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TO: John Garvin, Acting Deputy Assistant Secretary, Multifamily Housing, HT  
*Joan S. Hobbs*

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

SUBJECT: The Los Angeles Multifamily Hub Did Not Properly Monitor Its Performance-Based Contract Administrator, Los Angeles LOMOD

## HIGHLIGHTS

### What We Audited and Why

We audited the Los Angeles Multifamily Hub regarding its monitoring of its annual contributions contract with its performance-based contract administrator (contractor), Los Angeles LOMOD (LOMOD), a nonprofit organization under the Housing Authority of the City of Los Angeles. We performed this audit due to concerns identified during our earlier examination of LOMOD transactions. Our overall audit objective was to determine whether the U.S. Department of Housing and Urban Development (HUD) appropriately monitored LOMOD with respect to the annual contributions contract.

### What We Found

The Los Angeles Multifamily Hub did not properly monitor its contractor, LOMOD, in accordance with HUD guidance or its annual contributions contract with LOMOD. Specifically, the Los Angeles Multifamily Hub did not follow up on the findings in its 2004 annual compliance review of LOMOD in a timely manner. In addition, it made inappropriate decisions regarding the assessment and reversal of disincentives (penalties against LOMOD for work not adequately performed). It also inappropriately moved LOMOD to the "full implementation" stage of its contract for two required performance standards (activities) without properly supporting the decision. Further, it improperly allowed retroactive rent increases when owners did not make submissions within required timeframes and did not monitor LOMOD's activities with regard to the performance standard relating to review of monthly vouchers.

## What We Recommend

We recommend that the deputy assistant secretary for multifamily housing ensure that LOMOD is not reimbursed for the \$105,059 reduction in incentive fee (bonus for work above and beyond the minimum) for those findings in the 2004 compliance review that were improperly reversed. We also recommend that the deputy assistant secretary for multifamily housing assess disincentives or reduce LOMOD's incentive fee \$1,360,160; require the operations officer and the contract administrator oversight monitor (oversight monitor) to work together when assessing disincentives and that a separate multifamily hub review all contractor appeals of disincentives; return LOMOD to the transitional phase for standards 3 and 14 until the hub can show that LOMOD has met the acceptable quality level for three consecutive months; and begin monitoring LOMOD, in accordance with HUD guidance, with respect to its activities under standard 6 relating to the review, authorization, and payment of monthly vouchers to owners so that it doesn't put \$13.6 million at risk each month.

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

## Auditee's Response

We provided the auditee a draft report on September 11, 2007, and held an exit conference with officials on October 2, 2007. The auditee provided its response on October 19, 2007, and generally disagreed with our report findings. We evaluated that response and made appropriate changes to the report based on that response. 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**

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In May 1999, the U.S. Department of Housing and Urban Development (HUD) issued a request for proposals for contract administration services for project-based Section 8 housing assistance payments contracts under Section 8 of the United States Housing Act of 1937. This request for proposals covered contract administration for most HUD-administered projects.

Los Angeles LOMOD (LOMOD) was awarded an annual contributions contract in the 16th round. The contract was signed in March 2003 and implemented December 1, 2003. Under the contract, LOMOD was to provide contract administration services for up to 48,235 housing units valued at up to \$16.8 million per year. The contract includes 16 standards or activities for which the contractor is responsible.

### **Lines of Responsibility**

The HUD headquarters Office of Housing Assistance Contract Administration Oversight's responsibilities include administering the outsourcing of project-based Section 8 contract administration and subsidy contracts under multifamily rental subsidy programs. The office monitors, oversees, and provides technical assistance to performance-based contract administrators and assures that third-party, contract-administered, project-based, Section 8-subsidized properties continue to meet HUD's goal of providing decent, safe, and sanitary housing to low-income families.

The primary responsibility for monitoring and oversight of contractors rests with the multifamily hub and the program centers. The hub director and operations director should have limited direct contact with the contractor. Although Hub directors have the ultimate responsibility in the field, the supervisory project manager oversees the day-to-day interaction with the contractor. The oversight monitor is responsible for ensuring overall contractual compliance on the part of the contractor and for initiating corrective compliance actions.

### **Two Phases of the Contract**

There are two phases in the contract process, transitional and full implementation. During the transitional phase, HUD is supposed to work closely with the contractor to provide assistance, to ensure that the work is done correctly, and to ensure that the work is done in accordance with HUD's guidelines and regulations. During this phase, the contractor submits core task work products to the local HUD office on a monthly basis, and HUD's oversight monitor assesses the quality of the contractor's work.

Once the contractor has achieved an acceptable level of quality, based on specific indicators for each of the contract's required performance standards for three consecutive months, the contract is moved into the full implementation phase. After movement to full implementation, HUD reporting requirements are lifted. Ultimately, the local multifamily hub office determines whether the contractor moves to full implementation. The contractor is supposed to reach full implementation on each required incentive-based performance standard within one year of the start of the contract.

## **Acceptable Quality Level**

For each of the tasks LOMOD performs under the annual contributions contract with HUD, it is required to maintain an acceptable level of quality. We reviewed the annual contributions contract and HUD's Monitoring and Evaluation Policies and Procedures requirements for standards 1—management and occupancy reviews, 3—rent adjustments, and 14—contract renewals, since these are the standards for which the oversight monitor assessed the disincentives we reviewed. These documents require that LOMOD for standard 1, submit 95 percent of the required management and occupancy reports within 30 calendar days after scheduled completion of the review; for standard 3, correctly process 100 percent of rent adjustments within 30 days or by the housing assistance payments contract anniversary date for annual adjustment factor rent adjustments; and for standard 14, correctly execute 90 percent of renewal housing assistance payments contracts 60 calendar days before contract expiration. These standards are measured each month.

## **Incentive Fee or Disincentive**

An incentive fee may be earned for performance that exceeds the acceptable quality level on standards 1 – management and occupancy reviews, 2 – civil rights compliance, 5 – owner opt-out and contract terminations, and 14 – contract renewals. The incentive fee works as a bonus paid for work performed above and beyond the minimally acceptable. However, the contractor may also be assessed a disincentive for performance that fails to meet the acceptable quality level on any of the 16 standards. A disincentive is a penalty that is assessed for work performance that falls below the minimally acceptable.

The incentive fee pool is calculated for LOMOD at 50 percent of the basic fee each month and is paid at the end of each quarter. LOMOD will receive 20 percent of the incentive fee pool if 95 percent of its submissions for standard 14 are correct and completed on time. It will receive an additional 10 percent of the incentive fee pool if 100 percent of its submissions are correct and completed on time. If less than 90 percent of its submissions are correct and completed on time, a disincentive will be assessed. The disincentive is calculated by taking a 3 percent reduction in basic fee for every 1 percent that performance falls below the acceptable quality level. The disincentive for standard 3 is calculated by taking a 1 percent reduction in basic fee for every 1 percent that performance falls below the acceptable quality level of 100 percent of transactions being processed correctly and on time. However, if performance falls below 75 percent of the acceptable quality level, a 50 percent reduction in basic fee is made. LOMOD may appeal a disincentive assessment.

Specifically, we reviewed the appropriateness of (1) HUD's handling of the 2004 annual compliance review findings; (2) assessed and reversed disincentives; (3) movement of LOMOD to full implementation; (4) retroactive rent increases; and (5) HUD's monitoring of standard 6 – review of monthly vouchers to determine whether HUD appropriately monitored LOMOD with respect to the annual contributions contract.

## RESULTS OF AUDIT

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### Finding 1: The Los Angeles Multifamily Hub Did Not Properly Monitor LOMOD in Accordance with HUD Guidance or Its Annual Contributions Contract

#### The Los Angeles Multifamily Hub

- Did not follow up on the findings in its 2004 compliance review of LOMOD in a timely manner,
- Improperly assessed 9 of 14 disincentives that were later reversed by the operations officer and improperly reversed 5 of the 14,
- Moved LOMOD into full implementation for standards 3 and 14 and did not properly support the decision,
- Allowed LOMOD to provide owners of projects requesting rent increases under the annual adjustment factor or the mark-up-to-market option with retroactive rent increases totaling \$38,839 although the owners' submissions were not made within the required timeframes, and
- Left its contractor's activities pertaining to voucher review and disbursement of payments to project owners unmonitored.

This noncompliance occurred because there was a lack of communication between hub management and the oversight monitor; HUD did not have written policies and procedures for training of the oversight monitor or for dealing with disincentive appeals; it ignored or misinterpreted policies and procedures that were in place; it disregarded the recommendations of its project managers as well as concerns of the Office of Inspector General (OIG); and the oversight monitor did not have access to HUD systems to perform required monitoring.

HUD improperly reversed \$105,059 in disincentives applied as a result of its 2004 compliance review. In addition to not promptly resolving the findings in the compliance review, LOMOD continued to make the same or similar mistakes and should have been assessed more than \$1.3 million in additional disincentives or in reductions to the incentive fee. Also, HUD did not ensure that LOMOD correctly processed owner rent adjustment requests or correctly executed housing assistance payments contract renewals. Finally, HUD did not ensure that vouchers were reviewed and properly processed in a timely manner and in compliance with HUD requirements. Consequently, the Los Angeles Multifamily Hub did not fulfill its monitoring responsibilities.

## **HUD Did Not Follow Up on the Findings of Its 2004 Annual Compliance Review of LOMOD in a Timely Manner**

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HUD issued its first annual compliance review of LOMOD on November 30, 2004, for the period covering December 1, 2003, to November 30, 2004, as required by HUD's Monitoring and Evaluation Policies and Procedures. LOMOD's latest appeal of the findings resulting from this review was not resolved until March 23, 2007. The unresolved findings and LOMOD's continued poor performance occurred because of a lack of communication between hub management and the contract administrator oversight monitor. Consequently, \$105,059 in disincentives or in reductions in incentive fees associated with compliance review findings was improperly reversed and more than \$1.3 million in disincentives or in reductions in incentive fees that should have been applied for other incorrect work were not. These findings should be resolved to ensure that owners and tenants receive the subsidy amounts they deserve.

### **The First Annual Compliance Review Identified 36 Findings**

HUD's 2004 annual compliance review of LOMOD identified 36 findings. Twelve of these findings resulted in reductions in incentive fees or in disincentives being assessed against LOMOD totaling \$244,353.

Examples of findings from the compliance review include the following:

- Contrary to requirements, LOMOD did not verify that a rent schedule was complete and processed an incomplete rent schedule that did not include the nonrevenue units. A disincentive was assessed due to this finding.
- LOMOD (or its subcontractor) did not calculate the correct rental adjustment amount, resulting in the owner's receiving higher rents than it was entitled to receive. A reduction to the incentive fee was applied based on this finding. In addition, on another finding in which the rent adjustment amount was incorrectly calculated, a disincentive was assessed. Although the reduction to the incentive fee was appealed, the disincentive was not appealed.
- LOMOD's input into HUD's Real Estate Management System did not always reflect the actual events as supported by LOMOD's records. Specifically, a key date entered into HUD's system was not in accordance with LOMOD's records. In another instance, a date was missing from a field in HUD's system. In addition, HUD informed LOMOD in this finding that LOMOD must ensure that data posted to the Real Estate Management System are accurate. Disincentives were not assessed based on these findings.
- LOMOD delayed processing transactions for three projects while waiting for and pondering HUD guidance. HUD recommended that when LOMOD does not meet the timelines required by the annual contributions contract, disincentives should be assessed. Disincentives were not assessed at that time.

- LOMOD made changes to an owner's debt service amount without documenting the justification for the change or the owner's knowledge of the change. HUD recommended that LOMOD refrain from making changes to the owner's submission without justification and the owner's knowledge. LOMOD was also required to ensure that its files document correct conclusions. In addition, LOMOD was required to correct the error and resubmit the transaction to HUD for review. LOMOD's incentive fee was reduced as a result of this finding.

### **LOMOD Appealed the Findings**

From January 7, 2005 through June 20, 2005, LOMOD appealed the findings and twice sent action plans to the Los Angeles Multifamily Hub. LOMOD's appeals generally focused on the facts surrounding the specific deficiencies cited in the findings not the actual requirements. The appeals and action plans were rejected because the documentation provided did not support why the findings and disincentives should be reversed. The current hub director decided that there were not enough specifics in the report to resolve and close the findings. As a result, he told LOMOD that he would no longer follow up on the findings but that they would be covered in a future compliance review. That review was scheduled to be completed July 31, 2007, but has not yet been forwarded to our office.

