audit report

Issue Date November 12, 2009
Audit Report Number 2010-LA-0001

TO: Carol J. Galante, Deputy Assistant Secretary for Multifamily Housing, HT

Joan S. Hobbs

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

SUBJECT: HUD's Performance-Based Contract Administration Contract Was Not Cost Effective

HIGHLIGHTS

What We Audited and Why

We audited the U.S. Department of Housing and Urban Development's (HUD) annual contributions contract (contract) for performance-based Section 8 contract administrators (PBCA). We audited this contract because our prior audit of HUD payments to the PBCAs for certain performance standards indicated that HUD was not getting the best value for the dollars spent on the PBCA's services. Our audit objective was to determine whether the performance-based contract administration contract was cost effective.

What We Found

HUD did not always ensure accountability for results and include appropriate, cost-effective controls over its contracts. Consequently, HUD did not obtain the best value for the $291 million spent in 2008 on contract administration services. In particular, HUD spent $107 million of this amount on incentive fees. While we could not quantify how much of this amount was excessive, HUD continued to pay incentives for tasks that were included in the PBCAs' basic fees. In addition, at least $7.6 million may be wasted each year because HUD continues to extend the existing contracts beyond the original contract term of five years.

What We Recommend

We recommend that the Deputy Assistant Secretary for Multifamily Housing perform a detailed analysis to determine the most cost-effective method of performing the contract administration tasks. After selecting the best method, we recommend that the Deputy Assistant Secretary for Multifamily Housing ensure accountability for results and include appropriate, cost-effective controls in its contracts.

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 our discussion draft report to HUD on September 21, 2009, and it provided its written response on October 26, 2009. HUD officials generally agreed with our audit report but disagreed with portions of our findings and recommendations.

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

Performance-Based Section 8 Contract Administration

The U.S. Department of Housing and Urban Development (HUD) is authorized to enter into an annual contributions contract (contract) with public housing authorities. The contract provides contract administration services for units receiving project-based rental assistance under Section 8 of the United States Housing Act of 1937.

In May 1999, HUD issued a request for proposals for contract administration services for project-based Section 8 housing assistance payments contracts for each state. During the first year, HUD awarded contracts to only 37 performance-based contract administrators (PBCA) due to a lack of qualified applicants. HUD then issued a request for qualifications to ensure that applicants met the definition of a public housing authority, followed by a request for proposals, and awarded an additional seven contracts between 2001 and 2003. In 2003, HUD issued an invitation for submission of applications (invitation) rather than a request for proposals. HUD awarded the remaining nine contracts between 2003 and 2005 under this solicitation.

Under the request for proposals, the applicant was required to submit both a technical and cost proposal for evaluation. Once a PBCA was chosen, its cost proposal was reviewed to determine the contract rate of payment, sometimes resulting in a decrease in the rate. Under the invitation, the applicant was only required to submit a technical proposal and a proposed rate. No cost proposal was required.

Although not technically required to comply with the Federal Acquisition Regulation, HUD stated that it would use a best value trade-off source selection process for evaluating offers similar to the one defined in Federal Acquisition Regulation 15.101-1. This process is, in essence, a negotiated acquisition method that seeks to select the best technically qualified applicant and then negotiate the best price for the services to be acquired.

HUD entered into performance-based contracts because of a government-wide emphasis for service contracts to be performance based. Performance-based service contracting is based on the development of a performance work statement, which defines the work in measurable, mission-related terms with established performance standards and review methods to ensure quality. A performance-based contract allows for the assessment of disincentives for contractors that are not performing as required and incentives for value-added activities that are not part of the basic contract requirements.

Performance-Based Annual Contributions Contract Requirements

The contract includes 10 core tasks for which the PBCA is responsible:

1. Conduct management and occupancy reviews.
2. Adjust contract rents.
3. Process housing assistance payments contract terminations or expirations.
4. Pay monthly vouchers submitted by Section 8 owners.
5. Respond to health and safety issues.

6. Submit Section 8 budgets, requisitions, revisions, and year-end statements.
7. Submit audits of the PBCA's financial condition.
8. Renew housing assistance payments contracts.
9. Report on PBCA operating plans and progress.
10. Follow up on results of physical inspections of Section 8 projects.

Within the 10 core tasks, there are 16 incentive-based performance standards (performance standards). HUD measures the PBCA's performance for each standard against the acceptable quality level for that standard to determine the administrator's earned administrative fee. It also determines whether disincentive deductions or incentive fees apply.

Compliance with Annual Contributions Contract, HUD Regulations, and Directives

HUD requires the PBCAs to comply with Title 24 of the *Code of Federal Regulations*, including any revisions or additions to the regulations. HUD issues additional program requirements as HUD "directives," including HUD notices, handbooks, and forms. It requires the PBCAs to use program receipts in compliance with the U.S. Housing Act of 1937 and all HUD regulations and other requirements. However, according to the contract, "if required by HUD, program receipts in excess of current needs shall be promptly remitted to HUD or invested in accordance with HUD requirements."

Current Contract Administration Activity and Cost

During 2008, there were 53 PBCAs with contracts costing approximately $291 million. They perform administration for 15,571 housing assistance payments contracts valued at more than $6.8 billion. The annual contributions contracts were written for an initial three-year period with two one-year renewal options. On average, in 2008, each of the 15,571 project-based housing assistance payments contracts cost HUD $18,706 to administer.

Our audit objective was to determine whether the performance-based contract administration contract was cost effective.

