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Report to the Honorable
Tom McMillen, House of Representatives

June 1989

PUBLIC HOUSING

HUD Oversight of the Annapolis Housing Authority

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GAO

**United States
General Accounting Office
Washington, D.C. 20548**

**Resources, Community, and
Economic Development Division**

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June 5, 1989

The Honorable Tom McMillen
House of Representatives

Dear Mr. McMillen:

As requested in your July 27, 1988, letter, we assessed the adequacy of the Department of Housing and Urban Development's (HUD) oversight of the Housing Authority of the City of Annapolis, in Maryland. You expressed concern about allegations of fraud and mismanagement at that authority. As subsequently agreed with your office, we focused our review on HUD's oversight of a program to modernize Annapolis' public housing. We also determined why HUD did not complete an overall management review between 1985 and 1988 and why the housing authority's operating reserves have sharply declined since 1986.

Results in Brief

HUD's Baltimore field office generally followed its established procedures in overseeing the Annapolis housing authority's operations. The Baltimore office conducted required semiannual reviews of the modernization program and identified problems with contracting practices, which led it in July 1984, May 1985, and again in January 1986 to request an investigation by HUD's Office of Inspector General. This investigation was partially responsible for the indictment and subsequent conviction of the authority's former executive director on charges of fraud, bribery, and racketeering. The Baltimore office, however, did not find in a timely manner other weaknesses in Annapolis' modernization program, such as a $213,000 overrun on one project.

HUD officials did not conduct an overall management review of the Annapolis housing authority between 1985 and 1988, which is required when a problem is suspected, because they had requested an Inspector General investigation of the housing authority. However, HUD conducted other studies during the period that covered some of the same areas normally included in an overall management review and initiated an overall management review in December 1988. Finally, our review of the authority's financial records showed that its operating reserve dropped significantly from 1986 to 1988 primarily because of declining investment income and increasing operating expenditures—particularly for maintenance.

Background

Created in 1937, the Annapolis housing authority manages 10 public housing projects consisting of 1,103 dwelling units and provides additional financial assistance to 285 families so that they can afford rental housing in the private market. An executive director and housing authority staff manage the day-to-day activities. A board of commissioners —five volunteers appointed by the Mayor of Annapolis—establishes policies for the authority, provides oversight, and selects the executive director. The oversight role of the executive director and board of commissioners has become more important in recent years, as the Congress has moved toward decreasing federal reporting requirements and increasing autonomy for public housing authorities. This places an even greater responsibility for the effective operation of an authority on its executive director and board of commissioners.

HUD continues, however, to monitor housing authorities to ensure that they provide decent, safe, and sanitary housing for lower income families; properly manage federal funds; and carry out statutory, regulatory, and contractual requirements. It reviews authority-submitted financial and contractual information and periodically visits sites to evaluate specific areas of an authority's operations. The modernization program, for example, requires that HUD perform on-site reviews semiannually. HUD's procedures require it to conduct an overall management review of each authority at least every 8 years and/or at least within 4 years of a suspected problem at an authority.

HUD subsidizes the operations of public housing authorities through annual operating subsidies and modernization assistance. Operating subsidies are necessary because rents collected are usually too low to cover the costs to operate and maintain the housing. In 1988, HUD provided the Annapolis housing authority with $643,180 in operating subsidies. This amount is projected to increase to $697,362 in 1989. Modernization subsidies are provided to improve the physical condition of housing projects. Since 1981, HUD has approved about $14 million in modernization funds for the Annapolis authority.

HUD's Oversight Disclosed Problems

We found that HUD generally followed its established guidelines in overseeing the Annapolis housing authority's modernization program. At the Annapolis authority, HUD's oversight enabled it to detect various irregularities in the authority's contracting procedures. Among these irregularities were the successive awards of contracts between 1981 and 1984 to the same architectural and engineering firm without reopening competition and without submitting these contracts to HUD for review and approval, as required. Because of these irregularities and HUD's suspicion that the irregularities may have been symptomatic of deeper contracting problems, HUD's Baltimore field office requested the HUD Inspector General to review the Annapolis authority's contracting practices. This subsequent review, in part, led to the indictment and conviction of the housing authority's former executive director.

We found several weaknesses in the authority's modernization program that HUD did not detect. For example, the authority requested $504,000 for 300 exterior doors and storm doors ($1,680 per pair) at one project. HUD approved $360,000 for the doors ($1,200 per pair). These doors, however, actually cost about $124,500 ($415 per pair), or roughly one-third the amount approved by HUD. HUD field office officials said their primary concern in reviewing modernization project budgets is to be certain that the project's overall cost is reasonable. They said that they rely on the authority's competitive bidding process to keep costs as low as possible. HUD's modernization handbook does not require it to closely review the costs of individual items. In this case, however, a check against HUD's procurement catalogs would have shown the cost estimate to be high.