LOMOD also appealed the findings to the deputy assistant secretary for multifamily housing at the headquarters level. This appeal was an abbreviated version of the earlier appeals. It only addressed findings related to disincentives and reductions to LOMOD's incentive fee. Two of the findings for which disincentives were assessed were not contested in the appeal. On January 3, 2007, the appeal was returned to the Los Angeles Multifamily Hub for review. On March 23, 2007, the operations officer granted the appeal. We reviewed the appeal and response and found that, based on Section 8 guidance and the annual contributions contract, three of the appealed findings should not have been reversed and the other findings were not valid. In addition, the findings that were not impacted by disincentive assessments or reductions in incentive fees were not addressed in this latest appeal and have not been resolved.

### **Three Findings from the Annual Compliance Review Should Not Have Been Reversed**

Our review of HUD's decision to grant LOMOD's appeal revealed that, based on Section 8 guidance and the annual contributions contract, three findings that were reversed should



not have been. Two of these findings had been assessed a reduction in the incentive fee totaling \$105,059.<sup>1</sup>

For example, a disincentive was assessed because LOMOD did not process the submission for Steelworkers Oldtimers in a timely manner. HUD's operations officer granted LOMOD's appeal on this finding based upon poor information initially provided by HUD and by the six-month absence of an oversight monitor to provide LOMOD with advice in processing submissions. However, our review of the appeal documents that LOMOD submitted indicated that according to LOMOD's timeline of events, it requested funding for this project on April 2, 2004. HUD did not fund this project and did not perform any follow up on this transaction during the next six months. However, LOMOD also did not document any further attempt to complete the process until October 1, 2004, when it began the process for the next contract renewal. During these six months, LOMOD should have followed up on HUD's transmittal of the annual contributions contracts to complete the process and documented that follow-up.

In another example, regarding project Canyon Rim Apartments, the incentive fee was reduced because LOMOD renewed the contract without determining whether the correct renewal option was used. In addition, there was no supporting documentation in the file to show that the option selected was reviewed for accuracy. Further, the file did not show that the owner issued the required tenant notification. HUD's operations officer granted LOMOD's appeal of this finding because HUD authorized the processing of the contract using the option selected. The operations officer further stated that the lack of documentation of the required tenant notification did not indicate that notification was not issued. We agree with the operations officer that LOMOD was not responsible for the option used because HUD authorized the selected option. However, according to exhibit A of its annual contributions contract with HUD, LOMOD is required to verify that owners of projects with expiring Section 8 contracts provide the required notice to tenants. Since this is an element of the task, LOMOD did not demonstrate that this step was taken (it could not be verified to the file), and LOMOD admitted that this notification was not included in the file, it did not earn its incentive fee.

**LOMOD Continued to Make Mistakes Similar to Those Noted in the Annual Compliance Review**

During the time in which the annual compliance review findings went unresolved, LOMOD did not implement new controls or implement an action plan to prevent the same or similar mistakes from occurring, resulting in more than \$1.3 million in disincentives or reductions in incentive fees that should have been assessed. Specifically, LOMOD did not always process rent adjustments and housing assistance payments contract renewals in a manner that complied with program requirements. Our review of

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<sup>1</sup> One finding did not result in a disincentive or reduction in incentive fee because it was included in the calculation with another finding but did not change the calculation. The other finding was not appealed.

84 submissions revealed 40<sup>2</sup> with deficiencies (see appendix C for a listing of projects, deficiencies, and disincentives). These deficiencies included the following:

- LOMOD processed 19 of the 84 submissions reviewed in which rent schedules were inconsistent with the information shown in HUD's Real Estate Management System without the required notification to HUD. In addition, LOMOD processed one submission without a rent schedule. According to the instructions agreed upon by HUD multifamily management and LOMOD on February 19, 2004, and the Policy and Procedures issued by the Los Angeles multifamily office on August 16, 2004, when there is a discrepancy in the Section 8 and/or non-revenue-producing units identified between the rent schedule and the Real Estate Management System's Occupancy screen, LOMOD is required to notify HUD of the unit discrepancy because LOMOD does not have access to make the changes to the Occupancy screen.
- LOMOD did not correctly calculate the rent amount when it renewed four contract rents. It was notified in the first annual compliance review in November 2004 that it must correctly calculate rental adjustments. In that review, it was assessed a disincentive and had its incentive fee reduced as a result. Therefore, it was aware that rental adjustments must be correctly calculated.
- In 20 of the submissions reviewed, LOMOD removed a key date from HUD's Real Estate Management System, and in one submission reviewed, it entered an incorrect date into the system. In addition, the files for one submission did not include support for the date LOMOD entered into the system so the date could not be verified. LOMOD is required, as stated in the Project-Based Contract Administration Real Estate Management System input guide, to enter the date the owner signed the submission, the date the owner's submission package was initially received, and the date the complete package was received from the owner. Further, as noted above, LOMOD was informed in the first annual compliance review that it must ensure that data posted to the Real Estate Management System are accurate.
- LOMOD did not process three of the submissions in accordance with the timeframes in its annual contributions contract. In all three of the cases, it did not process the submissions within 30 days of receipt of a complete package from the owner or contributed to the owner's not submitting a complete package in a timely manner. In one case, it did not send the submission to HUD at least 60 days before contract expiration.

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<sup>2</sup>This number does not include the transactions shown in appendix C that are also shown in the next section for which the disincentive or reduction in incentive fee was improperly reversed.

### **The Compliance Review Findings Remained Unresolved Because of a Lack of Communication**

The findings that resulted from the 2004 annual compliance review remained unresolved because of the Los Angeles Multifamily Hub's inability to follow up with LOMOD regarding the findings identified in the review. A contributing factor was the lack of communication between hub management and the oversight monitor. The Los Angeles operations officer told us that he tried to resolve the findings but could not identify exactly what needed to be done to resolve them. When he spoke with the oversight monitor, he received an unsatisfactory response with regard to the steps that needed to be taken to resolve the findings. However, since that time, when reviewing specific recommendations for disincentive assessments, he has not requested any clarification from the oversight monitor, project managers, or contractor. Consequently, findings related to \$105,059 in assessed disincentives and reduced incentive fees were improperly reversed.

Further, hub management did not follow up with the issues identified in the report because management thought that they would get resolved in the 2005 annual compliance review. However, that review did not take place. Additionally, our review indicated that the annual compliance review findings for which disincentives were assessed or incentive fees were reduced can be resolved. Consequently, it is reasonable to infer that the remaining 24 of 36 findings can also be resolved. Also, these findings should be resolved to ensure that owners and tenants receive the subsidy amounts they deserve. In addition, LOMOD continued to submit inadequate submissions to HUD for review and funding, resulting in more than \$1.3 million in disincentives or incentive fee reductions that should have been assessed.

### **HUD Did Not Ensure That LOMOD Corrected Past Deficiencies**

HUD did not ensure that LOMOD corrected the deficiencies from the first annual compliance review and did not ensure that it put policies and procedures in place to prevent the same or similar deficiencies in the future. Consequently, HUD cannot ensure that LOMOD processed vouchers in a timely manner or that vouchers were reviewed, processed, and approved by LOMOD in compliance with HUD requirements. Further, HUD cannot ensure that LOMOD correctly processed rent adjustments and contract renewals in a timely manner.

## **HUD Inappropriately Assessed 9 of 14 Disincentives and Inappropriately Reversed 5 of the 14**

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We reviewed the Los Angeles Multifamily Hub's files for all of the 14 disincentives that were assessed by the oversight monitor between May 2005 and April 2006 and were later reversed by the operations officer. We also interviewed hub, headquarters, and contractor staff and reviewed additional documents provided to determine whether the reversals of the disincentives were appropriate. Our review revealed that nine of the disincentives should not have been assessed and the reversal of five of the disincentives was inappropriate.

### **There Was no Basis for Assessing Nine of the Disincentives**

There was no basis for the oversight monitor's assessment of nine of the disincentives, and they were correctly reversed by the hub's operations officer. In some cases, these disincentives were inappropriately assessed because

- HUD did not provide timely or adequate information to LOMOD,
- HUD did not adequately clarify policies to LOMOD,
- The oversight monitor did not correctly interpret the criteria, and/or
- The oversight monitor did not distinguish between a LOMOD error and one caused by HUD.

### **We Discussed the Disincentives With the Oversight Monitor**

We consulted with the oversight monitor on the disincentives assessed because she provided us with the documentation to support her assessment of disincentives and she represented to us that she was responsible for assessing the disincentives. HUD's Monitoring and Evaluation Policies and Procedures says the oversight monitor is responsible to draft policies and procedures that impact contract administrator oversight, provide guidance to the supervisory project manager, and oversee the work of the supervisory project manager and the project managers, and is the team leader for compliance reviews. The oversight monitor told us that once she receives the recommendation for a disincentive from the project manager or supervisory project manager, she reviews the package and if she agrees with the assessment, she will send an email to LOMOD identifying the issue. She then reviews LOMOD's response and will either rescind the disincentive or write up a formal disincentive recommendation and send it back to LOMOD.

### **The Operations Officer Inappropriately Reversed Five of the Disincentives**

The operations officer inappropriately reversed five of the disincentives assessed by the oversight monitor and did not have written policies and procedures to follow when making these decisions. Although the operations officer told us that he reviewed all emails and attachments that passed back and forth between HUD and LOMOD before he decided whether a disincentive should be reversed, the informal procedures that he followed did not include any steps for requesting clarification from the oversight monitor, the supervisory project manager, project managers, or LOMOD. Further, the informal procedures he followed failed to include steps to research written criteria applicable to the specific issues or to follow up with other HUD departments as applicable. Consequently, in some cases, the operations officer was unable to distinguish between system malfunctions and errors made by LOMOD and he made conclusions not supported by the documents he reviewed.

### **LOMOD Was Not Penalized for Unacceptable Performance**

When HUD improperly assessed disincentives both HUD and LOMOD wasted time and effort to resolve the issue. When disincentives were improperly reversed, funds were taken away from HUD. In this case, HUD did not penalize LOMOD when appropriate to obtain acceptable performance in a timely manner. In addition, if LOMOD does not pay for its mistakes, through disincentives or reductions in its incentive fee, it will not correct its substandard performance.

### **Lack of Management Controls Contributed to the Incorrect Assessments**

HUD's lack of management controls contributed to the incorrect assessments. HUD did not have specific written policies and procedures to ensure that the oversight monitor was properly trained. The oversight monitor was not provided with specific Section 8 training either before or during the time she oversaw the contract. In 2005, a task force was sent from HUD headquarters to Los Angeles to assist in the funding process for expired contracts. On September 22, 2005, the task force recommended that the oversight monitor be provided additional training in the multifamily area from more experienced oversight monitor personnel as well as training regarding other HUD requirements. The oversight monitor did not receive this training.

HUD also did not have specific written policies and procedures to ensure that only disincentives that have been incorrectly assessed are reversed upon appeal. The informal procedures the operations officer used did not include any steps for requesting clarification from HUD staff more intimately involved in the assessment of the

disincentives or from the contractor. In addition, these informal procedures did not include steps to follow up with other HUD departments or to research written criteria specific to the issues.

### **HUD Inappropriately Moved LOMOD to Full Implementation for Incentive-Based Performance Standard 3–Rent Adjustments and Standard 14–Contract Renewals and Did Not Properly Support Its Decision**

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The Los Angeles Multifamily Hub inappropriately moved LOMOD into full implementation for standards 3 and 14 and did not properly support the decision. It performed this action against the recommendation of its project managers, in opposition to the information presented in the monthly oversight monitor reports, against the concerns presented by OIG, and without evidence to show that LOMOD met the required quality level on each of these standards for three consecutive months before being moved to full implementation. As a result, LOMOD was no longer required to submit its work product for HUD’s review, and HUD does not have assurance that LOMOD is earned its entire basic fee and its incentive fee.