RESULTS OF AUDIT

Finding 1: HUD Did Not Always Ensure Accountability for Results and Include Appropriate, Cost-Effective Controls in Its Contracts

HUD did not always ensure accountability for results and include appropriate, cost-effective controls when it outsourced the Section 8 contracts with PBCAs. Specifically, HUD did not (1) adequately control costs, (2) protect resources from potential waste, (3) ensure compliance with laws and regulations, and (4) emphasize quality in performance standards. It also did not (5) require collection of information for decision making, (6) adequately develop the intended result, and (7) ensure that resources were used consistent with its mission. This issue occurred because HUD did not properly consider management accountability requirements when it developed, awarded, and continued to renew 53 annual contributions contracts. Therefore, HUD did not obtain the best value for the $291 million spent in 2008 on contract administration services. In particular, HUD spent $107 million of this amount on incentive fees. While we could not quantify how much of this amount was excessive, HUD continued to pay incentives for tasks that were included in the PBCAs' basic fees. In addition, at least $7.6 million, may be wasted each year because HUD continues to extend the existing contract beyond the original contract term of five years.

HUD Did Not Adequately Control Costs

Office of Management and Budget (OMB) Circular A-123[1] states that federal employees must ensure that government resources are used efficiently and effectively to achieve the intended program results. OMB Circular A-123 also states that management accountability includes the expectation that federal managers are responsible for controlling the costs of federal programs.

HUD's objectives for the Section 8 PBCA initiative included getting the best value for dollars spent on contract administration using performance-based service contracting. However, HUD did not achieve this objective because it did not adequately control costs when it allowed the PBCAs to earn incentive fees for baseline tasks. It also allowed the PBCAs to earn profits in excess of 10 percent of contract price and did not provide for sharing in cost savings when a PBCA rebid its subcontract. Finally, it did not require and review certified cost proposals for all potential PBCAs and did not negotiate with the PBCAs to obtain the lowest price.

<u>Incentive fee</u> - Performance-based service contracting is based on the development of a performance work statement. The work statement defines the work in measurable,

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[1]We used OMB Circular A-123, dated June 21, 1995, because it was the version applicable at the time of contract development and award. The circular, dated December 21, 2004, strengthened the process for conducting management assessments of the effectiveness of internal controls over financial reporting based on widely recognized internal control standards. The changes have no effect on audit conclusions.

mission-related terms with established performance standards and review methods to ensure quality. Incentives should be used when they will induce better quality performance and may be either positive (incentive fee), negative (disincentive deduction), or a combination of both. They should be applied selectively to motivate contractor efforts that might not otherwise be emphasized and to discourage inefficiency. In a pre-proposal conference held in 1999, HUD stated that it would limit the basic fee to 2 percent of the fair market rent.[2] The annual contributions contracts between HUD and the PBCAs provided an incentive fee of 1 percent to the PBCA. This fee was included because HUD felt that the tasks were important enough for it to pay extra to obtain services at a level greater than that established as the acceptable quality level.

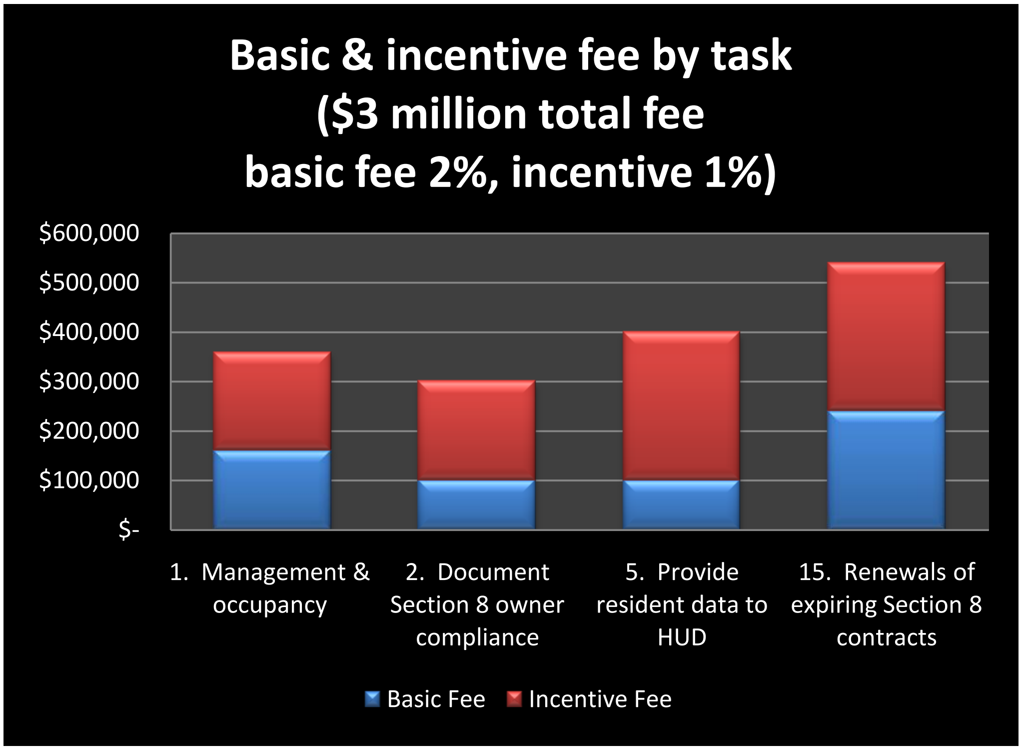
The contracts provided for incentive fee payments of almost $107 million in 2008[3] for completing work in a timely manner. This amount was almost 37 percent of the total contract fee for all 53 contracts. However, the incentives were actually for baseline tasks. This practice rewarded contract administrators for meeting contract requirements and complying with quantity and timeliness requirements rather than for inducing better quality performance. For fifteen of the sixteen contract requirements there was no requirement that the work performed be accurate, and disincentives could only be applied if the number of on-time submissions fell below the acceptable quality level. Incentive fees were paid for performance that exceeded the acceptable quality level for specific tasks as defined in the contract.

