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| Issue Date<br>July 11, 2006 |
| Audit Report Number<br>2006- B0-0001 |

TO: Orlando J. Cabrera, Assistant Secretary for Public and Indian Housing, P

FROM: John Dvorak, Regional Inspector General for Audit, Region 1, 1AGA

SUBJECT: HUD Incorrectly Approved $42 Million in Operating Subsidies for Phase-Down for Demolition Add-On Funding

# HIGHLIGHTS

## What We Audited and Why

We audited the U.S. Department of Housing and Urban Development (HUD), Office of Public and Indian Housing, phase-down for demolition add-on funding (phase-down funding) calculations for the Public Housing Operating Fund program. We initiated the audit based on results of a prior audit that indicated the Office of Public and Indian Housing did not always obtain adequate supporting documentation from public housing agencies before approving requests for phase-down funding. Our objective was to determine whether the Office of Public and Indian Housing obtained and adequately reviewed the supporting documentation for the $74.3 million in approved phase-down funding for fiscal years 2004 and 2005.

## What We Found

The Office of Public and Indian Housing did not always obtain and adequately review supporting documentation before approving $42 million in phase-down funding. This occurred because each local Office of Public and Indian Housing field office implemented its own procedures for the review of phase-down funding requests in the absence of formal guidance from the Office of Public and Indian Housing's national office. Without this guidance, the field offices (HUD staff) interpreted and applied phase-down for demolition regulations inconsistently. As a result, the Office of Public and Indian Housing funded more than $15.1 million in unsupported and $20.6 million in ineligible phase-down funding requests for fiscal years 2004 and 2005. By implementing needed controls, the Office of Public and Indian Housing can avoid funding an additional $6.3 million in ineligible requests for fiscal year 2006.

## What We Recommend

We recommend that the Office of Public and Indian Housing develop formal guidance and review procedures for approving requests for the phase-down for demolition funding. In addition, we recommend that it direct HUD staff to obtain and review support for the $15.1 million in unsupported phase-down funding requests for fiscal years 2004 and 2005, determine the correct amount of phase-down funding, and require the public housing agencies to reimburse HUD for any ineligible phase-down funding received. We also recommend that the Office of Public and Indian Housing recover the $20.6 million in ineligible phase-down funding paid to public housing agencies in fiscal years 2004 and 2005. We further recommend that the Office of Public and Indian Housing direct HUD staff to obtain and review complete support for phase-down funding requests for fiscal year 2006 to avoid funding the $6.3 million in incorrectly approved phase-down funding requests.

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

## Auditee's Response

We provided the Office of Pubic and Indian Housing draft finding details throughout the course of the audit. We also provided the Office of Public and Indian Housing a draft report on May 9, 2006 and held an exit conference on June 5, 2006. The Office of Public and Indian Housing provided us with formal written comments on June 23, 2006. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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# BACKGROUND AND OBJECTIVES

The United States Housing Act of 1937 as amended by the Quality Housing and Work Responsibility Act of 1998 authorizes operating subsidies for public housing agencies administering U.S. Department of Housing and Urban Development (HUD) low-income housing programs. HUD's Office of Public and Indian Housing provides annual operating subsidies through the Public Housing Operating Fund program to help public housing agencies pay some of the cost of operating and maintaining public housing units. Operating subsidies are essential for public housing agencies to provide cost-effective, decent, safe, and affordable dwellings for low-income and very low-income tenants who pay no more than 30 percent of their adjusted income for rent.

A special phase-down subsidy for public housing agencies is applicable when the Office of Public and Indian Housing approves demolition of units. Units that are both approved by the Office of Public and Indian Housing for demolition and vacated are excluded from a public housing agency's determination of "unit months available" when vacated, but they may remain eligible for phase-down funding.[1] Using data supplied by the public housing agency, the Office of Public and Indian Housing field office (HUD staff) determines operating subsidy eligibility including phase-down funding. Complete documentation must be submitted to HUD staff to support the calculation and amounts claimed for the phase-down funding on form HUD-52723, "Operating Fund Calculation of Operating Subsidy." HUD staff reviews the required documentation to ensure the phase-down-funding was supported and accurately calculated.

The Consolidated Appropriations Act of 2005 directed the Office of Indian and Public Housing to convert from funding operating subsidies based on public housing agency's fiscal year to funding based on the calendar year. Therefore, in accordance with the Appropriations Act of 2005, public housing agencies were only funded from January through December 2005 with fiscal year 2005 funds. For fiscal years 2004 and 2005, HUD staff approved $74.3 million in phase-down funding for 145 public housing agencies. Operating subsidies approved in fiscal year 2005 but not paid until calendar year 2006 will be funded with fiscal year 2006 funds.

| Fiscal year | Phase-down funding approved | Phase-down funding paid | Phase-down funding to be paid in fiscal year 2006 |
|---|---|---|---|
| 2004 | $39,451,765 | $39,451,765 | $0 |
| 2005 | $34,906,443 | $20,357,764 | $14,548,679 |
| Total | $74,358,208[2] | $59,809,529 | $14,548,679 |

On September 19, 2005, *Federal Register* notice, Docket Number FR-4874-F-08, made proposed revisions to the Public Housing Operating Fund program final. The Office of Public and Indian Housing will implement the revised allocation formula for calendar year 2007. An asset