Also, HUD did not recognize until August 1987 that the Annapolis authority had overrun its budget for one project by an amount later determined to be $213,000, although HUD had the information necessary to identify at least part of the overrun in January 1986. Officials said that this oversight occurred because the project was funded separately over 3 years and that their staff did not total the spending for the 3 years and compare it with the overall budget limit. HUD planned to withhold action on the overrun until after the trial of the former executive director because accusations against him concerned work at this project. Although the trial ended in November 1988, HUD had not, as of May 1989, decided how it would proceed.

HUD Appears Justified in Having Postponed the Overall Management Review

HUD's Baltimore office did not complete an overall management review of the Annapolis authority's operations between 1985 and 1988, despite its suspicion that the authority was mismanaging contracts for architectural and engineering services. However, we believe the Baltimore office carried out its responsibilities by referring this matter to the HUD Inspector General for further investigation and by completing other reviews. HUD field office officials said they did not conduct an overall management review because they had requested an Inspector General's investigation of the matter; however, field office officials said that they did not discuss this with the Inspector General. When the HUD Philadelphia Regional Inspector General for Investigations initiates an investigation, he said he usually tells HUD officials to conduct business as usual during the investigation, but to coordinate their activities with him. In this case, he said an overall management review by the Baltimore office would not have been advisable because the authority's contracting documentation was being held by both Inspector General and Federal Bureau of Investigation staff.

The HUD field office did, however, conduct various other reviews of the housing authority between 1985 and 1988 that incorporated some of the same aspects that would normally be evaluated in an overall management review. These included physical inspections of housing authority properties, reviews of procedures for filling vacant units, and reviews of the authority's financial procedures and condition. An overall management review of the authority was initiated by the HUD field office in December 1988 with a final report planned to be completed in May 1989.

Annapolis' Operating Reserves Have Declined Dramatically

HUD uses a housing authority's operating reserve, which is a reserve of unspent operating funds, as a key indicator of the authority's financial condition. The maximum allowable reserve is half of the authority's estimated total routine expenses for the next year. HUD generally considers a housing authority to be operationally and financially healthy if its operating reserve is 40 percent or more of this maximum.

The Annapolis housing authority's reserve changed significantly from 79 percent of the maximum allowed in 1985, to 42 percent in 1987, and 18 percent in 1988. The decline resulted from a drop in the authority's investment income and an increase in operating expenditures, particularly maintenance. The HUD field office was aware of the negative trend in the authority's operating reserve but because of the timing of budget submissions, did not realize that the authority's reserves had fallen below 40 percent. HUD reimbursed the authority $45,000 in fiscal year 1989 for maintenance work that was eligible for modernization funds. HUD also provided the Annapolis authority with $80,902 in additional operating subsidies for which it was eligible on the basis of changes in investment income and utility costs. These funds raised the reserve level to about 20 percent of the maximum. HUD field office staff and the housing authority's new executive director are working on operational changes that they hope will increase revenues and cut costs to raise the reserve level beyond 20 percent.

Our review was conducted between November 1988 and February 1989. We obtained and analyzed reports and correspondence in HUD program files that documented HUD's oversight of the authority since 1980. We also reviewed pertinent regulations and HUD handbooks and discussed oversight policies with HUD and Annapolis housing authority representatives. We reviewed HUD criteria for operating reserves and obtained documentation of the housing authority's reserve levels from 1985 to 1989. We discussed the decline in reserves with HUD officials and obtained financial reports that showed how the decline occurred.

We discussed the information in this report with officials at HUD's Baltimore field office and the Annapolis housing authority. The officials generally agreed with the information presented in this report. We also obtained the views of HUD headquarters, regional, and other field office officials during the course of our work and incorporated their views where appropriate.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 14 days after the date of this letter. At that time, we will send copies to the Secretary, HUD; the Chairperson, Board of Commissioners, and the Executive Director, Housing Authority of the City of Annapolis; and other interested parties. Should you require any additional information on this report, please call me on (202) 275-5525.

Major contributors to this report are listed in appendix V.

Sincerely yours,

John M. Ols, Jr.

John M. Ols, Jr.
Director, Housing and Community
Development Issues

Contents

Abbreviations

CIAP	Comprehensive Improvement Assistance Program
GAO	General Accounting Office
HACA	Housing Authority of the City of Annapolis
HUD	Department of Housing and Urban Development
FBI	Federal Bureau of Investigation
PHA	public housing authority

Introduction

The Housing Act of 1937, as amended (42 U.S.C. 1437, et seq.), established the public housing program to provide lower income families with decent, safe, and sanitary housing. Although the federal government provides financial assistance, public housing is owned and managed by local public housing authorities (PHA). Because rents are too low to cover costs, the Department of Housing and Urban Development (HUD) provides PHAs with operating subsidies to help maintain and operate their projects. Through the Comprehensive Improvement Assistance Program (CIAP), HUD also provides PHAs with modernization funds to help finance capital and management improvements.