Incentive fees were paid to the PBCAs on 4 of the 16 contract performance standards for:

- Performing management and occupancy reviews,
- Documenting Section 8 owner compliance,
- Providing resident data to HUD, and
- Renewing expiring Section 8 contracts.

PBCAs were highly motivated to meet the contract requirement of these performance standards because the incentive fee was always more than the basic fee, as shown in the graph below.

[2] The basic fee is calculated based on the number of units under contract per month, multiplied by 2 percent of the fair market rent of a two-bedroom unit in the service area.
[3] The total basic and incentives fees earned for all of the PBCAs were obtained from HUD's Line of Credit Control System, also referred to as LOCCS, for government fiscal year 2008.



In January of 2005, HUD informed the contract administrators that it was going to revise the incentive fee and described how the new basic and incentive fee tasks would be weighted. However, HUD did not follow through with its decision.

In early 2007, an independent assessment report stated that the contract contained incentives that were actually baseline tasks. It stated that HUD was rewarding contract administrators for meeting contract requirements and complying with expected outcomes. The assessment also stated that the incentive fee should move to a results-oriented outcome as opposed to a process-based program and should not exceed 15 percent of the total contract. In a later presentation to the PBCAs, HUD agreed and stated that when it revises the contract, the incentive fee would be limited to 15 percent of the total amount available. HUD also stated that the incentive fee would be paid for value-added activities rather than for meeting contract requirements. HUD paid more than $90.9 million in incentive fees in 2008 in excess of the 15 percent considered reasonable by the independent assessment report. HUD had not revised the contract.

<u>Profits</u> - In the 1999 pre-proposal conference, HUD stated that it would not allow a straight 3 percent rate because it would result in many of the PBCAs receiving a large profit. In a 1999 memorandum requesting final proposals, HUD further stated, "in general, profit margins exceeding 10 percent are generally considered to be unacceptable and contracts of this type usually see rates below that amount." However, HUD did not follow its own guidance and approved basic fees for one PBCA that included profit in excess of 21 percent. This action resulted in excessive profits of almost $1.8 million in basic fees in 2008 for that PBCA (see appendix A). We estimate that the total excessive

profit received by this PBCA since the award of the contract was $5 million.[4] HUD could not tell us why the excessive profit was allowed.

Rebidding the contracts - HUD did not include a mechanism to rebid the contracts after a set period to make the most of the benefits of competition, lower cost subcontractors, or experience gained by the PBCAs. The initial contract was for a total of five years, yet more than eight years after the first contract was awarded, the contracts continue to be extended. As the result of a state requirement, one of the PBCAs rebid its subcontractor services at a lower cost, resulting in increased profit for the PBCA. As a result, in 2008, this PBCA received approximately $5.8 million in additional unrestricted profit with no savings to HUD[5] (see appendix A).

According to the minutes from an August 25, 2004, contract administrators' conference call, HUD received approval from its Office of General Counsel to extend the contracts for an additional 10 years. One of the primary reasons for extending the contracts was to provide for better economies of scale created by the experience gained over the period under contract. In return, HUD wanted the PBCAs to examine their fees to determine their level and whether they needed to stay at that level.

HUD requested information from the PBCAs on the costs necessary to accomplish the provisions of the contract. However, a new contract was never fully developed; therefore, HUD continues to extend the original contracts. As a result, it does not receive the cost/benefits of lower cost subcontractors or the lower cost due to experience gained by the PBCAs. The cost to administer the contracts is $18,706 per contract. In addition, profits for some of the largest PBCAs ranged from 39 to 67 percent of the total expenses, with one PBCA receiving profits of 198 percent of its total expenses.[6] This amount includes the incentive fees paid.

Cost proposals not required for all contract awards - The original request for proposals required applicants to provide a cost proposal that certified that the costs proposed were accurate and allowable. HUD also wanted to ensure that it was paying a fair and reasonable price for the work performed. In 2003, HUD published an invitation for submission of applications (invitation). The invitation did not require a cost proposal. As a result, nine contract awards were based solely on the technical submission. According to a HUD official, the decision not to require a cost proposal "...was made for two reasons: (1) based on the previous RFP [request for proposals] process, the majority of the PBCAs bid the full 2 percent and a majority of those PBCAs were selected and (2) both the Offices of Procurement and Multifamily Housing did not have adequate staff resources to review the cost proposals."

[4] We computed the excessive profit using 2004 through 2008 LOCCS basic fee data and the profit percentage from the cost proposal submitted by the PBCA.

[5] We computed the cost savings from rebidding the subcontract using the PBCA's 2008 audited financial statements, 2008 official budget request, and its original cost proposal (budgeted information was used when the financial statements were not of sufficient detail to provide the needed information). The cost proposal provided us with the costs of the original subcontractor for that activity level. We compared this amount with the revenues and expenses in the 2008 audited financial statements and official budget and calculated the difference.

[6] Profits were determined using the PBCA's most current financial statements and official budgetary data.

In addition, since a cost proposal was not required for nine of the PBCAs, they were not required to certify that their proposed costs were accurate, complete, and current. They were also not required to certify that all costs and indirect rates included were allowable. Therefore, HUD did not have reasonable assurance that the rates for the fixed price service contracts were accurate and excluded unallowable costs.

Further, HUD did not have adequate procedures and metrics to evaluate the cost proposals it received. Although HUD had detailed procedures for evaluating the technical proposals, the procedures for evaluating the cost proposals were inadequate. HUD stated that it would review "the supporting pricing information for sufficiency to determine if the offeror has an adequate understanding of the contract requirements." However, HUD did not develop benchmarks, such as the number of projects recommended per employee. This process would have allowed it to determine whether the costs appeared reasonable and adequate to meet all of the contract responsibilities.