[1] The regulations governing the Public Housing Operating Fund program phase-down for demolition are in 24 CFR [*Code of Federal Regulations*] 990.114.
[2] The total phase-down funding approved and paid does not match the totals in the Scope and Methodology section of the report due to rounding.

repositioning fee will replace the phase-down funding.[3] The new rules established four significant changes to the phase-down funding:

1. Units approved for disposition are eligible for the asset repositioning fee;
2. Units replaced with Section 8 vouchers are eligible for the asset repositioning fee;
3. There are no provisions for units vacant more than 12 months; these units will be entitled to receive the asset repositioning fee if the entire building is approved for demolition; and
4. Public housing agencies are no longer required to track actual vacancy dates by unit. Entire projects approved for demolition or disposition are eligible for an asset repositioning fee on the first day of the next quarter six months after the date the first unit becomes vacant after the relocation date included in the approved relocation plan.

Our objective was to determine whether the HUD Office of Public and Indian Housing obtained and adequately reviewed supporting documentation for the $74.3 million in approved phase-down funding for fiscal years 2004 and 2005. If the Office of Public and Indian Housing obtained adequate supporting documentation, we also determined whether it ensured that the public housing agencies

- Did not request the phase-down funding for disposition of units,
- Deducted units replaced with Section 8 replacement and/or relocation vouchers,
- Calculated long-term vacancies approved for demolition at 20 percent of the allowable expense level for a maximum of 12 months, and
- Calculated the phase-down funding from the date the unit was approved for demolition and vacated.

[3] See appendix D for a comparison of the current phase-down rules and the new asset repositioning fee.

# RESULTS OF AUDIT

## Finding 1: The Office of Public and Indian Housing Incorrectly Approved $42 Million in Operating Subsidies for Phase-Down for Demolition Add-On Funding

The Office of Public and Indian Housing did not always obtain and adequately review supporting documentation before it approved phase-down funding totaling $42 million. This occurred because the Office of Public and Indian Housing national office had not provided formal guidance to the Office of Public and Indian Housing field offices regarding procedures for obtaining and reviewing phase-down funding documents. Absent formal guidance, each field office implemented its own procedures and inconsistently interpreted and applied the phase-down for demolition regulations. In addition, the Office of Public and Indian Housing did not establish formal guidance for recovery of overpayments of phase-down funding. As a result, the Office of Public and Indian Housing funded more than $15.1 million in unsupported and $20.6 million in ineligible phase-down funding requests for fiscal years 2004 and 2005. In addition, there were units eligible for phase-down funding totaling $1.7 million that were not identified when the requests were submitted. Also, the HUD field staff did not always recover overpaid phase-down funding. By implementing needed procedures and controls, the Office of Public and Indian Housing could avoid funding an additional $6.3 million in ineligible costs for fiscal year 2006.

### HUD Did Not Obtain Required Supporting Documentation

The Office of Public and Indian Housing approved more than $15.1 million in phase-down funding requests for 29[4] public housing agencies without obtaining adequate documentation to support the amounts claimed. In order for the Office of Public and Indian Housing field office (HUD staff) to determine whether the public housing agency properly supported the amount claimed for phase-down funding, the documentation should show the number of vacancies per month per year. However, HUD staff stated that they did not always receive supporting documentation from the public housing agencies for phase-down funding requests.

For example, HUD staff received a request from a public housing agency for fiscal years 2004 and 2005, which showed a calculation and that it requested 100 percent of the allowable expense level for the difference in units from 1999 to the date of the submission. The agency's request was not adequately supported

[4] Two of the twenty-nine public housing agencies were included in our sample; however, a portion of their phase-down funding was unsupported.

because it did not show and provide support for the number of vacancies per month per year. However, HUD staff approved $7.6 million in phase-down funding for this public housing agency in fiscal years 2004 and 2005 based solely on this request.

**HUD Did Not Adequately Review Phase-Down Funding Documentation**

HUD staff incorrectly approved phase-down funding totaling more than $20.6 million for 48 of the 50 public housing agencies we reviewed for fiscal years 2004 and 2005. In addition, HUD staff approved another $6.3 million in ineligible requests that the Office of Public and Indian Housing may fund in fiscal year 2006 and failed to identify $1.7 million in funding for eligible units. This occurred because HUD staff, without adequate review of phase-down funding support, approved (1) phase-down for demolition funding for units approved for disposition, (2) phase-down funding for units replaced with Section 8 replacement and/or relocation vouchers, (3) long-term vacancies in the three-year phase-down cycle, and (4) phase-down funding based on estimated dates instead of actual vacancy dates and provided 12 months of phase-down funding starting at the beginning of public housing agency's fiscal year for all units approved for demolition.[5]

A summary of the number and type of errors follows

| Frequency of Errors | | | | |
|---|---|---|---|---|
| Type of error | Units approved for disposition | Section 8 vouchers not properly applied | Long-term vacancies fully funded | Actual vacancy dated not used |
| Number of errors | 11 | 21 | 20 | 15 |

The review found that HUD staff incorrectly approved phase-down funding for units approved for disposition. Units approved for disposition are not eligible for phase-down funding, but due to misinterpretation of the phase-down regulations, HUD staff funded units approved for disposition. As a result, HUD staff incorrectly funded $1.1 million in phase-down funding to 11 public housing agencies for units approved for disposition. We estimate the Office of Public and Indian Housing will incorrectly provide an additional $189,586 to these public housing agencies for the disposition of units in fiscal year 2006 if not corrected.

