton Avenue, San Diego, California 92113-1038
 Director, Housing and Community Development Issue Area, U.S. GAO,
 441 G Street, NW, Room 2474, Washington, DC 20548,
 Attn: Judy England-Joseph
 The Honorable John Glenn, Ranking Member, Committee on Governmental Affairs, United
 States Senate, Washington, D.C. 20515-4305
 The Honorable Fred Thompson, Chairman, Committee on Governmental Affairs, United
 States Senate, Washington, D.C. 20515-4305
 The Honorable Dan Burton, Chairman, Committee on Government Reform and Oversight,
 Congress of the United States, House of Representatives, Washington, D.C. 20515-6143
 Mr. Pete Sessions, Committee on Government Reform and Oversight, Congress
 of the United States, House of Representatives, Washington, D.C.
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 212, O'Neill House Office Building, Washington, D.C. 20515

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