Negotiation of price - HUD used a best value trade-off source selection process for evaluating offers similar to the one defined in Federal Acquisition Regulation 15.101-1. HUD determined that the technical approach, not cost, was the most important factor. Although the contract was not subject to the Federal Acquisition Regulation, HUD should have negotiated with the PBCAs to obtain the lowest price.

HUD placed a 2 percent limit on the basic fee. Contracts were awarded to 30 of the 53 PBCAs with the maximum 2 percent fee, 27 of which were awarded during the first two years of the program. Of the 27 contract awards, 17 had no competition.

HUD Did Not Protect Resources from Waste

OMB Circular A-123 states that resources must be used in such a way as to protect them from waste, fraud, and mismanagement. However, HUD did not protect the funds used under the PBCA initiative from waste when it did not

- Restrict the use of excess revenues,
- Ensure that the administrative fee distribution to the tasks was commensurate with associated workload,
- Require the PBCAs to adopt a risk-based approach to monitoring reviews on low-risk projects,
- Include a mechanism in the contract to change contract elements and associated fees to allow for changes in program requirements, and
- Have an equitable method for paying the PBCAs.

The use of excess unrestricted revenues - The annual contributions contract states, "the [PBCA] may use or distribute any such earned administrative fee income, including basic fees and incentive fees, for any purpose." Because the incentive fee was significantly higher than the amount necessary to complete the administrative tasks, many PBCAs had profits in excess of the amount originally determined to be acceptable to HUD. These profits were not restricted by the contract and were in addition to the profit that was included in the cost proposals.

We estimate that since the inception of the contract, almost $558 million in incentive fees has been paid to the PBCAs.[7] Our review of 8 of the 53 PBCAs' most recent financial statements disclosed that there was at least $44.4 million in unrestricted funds on the PBCAs' books.[8] In addition, although Congress appropriated these funds for contract administration services, since the excessive funds were unrestricted, they could be used for any purpose.

We observed many examples in which PBCA organizations used these excess revenues to fund other activities within the organization or returned them to the parent organization's general fund. One state earmarked the proceeds of this contract to fund community planning and development projects and improve handicapped accessibility in single-family and multifamily dwellings. Another state used the funds to purchase apartments and "leisure time condominiums." In addition, excess revenues were used to repay millions of dollars for violations cited in Office of Inspector General (OIG) audit findings in which HUD-restricted funds were misused. In this case, the unrestricted excess revenues from the PBCA were transferred to the parent organization, a housing agency, to resolve prior violations and close audit recommendations. Sometimes, the revenue from contract administration activities was not separately identified in the financial statements but was commingled so that excess revenues were not apparent.

The contracts produced significantly more profits than those included in the cost proposals. In turn, these profits provided funding for other activities that were not part of the contract's stated purpose.

<u>Administrative fee distribution not commensurate with associated workload</u> - The administrative fee distribution to the performance standards in the contract was not commensurate with the associated workload for each of the performance standards. As a result, the related disincentives were not commensurate with the cost of meeting the performance standard.

We asked the HUD official responsible for this program to explain the basis for the original fee distribution. She stated that "the breakdown of base and administrative fees was based on both anticipated workload and departmental priorities at the time the contract was developed by the drafters…"

In 2004, HUD realized that the basic fee percentages distributed to each performance standard in the contract were not equitable. The responsible HUD official provided us with a revised draft contract that was developed in 2005 but had not been completed. HUD instead hired an independent assessor to review the PBCA activities and the contract.

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[7] The total incentive fees earned for all PBCAs were obtained from LOCCS for government fiscal years 2000 through 2008.
[8] Unrestricted funds were determined using the PBCAs' most current financial statements.

The independent assessment report received by HUD in February of 2007 discussed the distribution of the basic fee to the performance standards in depth. The contractor performing the assessment surveyed each of the PBCAs to determine whether the performance standards' distribution percentages were commensurate with the costs necessary to meet the performance standards. Several of the PBCAs provided HUD with distribution percentages based on their actual workload.

The independent assessment report stated that

- Four of the performance standards were the most time consuming and critical activities,
- Nine were administrative in nature,
- One was federally mandated, and
- Two were no longer required.

We compared the original contract performance standard distribution with the 2005 revised draft contract and the independent assessment. We determined that HUD's revised draft distribution percentages were similar to the independent contractor's assessment, while the current contract percentages were not, as shown below.

Performance standard	Type	Contract percentage	Assessment percentage
1. Management and occupancy reviews	Mission critical	8%	15%
2. Document Section 8 owner civil rights compliance	Administrative	5%	5%
3. Rental adjustments	Mission critical	5%	10%
4. Owner opt-out and Section 8 contract terminations	Administrative	5%	5%
5. Provide resident data to HUD	Administrative	5%	5%
6. Review, verify, and authorize monthly vouchers	Mission critical	15%	16%
7. Notice of corrective actions	Administrative	3%	5%
8. Income discrepancies	Not required[9]	3%	0%
9. Life-threatening health and safety	Administrative	7%	5%
10. Non-life-threatening health and safety	Administrative	5%	5%
11. Budgets	Not required[9]	8%	0%
12. Year-end statement	Administrative	8%	3%
13. PBCA audit report	Federally mandated	3%	3%

[9] OIG Audit Report Number 2007 SE 0001, HUD Did Not Ensure That Payments to Contract Administrators Were for Work Performed or That Interest Was Earned on Advances and Recovered, dated June 7, 2007 (see follow-up on prior audits).