The review also found that public housing agencies did not properly offset phase-down funding for Section 8 vouchers. This occurred because the Office of Public

[5] See appendix C for a list of errors by public housing agency.

and Indian Housing did not have adequate controls in place to ensure that public housing agencies accurately offset phase-down for demolition funding when it approved Section 8 replacement and/or relocation vouchers or public housing replacement units[6] became available. The review showed that 27 of the 40 public housing agencies received Section 8 replacement and/or relocation vouchers. HUD staff had not properly offset (reduced) phase-down funding for 21 of these 27 public housing agencies. As a result, these public housing authorities were paid more phase-down funding than they were eligible to receive.

In addition, the review found that long-term vacant units received full phase-down funding. HUD staff funded long-term vacancies in the three-year phase-down cycle. This occurred because HUD staff did not obtained adequate documentation to identify and verify the number of long-term vacancies when the units were approved for demolition. Some public housing agencies submitted a schedule that tracked the number of vacant units per month. HUD staff accepted this schedule as adequate support, but this information was not always sufficient to determine whether units were already vacant more than 12 months at demolition approval and only entitled to 20 percent of the allowable expense level for a maximum of 12 months. For example, a public housing agency requested and HUD staff approved the maximum 36-month phase-down funding for units that were vacant more than 10 years, according to the demolition approval letter. In addition, public housing agencies were provided the full phase-down funding as the result of HUD staff's misinterpretation of the regulations. For example, a public housing agency correctly requested only 20 percent of the allowable expense level for its units vacant more than 12 months before demolition approval. HUD staff incorrectly adjusted the public housing agency's submission and provided 100 percent of the phase-down funding for these long-term vacancies. As a result, the public housing agency received $1.3 million in ineligible funding.

HUD staff also did not ensure public housing agencies used actual vacancy dates. Instead, HUD staff approved phase-down funding based on estimated vacancy dates. In addition, HUD staff provided 12 months of phase-down funding starting at the beginning of the public housing agency's fiscal year for all units approved for demolition because they misinterpreted the regulations for phase-down funding. In many instances, public housing agencies may not have used actual vacancy dates because tracking vacancy dates on a unit-by-unit basis and calculating the phase-down funding was a complex and time-consuming task. Therefore, the public housing agencies started the phase-down for demolition funding at the beginning of their fiscal year. As a result, HUD staff approved more than the maximum 36 months of phase-down funding as follows:

- Public housing agencies did not exclude the units approved for demolition from their unit months available when vacated as required. Therefore, they received operating subsidies for these units instead of phase-down

[6] Due to time constraints, our audit did not determine whether phase-down funding ceased when replacement conventional public housing units became eligible for operating subsidy.

funding. The public housing agencies then claimed the maximum 36 months of phase-down funding starting at the beginning of their next fiscal year; or

- HUD staff approved phase-down funding retroactively in the following fiscal year to the month the units became eligible for phase-down funding. However, they had already provided operating subsidies for those units because they were never removed from the public housing agency's unit months available. Therefore, HUD staff inappropriately provided both operating subsidy for the demolition units and phase-down funding for these units.

Additionally, HUD may have underfunded phase-down funding to nine public housing agencies. The review showed that HUD staff did not identify units eligible for more than $1.6 million in phase-down funding when the requests were submitted for fiscal years 2004 and 2005. They also did not identify units eligible for $33,141 in funding for fiscal year 2006. However, due to the timing issues of phasing down demolition units explained above, it appears that these public housing agencies were not underfunded. For example, some of them did not remove the units approved for demolition from their unit months available (inventory) upon demolition approval as required. Therefore, the Office of Public and Indian Housing provided regular operating subsidy for these units. Others did not use actual vacancy dates; therefore, the public housing agencies may have claimed phase-down funding in the wrong fiscal year. Due to the appropriations laws for 2004 and 2005, HUD may only fund public housing agencies for the current fiscal year and may not fund prior-year costs. In addition, the Office of Public and Indian Housing notified the public housing agencies that they had submission deadlines[7] for revisions for additional funding for fiscal years 2004 and 2005, which have passed. Therefore, if a public housing agency did not request phase-down funding in the correct year, it is not eligible to request that funding in the following year.

## HUD Has No Provision to Collect Overpayments

The Office of Public and Indian Housing has no provisions in place to ensure the collection of operating subsidy overpayments. When HUD staff identified phase-down funding overpayments, they did not always know how to collect the overpaid funds. For instance, some HUD staff offset the overpaid amounts in the following year by reducing the amount of operating subsidies paid to the public housing agency. Other HUD staff established repayment plans to collect the

[7] In Notices PIH 2004-9 and PIH 2004-14, revisions to operating subsidy calculation due to new units and deprogrammed units for fiscal years 2004 and 2005 were due August 15, 2004, and August 12, 2005 respectively.

overpaid funds. For example, a public housing agency received approximately $600,000 in additional phase-down funding in fiscal year 2004. HUD staff withheld approximately $200,000 in funds not yet disbursed to correct the overpayment. However, they advised the public housing agency that there were no provisions to recapture the additional overpayment. Therefore, the public housing agency was allowed to keep almost $400,000 in ineligible phase-down funding.