#### **LOMOD Stayed in Transition for Standards 3 and 14 for More Than Two Years**

HUD’s Monitoring and Evaluation Policies and Procedures states that the maximum time for a contractor to remain in the transitional phase is one year. However, after nearly two and one-half years in transition, LOMOD had not been moved to full implementation for standards 3 and 14.

In addition, HUD assessed and improperly reversed several disincentives under standard 14 (see the reversed disincentive issue above), the HUD project managers were not consulted on the decision to move LOMOD to full implementation even though hub management had previously been told the project managers recommended that LOMOD not be moved to full implementation until the findings from the first annual compliance review were resolved, the monthly oversight monitor reports showed that LOMOD was not ready to be moved to full implementation because it had not met the required acceptable quality level, and preliminary results of OIG’s examination of LOMOD transactions identified many additional disincentives that should have been assessed on these standards. In spite of these issues, the Los Angeles Multifamily Hub moved LOMOD to full implementation for these standards on June 1, 2006.

#### **Project Managers Were Not Part of the Decision to Move LOMOD to Full Implementation**

Although project managers worked with LOMOD on a day-to-day basis and were in a position to evaluate its performance, Los Angeles Multifamily Hub management did not



solicit the input from any of its project managers before deciding to move LOMOD to full implementation. HUD's supervisory project manager said that there was nothing wrong with LOMOD's work product based on the documents she reviewed. Therefore, there was no reason to solicit input from the project managers.

We interviewed the two project managers that the Los Angeles Multifamily Hub management suggested we interview and two additional project managers. Two of the project managers told us that LOMOD should not have been moved to full implementation until the findings from the first annual compliance review were resolved. All four of the project managers told us that LOMOD continued to submit incorrect work products under standards 3 and 14 and as a result, should not have been moved to full implementation. Further, the Los Angeles Multifamily Hub management had previously been told that the project managers recommended that LOMOD not be moved to full implementation.

**The Monthly Oversight Monitor Reports Showed That LOMOD Did Not Meet the Required Acceptable Quality Level**

According to HUD's Monitoring and Evaluation Policies and Procedures, the contractor must meet the acceptable quality level for three consecutive months for each standard before moving from the transitional to the full implementation phase of the program. We reviewed the January, February, and March 2006 monthly oversight monitor reports because these were the last three reports that were available before LOMOD was moved to full implementation. The reports showed that LOMOD did not meet the required acceptable quality level for three consecutive months as required. The February report showed that LOMOD did not meet the acceptable quality level for standard 3. A disincentive was assessed against LOMOD for a transaction dealing with the Hacienda Del Norte project. The oversight monitor also wrote that there would be additional disincentives assessed for incorrect processing under standard 14 in that month.

In addition, in all three reports under standard 14, the oversight monitor stated that many of the contract renewals processed were done under a request for extenuating circumstances (explanations as to why LOMOD was not at fault for not meeting the acceptable quality level) but without documentation in support of those circumstances. In addition, the required monthly supervisory project manager report was not provided to the oversight monitor for consideration of LOMOD's performance. Therefore, the acceptable quality level could not be verified.

HUD procedures required the supervisory project manager and the project managers to provide monthly reports on the contractor's performance. These reports would have provided evidence as to whether LOMOD met the requirements to move to full implementation. However, these reports were not required by the Los Angeles Multifamily Hub management. Further, when we asked the operations officer and the

supervisory project manager whether they had any evidence to document that LOMOD met the requirement, they stated that they had none.

### **OIG's Examination of LOMOD Transactions Showed That 54 of 84 Transactions Reviewed Were Processed Incorrectly**

On May 25, 2006, one week before HUD moved LOMOD to full implementation for standards 3 and 14, we provided HUD with information from our examination of LOMOD transactions, which explained that 54 of the 84<sup>3</sup> transactions we examined were processed incorrectly and included deficiencies related to

- Incorrect rent schedules;
- Incorrect, inaccurate, and/or missing dates in HUD's Real Estate Management System;
- Unsupported annual project debt service amounts;
- Incorrect annual project debt service amount in HUD's Real Estate Management System;
- Incorrect rent calculations; and
- Untimely and incorrect rent adjustments and renewals.

In addition, we pointed out that Los Angeles Multifamily Hub staff spent 35 percent or more of its direct time on the initiative because LOMOD continued to send inadequate submissions to HUD for review and funding and HUD had to review these inadequate submissions.

### **Management Ignored Key Factors When It Moved LOMOD to Full Implementation**

The Los Angeles Multifamily Hub inappropriately moved LOMOD to full implementation without proper documentation for several reasons. It ignored or did not fully consider various policies and procedures and other information provided, which showed that LOMOD was not ready to be moved to full implementation.

Specifically, the Los Angeles Multifamily Hub ignored or did not fully consider its Monitoring and Evaluation Policies and Procedures, which invested the oversight monitor with the responsibility for making the determination of whether the contractor met the necessary requirements to be moved to full implementation. The oversight monitor was excluded from the meeting in which the decision to move LOMOD to full implementation was made.

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<sup>3</sup> The 54 incorrectly processed transactions were in a preliminary finding outline. This number changed as a result of further work performed on the audit and the incorporation of findings into this report beginning on page 10.



In addition, although the Los Angeles Multifamily Hub management had previously been told that the project managers recommended that LOMOD not be moved to full implementation, management still did not request their input when making the decision. The concerns of OIG were ignored as well. Specifically, OIG provided a preliminary finding outline to hub management one week before the movement to full implementation. In this outline, OIG explained that 54 of the 84 submissions it reviewed were processed incorrectly.

### **LOMOD Was No Longer Required to Submit Its Work Product to HUD for Review**

Once LOMOD was moved to full implementation for standards 3 and 14, it was no longer required to submit its work product for HUD's review. Since this was no longer required, HUD does not have assurance that LOMOD correctly processed rent adjustments and contract renewals in a timely manner and in accordance with the acceptable quality level identified in its annual contributions contract with HUD. Consequently, HUD does not have assurance that LOMOD earned its entire basic fee and its incentive fee.

### **HUD Inappropriately Allowed LOMOD to Provide Some Owners with a Retroactive Rent Increase, Although the Owner's Submissions Were Not Received within the Required Timeframes**

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Contrary to HUD's Section 8 Renewal Policy, its Guidebook for Section 8 Contract Administration, and a letter of clarification from headquarters, the operations officer allowed LOMOD to provide owners with a retroactive rent increase if a partial submission was made within the required timeframe.

### **There Is a Required Timeframe for Submissions for Annual Adjustment Factor and Operating Cost Adjustment Factor Rent Adjustments**

An owner's request for a rent adjustment using the annual adjustment factor must be submitted at least 60 days before the housing assistance payments contract anniversary date for the increase to be effective on the anniversary date. If the request is submitted less than 60 days before the anniversary date, the rent adjustment (rent increase) will not take effect until 60 days after receipt of the owner's complete submission.

An owner's request for a rent adjustment using the operating cost adjustment factor under option one, mark-up-to-market, must be submitted at least 120 days before the expiration of the housing assistance payments contract. If the process is not completed within 120

days, through no fault of the owner, the owner is due a retroactive rent increase for any time over the 120 days that it takes to process the transaction. However, because 120 days are allowed for processing time, if the owner submits a complete request less than 120 days before contract expiration, the owner is not entitled to a retroactive rent increase for the number of days (up to 120 from the date of a complete submission) it takes to process the transaction. The owner will, however, receive a retroactive rent increase for any time over the 120 days it takes to process the rent adjustments.

### **LOMOD Requested Clarification and HUD Responded**

On July 26, 2005, LOMOD requested clarification from HUD stating, “As discussed, in cases where the owner submission is not timely or complete 120 days prior to contract expiration, we may still proceed to apply the rent adjustment effective the same day as the effective date for the contract renewal. This policy recognizes that while most owners are making a good faith effort to comply with the 120-day submission, very few submissions are submitted 100% complete and correct 120 days prior to expiration.”

Without consideration of the two types of rent adjustments referred to above, the operations officer responded that this was a correct assessment of the process, and LOMOD began providing retroactive rent increases to owners, even when they were requesting annual adjustment factor and operating cost adjustment factor adjustments but did not make the submission within required timelines.

### **The Operations Officer Misinterpreted the Requirement**

Although the requirements and the headquarters clarification letter state that the above types of rent adjustment submissions must be complete within the required timeline, the operations officer agreed that owners who made a “good faith effort” and submitted most of the required documents could receive a rent increase retroactive to the housing assistance payments contract anniversary date even if processing was not complete by that date.

In our examination of LOMOD’s transactions performed on 84 projects, we reviewed rental adjustments and contract renewals of expiring housing assistance contracts for compliance with standards 3 and 14. We used this sample to determine whether LOMOD paid retroactive rents to owners when the owner submission was not made to LOMOD at least 60 days before contract expiration for annual adjustment factor rent adjustments and at least 120 days for mark-up-to-market operating cost adjustment factor adjustments. As a result of the misinterpretation of the requirements, \$38,839 in retroactive rent increases was improperly paid to owners that did not qualify to receive the funds and could have been better used to assist other low-income households.

		<b>Total amount</b>		
<b>Project</b>	<b>Contract no.</b>	<b>overpaid</b>	<b>AAF* total</b>	<b>OCAF** total</b>
Northpointe Apartments	CA16M000378	\$ 3,053	\$ 3,053	
Clark Seniors Apartments	CA16H113142	2,382	2,382	
Springdale West I & II	CA16M000303	15,912		\$ 15,912
Springdale West III	CA16M000304	16,656		16,656
Palmdale Garden Apartments	CA160007006	836		836
<b>Total inappropriate retroactive rent increase</b>		<b>\$ 38,839</b>	<b>\$ 5,435</b>	<b>\$ 33,404</b>

\* Annual adjustment factor

\*\* Operating cost adjustment factor

**Contrary to HUD Requirements, the Los Angeles Multifamily Hub Did Not Monitor LOMOD’s Activities Pertaining to Standard 6–Voucher Review and Disbursement of Payments to Project Owners**

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HUD did not follow its Guidebook for Section 8 Contract Administration, which requires that it monitor standard 6 on a regular basis. In November 2004, HUD performed a compliance review of LOMOD in which it reviewed LOMOD’s work under standard 6. However, it was unable to provide evidence to show how it monitored LOMOD’s activities during that review. Then, from November 2004 through at least September 2006, HUD did not monitor LOMOD’s activities pertaining to voucher review and disbursement of payments to project activities because the oversight monitor did not have access to the necessary HUD systems. During an interview, the oversight monitor agreed with our statement that the Los Angeles Multifamily Hub did not adequately monitor LOMOD’s performance on standard 6. Consequently, HUD did not ensure that vouchers were accurately reviewed, processed, and paid in a timely manner in accordance with HUD requirements.

**The Oversight Monitor Required Access to HUD Systems to Monitor LOMOD**

HUD’s Monitoring and Evaluation Policies and Procedures states that the primary systems that the contractor will use to record performance and that the oversight monitor will use to review the contractor’s performance are HUD’s Real Estate Management System, its Tenant Rental Assistance Certificate System, and its Line of Credit Control System. These policies and procedures further state that the oversight monitor will use reports generated by these systems to support the invoice review process wherever possible. The oversight monitor is also required to conduct a monthly random sample of voucher processing in the Tenant Rental Assistance Certificate System and compare the sample with the monthly invoice to ensure that voucher payments are made correctly and reflect actual performance and timing.

Although access to the Tenant Rental Assistance Certificate System and the Line of Credit Control System are required for adequate monitoring, the oversight monitor did not have any access to these systems from April 2004 until May 2006 and did not receive full access until September 2006. Although neither the oversight monitor nor hub management had the power to make the process go faster, they did not take further steps

to ensure that standard 6 was monitored, nor did they try to develop an alternate means of monitoring this task. The oversight monitor only reported her inability to access HUD's systems in her monthly report.

Since the oversight monitor reported her lack of access to HUD systems as early as October 2004 in her monthly report and continuously reported it for at least another 20 months thereafter, the operations officer knew or should have known that the oversight monitor could not perform her required monitoring duties for standard 6. Although the operations officer told us that he thought someone in another office was performing the monitoring duties, it is apparent that he did not fully consider the problem statements the oversight monitor reported in her monthly report. Each of the monthly reports contained a statement such as the following from the October 2005 report:

[T]he CAOM [contract administrator oversight monitor] has no access to HUDs Systems for monitoring...[t]he AQL [ acceptable quality level]cannot be verified.