Performance standard	Type	Contract percentage	Assessment percentage
14. Renewal of expiring Section 8 contracts	Mission critical	12%	15%
15. General reporting	Administrative	5%	5%
16. Monitoring physical inspection results	Administrative	3%	3%

Risk-based approach - It is not cost effective to perform monitoring reviews every year on low-risk projects. We consider low-risk projects as those that have high physical and financial assessment scores, good internal controls, no changes in ownership or management, and low employee turnover. HUD did not obtain the best value for dollars spent when it did not require the PBCAs to use a risk-based approach in performing monitoring reviews.

Before the contract award, HUD was the contract administrator and was required to monitor the Section 8 housing assistance payments contracts. The schedule of management and occupancy reviews was based on yearly risk assessments of the projects, considering experience and physical and financial assessments. However, HUD decided that the PBCAs should perform a 100 percent review of the projects because it was the "right" way to do it. A 100 percent review of projects does not result in the best value for dollars spent on contract administration services.

Contract changes - HUD did not include a mechanism in the contract to change contract elements and associated fees to allow for changes in program requirements.[10] Although the contract allowed for changes in the contract terms, there was nothing in the contract allowing for a change in contract price as a result of changes in terms. Consequently, when three tasks were no longer required, HUD could not reduce the contract price. When other tasks needed to be performed, HUD had no way of amending the contract or the administrative fee. This HUD decision resulted in more than $35 million being paid in fiscal year 2008 for activities that were no longer required or performed.

In addition, the United States Government Accountability Office (GAO) issued a report on HUD's "Challenges in Measuring and Reducing Improper Rent Subsidies."[11] The report stated that HUD's guidance for collecting data on the types and frequency of errors property owners made in determining subsidies was not widely followed. GAO determined that this deficiency occurred because the data collection effort was not mandatory and duplicated some of the PBCAs' existing procedures. According to a GAO representative, the report did not include a recommendation to revise the contract since HUD stated that it was already rewriting it (see Follow-up on Prior Audits section).

[10] OIG Audit Report Number 2007 SE 0001, HUD Did Not Ensure That Payments to Contract Administrators Were for Work Performed or That Interest Was Earned on Advances and Recovered, dated June 7, 2007 (see follow-up on prior audits).

[11] GAO-05-224 Report on HUD Rental Assistance, Progress and Challenges in Measuring and Reducing Improper Rent Subsidies, dated February 2005 (see Follow-up on Prior Audits section).

Method of payment - HUD did not develop an equitable method of paying the PBCAs. It paid the contractors on a per unit basis; however, the contractor was responsible for the housing assistance payments contracts, not individual units. HUD needs to determine a method of payment that considers both the number of housing assistance payments contracts and the number of assisted units so that payment is equitable across all of the PBCAs.

HUD Did Not Ensure Compliance with Laws and Regulations

HUD did not define what activities in the contract could not be contracted out. As a result, some of the PBCAs allowed their subcontractors to sign the housing assistance payments contracts with the owners. This practice made enforceability of the housing assistance payments contracts questionable since the PBCA's subcontractor is technically not an agent of HUD. Consequently, HUD should clarify which activities cannot be performed by subcontractors to ensure that these tasks are performed directly by the PBCA or HUD.

HUD Did Not Emphasize Quality in Performance Standards

The acceptable quality level was the required performance level for each of the 16 performance standards. The basic fee as well as the acceptable quality level for 15 of the 16 contract performance standards was based on timeliness and/or quantity with no consideration of quality. For example, the acceptable quality level for performance standard 1, management and occupancy reviews, was for the contract administrator to submit 95 percent of required reports and data to HUD within 30 days after scheduled completion of the management and occupancy review. The incentive fee would be earned if 100 percent of the required reports were submitted on time. Since the incentive fees are also based on timeliness and/or quantity, the PBCAs were motivated to perform the work in a timely manner without regard to the quality of the work performed. Additionally, since HUD can return the submissions but cannot assess disincentives for incomplete or inaccurate reporting, the risk of incomplete and/or inaccurate reporting increases.

HUD Did Not Require Collection of Information for Decision Making

HUD stated that the outsourcing of contract administration would save the government in excess of $600 million per year. However, the contract did not include a measurement of results, such as voucher errors (number of errors and amount of error), abatements due to physical inspections, or income errors. Further, HUD did not perform studies to determine whether outcomes were sufficient in relation to the cost of providing the service, more than $291 million in 2008.

We asked the Director of Housing Assistance Contract Administration Oversight if there were any tangible benefits due to the PBCA contract activities. The director provided us with the Web site for the Rental Housing Integrity Improvement Project Newsletters from 2003 through 2008. The newsletters indicated that the PBCAs' use of the Enterprise Income Verification system (system) ensured the accuracy of tenant income. However, when we reviewed the newsletters, we determined that the system was not available for the project-based Section 8 program until the latter part of fiscal year 2006. Further, it was the owners' responsibility to certify that the tenants' income was accurate. It was the PBCAs' responsibility to examine tenant documentation when they performed the management and occupancy review. However, since the PBCAs do not have a contractual requirement to track income errors, HUD could not show what tangible benefits were provided.

HUD Did Not Adequately Develop the Intended Result

OMB Circular A-123, states that federal employees must ensure that government resources are used efficiently and effectively to achieve intended program results. Not only were the incentive fees excessive, they should have been used to promote HUD's goals such as self-sufficiency and housing preservation rather than to promote work already included in the basic fee.

HUD had several clear objectives for subsidized housing including the promotion of economic self-sufficiency and independence for elderly and disabled populations. HUD had good specific goals for improving physical quality through the Real Estate Assessment Center but did not have good specific goals for improving the economic self-sufficiency of families receiving project-based assistance.