## Conclusion

Based on the revisions to the Public Housing Operating Fund program scheduled for implementation beginning calendar year 2007, most of the errors identified will no longer occur after fiscal year 2006. However, the Office of Public and Indian Housing needs to ensure that current regulations were followed for fiscal years 2004 through 2006 to appropriately determine phase-down funding. The Office of Public and Indian Housing needs to provide formal guidance to HUD staff regarding procedures for approving requests for phase-down for demolition add-on funding and collecting overpayments to public housing agencies. The Office of Public and Indian Housing also should ensure that the $15.1 million in unsupported phase-down funding in fiscal years 2004 and 2005 were valid requests based on the regulations and recover incorrectly approved requests. In addition, the Office of Public and Indian Housing should recover the $20.6 million that it funded for ineligible phase-down funding requests for fiscal years 2004 and 2005 and not fund the $6.3 million in ineligible phase-down requests for fiscal year 2006. The units eligible for $1.6 million in phase-down funding that were identified would not be funded since revisions to request the funding were not submitted by the deadlines, but the Office of Public and Indian Housing should determine whether $33,141 identified for fiscal year 2006 should be funded.

## Recommendations

We recommend that HUD's Office of Public and Indian Housing

1A. Provide HUD staff formal guidance and procedures for approving requests for phase-down for demolition add-on funding, including written procedures for collecting operating subsidy overpayments.

1B. Obtain and review support (as identified in recommendation 1D) for $15.1 million in unsupported phase-down funding in fiscal years 2004 and 2005, determine the correct amount of phase-down funding, and require the public housing agencies to reimburse HUD for any ineligible funding received.

1C. For the overpayments of phase-down funding identified in appendix C, recover \$20.6 million in ineligible phase-down funding requests from the public housing agencies for fiscal years 2004 and 2005.

1D Obtain and review complete support for phase-down funding, including unit vacancies per month/year, demolition approval letters, Section 8 replacement and/or relocation vouchers, and public housing replacement units for fiscal year 2006.

1E. Submit revisions to the HUD Real Estate Assessment Center Financial Management Division to avoid funding \$6.3 million in ineligible phase-down requests and determine whether to fund the \$33,141 eligible for funding for fiscal year 2006.

# SCOPE AND METHODOLOGY

To accomplish our audit objectives, we

- Reviewed the 2004 and 2005 appropriations laws, applicable sections of 24 CFR [*Code of Federal Regulations*] 990, "The Public Housing Operating Fund Program"; *Federal Register* notice, Docket Number FR-4874-F-08; applicable Office of Public and Indian Housing notices, and directions for applicable operating subsidy forms.

- Conducted interviews with HUD Office of Public and Indian Housing staff and staff at the Real Estate Assessment Center Financial Management Division.

- Requested from HUD supporting documentation for all public housing agencies that received phase-down funding in fiscal years 2004 and/or 2005. Reviewed the supporting documentation to determine its adequacy.

- Examined supporting documentation for 40 public housing agencies approved for the highest amount of phase-down funding, using a schedule provided by a HUD contractor, Casterline Associates, P.C.

- Verified that 11 public housing agencies received phase-down funding for disposition units.

The table describes the universe of public housing agencies approved for phase-down funding.

| | Number of public housing agencies | Total phase-down funding approved for fiscal years 2004 and 2005 |
|---|---|---|
| Public housing agencies paid phase-down funding for disposition activities | 11 | $1,370,884 |
| Sample of public housing agencies reviewed | 40 | $49,262,611 |
| **Total reviewed** | **51** | **$50,633,495** |
| Unsupported (HUD did not obtain required documentation) | 27 | $14,909,732 |
| Public housing agencies not reviewed | 68 | $8,814,997 |
| **Universe** | **146**[8] | **$74,358,224** |

[8] Only 145 public housing agencies received phase-down funding in fiscal years 2004 and 2005; however, one public housing agency received phase-down funding for disposition units and was included in our sample of public housing agencies reviewed for both.

During fiscal years 2004 and 2005, public housing agencies had one of four possible fiscal years beginning January 1, April 1, July 1, or October 1. To understand the operating subsidy process, we gained an understanding of how the public housing agency's fiscal year relates to the fiscal year and the due date for operating subsidy calculations. See the tables below.

| **Fiscal year 2004<br>October 1, 2003, to September 30, 2004** | | |
|---|---|---|
| Public housing agency fiscal year begins | Public housing agency fiscal year ends | Operating subsidy due to Real Estate Assessment Center |
| Jan. 1, 2004 | Dec. 31, 2004 | Nov. 21, 2003 |
| Apr. 1, 2004 | Mar. 31, 2005 | Dec. 12, 2003 |
| July 1, 2004 | June 30, 2005 | Apr. 30, 2004 |
| Oct. 1, 2004 | Sept. 9, 2005 | June 11, 2004 |

| **Fiscal year 2005<br>October 1, 2004, to September 30, 2005**[9] | | |
|---|---|---|
| Public housing agency fiscal year begins | Public housing agency fiscal year ends | Operating subsidy due to Real Estate Assessment Center |
| Jan. 1, 2005 | Dec. 31, 2005 | Nov. 19, 2004 |
| Apr. 1, 2005 | Mar. 31, 2006 | Dec. 10, 2004 |
| July 1, 2005 | June 30, 2006 | Apr. 29, 2005 |
| Oct. 1, 2005 | Sept. 30, 2006 | June 10, 2005 |