### **We Performed Monitoring Steps That the Hub Should Have Performed**

Once we determined that the Los Angeles Multifamily Hub did not monitor standard 6, we developed testing procedures to determine what its monitoring could have revealed. Specifically, we performed monitoring steps that HUD should have performed to test whether LOMOD used electronic funds transfers to make voucher payments to owners, made payment of vouchers accurately and in a timely manner, issued formal notification to HUD of payment discrepancies, and verified that resident data were accurate.

Although LOMOD used electronic funds transfers to make voucher payments to owners its payment of vouchers was not always timely or accurate. Specifically, 3 of the 40 vouchers we reviewed for timeliness were not processed in a timely manner. This could have resulted in a disincentive since the acceptable quality level for review of vouchers is for 100 percent to be processed so that owners receive payment no earlier than the first calendar day of the month and no later than the first business day of the month. However, LOMOD's brief explanations in its monthly invoice did not identify where the fault lay, and the owners for all three vouchers in question told us that they were not aware of the reason for the delay of payments. The payment notification provided to them by LOMOD did not explain the reason for the delay. As a result, one owner expressed dissatisfaction with LOMOD. Although the invoice included information to show that many of the payments were delayed due to "Pending contract renewal in TRACS [Tenant Rental Assistance Certificate System]", the oversight monitor did not follow up with LOMOD or other HUD personnel to resolve the issue of the delayed payments to determine whether the reason for the delay was justified.

Two of the four months' vouchers we reviewed for accuracy contained discrepancies that were not mentioned in LOMOD's monthly reports to HUD. The May 2006 voucher month (first batch) showed that HUD wired to LOMOD \$12,531,744 intended for 505

contracts. LOMOD wired to owners only \$12,528,200 for 504 contracts (a difference of \$3,544 and one contract). LOMOD's electronic funds transfer reconciliation showed that contract number CA160049025 represented the difference but did not provide an explanation. Neither LOMOD's monthly report nor the oversight monitor's monthly report mentioned the discrepancy. The oversight monitor might have discovered and followed up on this discrepancy to resolve the problem if she had appropriately monitored standard 6 on a regular basis as required. The July 2006 voucher month (first batch) showed that HUD wired LOMOD \$13,139,494 intended for 504 contracts. LOMOD wired to owners only \$13,046,085 for 502 contracts (a difference of \$93,409 and two contracts). LOMOD's reconciliation documents accounted for the discrepancy as being due to an unestablished owner bank account for Cypress Sunrise and Wysong Plaza. The discrepancy was not explained in its July 2006 monthly report. Its July 2006 invoice, however, stated that Wysong Plaza's voucher payment was delayed due to "pending REMS [Real Estate Management System] update by HUD," but the reason stated in its electronic funds transfer reconciliation says "pending bank account from O/A [owner/agent]." There was no comment in the reconciliation as to when these projects received their money or established their bank accounts. The oversight monitor's monthly report also did not mention the problem.

On October 19, 2006, we inquired about the \$93,409 discrepancy. LOMOD told us that it would continue to follow up with HUD and that Cypress Sunrise's money was released on July 27, 2006. However, as of October 20, 2006, Wysong Plaza's payments for July through October 2006 were still outstanding due to incorrect owner/agent information in HUD's Real Estate Management System.

Because HUD did not monitor standard 6, it did not follow up when LOMOD did not provide the formal, written notification of the discrepancy required by standard 7 of the annual contributions contract. As a result, the HUD project manager did not resolve the problem in a reasonable amount of time and it took more than three months for the project to receive its subsidy payments.

Further, LOMOD processed a voucher that may have contained inaccurate income verification for one tenant. We selected one tenant from each of five vouchers for review to determine whether the information from the Form HUD 50059, Owner's Certification of Compliance with HUD's Tenant Eligibility and Rent Procedures, matched the data in HUD's Tenant Rental Assistance Certificate System and whether the information was up to date and signed. One of the five tenants in the vouchers reviewed had income information that may have been improperly obtained. Although each of the five Form HUD 50059s reviewed matched the data in HUD's Tenant Rental Assistance Certificate System and the certifications were up to date and signed, the Social Security number on the recertification questionnaire used by the project owner for income verification for one Section 8 tenant was wrong. This Social Security number belonged to a deceased person with the same last name as the Section 8 tenant's middle or maiden name, but no relationship was specified. It is, therefore, questionable whether the Social Security income information gathered for the subject tenant was accurate. The oversight monitor might have discovered this discrepancy if she had monitored this standard as required.

### **HUD Did Not Require or Review the Work Plan from LOMOD for Standard 6**

Review of LOMOD's annual work plan is required by HUD's Guidebook for Section 8 Contract Administration and the Monitoring and Evaluation Policies and Procedures. The work plan is used to monitor a contractor's progress and to verify what accomplishments are billed to HUD. However, the Los Angeles Multifamily Hub did not require this document from LOMOD in relation to standard 6. Therefore, HUD did not perform the required review.

### **The Hub Did Not Explore Alternative Methods of Monitoring**

The hub did not practice due diligence to ensure that standard 6 was monitored. During the more than two years in which the oversight monitor did not have access to the HUD systems required to monitor this standard, neither she nor the operations officer took appropriate steps to monitor this standard. The oversight monitor said that she asked some of the multifamily staff to print data from HUD systems for her, but she did not get quality results. However, she did not take further steps to resolve the issue of not being able to monitor standard 6 other than reporting her inability to access HUD's systems in her monthly report.

The operations officer is responsible for supervising the oversight monitor but did not fully consider the problem statements that the oversight monitor reported in her monthly report. He was aware that for the oversight monitor to do her job, she needed access to HUD systems. He told us that he was also aware that the reason for the delay in getting her access to the required systems was that the background-check process takes a long time. The oversight monitor reported the access problem as early as October 2004 and continuously reported it for at least another 20 months thereafter. However, the operations officer was not aware that the oversight monitor was still having access problems as of our meeting with him on July 12, 2006. While the access problem was beyond the control of the Los Angeles Multifamily Hub, the operations officer did not explore alternative methods to ensure that this task was monitored during the time in which the oversight monitor did not have access to HUD's systems. In addition, the operations officer was under the mistaken impression that the oversight monitor from a different office was providing the monitoring, but he did not take steps to ensure that this was the case.



**HUD Put an Average of \$13.6 Million at Risk Each Month by Not Adequately Monitoring LOMOD's Voucher Processing**

HUD put an average of \$13.6 million at risk each month by not adequately monitoring LOMOD's review, processing, approval, and payment of the monthly vouchers. Since HUD did not monitor standard 6, it did not ensure that LOMOD processed vouchers in a timely manner. If vouchers are not paid in a timely manner, the owners may be at risk of defaulting on the mortgage and risking the physical condition of the property due to insufficient cash flow. HUD could also face negative publicity if residents are displaced or living in inadequate housing. HUD also risks that LOMOD could knowingly or unknowingly abuse voucher funds.

Accordingly, HUD should monitor standard 6 on a regular basis as required by the Section 8 Guidebook for Contract Administration and the Monitoring and Evaluation Policies and Procedures including but not limited to the following:

- Review LOMOD's electronic funds transfer records (i.e., the flow of funds from HUD to LOMOD and from LOMOD to the owners to ensure accuracy and timeliness);
- Review a sample of vouchers that LOMOD
  - (i) Paid on time (to ensure voucher accuracy),
  - (ii) Disapproved (to ensure that LOMOD's disapproval is warranted), and
  - (iii) Did not pay on time (to ensure that the delay is warranted); and
- Monitor discrepancies to ensure that corrective actions are taken.

**The Los Angeles Multifamily Hub Did Not Fulfill Its Responsibilities to Monitor LOMOD's Performance as Contract Administrator**

As a result of the deficiencies noted, we determined that the Los Angeles Multifamily Hub did not fulfill its responsibilities to monitor LOMOD's performance as a contractor. The Los Angeles Multifamily Hub failed to follow up on the findings of the 2004 annual compliance review in a timely manner and improperly assessed or reversed disincentives because it lacked adequate internal and management controls. It improperly moved LOMOD to full implementation for standards 3 and 14 because it ignored or did not fully consider various policies and procedures; it did not fully consider the concerns of its oversight monitor, project managers, and OIG; and its project managers and supervisory project manager were not required to provide the requisite monthly reports. In addition, it allowed LOMOD to pay inappropriate retroactive rent increases to owners because it misinterpreted the requirements. It allowed standard 6 for the review, authorization, and

payment of vouchers to owners to go unmonitored. Consequently, the Los Angeles Multifamily Hub did not fulfill its responsibilities to monitor LOMOD's performance as a contractor.

## Recommendations

We recommend that the deputy assistant secretary for multifamily housing

- 1A. Appoint the staff of a hub other than the Los Angeles Multifamily Hub to review appeals from LOMOD to maintain objectivity.

We recommend that the deputy assistant secretary for multifamily housing require the Los Angeles Multifamily Hub to

- 1B. Ensure that LOMOD is not reimbursed for the \$105,059 reduction in incentive fee for those findings in the 2004 compliance review that were improperly reversed.
- 1C. Assess \$1,360,160 in disincentives or in reductions to the incentive fee as appropriate for the deficiencies noted in the finding and listed in appendix C.
- 1D. Require that the operations officer and the oversight monitor work together with the project managers in assessing disincentives and reductions to incentive fees and to create and implement policies and procedures for assessing disincentives and reductions to incentive fees.
- 1E. Provide the oversight monitor with training in the Section 8 performance-based contract administration program to enhance her ability to assess whether LOMOD is performing adequately on the contract.
- 1F. Require that LOMOD make the appropriate corrections and provide supporting documents for those findings in the 2004 annual compliance review for which it has not yet provided adequate documentation. In addition, LOMOD's support should be provided with clear narratives for each supporting document provided.
- 1G. Require that LOMOD create and implement policies and procedures as noted in the annual compliance review to ensure that deficiencies related to rent adjustments and contract renewals do not recur.
- 1H. Discuss each of the inappropriately reversed disincentives with LOMOD to explain that in each case, LOMOD processing was incorrect.
- 1I. Monitor LOMOD's standard 3 and 14 transactions until HUD can show that LOMOD has met the acceptable quality level for three consecutive months,



the findings of the annual compliance review are resolved, and the LOMOD errors identified in this report are resolved.

- 1J. Allow the oversight monitor and project managers to participate in the decision to move LOMOD to full implementation as these are the employees with day-to-day knowledge of the work that LOMOD performs.
- 1K. Require the project managers and the supervisory project manager to follow the requirements of the Monitoring and Evaluation Policies and Procedures to provide a monthly report on LOMOD's performance to the oversight monitor.
- 1L. Clarify to LOMOD that it must not provide improper retroactive rent increases. This will allow \$38,839 in project funds to be put to better use over the next year.
- 1M. Monitor standard 6 on a regular basis as required by the Section 8 Guidebook for Contract Administration and the Monitoring and Evaluation Policies and Procedures
- 1N. Discuss with the oversight monitor future issues reported in her monthly report to ensure that it understands the issues presented and takes corrective actions to resolve those issues.
- 1O. Obtain and review an annual work plan for standard 6 from LOMOD as an added monitoring tool to ensure that it is making reasonable progress in what it is telling HUD it plans to accomplish.

## SCOPE AND METHODOLOGY

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To achieve our audit objectives, we reviewed applicable federal regulations, HUD handbooks, and other HUD requirements. In addition, we interviewed HUD headquarters staff, local and other HUD staff, LOMOD staff, and management agents. We performed audit work at HUD's Los Angeles, California, office and the offices of LOMOD in Los Angeles, California, from February 2006 through June 2007. Our audit generally covered the period December 2003 through January 2006 and was expanded or changed as needed.

We selected a statistical sample of 84 of the 610 Section 8 project-based projects in LOMOD's portfolio to determine whether LOMOD adequately reviewed the processing of contract adjustment and renewal of housing assistance payments contracts in accordance with its annual contributions contract. We reviewed the most current submission for the projects selected in our sample. These submissions spanned the period November 2003 through September 2005. If the most current submission was a budget-based adjustment and the adjustment is 5.49 percent or higher, HUD is required to review the submission; therefore, we selected the next submission for review.