HUD and PHA Roles

PHAs generally have a board of commissioners, appointed by locally elected officials, who are responsible for establishing and overseeing the PHAs' operating policies. An executive director, usually appointed by the board of commissioners, is responsible for carrying out these policies and for day-to-day operation of the PHA.

In return for financial assistance, PHAs agree to assume certain legal obligations and responsibilities that are set forth in an Annual Contributions Contract. This contract requires, among other things, that housing agencies maintain their projects in good repair, operate them with maximum efficiency and economy, and maintain their books and records according to HUD requirements. In recent years, there has been an increasing emphasis on reduction of federal requirements and increased autonomy for PHAs. This trend places an even greater responsibility on the executive director and board of commissioners for the effective operation of a PHA.

HUD field offices monitor PHAs in a limited way to ensure that they provide decent, safe, and sanitary housing for lower income families; properly manage federal funds; and carry out statutory, regulatory, and contractual requirements. Field office monitoring is often confined to desk reviews of PHA-submitted data relating to its financial and operating condition. Should this data indicate a particular problem, the field office may schedule an on-site management review to further explore the problem. In any event, HUD procedures require that it conduct limited management reviews at PHAs at least every 8 years to ensure satisfactory performance. For those PHAs receiving CIAP funding, the HUD field office also conducts on-site reviews at least semiannually to ensure compliance with modernization requirements and to monitor construction progress.

Annapolis Public Housing Authority

Created in 1937, the Housing Authority of the City of Annapolis (HACA), in Maryland, manages 10 projects consisting of 1,103 dwelling units. HACA also provides section 8 rental assistance to 285 families so they can afford rental housing in the private sector.[1] HUD's Baltimore field office oversees HACA's operations. The authority is governed by a board of commissioners, five volunteers appointed by the Mayor. The commissioners select the executive director who manages HACA's activities and its staff of about 65 people.

The executive director of HACA from 1973 to 1988 was convicted in November 1988 on fraud, bribery, and racketeering charges. As part of his sentence, he was ordered to pay $157,800 in fines, which was the value the jury assigned to kickbacks he received from contractors in exchange for directing about $5 million in contracts to them.

The funds misappropriated by the former executive director were CIAP funds. Since 1981, HUD has approved about $14 million in CIAP funds for HACA. The majority of these funds were to be used to modernize 278 of HACA's 1,103 public housing units with the expectation that they would remain viable for 20 more years without major repairs. As of February 1989, modernization work was complete on one 150-unit project at a cost of about $5.9 million, or about $40,000 per unit. Work at two other projects with 77 and 51 units was still ongoing. According to the HACA modernization coordinator, construction will be complete on these projects in June 1989 and September 1989, respectively.

In 1988, HUD provided HACA with $643,180 in operating subsidies. The estimated 1989 subsidy is $697,362. These subsidies represent about one-fourth of HACA's annual income, with the balance coming primarily from tenant rents. If more rent is collected than is anticipated, the extra funds can be placed in an operating reserve fund up to an allowable maximum level. The operating reserve is not a budgeted item, but rather a reserve fund made up of unspent operating funds. The maximum reserve is half the authority's estimated total routine expenses for the coming fiscal year. A PHA can use the reserve to fund budgetary shortfalls in future years.

[1]The section 8 rental assistance program provides subsidies to eligible families by paying a monthly stipend to a private landlord on their behalf. See also Rental Housing: Housing Vouchers Cost More Than Certificates but Offer Added Benefits (GAO/RCED-89-20, Feb. 16, 1989).

Objectives, Scope, and Methodology

On July 27, 1988, Representative Tom McMillen, concerned about alleged mismanagement at HACA, asked us to review the authority's operation. In subsequent meetings, it was agreed that we would (1) assess HUD's oversight of HACA's modernization program, (2) determine why HUD did not conduct an overall management review of HACA between 1985 and 1988, and (3) examine changes to the HACA operating reserve level between 1985 and 1988.

We reviewed legislation, HUD regulations, handbooks, and other guidance regarding public housing modernization and HUD's role in oversight of public housing modernization. We discussed HUD's oversight of the HACA modernization program with HUD's Baltimore field office manager, deputy manager, director of the housing management division, and chief of the assisted housing management branch; and with the former director and the acting director, Office of Public Housing, at HUD's Philadelphia Regional Office. We toured the modernized projects and discussed HUD's oversight with the acting executive director and his staff. At HUD and the housing agency, we reviewed program files for documentation of HUD's on-site modernization monitoring visits since 1981. We also reviewed the files for evidence of HUD's in-office CIAP reviews of project applications, quarterly financial reports, and budget revisions.