Using data supplied by the public housing agency, the Office of Public and Indian Housing field office (HUD staff) determined operating subsidy eligibility including phase-down funding. Complete documentation must be submitted to HUD staff to support the calculation and amounts claimed for the phase-down funding on form HUD-52723, "Operating Fund Calculation of Operating Subsidy." However, HUD staff did not always obtain and review the required documentation to ensure the phase-down-funding was supported and accurately calculated for fiscal year 2006 funding requests. If the Office of Public and Indian Housing staff obtains and reviews complete support for phase-down funding requests for fiscal year 2006 they can avoid funding the $6.3 million in incorrectly approved phase-down funding requests.

We performed the majority of our fieldwork from September 2005 through April 2006. The audit generally covered the period October 1, 2003, to September 30, 2005, but was expanded when necessary.

We performed our review in accordance with generally accepted government auditing standards.

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[9] In accordance with the Appropriations Act of 2005, public housing agencies were only funded from January 2005 through December 2005 with fiscal year 2005 funds.

# INTERNAL CONTROLS

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

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

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

## Relevant Internal Controls

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

- Controls over the requisitioning of funds by public housing agencies and
- Controls over recovery of operating subsidy overpayments.

We assessed the relevant controls identified above.

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

## Significant Weaknesses

Based on our review, we believe the following items are significant weaknesses (see finding 1):

- The Office of Public and Indian Housing did not ensure documentation submitted by public housing agencies was complete and correct, and
- The Office of Public and Indian Housing did not have consistent procedures for collecting operating subsidy overpayments.

# FOLLOWUP ON PRIOR AUDITS

**Office of Public and Indian Housing, Region 1, Boston, Massachusetts, Approved Incorrect Operating Subsidies for Several Public Housing Agencies, 2005-BO-0001**

The Office of the Inspector General (OIG) conducted an audit of the Public Housing Operating Fund program in Region 1 in 2004, audit report number 2005-BO-0001. The audit report contained one finding with seven recommendations. Six of the seven recommendations are closed. The one recommendation that remains open relates to the HUD Real Estate Assessment Center's consideration to revise certain cells in the Excel tool to calculated fields. The expected completion date for this nonmonetary recommendation is January 7, 2007.

# APPENDIXES

## Appendix A

### SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

| Recommendation number | Ineligible 1/ | Unsupported 2/ | Funds to be put to better use 3/ | Total |
|---|---|---|---|---|
| 1B. | | $15,153,923 | | $15,153,923 |
| 1C. | $20,601,738 | | | 20,601,738 |
| 1E. | | | $6,328,499 | 6,328,499 |
| 1E. | | | $33,141 | 33,141 |
| | | | | $42,117,301 |

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 polices or regulations.

2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a 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 to be put to better use" are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings which are specifically identified. In this instance, if the HUD implements our recommendation, they will determine the correct amount of phase-down funding for the fiscal year 2006 funding requests, and avoid funding the $6.3 million in incorrectly approved phase-down funding requests and only fund eligible requests. Once the Agency successfully implements recommendation 1E, this will be a one time benefit. Our estimate reflects the fiscal year 2006 funds only, which are available for use only during fiscal year 2006.

# Appendix B

## AUDITEE COMMENTS AND OIG'S EVALUATION

**Ref to OIG Evaluation** **Auditee Comments**

06/26/2006 11:56 REAC SUPPORT SERVICES → 617 565 6878 NO.160 002

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
550 12TH Street, SW
Suite 100
Washington, DC 20410

June 23, 2006

OFFICE OF PUBLIC AND INDIAN HOUSING
REAL ESTATE ASSESSMENT CENTER

MEMORANDUM FOR: John Dvorak, Regional Inspector General for Audit, Region 1, AGA

FROM: Elizabeth A. Hanson, Deputy Assistant Secretary, Real Estate Assessment Center, PX

SUBJECT: The HUD Office of Public Housing Incorrectly Approved $42 Million in Public Housing Operating Subsidies for Phase-Down for Demolition Add-on Funding, Office of Inspector General, Audit Report

This memorandum responds to the above-referenced draft audit report submitted to Office of Public and Indian Housing (PIH) via email on May 9, 2006. In preparing this response the Real Estate Assessment Center has consulted with the PIH Office of Field Operations and the Special Applications Center.

The draft audit disclosed one finding "The Office of Public and Indian Housing did not always obtain and adequately review supporting documentation before approving $42 million in phase-down funding covering two different appropriation years (federal fiscal years 2004 and 2005) with 5 corrective actions. The finding is based on the following errors in applying phase-down funding:

A. PHA requests for phase-down funding include disposition units.

B. Not deducting units replaced with Section 8 replacement and/or relocation vouchers.

C. Not calculating long-term vacancies approved for demolition at 20% of the allowable expense level for a maximum of 12 months.

D. Not calculating the phase-down funding from the date the unit was approved for demolition and vacated.

The report cites several reasons for the errors, some due to PHA tracking and documentation and some due to HUD approvals of PHA subsidy submissions that were not accurate or complete.