We selected LOMOD invoices from the months between December 2004 and July 2006 to review for determining the consequences of HUD's lack of monitoring of the contractor's review, verification, and authorization of Section 8 vouchers. The basis for our selections are noted below.

1. **Timeliness of voucher payments.** We selected the November 2005 and July 2006 LOMOD invoices to review for voucher payment timeliness. This selection was made using a nonstatistical process without any special reason for including or excluding any particular invoice. We expected each invoice selected to be representative of the population. From each invoice selected, we then reviewed 100 percent of the vouchers that were approved by LOMOD but unpaid by HUD as well as 100 percent of the vouchers that LOMOD disapproved. The selected invoices contained 22 and 26 (48 vouchers total) vouchers from the November 2005 and July 2006 invoices, respectively, that fit one of these profiles.
2. **Accuracy of voucher information.** We selected the December 2004, June and December 2005, and June 2006 vouchers to review for accuracy as these were evenly spread throughout our audit period. To review tenant data, we then selected one contract from each voucher and one tenant from each contract without conscious bias and without any particular reason for including or excluding other contracts or tenants. We expected each contract and tenant selected to be representative of the population. However, when we asked for the documentation related to the contract selected for December 2004, we found that this project did not voucher for its first Section 8 payment until April 2005, so we substituted that month. In addition, due to a misunderstanding when we requested documents, we received documents for one contract for two different months. We added another tenant for this contract/month and reviewed those documents as well.

3. Electronic funds transfers. Due to time constraints, we did not intentionally perform a statistical or nonstatistical sample of LOMOD's electronic funds transfers. However, during our background research, we requested records on electronic funds transfers for November 2005 and May, June, and July 2006. These are the records we used for our testing of the electronic funds transfer amounts.
4. Invoice review for basic fee calculation. We selected the December 2004, July 2005, and June 2006 LOMOD invoices to review for accuracy of voucher information relating to the number of covered units used to calculate the basic administrative fee. This selection was made using a nonstatistical process without any special reason for including or excluding any particular invoice. We expected each invoice selected to be representative of the population.

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

# INTERNAL CONTROLS

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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.

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## Relevant Internal Controls

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

- Program operations - Policies and procedures that officials of the audited entity have implemented to reasonably ensure that a program meets its objectives and that unintended actions do not result.
- Compliance with laws and regulations - Policies and procedures that officials of the audited entity have implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding resources - Policies and procedures that officials of the audited entity have implemented to reasonably prevent or promptly detect unauthorized acquisition, use, or disposition of resources.

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:

- The Los Angeles Multifamily HUD did not have any written policies and procedures to ensure that the oversight monitor received recommended training from more experienced oversight monitors as well as training regarding other HUD requirements.
- The hub did not have any written policies and procedures for addressing appeals to ensure that only incorrectly assessed disincentives were reversed upon appeal.
- HUD did not ensure that rent adjustments and contract renewals were processed correctly and on time.

## APPENDIXES

### Appendix A

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

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Recommendation number	Ineligible 1/	Funds to be put to better use 2/
1B	\$ 105,059	
1C	1,360,160	
1M		38,839

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/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy 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 HUD implements our recommendation, housing assistance payments funds will not be spent on retroactive rent increases where the owner was not eligible to receive them.

# Appendix B

## AUDITEE COMMENTS AND OIG'S EVALUATION

### Ref to OIG Evaluation

### Auditee Comments

**Comment 1**

**Comment 2**

**Comment 3**



OFFICE OF HOUSING

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
WASHINGTON, DC 20416-8006

OCT 19 2007

Joan S. Hobbs, Regional Inspector General for Audit, 9DGA  
U.S. Department of HUD  
Office of Inspector General, Region IX  
611 West Sixth Street, Suite 1160  
Los Angeles, CA 90017-3101

**RE: Response to draft audit report for the Los Angeles Multifamily Hub Monitoring of the Performance-Based Contract Administrator**

Dear Ms. Hobbs:

Thank you for providing the Inspector General's draft audit report dated September 11, 2007, and allowing my office an opportunity to review and provide comments.

The Los Angeles Multifamily Hub previously provided comments to the draft finding outlines November 2006, and it appears that these responses have not been considered in the September 11, 2007 draft report. No reference is made under Appendixes B – Auditee Comments and OIG's Evaluation. I have attached an additional response regarding the reversed disincentives.

The Contract Administrator Oversight Monitor is referenced throughout the report, and the responsibilities of the oversight monitor require explanation. This position function is required to ensure overall contractual compliance. In accordance with this contract initiative, the Supervisory Project Manager is responsible for overseeing the Project Manager's day-to-day interaction with the Performance-Based Contract Administrator.

With respect to the section entitled LOMOD Appealed the Findings, page 8, paragraph 2 states: "LOMOD also appealed the findings to the acting deputy assistant secretary for multifamily housing at the headquarter level." This appeal was submitted to the Deputy Assistant Secretary for Multifamily Housing, Charles Williams.

Sincerely,

John L. Garvin  
Senior Advisor to Assistant Secretary for Housing-  
FHA Commissioner/Acting Deputy Assistant Secretary  
for Multifamily Housing Programs

[www.hud.gov](http://www.hud.gov)

[espanol.hud.gov](http://espanol.hud.gov)

**Multifamily responses to the Inspector General recommendations are as follows:**

**Comment 4**

**IA. Appoint the staff of a hub other than the Los Angeles Multifamily Hub to review appeals from LOMOD to maintain objectivity.**

**Response:** Processes and Procedures are in place for the PBCA program to address appeals of disincentives. Field office assessment of disincentives to a PBCA based on the review of the invoice and supporting documentation requires notification of the PBCA in writing, providing the basis for the disincentives. The PBCA may appeal this action and is required to provide documentation that supports the grounds for overturning the appeal. The HUD field office will review the appeal, make a final determination and provide an explanation in writing.

The Los Angeles Multifamily Hub has established an Appeals Committee that is comprised of seasoned asset management staff, in an effort to streamline the appeal process. Some of the committee members are not assigned to the Performance-Based Contract initiative, and we believe their review process is objective. The committee review results have been consistent with the Project Manager's prior decision, and the Inspector General's Los Angeles Performance-Based Contract Administrator external audit results.

The PBCA has a second appeal review if the field office determination requires an independent review. The PBCA may submit a second level appeal to HUD HQ providing all relevant documentation for review and HQ to render a decision. We recommend that the process and procedures for the PBCA program are observed by the HUD field office.

**Comment 5**

**IB. Ensure that LOMOD is not reimbursed for the \$105,059 reduction in incentive fee for those findings in the 2004 compliance review that were improperly reversed.**

**Response:** The Acting Los Angeles Hub Director has implemented corrective action that will resolve the outstanding 2004 Annual Compliance Review appeal and associated disincentives which include the \$105,059. LOMOD has the option of appealing any disincentives under the process described in the response to IA.

**IC. assess \$1,360,160 in disincentives or in reductions to the incentive fee as appropriate for the deficiencies noted in the finding and listed in appendix C.**

**Response:** Multifamily will review the deficiencies noted in appendix C and assess appropriate disincentives and or reductions in incentive fee if applicable based on existing policy and any Headquarters clarification.

**Comment 6**

**ID. Require that the operations officer and the oversight monitor work together with the project managers in assessing disincentives and reductions to incentive fees and to create and implement policies and procedures for assessing disincentives and reductions to incentive fees.**

**Response:** Assessing PBCA performance requires input from all HUD field staff considered part of the PBCA team including project managers, supervisory project managers, COAM, funding points of contact and the operations officer. Reference is made to paragraph 3 of this response. The CAOM is required to enforce contractual compliance. The monitoring policy requires that the Hub Director and Operations



Officer have limited direct involvement with the contractor as stated on page 4 of the draft audit report. The Acting Multifamily Hub Director has implemented the necessary measures to ensure that the monitoring guide procedures are followed. In addition Headquarters will be providing training to the HUD staff to obtain a better understanding of the performance based contract and how performance measurements are applied to payment of performance.

**1E. Provide the oversight monitor with training in the Section 8 performance based contract administration program to enhance her ability to assess whether LOMOD is performing adequately on the contract.**

**Response:** The Los Angeles Oversight Monitor joined HUD with a FDIC contracting background; has worked under HUD's Section 8 program since 1999 which has included contract oversight for a major contract. Additionally, the Oversight Monitor has continued to work closely with the Asset Management staff under the Multifamily Section 8 program. The CAOM will receive additional training provided by Headquarters staff to obtain a better understanding of the performance based contract and how performance measurements are applied to payment of performance.

**1F. Require that LOMOD make the appropriate corrections and provide supporting documents for those findings in the 2004 annual compliance review for which it has not yet provided adequate documentation. In addition, LOMOD's support should be provided with clear narratives for each Supporting document provided.**

**Response:** Multifamily agrees with this recommendation.

**1G. Require that LOMOD create and implement policies and procedures as noted in the annual compliance review to ensure that deficiencies related to rent adjustments and contract renewals do not recur.**

**Response:** The Acting Multifamily Hub Director has implemented a 90-day corrective action plan effective September 04, 2007. It should be noted that LOMOD should not be "creating and implementing" policies. Its contractual responsibility is to implement existing HUD policies and procedures. HUD staff will provide LOMOD with program and procedural clarification as intended in the corrective action plan.

**1H. Discuss each of the inappropriately reversed disincentives with LOMOD to explain that in each case, LOMOD processing was incorrect.**

**Response:** Multifamily agrees with this recommendation.

**II. Return LOMOD to the transitional phase for standards 3 and 14 until HUD can show that LOMOD has met the acceptable quality level for three consecutive months, the findings of the annual compliance review are resolved, and the LOMOD errors identified in this report are resolved.**

**Response:** The HUD field office has developed a 90 day corrective action plan to address the PBCA contract performance deficiencies inclusive of IBPS 3 and 14. The intent and scope of the plan is broader and more comprehensive than reinstating the transition phase for two tasks, IBPS 3 and 14. The objective of this plan is to provide program clarification and guidance including but not limited to contract renewals,

**Comment 7**

**Comment 8**

rent increases, REMS input, and work plan. This contractual corrective period will expire December 4, 2007. During this period, the 2004 Annual Compliance Review findings will be resolved.

**IJ. Allow the oversight monitor and project managers to participate in the decision to move LOMOD to full implementation as these are the employees with day-to-day knowledge of the work that LOMOD performs.**

**Response:** Reference is made to response 1I. All Multifamily HUD staff will continue to monitor LOMOD's performance during the corrective period.

**IK. Require the project managers and the supervisory project manager to follow the requirements of the Monitoring and Evaluation Policies and Procedures to provide a monthly report on LOMOD's performance to the oversight monitor.**

**Response:** Multifamily agrees with this recommendation.

**IL. Clarify to LOMOD that it must not provide improper retroactive rent increases this will allow \$38,839 in project funds to be put to better use over the next year.**

**Response:** Headquarters' staff and Los Angeles Multifamily Hub staff are coordinating the correct clarification to provide to LOMOD.

**IM. Monitor standard 6 on a regular basis as required by the Section 8 Guidebook for Contract Administration and the Monitoring and Evaluation Policies and Procedures.**

**Response:** Multifamily agrees with this recommendation. The monitoring of IBPS 6 is assigned to the Los Angeles funding staff.

**IN. Discuss with the oversight monitor future issues reported in her monthly report to ensure that it understands the issues presented and takes corrective actions to resolve those issues.**

**Response:** Multifamily agrees with this recommendation.

**IO. Obtain and review an annual work plan for standard 6 from LOMOD as an added monitoring tool to ensure that it is making reasonable progress in what it is telling HUD it plans to accomplish.**

**Response:** Multifamily agrees with this recommendation. However, as a point of clarification, the PBCA program and the PB-ACC requires submission of an annual work plan which is outlined in the PBCA guidebook and provides the framework for information required in the plan. The submission requirements cover all areas, not just standard 6. The annual work plan is reviewed by the HUD office and is utilized throughout the year as one of the program monitoring tools.