HUD Did Not Ensure That Resources Were Used Consistent with Its Mission

Management controls include organization, policies, and procedures used to reasonably ensure that resources are used consistent with the agency mission. As stated above, HUD did not restrict funds, and as a result, excess funds were spent on non-mission-related activities such as repaying OIG audit findings. At the same time, HUD did not adequately monitor the PBCAs. We performed a concurrent audit of HUD's monitoring of the PBCAs, which was issued September 1, 2009. This review indicated that HUD field offices were not able to perform all of the required reviews of PBCA activities due to a lack of available resources.

In addition, HUD's 2009 budget request asserts that the "PBCAs for project-based Section 8 contract administration 'are a vital tool' in the Department's efforts to transform and improve program administration and monitoring." In particular, HUD stated that it used PBCAs to

(1) Reduce payment errors. HUD stated that in conjunction with its Rental Housing Integrity Improvement Project (RHIIP), PBCAs have helped make HUD a leader among federal agencies in reducing improper payments.

(2) Improve the physical condition of units.

(3) Ensure timely payment of rents to property owners. HUD stated that PBCAs help to ensure the timely payment of housing assistance to property owners.

However, in relation to the above activities, we determined the following:

(1) HUD could not tell whether PBCAs were reducing payment errors because the contract did not contain a mechanism to quantify payment errors. Further, PBCAs were not required to participate in RHIIP.

(2) The PBCAs assumed a follow-up role, but HUD's Real Estate Assessment Center was the primary organization that helped improve the physical condition of units.

(3) According to a GAO report, PBCA numbers may not be accurate because the funds are disbursed to the PBCA, rather than directly to the owner. Also, HUD's data systems do not track the date owners receive payment under these contracts. PBCAs' timeliness was based on the date the funds were disbursed to the PBCAs. It generally takes PBCAs anywhere from one to five days to pay owners.[12]

HUD Needs to Determine the Most Cost-Effective Method of Obtaining Contract Administration Services

While using PBCAs may have a positive impact on the overall program, it was not the most cost-effective method of delivering the contract administration services. In addition, HUD did not have adequate resources to monitor the PBCAs, and its field offices were not able to perform all of the required reviews of PBCA activities.

OMB Circular A-123 states that federal employees must ensure that government resources are used efficiently and effectively to achieve intended program results. Resources must be used consistent with agency mission and with minimal potential for waste and mismanagement.

Consequently, instead of continuing to renew the same contracts, HUD needs to look at all available options to ensure that it is using the most cost effective method of

[12] GAO-06-57, dated November 2005, Report to Congressional Requesters, Project-Based Rental Assistance, HUD Should Streamline Its Processes to Ensure Timely Housing Assistance Payments.

performing the contract administration tasks and that it complies with management accountability requirements. Depending on the method determined to be most cost effective, HUD needs to build certain management controls into the process for obtaining these services. Three possible options for consideration in determining the most cost-effective method and some courses of action HUD should consider are

Option 1 - HUD as contract administrator. HUD could increase its staffing levels and bring all of the contract administration functions back in house. This option eliminates layers of management and profit that are inherent in the other methods of obtaining these services. Currently, for most of the larger PBCAs, HUD monitors the PBCAs that monitor their subcontractors that monitor their lower tier subcontractors. There is also profit built into each layer.

Further, HUD established its Financial Management Center to handle some aspects of vouchers and housing assistance payments and its Real Estate Assessment Center to handle physical assessments. These centers could handle at least three of the tasks being performed by PBCAs.

In 2007, HUD employees submitted an issue paper, "Contracting Out at HUD."[13] The paper asked OMB to (1) require that HUD subject current contracts, including the PBCA contracts, to a review in accordance with OMB Circular A-76 or (2) require a small pilot program of no more than 100 full-time-equivalent HUD employees to compare both the cost and quality of the services as provided by HUD employees versus PBCAs. At the employees' request, this paper was provided to a congressional appropriations subcommittee on February 9, 2009. At the time of this report, we are unaware of any decisions made on this issue paper.
If HUD selects the option 1 method of contract administration, it needs to ensure that there are adequate resources. It will need sufficient staff and travel funds to adequately perform the contract administration activities.

Option 2 - HUD as contract administrator, contract out some administration activities. As stated above, the outsourcing of contract administration resulted in multiple layers of management and profit. To reduce the management layers and increase control, HUD could be the contract administrator and contract out some activities that could be performed by other entities. This change would allow for outsourcing of administration activities that could be performed by commercial for-profit entities, current PBCAs, other nonprofits, and HUD employees, which would increase competition and decrease overall costs.

If HUD decides that this option is the most cost-effective method for contract administration, it needs to

- Adequately control costs by awarding the contract to the lowest priced qualified applicant. In addition, if there is no competition for any specific geographic locality, it should obtain a cost proposal from the sole applicant and negotiate the rate.

[13] American Federation of Government Employees, HUD Council 222, Issue Paper, Contracting Out at HUD.

- Include a clause in the new contract stating that any savings generated by the contract administrator as a result of rebidding/renegotiating its subcontracts should be shared with HUD.
- Protect resources from waste by rebidding the contract periodically to ensure that HUD continues to receive the best price for the work performed.
- Follow the Federal Acquisition Regulation in the solicitation process.
- Include quality performance standards in the annual contributions contract.
- Ensure that HUD promotes its goals and focuses on quality and/or other results-oriented outcomes if an incentive fee is made part of the new contract.
- Require collection of information for decision making in the annual contributions contract.
- Adequately develop the intended result.

<u>Option 3 - PBCAs as contract administrator.</u> Continue outsourcing contract administration using a revised annual contributions contract. HUD employees should also be allowed to submit a bid as a PBCA under this option.