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# Appendix B

## AUDITEE COMMENTS AND OIG'S EVALUATION

| Ref to OIG Evaluation | Auditee Comments |
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**Corrective actions taken to date:**

For the federal fiscal year (FFY) 2006 calculation errors, financial analysts have been reviewing the phase-down funding cases and making corrections.

For errors found in prior FFY 2004 and FFY 2005, Appropriation Law and PIH policy govern the processing of revisions.

**Responses to IGA Recommendations (Page 10):**

**1A. Provide HUD staff formal guidance and procedures for approving requests for phase-down for demolition add-on funding, including written procedures for collecting operating subsidy overpayments.**

**1B. Obtain and review support (as identified in recommendation D1) for $15.1 million in unsupported phase-down funding in fiscal years 2004 and 2005, determine the correct amount of phase-down funding, and require the public housing agencies to reimburse HUD for any ineligible funding received.**

**1C. For the overpayments of phase-down funding identified in appendix C, recover $20.6 million in ineligible phase-down funding requests from the public housing agencies for fiscal years 2004 and 2005.**

**Comment 1**

**Response to 1A, 1B, 1C:** Starting in the 2007 calendar year funding cycle, the new final Operating Fund Program final rule will implement significant changes to the Public Housing Operating Fund program that will directly address the issues concerning phase-down funding that have been raised in the draft audit report. The new Operating Fund Program final rule has an "asset repositioning fee" which is payable regardless of whether the PHA receives replacement vouchers or hard replacement units for the demolished units. The "asset repositioning fee" will be paid for the entire building, not on a unit-by-unit basis, at the prescribed time after the first unit becomes vacant.

In addition, under the new rule, long-term vacant units have been eliminated as a unit status category eligible to receive operating subsidy.

These two important changes to the Operating Fund Program regulation greatly simplify the tracking and monitoring of such payments. Moreover, the Operating Fund program is in process of developing specific guidance for implementation of various components of the new regulations, including the asset reposition provision, which guidance will address the required documentation and tracking by PHAs and field office staff.

**Comment 2**

The PIH staff has been developing a collection policy to collect overpayment of subsidy. In a recent meeting to discuss the policy, the Office of General Counsel indicated that there may be statutory and other restrictions on the Department's ability to recapture overpayments of operating subsidy, which restrictions are not present in other Departmental programs. The

## Appendix B

# AUDITEE COMMENTS AND OIG'S EVALUATION

| Ref to OIG Evaluation | Auditee Comments |
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possible restrictions stem from language in the 1998 Quality Housing and Work Responsibility Act amendments to the United States Housing Act of 1937 and a historical Department of Justice opinion on formula grant programs. These matters are being researched further. However, legislation may be necessary to address this problem.

**1D. Obtain and review complete support for phase-down funding, including unit vacancies per month/year, demolition approval letters, Section 8 replacement and/or relocation vouchers, and public housing replacement units for fiscal year 2006.**

**Comment 3**

**Response:** The Department is reviewing all operating subsidy submissions for PHAs receiving phase-down in fiscal year 2006 and as part of the review will obtain the supporting documents. The Real Estate Assessment Center and Office of Field Operations is notifying all field offices of the common errors associated with phase-down funding requests that have been identified in the draft audit.

**1E. Submit revisions to the HUD Real Estate Assessment Center Financial Management Center Division to avoid funding $6.3 million in ineligible phase-down requests and determine whether to fund the $33,141 eligible for funding for fiscal year 2006.**

**Comment 3**

**Response:** The Department will review all fiscal year 2006 revisions from PHAs receiving phase-down funding to assure that they are consistent with program rules and include all necessary supporting documents, using best efforts to complete the reviews and revisions prior to the final round of funding for this federal fiscal year.

## OIG Evaluation of Auditee Comments

**Comment 1** The audit report acknowledges the revisions to the Public Housing Operating Fund program scheduled for implementation beginning calendar year 2007 and agrees most of the errors identified will no longer occur. However, the Office of Public and Indian Housing needs to ensure that current regulations were followed for fiscal years 2004 through 2006 to appropriately determine phase-down funding. Since fiscal years 2004 and 2005 have already been funded, HUD should recover any ineligible funding provided to the public housing agencies. For 2006, HUD should issue specific procedures to the field offices, including the level of support and review required to verify the requested funding.

**Comment 2** Audit Report 2005-BO-0001 identified a similar condition and recommended that HUD recover overpaid operating subsidy payments. HUD's Management response to this recommendation indicated that HUD Headquarters will issue a Notice for collection of overpaid subsidy. The final action target date is September 30, 2006. However, current HUD regulations include a provision for adjustments to the operating subsidy amount. Specifically, HUD may at any time make an upward or downward adjustment in the amount of the public housing agency's operating subsidy as a result of data subsequently available to HUD which alters projections upon which the approved operating subsidy was based. If a downward adjustment would cause a severe financial hardship on the public housing agency, the HUD Field Office may establish a recovery schedule which represents the minimum number of years needed for repayment. Due to the Appropriations Law for 2004 and 2005 HUD may only fund public housing agencies for the current fiscal year and may not fund prior year costs. However, there is no stipulation in the Appropriations Law which prohibits recovering overpaid funds.