#### **Multifamily Reversed Disincentive Responses**

All cases have been reviewed by our Multifamily Asset Management staff, and we believe that the Inspector General has in some cases misinterpreted the applicable policy which was addressed in our

## **Comment 9**

**Comment 2**

November 2006 response to the draft finding outline as to why the disincentive was assessed in accordance with the contractual terms; made reference to the incorrect applicable policy; did not acknowledge local processing and written instructions that were provided to the PBCA as in the case of debt service during the transitional phase which required the Hub's prior approval; and most importantly in all cases, the Inspector General did not discuss or interview the Multifamily staff who processed the disincentives. Therefore, Multifamily is concerned with the Inspector General's conclusions.

**Comment 10**

**1. Casa Bella - Multifamily Determination – IBPS 14**

The primary reason for assessing a disincentive was the technical staff determined that an incorrect owner option was processed. Additionally, a contract renewal was issued absent HUD's approved RCS, which is a requirement.

Applicable Policy Reference:

- Section 8 Renewal Policy – Chapter Four, Option 2, The Guidebook for Section 8 Contract Administration Initiative dated March 15, 2001, Chapter 11.
- The Proposed Monitoring and Evaluation Policy and Procedures Guide dated August 22, 2000.
- PB-ACC requires the PBCA to ensure that all work is processed accurately and correctly.
- PBCA REMS Data Input User Guide, Attachment 1- Requires REMS Entry Fields including "Comparability Study"
- Chapter 9 ( Rent Comparability Studies)

**Comment 11**

**2. Alosta Gardens – Multifamily Determination – IBPS 14**

The Los Angeles Multifamily November 2006 response states that the Inspector General misstated HUD's rent comparability study policy and no changes were made to this draft report. The appropriate transaction was an amend rent under IBPS 3. Basic business judgment must be exercised as HUD's written policy does not account for every possible scenario. The existing HAP expiration date (2006) was the primary issue under review and the PBCA did not consult with HUD and unnecessarily delayed the renewal process 5 months (June 28, 2004 through November 22, 2004) which by any means is unacceptable. The technical staff determined that a disincentive was warranted, and the contractual requirements were not satisfied.

The Inspector General's cited reason for the assessed disincentive is misrepresented. The FY2005 transaction was processed as a contract renewal (IBPS 14) and it should have been processed as an Amend rent transaction (IBPS 3).

The renewal of a contract and HUD's requirement for an owner to provide a rent comparability study are synonymous. If HUD previously authorized a current HAP Contract with an expiration date of 2006, the existing HAP would not be terminated during its current contract term.

Reference is made to the 2004 Annual Compliance Review regarding the contractor's requirement regarding performing a timely and accurate initial review of the owners' submission.

**Comment 2**

**Comment 12**

Applicable Policy Reference:

- Section 8 Renewal Policy - Chapter Two, Section 2-3.
- Section 8 Renewal Policy – Chapter Four, Option 2, Sections 4-3 and 4-3(A).
- The Guidebook for Section 8 Contract Administration Initiative dated March 15, 2001, Chapter 11.
- The Proposed Monitoring and Evaluation Policy and Procedures Guide dated August 22, 2000.

**3. Amerige Villa – Multifamily Determination - IBPS 14**

The technical Los Angeles staff that processed the disincentive was not consulted.

The issue surrounding the disincentive assessment is the data that was posted in REMS by the contractor at the time Multifamily reviewed the contractor's work product. The documents in support of the assessment did not involve a HUD employee since the agency was not the party who processed the work. Therefore, the assessment of incomplete data entry was accurate based on the fact that the contractor solely processed the work. Copies were provided to the Inspector General.

The REMS documentation provided by LA LOMOD to HUD dated April 19, 2005, did not represent data from HUD's system (REMS). For example, there are no dashes in dates contained within REMS. The "*Date Complete Package Received From Owner*" field was altered. Subsequently, HQ REMS confirmed at the time the initial work product review was conducted, that the error was processed by LA LOMOD's subcontractor.

During the Inspector General's external PBCA audit which commenced January 23, 2006, and ended June 2006, their review results were consistent in citing the same data discrepancies as Multifamily (*Date Complete Package Received From Owner*) and later confirmed with HQ REMS that an erroneous system update had occurred by LA LOMOD's subcontractor while attempting to run an automated program to extract data from HUD's system (REMS). Outside contractors normally should not have access to HUD's system at a level which would allow the manipulation of HUD's primary REMS data.

The "Date Owner Signed Submission" field is incorrect since the Owner's initial submission was dated February 28, 2005, and date stamped received by the PBCA on March 3, 2005. Therefore, the Owner's signed submission date could not be April 1, 2005. The dates posted in REMS were inconsistent with the local office practice that had been communicated to the PBCA, and exercised regarding processed work in the past. HUD's policy has not been misinterpreted by seasoned multifamily staff based on the posted data at the time of the review.

Applicable Policy Reference:

- The Guidebook for Section 8 Contract Administration Initiative dated March 15, 2001, Chapter 11
- The Proposed Monitoring and Evaluation Policy and Procedures Guide dated August 22, 2000.

- The Section 8 Renewal Policy Chapter 4.

**4. Casitas Del Mar I - Multifamily Determination - IBPS -3**

The technical Los Angeles staff that processed the disincentive was not consulted.

A processing error occurred. The cited finding is not accurately represented. The assessment was immediately withdrawn by the CAOM, and agreed upon by Asset Management. The auditor in charge of the external Inspector General PBCA audit discovered while reviewing two similar transactions that the REMS screens were different, and sought an answer from the technical staff. Multifamily confirmed that a system change had occurred.

After verifying with HQ that a REMS change had been implemented and that they had omitted this information from their released announcement regarding rent adjustments. This would have been Multifamily' normal practice for this type of situation.

It's unclear as to why this project was included in the audit since Multifamily identified the processing error, notified both auditors, and implemented corrective action when the issue was identified. Additionally, Multifamily' documentation was provided to both auditors who had not begun an audit for the selected project.

**5. Casitas Del Mar II - Multifamily Determination - IBPS 3**

The technical Los Angeles staff that processed the disincentive was not consulted.

A processing error occurred. The cited finding is not accurately represented. The assessment was immediately withdrawn by the CAOM, and agreed upon by Asset Management. The auditor in charge of the external Inspector General PBCA audit discovered while reviewing two similar transactions that the REMS screens were different, and sought an answer from the technical staff. Multifamily confirmed that a system change had occurred.

After verifying with HQ that a REMS change had been implemented and that they had omitted this information from their released announcement regarding rent adjustments. This would have been Multifamily' normal practice for this type of situation.

It's unclear as to why this project was included in the audit since Multifamily identified the processing error, notified both auditors, and implemented corrective action when the issue was identified. Additionally, Multifamily' documentation was provided to both auditors who had not begun an audit for the selected project.

**6. Milwood Apartments –Multifamily Determination - IBPS 1**

The technical Los Angeles staff that processed the disincentive was not consulted.

Reference is made to LOMODs 2004 Annual Compliance Review Management and Occupancy Review finding with respect to this matter, and various subsequent meetings that have been held

**Comment 2**

**Comment 13**

**Comment 2**

**Comment 13**

**Comment 2**

**Comment 14**

**Comment 2**

**Comment 15**

with LOMOD thereafter. Based on the documentation provided to the Inspector General, the incorrect rating was issued in accordance with HUD's policy, procedures, and local practice.

The Inspector General has not considered the multifamily written and verbal processing instructions to the PBCA.

Applicable Policy Reference:

- HUD Handbook 4350.1, Section 6-10e
- Local Los Angeles Multifamily Field Office practice
- The Proposed Monitoring and Evaluation Policy and Procedures Guide dated August 22, 2006.

**7. Grant Heights – Multifamily Determination - IBPS 14**

The technical Los Angeles staff that processed the disincentive was not consulted.

Multifamily November 2006 response states that the Inspector General is applying the incorrect policy that was associated with the disincentive assessment.

The primary assessment was due to issuing a HAP contract when there was an outstanding RCS under review and failure to enter the RCS data into REMS. Additionally, funding had been requested utilizing the owners RCS without prior HUD approval. All of which is non-compliant with HUD's policy and procedures.

During the Inspector General's external PBCA audit which commenced January 23, 2006, and ended June 2006, their review results were consistent in citing the same data discrepancies as Multifamily (*Date Complete Package Received From Owner*), and later confirmed with HQ REMS that an erroneous system update had occurred by LA LOMOD's subcontractor while attempting to run an automated program to extract data from HUD's system (REMS). Outside contractors normally should not have access to HUD's system at a level which would allow the manipulation of HUD's primary REMS data. The disincentive was warranted.

Applicable Policy Reference:

- The Guidebook for Section 8 Contract Administration Initiative dated March 15, 2001, Chapter 11.
- The Proposed Monitoring and Evaluation Policy and Procedures Guide dated August 22, 2000.
- PB-ACC is requires the CA to ensure that all work is processed accurately and correctly.
- PBCA REMS Data Input User Guide, Attachment 1 - "Comparability Study". Section 8 Policy Renewal Policy
- Chapter 2 (Section 2-1, Paragraph D - RCS)
- Chapter 4 (Section 4-5, Paragraphs F and H – RCS/Renewal)
- Chapter 9 ( Rent Comparability Studies)
- Los Angeles Multifamily Local Practice Policy dated 08-16-2004.

**Comment 2**

**Comment 16**

- The Guidebook for Section 8 Contract Administration Initiative dated March 15, 2001, Chapter 1, Section 1-6.

**8. Delta Manor - Multifamily Determination IBPS 14**

The technical Los Angeles staff that processed the disincentive was not consulted.

The Inspector General utilized the PBCA's correction date of February 18, 2005, which followed Los Angeles' rejection of the initial and subsequent submitted work product.

The PBCA's work product was deemed unacceptable due to incorrect debt service, incomplete REMS data, incorrect contract term; and inaccurate RCS data. All of which are required by Multifamily. The disincentive was warranted.

Applicable Policy Reference:

- The Guidebook for Section 8 Contract Administration Initiative dated March 15, 2001, Chapter 11.
- The Proposed Monitoring and Evaluation Policy and Procedures Guide dated August 22, 2000.
- PB-ACC requires the PBCA to ensure that all work is processed accurately and correctly.
- PBCA REMS Data Input User Guide, Attachment 1- Requires REMS Entry Fields including "Comparability Study"

Section 8 Renewal Policy:

- Chapter 2 (Section 2-1, paragraph D)
- Chapter 4 (Section 4-5, paragraphs F and H)
- Chapter 9 ( Rent Comparability Studies)
- The Guidebook for Section 8 Contract Administration Initiative dated March 15, 2001, Chapter 1.

**9. Oxford Park - Multifamily Determination - IBPS 14**

The primary reason for the disincentive assessment was that the PBCA inaccurately processed an Annual Adjustment Factor ("AAF"), due to utilizing the incorrect rate. HUD's written policy was not followed with respect to accurately processing an AAF transaction.

Applicable Policy Reference:

- The Guidebook for Section 8 Contract Administration Initiative dated March 15, 2001, Chapter 11.
- The Proposed Monitoring and Evaluation Policy and Procedures Guide dated August 22, 2000.
- Federal Register (FR-5031-N-01) Annual Adjustment Factor
- PBCA REMS Data Input User Guide, Attachment 1

**Comment 17**

- HUD Notice H 2002-10, Issued 05-17-2002; and
- Notice H-2002-10, issued May 17, 2002



## OIG Evaluation of Auditee Comments

- Comment 1** In November 2006, we received an unofficial response to our draft finding outlines from the oversight monitor who told us we would receive the official response from the Hub director. We did not receive that response, but considered the oversight monitor's unofficial response when we drafted our report. However, her response did not change our opinion.
- Comment 2** We consulted with the oversight monitor on all disincentives assessed because she provided us with the documentation to support her assessment of disincentives and she represented to us that she was responsible for assessing the disincentives. She told us on March 8, 2006, that in the process of generating a disincentive, once she receives the recommendation for a disincentive from the project manager or supervisory project manager, she reviews the package and if she agrees with the assessment, she will send an email to LOMOD identifying the issue. She then reviews LOMOD's response and will either rescind the disincentive or write up a formal disincentive recommendation and send it back to LOMOD. Therefore, it is clear the oversight monitor ultimately makes the decision whether to assess a disincentive.