To determine why HUD did not conduct a management review of HACA between 1985 and 1988, we reviewed the HUD handbook that specifies the review requirements and obtained copies of reviews relating to HACA's financial condition, maintenance operations, and project occupancy. We discussed the nature of these reviews with the assisted housing management branch chief of the HUD Baltimore field office and his staff to determine the extent they covered areas also evaluated during a comprehensive management review. We also discussed this issue with the former director and the acting director of the Philadelphia regional HUD office.

To examine the status of the HACA operating reserve, we reviewed applicable HUD criteria and obtained documentation from the HUD field office regarding the HACA reserve levels between 1980 and 1989. We also obtained financial records from the HUD field office that showed changes in this reserve level. We discussed these changes with the HUD assisted housing management branch chief and the field office financial analyst.

We discussed the information in this report with officials from HUD's Baltimore field office and HACA. In general, the officials agreed with the information presented in the report. We also obtained the views of HUD headquarters, regional, and other field office officials during our work, and we have incorporated their views into the report where appropriate. We performed our work between November 1988 and February 1989, in accordance with generally accepted government auditing standards.

HUD's Oversight Detected Some CIAP Program Irregularities

HUD's Baltimore field office generally performed reviews at HACA necessary to comply with HUD's CIAP regulations. The monitoring efforts HUD made at HACA allowed it to detect sufficient irregularities to merit a HUD Inspector General review of the authority's contracting procedures for architectural and engineering services. This review and a simultaneous investigation by the Federal Bureau of Investigation (FBI) led to the indictment of the former executive director.

While HUD played a definite role in detecting program abuses at HACA, its level of monitoring did not detect other weaknesses in HACA's modernization program. For example, HUD did not provide a detailed enough review of individual budget line items to sufficiently reduce an unreasonable cost estimate. In addition, HUD did not realize until after it made its final CIAP disbursement for one project that HACA had overrun its modernization budget by $213,000. HUD should have recognized these problems based on data it received from HACA.

HUD's Application Review and Approval Process Generated Mixed Results

In reviewing a PHA's application for modernization funding, the CIAP handbook directs HUD field office personnel to check proposed costs for reasonableness and to compare the total project cost with the allowable cost ceiling. However, the handbook does not specify what level of review the field office should make of individual cost items. HUD also meets with PHA officials to review and reach agreement on the scope of modernization work that is needed, the costs associated with meeting these needs, and the schedule for the completion of the modernization. We found that HUD's Baltimore field office generally reviewed HACA's application in accordance with HUD handbook requirements and detected certain contracting irregularities associated with HACA's modernization program, which led to the investigation of HACA's former executive director. (See app. III.) However, HUD did not sufficiently reduce costs for some individual items.

HUD Monitoring Successfully Uncovered Some Contracting Irregularities

During a March 1984 meeting to discuss a modernization application, HUD field office officials found that HACA had not complied with the modernization handbook requirements for obtaining professional architectural and engineering services. Specifically, HACA had successively awarded contracts to the same firm without reopening competition. HUD officials said that virtually all the major architectural and engineering contracts awarded between fiscal years 1981 and 1984 were awarded to the same firm. Further, HACA did not submit three of these contracts to HUD for review and approval even though they exceeded the dollar value requiring HUD's approval. In addition, one contract awarded on December 15, 1983, was advertised in January 1984, suggesting the advertisement was placed simply to create the appearance of complying with requirements.

HUD's Baltimore office notified HUD's Assistant Secretary for Public and Indian Housing of these issues and requested an explanation of these irregularities from HACA in May 1984. The executive director explained that HACA procured architectural and engineering services on an annual basis to provide continuity for ongoing and related work. HUD's field office did not accept this explanation. The field office, upon the advice of HUD's Assistant Secretary for Public and Indian Housing, instructed HACA to cease engaging architectural and engineering services on a retainer basis because this violated the law. Following an exchange of correspondence between HUD's Baltimore office and HACA, HUD informed HACA in June 1985 that its December 1983 architectural and engineering contract was inappropriate and an ineligible CIAP expense.

In early 1986, after HUD advised HACA that the Department would not pay for the contract, the field office reported that HACA's executive director had agreed to terminate the contract and readvertise the work. Despite this agreement, HUD suspected that the incident may only have been symptomatic of deeper problems within HACA's general contracting activities. On the basis of these suspicions, HUD requested its Inspector General to investigate administration of HACA's architectural and engineering contracts. (See app. III.)