**Comment 3** HUD should issue guidance to the field offices to ensure they obtain adequate supporting documentation and perform an effective review of the support to verify the requested phase-down for demolition funding for calendar year 2006 is consistent with program rules.

## Appendix C

# LISTING OF PUBLIC HOUSING AGENCIES AND ERRORS IDENTIFIED

| | | | | | Reason for errors | | | |
|---|---|---|---|---|---|---|---|---|
| Agency code | Unsupported fiscal years 2004 and 2005 | Ineligible amount fiscal year 2004 | Ineligible amount fiscal year 2005 | Funds put to better use | Section 8 vouchers not properly applied | Long-term vacancies fully funded | Actual vacancy dates not used | Units approved for disposition |
| PA002 | $0 | $3,101,079 | $1,354,493 | $456,052 | | X | X | |
| DC001 | $0 | $1,054,502 | $741,706 | $2,226,618 | X | X | | |
| VA006 | $0 | $888,751 | $373,796 | $370,526 | X | | | |
| CA004 | $0 | $830,983 | $526,265 | $0 | X | | | |
| MD002 | $0 | $708,279 | $0 | $0 | X | X | | X |
| AL169 | $0 | $702,497 | $57,883 | $57,119 | X | X | | |
| IL012 | $0 | $643,776 | $105,549 | $35,560 | | X | | |
| PA006 | $0 | $571,225 | $33,320 | $99,661 | | | | X |
| GA010 | $0 | $515,085 | $61,969 | $185,664 | X | | | |
| WI002 | $0 | $435,736 | $1,006,121 | $0 | X | X | | |
| VQ001 | $0 | $383,115 | $93,891 | $0 | X | X | | |
| GA006 | $0 | $348,626 | $44,707 | $45,210 | X | | | |
| FL003 | $0 | $243,642 | $34,277 | $11,557 | | X | | |
| LA001 | $0 | $242,161 | $42,582 | $128,251 | X | | | |
| AL006 | $0 | $241,644 | $130,083 | $44,227 | | X | X | |
| GA002 | $0 | $237,687 | $113,427 | $38,520 | X | | X | |
| KS001 | $0 | $235,092 | $125,380 | $42,364 | | X | | |
| NJ003 | $0 | $232,346 | $54,661 | $55,288 | | | X | |
| LA001 | $0 | $208,551 | $33,272 | $101,544 | X | | | |
| VA004 | $0 | $203,066 | $141,497 | $0 | | X | | |
| NC012 | $0 | $183,506 | $24,847 | $75,595 | X | | | |
| IL015 | $0 | $171,218 | $122,391 | $0 | | X | X | |
| CA011 | $0 | $164,372 | $56,325 | $19,146 | | | | X |
| MD003 | $0 | $156,732 | $89,292 | $29,956 | X | X | | |
| PA015 | $0 | $152,988 | $236,381 | $239,109 | X | X | X | |
| TN003 | $0 | $144,812 | $0 | $0 | | | X | |
| PA020 | $0 | $127,258 | $18,930 | $19,196 | | | | X |
| NY041 | $0 | $99,516 | $18,209 | $54,976 | | X | X | |
| VA003 | $0 | $61,567 | $18,259 | $18,302 | | | X | |
| AK001 | $0 | $49,741 | $0 | $0 | | | | X |
| CA003 | $0 | $35,699 | ($32,382) | ($33,141) | | X | X | |
| PA024 | $0 | $31,201 | $0 | $0 | | | | X |
| TN039 | $0 | $25,410 | $2,238 | $6,609 | | | | X |
| TN004 | $0 | $13,806 | $2,881 | $0 | X | | | |
| NC001 | $0 | $13,382 | $0 | $0 | X | | | |
| MO004 | $0 | $7,929 | $0 | $0 | | | | X |
| PA046 | $0 | $2,688 | $0 | $0 | | | | X |
| OH004 | $0 | ($28,427) | $663,502 | $669,588 | | X | | |