Further, the monitoring and evaluation guide says the oversight monitor is responsible (among other things) to draft policies and procedures that impact contract administrator oversight, provide guidance to the supervisory project manager, and oversee the work of the supervisory project manager and the project managers, and is the team leader for compliance reviews. Under task 3, the monitoring and evaluation guide says the oversight monitor will, "...verify that adjustments have been processed in accordance with HUD guidelines..." and "...that adjustments have been processed within the required timeframes." Under standard 14, the oversight monitor is supposed to, "...verify that contracts have been renewed in a timely manner and in accordance with HUD guidelines." In another section, under standard 3, the oversight monitor is responsible to "...verify the timing of all adjustments..." This guide also states that the oversight monitor is responsible for all contracting issues. Disincentives *are* contracting issues. They are issued when the contract administrator is not in conformance with the contract. In addition, the oversight monitor told us that she provides assistance and guidance to LOMOD.

- Comment 3** The appeal sent by LOMOD to HUD headquarters was addressed to the, "Acting Deputy Assistant Secretary for Multifamily Housing." However, since he was not "acting" in the position, we have corrected the report to delete "acting" from his title.
- Comment 4** The processes and procedures in place for addressing appeals of disincentives, including the use of an appeals committee, have not worked well in the past. Historically, the appeals committee has supported the assessment of disincentives while the operations officer has routinely granted LOMOD's appeals. Although the former operations officer is no longer in the position, in the interests of

fairness and objectivity, we recommend that the acting deputy assistant secretary for multifamily housing appoint the staff of a hub other than the Los Angeles multifamily Hub to review appeals from LOMOD.

**Comment 5** The 90-day corrective action plan implemented by the acting Hub director does not address the findings or the disincentives from the 2004 compliance review. HUD must ensure that LOMOD is not reimbursed for the reduction in incentive fee for those findings that were improperly reversed.

**Comment 6** Policies and procedures also need to be created and implemented to ensure disincentives and reductions to the incentive are properly assessed and are consistently applied to transactions that do not meet the annual contributions contract's acceptable quality level.

**Comment 7** It appears HUD has misinterpreted our recommendation. We are not implying that LOMOD should reinterpret HUD's policies but rather that LOMOD should create and implement policies and procedures to ensure that it and its subcontractor have controls in place to ensure it is in compliance with HUD's requirements when performing its day-to-day functions.

**Comment 8** We considered HUD's verbal comments and modified recommendation 1I as appropriate.

The 90-day corrective action plan (plan) states that a specific annual adjustment factor applies to all contracts with an anniversary date on or after the date the rate is published in the Federal Register. However, LOMOD is required to complete processing of rent adjustments within 30 days and contract renewals must be completed 60 days prior to the housing assistance payments anniversary date. The new factor may not yet be issued in these cases. HUD's corrective action plan must address this possible problem.

The plan also implies that any owner who does not submit its renewal request 120 days prior to contract expiration will not receive a retroactive rent increase. However, in accordance with Section 3-7C of the Section 8 Renewal Policy Guide and the memorandum from the director of HUD's Housing Assistance and Grant Administration, dated September 28, 2007, this policy applies only to those projects renewing under option 1 of the operating cost adjustment factor method. In addition, the Guidebook for Section 8 Contract Administration does not allow retroactive rents to owners of projects receiving rental adjustments under the annual adjustment factor method unless its submission is made at least 60 days prior to the housing assistance payments anniversary date. These policies do not apply to projects renewing or receiving rental adjustments under other methods.

Further, the plan does not include steps for HUD to monitor and review transactions under standards 3 and 14 during the corrective action period as was done during the transition phase of contract performance. In addition, the plan

does not ensure that the corrective action period does not expire until HUD can demonstrate that LOMOD has met the acceptable quality level for three consecutive months as required for each standard.

**Comment 9** We reviewed the packages the oversight monitor provided documenting the disincentives assessed and the reversal of those disincentives. Those documents explained why the disincentives were assessed. We did acknowledge local written policies and instructions that were provided to LOMOD, but did not rely on verbal explanation to LOMOD as a formal policy since HUD could not demonstrate that the verbal discussions included policy discussion.

**Comment 10** The documentation and information we received from the oversight monitor did not show that this disincentive was assessed because an incorrect owner option was processed. This disincentive was assessed because LOMOD did not follow HUD's instruction to issue a short-term contract and LOMOD issued an incorrect contract due to unapproved rents.

Although the project manager's request for LOMOD to issue a short-term contract was sent to the supervisory project manager, she did not forward the request to LOMOD. Therefore, LOMOD should not be held accountable. In addition, LOMOD explained that it was following a HUD headquarters memorandum issued July 2, 2001. In accordance with that memorandum, LOMOD obtained the owner's signature in order to expedite the process, but did not fully execute the contract. Therefore, it did not issue an incorrect contract.

**Comment 11** In our report, we identified this project as having been assessed a disincentive based on standard 14 (contract renewals) because the oversight monitor's emails to LOMOD stated that a disincentive was recommended related to standard 14. This disincentive was assessed because LOMOD inappropriately requested a rent comparability study from the owner resulting in a processing delay and the processing should have been for an amend rents only transaction under standard 3 (rental adjustments) instead of a contract renewal under standard 14.

We determined it was appropriate for LOMOD to request a rent comparability study from the owner because the old rent comparability study had expired and rents determined by using the old study would not be valid rents. The Guidebook for Section 8 Contract Administration Initiative gives the following example. "If the owner renewed the contract in Fiscal Year 1999 under Section 524(a)(1) of MAHRA [Multifamily Assisted Reform and Affordability Act] for a one-year term, and in Fiscal Year 2000 wishes to renew for a five-year term, the owner may either: a) renew the contract for four years, using the RCS [rent comparability study] submitted at initial renewal; or b) submit a new RCS [rent comparability study] and renew the contract for a five-year term."

The policy to which HUD refers, Section 8 Renewal Policy – Chapter Two, Section 2-3 supports our position. Specifically, paragraph B states, "HUD/CA's [contract administrators] should make every effort to align contract renewal terms with the five-year life cycle of the RCS [rent comparability study]." Further,

Note 2 in Section 4-3A2 states that if a contract is for a period greater than five years, an owner must complete a new rent comparability study every five years. Taken together, these policies show a new rent comparability study should have been provided in this case. Then, the following year, when the housing assistance payments contract was renewed, it would be renewed for only four years, to coincide with the expiration of the rent comparability study.

There was no documentation to support the assertion that LOMOD processed this transaction under standard 14, but HUD's real estate management system and the documents provided show this transaction was processed under standard 3.

**Comment 12** Our review and follow up with HUD's real estate management system specialists showed that the Date Complete Package Received from Owner was input when LOMOD processed the transaction. However, it was later deleted by a HUD employee.

HUD states that the document provided that showed dashes in the dates were altered by LOMOD from HUD's real estate management system. However, it did not provide any documentation to support this statement. Further, HUD headquarters Multifamily Office of Program System Management already admitted shared responsibility in the erroneous system updates by LOMOD's subcontractor because the real estate management system did not have controls in place to prevent data from being changed when LOMOD downloaded information from the system. Further, this transaction was not one of the transactions accidentally updated.

The Date Owner Signed Submission field was not incorrect. There is no criteria that states if this field should be populated with the date the owner signed its initial submission, or the date the owner signed any subsequent submission.

**Comment 13** On November 21, 2005, the oversight monitor initially assessed this disincentive. On December 14, 2005, the oversight monitor stated that she had completed her review of the documentation provided and continued to assert that this disincentive was warranted based on standard 3 because she said that LOMOD input an adjusted utility allowance in error. However, the documentation shows that LOMOD followed the instructions in the Real Estate Management System User's Guide.

HUD's response also stated that it is unclear as to why this project was included in the audit since Multifamily identified the processing error, notified the auditors, and implemented corrective action. However, it was not until April 25, 2006, after our audit had begun, after the oversight monitor had provided us with the package documenting the disincentive, and as a result of the questions we began asking about these projects that she admitted to us that the appeal granted by the operations officer for this transaction was appropriate. Therefore, we stand by our assessment that the disincentives initially assessed based on these transactions were inappropriate.

**Comment 14** This disincentive was assessed based on standard 1 (management and occupancy reviews). The oversight monitor stated that she issued this disincentive because LOMOD rated the project's management and occupancy review as satisfactory when it rated the project's leasing and occupancy at below average. Although the oversight monitor stated that this had been discussed in various meetings with LOMOD, she told us this had never been issued in writing to LOMOD. Contrary to the HUD response, HUD Handbook 4350.1 does not contain a Section 6-10e. However, Section 6-11e states that, "There is no numerical formula for converting action codes and categorical ratings into an overall rating. The servicer must develop the overall rating by assessing the impact of various management deficiencies on a specific project. Generally, the categories of Maintenance and Security, Financial Management, and Leasing and occupancy on subsidized projects have the greatest impact on the project. Therefore, if the lowest categorical rating given on the Management Review report is in one of these categories, that categorical rating would normally be the overall rating." This indicates that there could be exceptions and does not mandate that this is an absolute requirement. Further, in a similar situation on Orchard Park, the HUD project manager told LOMOD he would recommend the lower overall rating, but told LOMOD, "...it's your call."

**Comment 15** The oversight monitor assessed this disincentive for three reasons, a short-term renewal was an incomplete work product, the contract renewal was prematurely received, and because a real estate management system entry was missing.

HUD's response to our draft audit report said that LOMOD failed to enter the rent comparability study data into the real estate management system for a short-term contract renewal. However, our audit disclosed that although LOMOD failed to specifically select the applicable button in HUD's real estate management system to indicate a rent comparability study was required for this contract, the REMS User Guide says in chapter 18.3.3.1 that one of the reasons for entering into a short-term renewal is to allow HUD or the contract administrator to review an owner's comparability study. In addition, the Decision Comments section of the FY 2006-2: Request Renewal Without Restructuring at or Below Comparable Rents real estate management system screen stated that a short-term contract was being used to allow HUD time to review the rent comp study. In addition the field Reason for Short-Term Renewal said the same thing. Consequently, the information was in the system, so failing to select one button does not seem to warrant a disincentive.

HUD's response also said LOMOD requested funding based on the owner's rent comparability system without prior HUD approval. LOMOD tried to expedite the process and indicated in the real estate management system that the submission was "in process." This also conforms to the headquarters memorandum discussed under comment 10 above. Therefore, LOMOD should not have been assessed a disincentive on this basis.

Further, HUD's response identified this transaction as one in which the template LOMOD used to obtain updates from the real estate management system

accidentally updated the system with incorrect information (see comment 12). However, we contacted the HUD real estate management system specialist who provided documentation that showed that a LOMOD employee completed this field when the transaction was processed and this field was deleted when a HUD employee updated the record. Therefore, it was HUD's actions, and not LOMOD's actions that caused the problem and LOMOD should not be assessed a disincentive.

**Comment 16** The oversight monitor told LOMOD that a disincentive was being issued because, "...the rents appear to have been final on 2-18-2005, and processed prior to the posting of HUD's approved RCS [rent comparability study] rents." Therefore, we used the same date as the oversight monitor to determine if the rent comparability study was approved before or after the rents were final. Our audit showed that the rent comparability study was approved before the rents were final. Further, on May 22, 2006, the oversight monitor agreed that the rent comparability study was approved prior to the rents being finalized. Therefore, a disincentive is not warranted on this basis.

LOMOD corrected the owner's incorrect debt service prior to submitting the package for approval. While the package was being processed, HUD issued a policy that stated that LOMOD was not to make any changes to owners' debt service in the submission. As a result, LOMOD changed the submission back to the original as submitted by the owner and should not be assessed a disincentive for incorrect information submitted by the owner after being told by HUD not to change the owner's information.

The incomplete real estate management system data, a blank field, was caused because the field was not originally a part of the system, but was added later, after the initial processing of this transaction. In addition, our audit revealed that LOMOD entered the correct contract term. Further, the documentation provided by the oversight monitor stated that the processing for fiscal year 2005 was intentionally omitted from the notice of assessed disincentive. Therefore, we did not review the allegation that there was inaccurate rent comparability study data.