If HUD determines that this option is the best course of action, it needs to

- Adequately control costs.
    - Consider using a budget-based system, paying the contractor only what is needed to accomplish the tasks plus a reasonable profit.
    - Require the applicants to submit cost proposals, including subcontract proposals, and negotiate the rates based on consistent requirements.
    - Rebid the contracts periodically to ensure that HUD continues to receive the best price for the work performed.
    - Include a clause in the new contract stating that any savings generated by the contract administrator as a result of rebidding/renegotiating its subcontracts should be shared with HUD.
- Protect resources from waste.
    - Restrict the use of administrative fees earned in excess of expenses to low- and moderate-income housing activities.
    - Ensure that the administration fee distribution to performance standards is commensurate with associated workload.
    - Use a risk-based approach so that HUD receives the best value for dollars spent.
    - Include a method in the new contract for adjusting administrative fees when HUD modifications change or eliminate work for which contract administrators are specifically paid.
    - Use an equitable method of payment that considers the number of projects and units.

- Ensure compliance with laws and regulations.
    - Follow grant requirements and regulations.
    - Clarify which activities cannot be performed by subcontractors to ensure that these tasks are performed directly by the PBCA or HUD.
- Include quality performance standards in the contract.
- Include an incentive fee that promotes HUD goals and focuses on quality and/or other results-oriented outcomes.
- Require collection of information for decision making in the contract.
- Adequately develop the intended result.
- Ensure that resources are used consistent with HUD's mission.

We realize that the above options may not work in all circumstances. Therefore, a combination of the three options could be considered, depending on items such as the geographic area serviced and market conditions. If these options are combined, the courses of action listed above should be similarly combined.

Conclusion

We estimate that HUD will annually pay more than $90.9 million in incentive fees in excess of the 15 percent level recommended in a 2007 independent assessment report. Another $7.6 million could be put to better use annually if HUD were to eliminate excessive profits for one PBCA and rebid contracts to take advantage of lower subcontractor costs. HUD knew in 2004 that the contracts cost more than necessary but did not finalize a revised contract. Further, these amounts do not reflect additional unreasonable and unnecessary costs incurred because of

- Lack of adequate competition,
- Inadequate review of cost proposals,
- Multiple layers of profit and monitoring,
- Costs spent on 100 percent management and occupancy reviews when a risk-based approach to these reviews would be more cost effective, and
- Costs incurred by HUD to monitor the PBCAs.

Recommendations

We recommend that the Deputy Assistant Secretary for Multifamily Housing

1A. Perform a detailed analysis to determine the most cost-effective option for performing the contract administration tasks and initiate that method.

1B. Ensure accountability for results and include appropriate, cost-effective controls so that at least $7.6 million in funds is put to better use or eliminated.

SCOPE AND METHODOLOGY

Our audit testing included the preliminary analysis and drafting of the requests for proposals from 1997 through 1999. Also, we tested the awarding of contracts from 2000 through 2005 and contract performance from 2000 through 2008. We conducted our work from July 2008 through March of 2009.

To accomplish our audit objectives, we examined HUD records and interviewed officials from HUD's Office of Housing Assistance Contract Administration Oversight in Washington, DC; a HUD contracting official from Denver, Colorado; and individuals who worked on the contract to perform an independent assessment of the annual contributions contract. We obtained information from HUD officials, various HUD OIG audit assignments, a HUD independent consultant, GAO and OMB reports, the Internet, and staff of all 53 PBCAs.

The methodologies used included

- Compiling information to determine the history of the contract administration program.
- Reviewing PBCA technical and cost proposal files.
- Reviewing and compiling financial information obtained from the PBCAs.
- Reviewing and compiling information from the independent assessment.
- Reviewing and compiling information from files archived by the HUD contracting officer who worked on the request for proposals and contract award.
- Reviewing and compiling information from GAO and OMB reports.
- Obtaining and summarizing basic and incentive administrative fees paid to contract administrators for fiscal years 2000 through 2008 from HUD's Line of Credit Control System (LOCCS). Costs have steadily increased since 2000. Therefore, we used 2008 dollars for future projections of costs to be conservative. The actual amount will exceed these amounts based on the rate of increase from 2006 to 2008.
- Calculating the excessive profits for one of the PBCAs from its cost proposal and 2008 revenues from LOCCS.
- Calculating savings due to rebidding the subcontract based on the PBCA cost proposal, 2008 financial statements, and official budgetary information.
- Calculating fees paid for tasks no longer required using 19 percent of the basic fees earned for 2008.
- Calculating unrestricted profits currently reported in 8 of 53 PBCA financial statements.

We relied on computer-processed data contained in LOCCS to estimate our finding's impact. We relied on the HUD financial audit and quality management reviews of grant closeout procedures, which reconcile LOCCS cash drawdown balances to grants. However, we did not perform a detailed assessment of the reliability fo the data. We found the data to be reliable for our purposes since the data are used primarily for the purposes of estimating our finding's impact. We included only those transactions that were paid to the PBCAs.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are 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. They include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal control was relevant to our audit objective:

- Policies and procedures in place to ensure that the performance-based contract administration contract was cost effective.

We assessed the relevant control identified above.

A significant weakness exists if internal 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 that the following items are significant weaknesses:

HUD did not have adequate policies and procedures to ensure

- Compliance with management accountability requirements contained in OMB Circular A-123.

- That outsourcing of contract administration included accountability for results and appropriate cost-effective controls.