HUD Did Not Always Determine the Reasonableness of Individual Item Costs

According to the CIAP handbook, in reviewing cost estimates the HUD field office is to determine if the proposed estimates are reasonable. According to the field office engineer and the assisted housing management branch chief, the field office is not required to determine what the cost of each item should be. In fact, the CIAP handbook does not specify what level of review the field office should make of individual items. However, the Baltimore field office's review of HACA's modernization application for one project only partially reduced excessive costs that had been budgeted for exterior doors and storm doors. In evaluating the preliminary application for this project, the Baltimore field office engineer questioned HACA's request for $1,680 each for 300 exterior doors and storm doors. The total budgeted cost for these doors was $504,000. In a meeting with HACA officials, the engineer suggested an estimate of $1,200 per door combination, yielding a total project cost of $360,000. This figure represented the final approved budget amount. The engineer said he based his lower $1,200 estimate on a previous contract for exterior doors and storm doors, but did not consult any outside sources or HUD's Consolidated Supply Program for price comparisons.[1] According to the assisted housing management branch chief, HUD relies on the PHA's competitive bidding process to result in the lowest cost possible.

To determine the reasonableness of the exterior and storm door estimate, we reviewed what exterior doors and storm doors would cost through HUD's Consolidated Supply Program. The most expensive storm door in the program catalog was $171 while the most expensive exterior door was $508. Using the catalog costs, each combination exterior and storm door would total approximately $679, or a total of $203,700, a difference of $300,300 from the original budget request and $156,300 less than the approved budget. According to the executed contract, the exterior doors alone actually only cost $305 each. The purchase order for the screen doors showed that they cost $110 each. Therefore, the amount HACA needed for the doors was considerably less than the amount it requested.

HUD Made On-Site Visits to Monitor CIAP Progress

A major component of HUD's oversight responsibility is semiannual visits to monitor modernization projects. The HUD CIAP handbook requires the field office to conduct these reviews as a means of assessing the quality and adequacy of physical and management improvements. HUD began conducting semiannual monitoring visits at Annapolis in 1983. Documentation in the field office files shows that the field office missed only one of these 6-month reviews between July 1983 and April 1989. According to the field office branch chief, this omission occurred during a time when the HUD field office was short of personnel.

In conducting CIAP reviews at HACA, field office engineers and housing management specialists inspected some of the ongoing physical improvements to ensure the adequacy of the physical work and reviewed contracting files for compliance with established contracting procedures. These reviews lasted 1 to 2 days. Letters to the executive director following these reviews listed the areas reviewed, explained concerns relating to observed problems, and suggested corrective actions necessary. The branch chief reported that these letters were not sent to the

[1]The Consolidated Supply Program was designed by HUD to allow PHAs to procure supplies and labor for specific work items from a published catalog of services. These published costs reflect geographical differences in labor and supply costs and include all costs associated with providing materials, labor, and other services necessary for complete installation of the designated item.

board of commissioners because the CIAP handbook did not require this type of notification.

Through these monitoring activities, the Baltimore field office identified and successfully corrected several problems, including physical deficiencies and contracting errors. However, other problems, such as a budget overrun for one project, were not immediately discovered. The following discusses some of the problems discovered by HUD and HACA's responses to the deficiencies.

Inadequate Roofing Installation

During one review, the HUD engineer observed water running down the exterior walls from the roof gutters at one project. He explained in the monitoring report that the gutters appeared to be installed incorrectly, allowing water to run behind them. In the letter to HACA, the engineer suggested that HACA negotiate with the contractor to correct the problem. At a subsequent monitoring visit, the HUD engineer reinspected the roofs and noted that the problem had been corrected.

Legal Fees Charged to Wrong Account

During a contract file review done as part of another monitoring visit, the HUD housing management specialist found that approximately $34,000 in legal fees for work performed in conjunction with the proposed sale of one of HACA's projects had erroneously been charged against the CIAP budget. In the monitoring letter, HUD requested explanation for these payments and justification for charging them against the CIAP budget. HACA responded that an error had been made and reported that the charge had been shifted from the project's modernization budget to HACA's general operating budget.

Budget Overrun Was Not Promptly Detected

HUD became concerned in 1984 that modernization on a 150-unit project might exceed its approved budget. Despite these concerns, it was not until August 1987 that HUD detected an overrun, which was later determined to be about $213,000. On the basis of reports HUD received from HACA, the assisted housing management branch chief said his office should have identified part of the overrun in January 1986. Following discovery of the error, HUD decided to withhold action until the trial of the former executive director was concluded because the accusations against him concerned work completed at the project. In a September 1987 letter notifying the HUD Philadelphia Regional Office of the overrun, the field office said that under normal circumstances, it would argue that the overrun was reasonable and would request approval of the overrun. HUD's other option is to request that HACA repay the excess funds. Although the trial ended in November 1988, in May 1989 HUD had yet to decide how it would proceed on this matter. We believe that HUD should have detected the overrun sooner and should resolve this matter as soon as possible.