| | | | | | Reason for errors | | | |
|---|---|---|---|---|---|---|---|---|
| Agency code | Unsupported fiscal years 2004 and 2005 | Ineligible amount fiscal year 2004 | Ineligible amount fiscal year 2005 | Funds put to better use | Section 8 vouchers not properly applied | Long-term vacancies fully funded | Actual vacancy dates not used | Units approved for disposition |
| NC002 | $0 | $0 | $0 | $0 | | | X[10] | |
| WI037 | $0 | $0 | $13,121 | $12,466 | | | | X |
| AL054 | $0 | $0 | $10,725 | $32,508 | | | | X |
| SC003 | $0 | ($12,024) | $151,325 | $454,845 | X | X | | |
| NV002 | $177,055 | ($39,840) | $64,276 | $193,739 | | X | X | |
| TX009 | $67,136 | ($241,305) | $57,658 | $0 | X | | X | |
| LA001 | $0 | ($277,741) | $5,187 | $15,540 | | | | |
| MO001 | $0 | ($324,430) | $50,550 | $151,764 | X | X | X | |
| TN005 | $0 | ($327,039) | $3,667 | $11,131 | | | | |
| KY001 | $0 | ($399,106) | $447,427 | $425,868 | X | | X | |
| NJ009 | $7,647,822 | $0 | $0 | $0 | | | | |
| WA005 | $1,515,157 | $0 | $0 | $0 | | | | |
| CA010 | $882,202 | $0 | $0 | $0 | | | | |
| TN007 | $805,435 | $0 | $0 | $0 | | | | |
| TN001 | $790,549 | $0 | $0 | $0 | | | | |
| FL079 | $507,274 | $0 | $0 | $0 | | | | |
| IN011 | $437,962 | $0 | $0 | $0 | | | | |
| LA003 | $382,463 | $0 | $0 | $0 | | | | |
| IN005 | $352,612 | $0 | $0 | $0 | | | | |
| NJ002 | $328,703 | $0 | $0 | $0 | | | | |
| FL076 | $318,226 | $0 | $0 | $0 | | | | |
| MS004 | $287,987 | $0 | $0 | $0 | | | | |
| AR099 | $192,252 | $0 | $0 | $0 | | | | |
| MI001 | $185,830 | $0 | $0 | $0 | | | | |
| TX017 | $96,067 | $0 | $0 | $0 | | | | |
| MS002 | $76,882 | $0 | $0 | $0 | | | | |
| MS040 | $34,311 | $0 | $0 | $0 | | | | |
| MS071 | $20,292 | $0 | $0 | $0 | | | | |
| NJ014 | $14,140 | $0 | $0 | $0 | | | | |
| TN057 | $11,242 | $0 | $0 | $0 | | | | |
| NM006 | $6,043 | $0 | $0 | $0 | | | | |
| AR103 | $4,673 | $0 | $0 | $0 | | | | |
| MS079 | $3,245 | $0 | $0 | $0 | | | | |
| AR071 | $3,121 | $0 | $0 | $0 | | | | |
| MS066 | $2,819 | $0 | $0 | $0 | | | | |
| AR016 | $1,616 | $0 | $0 | $0 | | | | |
| MS082 | $807 | $0 | $0 | $0 | | | | |
| Total underfunded | **$0** | **($1,649,912)** | **($32,382)** | **($33,141)** | | | | |
| Total overfunded | **$15,153,923** | **$13,469,668** | **$7,132,070** | **$6,328,499** | | | | |
| Total | | | | | **21** | **20** | **15** | **11** |

[10] The review did not identify ineligible phase-down funding to this public housing agency; however, based on the documentation HUD staff provided; it appears that it used estimated vacancy dates. Therefore, our review was not able to identify any long-term vacant units and ensure HUD accurately calculated phase-down funding.

# Appendix D

## COMPARISON OF EXISTING AND NEW PHASE-DOWN FUNDING REGULATIONS

| **Current phase-down for demolition add-on funding (24 CFR [*Code of Federal Regulations*] 990.114)** | **New asset repositioning fee (*Federal Register* notice, Docket Number FR-4874-F-08, subpart C, section 990.190(h))** |
|---|---|
| A special phase-down of subsidy to public housing agencies is applicable when demolition of units is approved by HUD. | This asset repositioning fee supplements the costs associated with administration and management of demolition or disposition, tenant relocation, and minimum protection and service associated with such efforts. |
| Funding is calculated by unit–public housing agencies need to track vacancies by unit. | An agency that transitions projects or entire buildings of a project out of its inventory is eligible for an asset repositioning fee. The asset repositioning fee is not intended for individual units within a multiunit building undergoing similar activities. |
| Units become eligible for funding when they meet two conditions–approved for demolition and vacant. | Projects approved for demolition or disposition shall be eligible for an asset repositioning fee on the first day of the next quarter, six months after the date the first unit becomes vacant after the relocation date included in the approved relocation plan. |
| Units approved for demolition are eligible for funding as follows:<br>• Full allowable expense level for the first 12 months beginning with the month that the unit meets both conditions of being approved for demolition and vacant.<br>• During the second 12-month period, 66 percent of the allowable expense level will be allowed for the unit.<br>• During the third 12-month period, 33 percent of the allowable expense level will be allowed for the unit. | Units categorized for demolition and which are eligible for an asset repositioning fee are eligible for operating subsidies as follows:<br>• For the first 12 months, 75 percent of the project expense level per unit.<br>• During the next 12 months, 50 percent of the project expense level per unit.<br>• During the third 12 months, 25 percent of the project expense level per unit. |
| Units that have been vacant for longer than 12 months when they are approved for demolition are only eligible for funding equal to 20 percent of the allowable expense level for a 12-month period. | There are no provisions for units vacant more than 12 months. |
| The unit approved for demolition is no longer eligible for funding if replaced with a Section 8 voucher or when replacement conventional public housing units become eligible for operating subsidy. | There are no provisions to offset the asset repositioning fee when Section 8 vouchers are received or when replacement conventional public housing units become eligible for operating subsidy. |
| Funding is only available to units approved for demolition. | Projects covered by applications approved for disposition shall be eligible for an asset repositioning fee. |
| No funding is available for disposition of units. | Units categorized for disposition and which are eligible for an asset repositioning fee are eligible for operating subsidies as follows:<br>• For the first 12 months, 75 percent of the project expense level per unit.<br>• During the next 12 months, 50 percent of the project expense level per unit. |
| Public housing agencies must submit complete documentation to support phase-down for demolition funding. | Each public housing agency is responsible for accurately applying and maintaining supporting documentation on the start date of this transition period or is subject to forfeiture of this add-on. |