**Comment 17** This transaction was initially processed prior to the new adjustment factors being released. Therefore, LOMOD used the factors in effect at the time of processing. As a result, a disincentive is not warranted (see comment 8).

## Appendix C

### SCHEDULE OF PROJECTS THAT DID NOT COMPLY WITH THE ANNUAL CONTRIBUTIONS CONTRACT

Project name & contract number	Deficiencies found/disincentives recommended	Disincentive/unearned incentive amount	Invoice month/year & standard
Rodeo Dr./Victorville CA16M000384	<ul style="list-style-type: none"> <li>Contract rents not renewed correctly</li> </ul>	\$1,749 (disincentive)	April 2004 (standard 3)
Casa Longwood CA16L000136	<ul style="list-style-type: none"> <li>HUD was not notified of the unit discrepancy between the rent schedule and the Occupancy screen in the Real Estate Management System</li> </ul>	\$3,658 (disincentive)	January 2005 (standard 3)
Whittier Lutheran Towers CA16L000117	<ul style="list-style-type: none"> <li>Missing date in the Real Estate Management System</li> </ul>	\$1,829 (disincentive)	March 2005 (standard 3)
Maple Park Apts. CA16T811022	<ul style="list-style-type: none"> <li>Missing date in the Real Estate Management System</li> </ul>	\$732 (disincentive)	April 2005 (standard 3)
Naomi Gardens CA16T811017	<ul style="list-style-type: none"> <li>HUD was not notified of the unit discrepancy between the rent schedule and the Occupancy screen in the Real Estate Management System</li> </ul>	\$1,829 (disincentive)	May 2005 (standard 3)
Figueroa Gardens	<ul style="list-style-type: none"> <li>Missing date in the Real Estate Management System</li> <li>Incomplete entry in the Real Estate Management System</li> </ul>	\$109,728 (unearned incentive)	May 2005 (standard 14) (improperly reversed disincentive/reduction in incentive fee)
Willow Village CA160034022	<ul style="list-style-type: none"> <li>Missing date in the Real Estate Management System</li> <li>HUD was not notified of the unit discrepancy between the rent schedule and the Occupancy screen in the Real Estate Management System</li> </ul>	\$1,829 (disincentive)	June 2005 (standard 3)
Valencia Villa Apts. CA160007004	<ul style="list-style-type: none"> <li>Missing date in the Real Estate Management System</li> </ul>		June 2005 (standard 3)

<b>Project name &amp; contract number</b>	<b>Deficiencies found/disincentives recommended</b>	<b>Disincentive/unearned incentive amount</b>	<b>Invoice month/year &amp; standard</b>
Rammton Arms CA33M000046	<ul style="list-style-type: none"> <li>Contract rents not renewed correctly</li> </ul>	\$73,146 <sup>4</sup> (unearned incentive)	June 2005 (standard 14)
High Valley	<ul style="list-style-type: none"> <li>Renewed contract under an incorrect option</li> </ul>		June 2005 (standard 14) (improperly reversed disincentive/reduction in incentive fee)
St. Andrews & Venice CA16M000418	<ul style="list-style-type: none"> <li>Missing Real Estate Management System entry</li> </ul>	\$114,986 (\$5,267 disincentive plus \$109,719 unearned incentive)	July 2005 (standard 14)
Finley Square CA16L000111	<ul style="list-style-type: none"> <li>Missing date in the Real Estate Management System</li> <li>HUD was not notified of the unit discrepancy between the rent schedule and the Occupancy screen in the Real Estate Management System</li> </ul>		
St. Andrews Place CA16M000414	<ul style="list-style-type: none"> <li>Missing date in the Real Estate Management System</li> </ul>		
Rainbow Plaza CA16T781036	<ul style="list-style-type: none"> <li>HUD was not notified of the unit discrepancy between the rent schedule and the Occupancy screen in the Real Estate Management System</li> </ul>	\$1,828 (disincentive)	August 2005 (standard 3)
Summer Field CA16M000352	<ul style="list-style-type: none"> <li>Contract rents not renewed correctly</li> <li>Missing date in the Real Estate Management System</li> </ul>	\$109,690 (unearned incentive)	August 2005 (standard 14)
Wycliffe Plaza CA33M000056	<ul style="list-style-type: none"> <li>Missing date in the Real Estate Management System</li> </ul>		
Subsidized Housing Corp. 4 CA160002004	<ul style="list-style-type: none"> <li>Missing date in the Real Estate Management System</li> </ul>		
Springdale West III CA16M000304	<ul style="list-style-type: none"> <li>HUD was not notified of the unit discrepancy between the rent schedule and the occupancy screen in the Real Estate Management System</li> </ul>	\$8,394 (disincentive)	September 2005 (standard 3)
Lions Community Manor CA16T791002	<ul style="list-style-type: none"> <li>Missing date in the Real Estate Management System</li> </ul>		
Villa La Jolla CA160059002	<ul style="list-style-type: none"> <li>Missing date in the Real Estate Management System</li> </ul>		
Springdale West I & II CA16M000303	<ul style="list-style-type: none"> <li>Missing date in the Real Estate Management System</li> </ul>		

<sup>4</sup> If LOMOD has been reimbursed for the reduction in incentive fee resulting from the operations officer's reversal of High Valley's assessed disincentive, the total amount will be \$109,719 instead of \$73,146.



<b>Project name &amp; contract number</b>	<b>Deficiencies found/disincentives recommended</b>	<b>Disincentive/unearned incentive amount</b>	<b>Invoice month/year &amp; standard</b>
Anaheim Memorial Manor CA16T851008	<ul style="list-style-type: none"> <li>• HUD was not notified of the unit discrepancy between the rent schedule and the Occupancy screen in the Real Estate Management System.</li> <li>• Submission was not processed in 30 days (date the initial submission was received: June 8, 2005; date the complete package was received: July 11, 2005 (LOMOD listed Aug. 29, 2005); date the submission sent was to HUD: Sept. 29, 2005)</li> </ul>		
Summer Field CA43L000002	<ul style="list-style-type: none"> <li>• Missing date in the Real Estate Management System</li> </ul>	\$109,485 (unearned incentive)	September 2005 (standard 14)
Roscoe Park Apts. CA16M000397	<ul style="list-style-type: none"> <li>• Missing date in the Real Estate Management System</li> </ul>		
Reseda Park Apts. CA16M000207	<ul style="list-style-type: none"> <li>• Missing date in the Real Estate Management System</li> <li>• HUD was not notified of the unit discrepancy between the rent schedule and the Occupancy screen in the Real Estate Management System</li> </ul>		
Rayen Park Apts. CA16M000254	<ul style="list-style-type: none"> <li>• Missing date in the Real Estate Management System</li> <li>• HUD was not notified of the unit discrepancy between the rent schedule and the Occupancy screen in the Real Estate Management System</li> </ul>		
Green Hotel CA16L000041	<ul style="list-style-type: none"> <li>• Missing date in the Real Estate Management System</li> <li>• Submission not processed within 30 days (date the initial submission received: Feb. 11, 2005; date the complete package was received: Feb. 25, 2005 (LOMOD listed April 8, 2005); date the submission was sent to HUD: Apr. 29, 2005)</li> </ul>		
Highland Manor Apts. CA33L000073	<ul style="list-style-type: none"> <li>• Missing date in the Real Estate Management System</li> </ul>		
Candlewood Apts. CA160004002	<ul style="list-style-type: none"> <li>• Entry into the Real Estate Management System was unsupported.</li> </ul>		
Meadowbrook	<ul style="list-style-type: none"> <li>• Incomplete entry in the Real Estate Management System</li> </ul>		

<b>Project name &amp; contract number</b>	<b>Deficiencies found/disincentives recommended</b>	<b>Disincentive/uneared incentive amount</b>	<b>Invoice month/year &amp; standard</b>
Clark Senior Apts. CA16H113142	<ul style="list-style-type: none"> <li>HUD was not notified of the unit discrepancy between the rent schedule and the Occupancy screen in the Real Estate Management System</li> </ul>	\$2,190 (disincentive)	October 2005 (standard 3)
39th Place Apts. CA16L000131	<ul style="list-style-type: none"> <li>Contract rents were not renewed correctly</li> <li>HUD was not notified of the unit discrepancy between the rent schedule and the Occupancy screen in the Real Estate Management System</li> </ul>		
Jessie L. Terry Manor CA16M000199	<ul style="list-style-type: none"> <li>Incorrect Real Estate Management System entry</li> </ul>	\$109,485 (uneared incentive)	October 2005 (standard 14)
Carlota Park Apts. CA16M000344	<ul style="list-style-type: none"> <li>HUD was not notified of the unit discrepancy between the rent schedule and the Occupancy screen in the Real Estate Management System</li> </ul>		
Peppertree Apts. CA16R000004	<ul style="list-style-type: none"> <li>HUD was not notified of the unit discrepancy between the rent schedule and the Occupancy screen in the Real Estate Management System</li> </ul>	\$109,457 (uneared incentive)	November 2005 (standard 14)
Rancho Niguel CA160050003	<ul style="list-style-type: none"> <li>HUD was not notified of the unit discrepancy between the rent schedule and the Occupancy screen in the Real Estate Management System</li> </ul>	\$7,434 (disincentive)	December 2005 (standard 3)
Jewel Terrace CA16L000018	<ul style="list-style-type: none"> <li>HUD was not notified of the unit discrepancy between the rent schedule and the Occupancy screen in the Real Estate Management System</li> </ul>	\$43,730 (uneared incentive)	December 2005 (standard 14)
Preservation II CA16L000100	<ul style="list-style-type: none"> <li>Missing rent schedule</li> </ul>	\$2,624 (disincentive)	January 2006 (standard 3)
Coachella Valley CA16R000009	<ul style="list-style-type: none"> <li>HUD was not notified of the unit discrepancy between the rent schedule and the Occupancy screen in the Real Estate Management System</li> </ul>	\$156,365 (\$25,186 disincentive plus \$131,179 uneared incentive)	January 2006 (standard 14)

<b>Project name &amp; contract number</b>	<b>Deficiencies found/disincentives recommended</b>	<b>Disincentive/uneared incentive amount</b>	<b>Invoice month/year &amp; standard</b>
Sunnyview Villa CA160021004	<ul style="list-style-type: none"> <li>Submission not sent to HUD 60 days before expiration (date the initial submission was received: Jan. 27, 2005; date the complete package was received: Jan. 27, 2005 (LOMOD listed April 25, 2005); Submission due to HUD: Apr 1, 2005; date the submission was sent to HUD: Apr. 29, 2005)</li> </ul>		
Hacienda Del Norte	<ul style="list-style-type: none"> <li>Incorrect Real Estate Management System entry</li> </ul>		(improperly reversed disincentive/reduction in incentive fee)
Gardena South Park CA16T831001	<ul style="list-style-type: none"> <li>HUD was not notified of the unit discrepancy between the rent schedule and the Occupancy screen in the Real Estate Management System</li> </ul>	\$131,198 (uneared incentive)	February 2006 (standard 14)
Arrowhead Vista CA16T821025	<ul style="list-style-type: none"> <li>HUD was not notified of the unit discrepancy between the rent schedule and the Occupancy screen in the Real Estate Management System</li> </ul>	\$129,397 (uneared incentive)	March 2006 (standard 14)
Valley Village #3 CA16T781041	<ul style="list-style-type: none"> <li>HUD was not notified of the unit discrepancy between the rent schedule and the Occupancy screen in the Real Estate Management System</li> </ul>		
Woodman Nordhoff CA16M000345	<ul style="list-style-type: none"> <li>Delay of processing the contract</li> </ul>	\$129,397 (uneared incentive)	April 2006 (standard 14) (improperly reversed disincentive/reduction in incentive fee)
Sheridan South Villas CA16L000159	<ul style="list-style-type: none"> <li>Missing date in the Real Estate Management System</li> </ul>	\$0 <sup>5</sup>	
<b>Total</b>		<b>\$1,360,160 (\$64,549 disincentives plus \$1,295,611 uneared incentives)</b>	

<sup>5</sup> This transaction was not billed to HUD. Therefore, there is no associated disincentive for this incorrect work product.