HACA received roughly $5.9 million to modernize the 150-unit project primarily through three funding authorizations in 1981, 1982, and 1983. This figure, less about $400,000 authorized for management improvements and relocation costs represented the project cost ceiling set by HUD. HUD became concerned that HACA might overrun its budget as early as July 1984 when it requested approval to transfer approximately $245,000 in unspent funds from other CIAP allocations to cover the costs which exceeded the exterior work budget for the project. HUD disapproved the transfer and said it would not approve any transfers of additional CIAP funds because the project had been funded to the maximum project cost limit. HUD suggested that HACA consider reducing the scope and cost of the remaining work for the project. The executive director responded that he declined to "delete any portion of the work." HUD advised HACA that it would have to find alternative funding for any overage because the field office would not approve a waiver to allow funding over the approved ceiling.

However, it was not until August 1987 that a field office housing management specialist, in reviewing budget reports for the project, noticed that HACA had overrun its budget. The overrun was approximately $213,000. HUD officials' explanation for not detecting the overrun sooner was that the project had three separate budget authorizations—1981, 1982, and 1983—and that HUD had neglected to consider all of them together to determine what had actually been authorized and spent for the project as a whole. In addition, the officials said that the PHA shares in the responsibility of ensuring that the PHA does not overrun its modernization budget.

HUD Did Not Perform Overall Management Review Because of Other Investigations

Although HUD had documented problems with HACA's management of its architectural and engineering contracts in 1984, and suspected that these may be indicative of broader management problems at the authority, HUD did not initiate an overall management review of HACA until December 1988. HUD anticipated completing this review in May 1989. Instead of conducting this review sooner, the HUD field office requested that HUD's Office of Inspector General investigate its suspicions about contract mismanagement. In addition, HUD conducted other reviews at HACA between 1985 and 1988, which included some of the same issues that would have been covered during the overall management review. Because of these reviews and the Inspector General investigation, HUD's field office believed that the required overall management review could be postponed until late 1988. We believe HUD fulfilled its oversight responsibilities by conducting other reviews and referring its suspicions regarding contract mismanagement to the Inspector General.

HUD's Monitoring Process

HUD's field office monitoring of housing authorities handbook provides flexibility regarding the type, extent, and frequency of management reviews. It requires that the field office conduct in-office monitoring of the PHA by compiling and updating a PHA performance profile. This profile includes information on selected operating characteristics such as vacancy rates, operating reserves, and unpaid tenant rents. Data for the profile are derived from periodic reports and information submitted by the PHA. This profile also discusses known or suspected fraudulent or wasteful practices. The nature of the problems identified determines the type of review performed. If fraudulent or wasteful practices are suspected, the handbook requires HUD to schedule a management review, ideally within 1 year, but definitely within 4 years. For PHAs with satisfactory performance, a limited management review at 4- to 8-year intervals is required. Copies of reports from the reviews conducted are to be sent to the chairman and members of the PHA's board of commissioners, the chief executive officer of the local government, and to the executive director of the PHA.

HUD Suspected Contracting Problems but Decided Not to Do a Management Review

In 1984, the HUD field office began to suspect impropriety in HACA's management of architectural and engineering contracts. (See app. II.) Although HACA terminated one contract in 1986 and readvertised the work, field office officials continued to believe there was the appearance of impropriety regarding how HACA awarded its architectural and engineering contracts. Instead of conducting a management review of HACA, HUD field office officials said they requested assistance from the HUD

Regional Inspector General in July 1984 and May 1985. The Inspector General told the field office that its information was insufficient to warrant an investigation. In January 1986, the field office compiled additional information on HACA's architectural and engineering contract award procedures and requested assistance from the HUD regional contracting officer in exploring the problem. In its request, the field office suggested that the supporting information contained in its letter be forwarded to the Inspector General as well. Shortly thereafter, the Inspector General began its investigations of HACA. The FBI later joined the Inspector General in the investigation. The HUD field office manager said that the FBI and HUD Inspector General investigations precluded the field office from conducting a comprehensive management review, which ordinarily would have been scheduled between 1984 and 1988. However, HUD field office officials said they did not document this rationale for not conducting a management review during these years nor did they discuss the issue with the FBI or the Inspector General prior to making their decision because they considered the decision an internal matter. The HUD Philadelphia Regional Inspector General for Investigations said that when an investigation is opened, he usually tells HUD officials to continue their business as usual, but to notify him of any actions that relate to the Inspector General investigation. However, in this case, the official said an overall management review by the field office would not have been advisable because HACA's contracting documentation was being used by their office and the FBI staff.

HUD Conducted Other Reviews

The field office manager said that HUD executed its oversight responsibilities through numerous other reviews. These reviews included physical inspections of housing authority properties, management reviews of the section 8 program, and monitoring of modernization activities. In addition, HUD completed other reviews that incorporated some of the aspects normally evaluated in a management review. For instance, engineering surveys were conducted to assess the condition of the projects; maintenance reviews were done to determine how quickly vacant units were made ready for new occupants and whether preventive maintenance was being done; occupancy reviews were conducted to determine whether the authority was complying with Housing Act requirements; and financial reviews were conducted to assess the adequacy of the authority's financial procedures and condition. These reviews appeared to meet the requirements of the housing authority monitoring handbook.

The HUD field office completed a number of reviews between 1980 and 1988 and provided copies of the results to HACA's executive director and board of commissioners. The dates and types of reviews were as follows:

- 1980. Overall management review, engineering survey, and occupancy audit.
- 1982. Occupancy audit, engineering survey, and maintenance review.
- 1984. Maintenance review, financial review, and engineering survey.
- 1988. Engineering survey.

The HUD field office's assisted housing management branch chief said his office probably spent more time monitoring HACA than any other housing authority it oversees. Even though less than 5 percent of the public housing units the Baltimore field office oversees are in Annapolis, he estimated that his branch has spent 20 percent of its time overseeing HACA operations since 1984. He said a great deal of this time was spent in assisting in the Inspector General and FBI investigation.

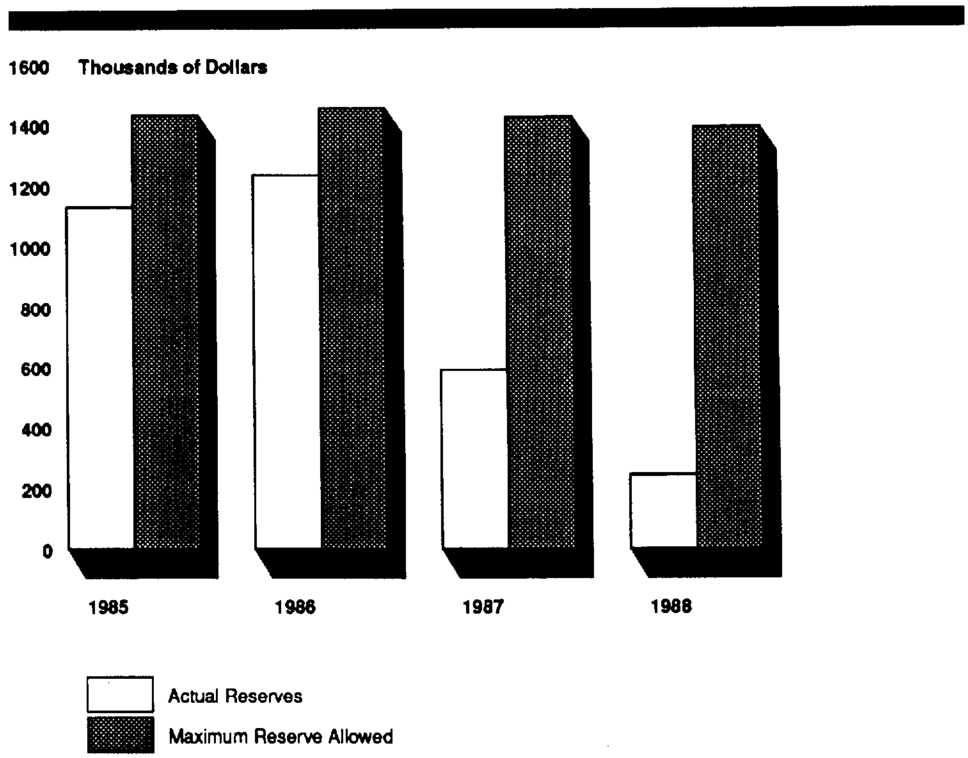
HACA's Operating Reserve Declined Between 1985 and 1988

HUD regards a PHA's operating reserve level to be a key indicator of its financial health. Between 1985 and 1988, HACA's operating reserve declined from 79 percent to 18 percent of the maximum allowed. The reserve cannot exceed half the authority's estimated total routine expenses for the coming fiscal year. The reserves dropped because its investment income declined while certain expenditures increased. HACA then had to use reserves to make up the shortfalls. The HUD field office was aware of the negative trend in the PHA's operating reserve status and became involved in detailed oversight of HACA's expenditures when the reserve fell below 40 percent.

HACA Operating Reserve Declined Because of Decreased Income and Budget Overruns

The HACA operating reserve declined from 79 percent of the maximum allowed in 1985, to 42 percent in 1987, and 18 percent in 1988. Figure IV.1 shows the changes in the HACA operating reserve compared with the maximum amount of reserve allowed between fiscal years 1985 and 1988.

Figure IV.1: HACA Operating Reserve, Fiscal Years 1985 Through 1988



Source: GAO analysis of HACA financial records

Until October 1987, HUD generally considered a PHA to be operationally and financially stable if its operating reserve was 40 percent or more of the maximum allowed. Subsequently, HUD reduced the indicator to 30 percent because it no longer included unpaid tenant rents in the calculation. However, to be consistent with past years, we included unpaid tenant rents in our analysis of HACA's operating reserve.

The reserve level declined over the 1986-88 period because HACA's investment income declined at the same time its expenditures for ordinary maintenance, administrative expenses, general expenses, and nonroutine maintenance expenses were increasing significantly. Budgetary shortfalls thus followed that were funded through HACA's operating reserve account. The deficit in fiscal year 1987, which was about $696,000, resulted in reducing the operating reserve to about $592,000, or about 42 percent of the maximum allowed. Budgetary shortfalls continued in fiscal year 1988. The fiscal year 1988 deficit was about $347,000, which reduced the operating reserve further from $592,000 to about $245,000. Even though the deficit was less in fiscal year 1988 than in fiscal year 1987, the shortfall in 1988 caused HACA's reserves further to fall below HUD standards to about 18 percent of the maximum allowed. Table IV.1 shows the trends in HACA's income and expenditures from 1986 to 1988.

Table IV.1: HACA's 1986 to 1988 Expenditures for Selected Budget Categories (Dollars in Thousands)

	Fiscal Year		
Category	**1986**	**1987**	**1988**
Operating receipts (exclusive of HUD)	**$2,121**	**$2,017**	**$2,019**
Operating expenses:			
Routine expenses			
Administrative expenses	377	458	434
Tenant services	55	70	59
Utilities	1,193	1,140	1,091
Ordinary maintenance and operations	671	963	939
General expenses	265	303	334
Total routine	**2,561**	**2,933**[a]	**2,858**[a]
Nonroutine maintenance	24	251	163
Total operating	**2,585**	**3,184**[a]	**3,021**[a]
Capital expenditures	28	90	12
Prior year adjustment	(172)	(49)	(24)
Total	**$2,441**	**$3,224**[a]	**$3,009**[a]
Deficit before HUD subsidy	(319)	(1,207)	(990)
HUD subsidy	476	511	643
Total deficit or surplus	**$157**	**($696)**	**($347)**

[a]Total does not add due to rounding.

The HUD field office was aware of the negative trend in HACA's operating reserves. Given the fiscal year 1988 budget, the reserve at the end of the year would have only been about 39.2 percent of the maximum allowed. In an April 1987 letter, HUD cautioned HACA regarding the projected reserve level and told it to cut the operating budget by $11,000 to be certain reserves did not fall below 40 percent. HACA agreed to make the budget cuts. In a June 1987 letter, HUD approved HACA's proposed budget cuts and cautioned HACA about its falling reserve levels.

However, it was not until September 1987 that HUD received HACA's final fiscal year 1987 statement which contained information on the extent of the 1987 decline in the operating reserves. A HUD field office financial analyst said that because of the timing of PHA budget submissions, HUD often does not have a final expenditure statement for the previous year when it approves the next fiscal year's budget. In its review of HACA's final fiscal year 1987 financial statement, the HUD field office questioned some expenses but did not request an explanation from HACA for the decline in receipts or the increases in expenditures. According to HACA officials, previously submitted budget revisions provided information on these expenditures. However, HUD did ask HACA to improve control over nonroutine expenditures and provide more detailed reporting to HUD.

Budget revisions submitted to HUD by HACA for the 1988 fiscal year forecasted a reserve level of 42 percent. It was not until HUD received the authority's final financial statements that it knew HACA's reserves had fallen below 40 percent, according to the HUD field office branch chief and financial analyst. According to the financial analyst, HACA spent funds for both emergencies (such as boiler replacements) and other improvements (such as landscaping) but did not obtain HUD approval until the funds had been spent.

In a November 2, 1988, letter to HACA, the field office expressed concern over the authority's financial condition, as demonstrated by its low operating reserve level. The field office advised the authority that it had overrun the total operating expense line by $94,341. HUD said this amount could be declared ineligible for funding since HUD had not approved the expenditures. HUD requested justification for two contracts for boiler and electrical repairs that accounted for about $30,000 of the overrun. HUD also said that (1) leave payments were erroneously made to the former executive director and his administrative assistant, (2) they were being recaptured, and (3) they would be reimbursed to the housing program. According to HUD's assisted housing management branch chief, HACA had already provided HUD with an explanation for the remainder of the overrun.

HUD Actions to Help HACA Improve Its Reserve Status

In November 1988, HUD notified HACA that it was eligible for additional subsidies. HUD identified an additional $80,902 in operating subsidies for which HACA was entitled because of changes in its utility costs and investment income. In addition, HUD stated that approximately $45,000 could be classified as emergency maintenance and reimbursed with CIAP funds in fiscal year 1989. HUD reported, however, that these actions would only increase the reserve level to 20 percent, which was still well below the 30-percent level HUD considers (using post-1987 criteria) as an indicator of a financially stable PHA. HUD requested that the PHA closely monitor expenditures.

A new executive director began work at HACA in March 1989. He said he is making changes in the rent collection process to increase receipts and is working closely with HUD to monitor expenditures.

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