FOLLOW-UP ON PRIOR AUDITS

OIG Audit Reports

Audit Report Number 2007 SE 0001, HUD Did Not Ensure That Payments to Contract Administrators Were for Work Performed or That Interest Was Earned on Advances and Recovered

We issued audit report number 2007-SE-0001 on June 7, 2007. We reported that 3 of the 16 performance standards were no longer required or performed. However, HUD continued to pay PBCAs for these services. HUD paid PBCAs $27.2 million during fiscal year 2006 for the eliminated work. In addition, HUD did not include a mechanism in the contract to change contract elements and associated fees to allow for changes in program requirements. Although the contract allowed for changes in the contract terms, there was nothing in the contract allowing for a change in contract price as a result of changes in terms. Consequently, when three tasks were no longer required, HUD could not reduce the contract price. When other tasks needed to be performed, HUD had no way of amending the contract or the administrative fee. This HUD decision resulted in more than $35 million for fiscal year 2008 for activities that were no longer required or performed. The report contains two recommendations that are still open as follows:

1A. Revise the annual contributions contract when entering or renewing contracts so that it properly reflects the work required.

1B. Include in the revised annual contributions contract a method for adjusting administrative fees when HUD modifications change or eliminate work for which contract administrators are specifically paid. This revision would result in about $27.2 million in annual savings from discontinuing payments for services that are no longer required.

On October 31, 2007, HUD and OIG entered into an agreed-upon management decision with a final action target date of October 31, 2008. The management decision for these recommendations stipulated that HUD would revise its performance-based annual contributions contract when entering or renewing contracts. The revised contract would properly reflect the work required and would include a method for adjusting the contract in the future if or when requirements changed.

On September 19, 2008, we followed up with the Acting Deputy Assistant Secretary for Multifamily Housing to determine whether HUD was still on target to meet the October 31, 2008, deadline. The Acting Deputy stated, "…based on limited staff and travel resources, a working group has not yet been established to revise the contract. We are anticipating forming a working group in the late first quarter of FY [fiscal year] 2009."

We followed up again on January 15, 2009. The Acting Deputy Assistant Secretary for Multifamily Housing stated, "…the Office that handles the PBCA program also handles the funding of the project-based Section 8 program. Over the last 24 months that Office's priority has been dealing with inadequate funding and poor management of that program."

Memorandum Report Number 2009-SE-0801, dated December 8, 2008, HUD's Recent Performance-Based Contract Administration Activity Was Inconsistent with Agreed-Upon Management Decisions between HUD and HUD OIG on Audit Report 2007-SE-0001, dated June 7, 2007

HUD's Office of Multifamily Housing decided not to renew the annual contributions contract for the PBCA for the Southern California geographic service area, which expired in July of 2009. On October 1, 2008, HUD issued an invitation for submission of applications to award a new annual contributions contract. However, HUD used the outdated invitation, which still included the tasks that were no longer required.

On December 8, 2008, we issued a memorandum recommending that HUD immediately rescind the invitation until it revises its contract. The revised contract should include only tasks that are required and a mechanism to adjust workload and commensurate fees as program needs change. It should also include a provision for making adjustments to the contracts in the future if or when requirements further change.

HUD has made initial changes to the contract for the Southern California geographic region to rearrange the fee percentages to reflect current program practices and related contract administration activities. In addition, HUD changed the contract to provide for a one-year term to ensure that HUD will be able to adjust the contract for future changes in contract requirements as contracts expire. Further, HUD will enter into this new contract with the newly selected contract administrator for the Southern California geographic region.

GAO Audit Reports

GAO-05-224 Report on HUD Rental Assistance, Progress and Challenges in Measuring and Reducing Improper Rent Subsidies, dated February 2005

In February of 2005, GAO issued a report on HUD's "Challenges in Measuring and Reducing Improper Rent Subsidies." The report stated that HUD's guidance for collecting data on the types and frequency of errors property owners made in determining subsidies was not widely followed. This deficiency occurred because the data collection effort was not mandatory and duplicated some PBCAs' existing procedures. Although HUD's monitoring guidance called for PBCAs to collect information on improper rent subsidies at each property, compliance with this guidance was limited. The report went on to say that implementing oversight measures could be challenging for HUD. Prior GAO reviews showed that HUD had not always provided adequate oversight of contractors.

HUD concurred with the findings, stating, “HUD is rewriting its PBCA contract requirements and will address GAO’s issue that more consistent reporting of monitoring results is needed as a basis for measuring, analyzing, and resolving compliance and performance problems.” According to a GAO representative, the report did not include a recommendation to revise the contract since HUD stated that it was already rewriting it.

APPENDICES

Appendix A

SCHEDULE OF FUNDS TO BE PUT TO BETTER USE

Recommendation number	Description	Funds to be put to better use 1/
1B	Profits	$1,780,306
1B	Rebidding the contract	5,820,449
Total		$7,600,755

1/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in pre-award reviews, and any other savings that are specifically identified. The amounts above represent our estimate of savings that could be achieved by eliminating excessive profits on one contract and instituting a mechanism to rebid the contracts after a set period to benefit from reduced subcontractor costs. These amounts reflect only one year of savings although the savings would incur indefinitely if HUD implements our recommendations.

- Profits - We computed the excessive profit using 2008 basic fee data and the profit percentage from the cost proposal submitted by the PBCA that exceeded the 10 percent that HUD determined to be appropriate. (Basic fee divided by one plus proposed profit percentage multiplied by the excessive profit percentage = $19,004,018/121.37 *11.37 = $1,780,306)

- Rebidding the contract - We computed the cost savings for rebidding the subcontract using the PBCA's fiscal year 2008 basic fee earned, 2008 official budget request, and its original cost proposal. The cost proposal provided us with the costs of the original subcontractor for that activity level. We compared this amount with the 2008 projected revenues and expenditures from the official budget, adjusted to 2008 actual fees earned, and calculated the difference.

Proposed subcontract costs	Total proposed basic fee	Proposed subcontract percentage	Total 2008 basic fee earned	Estimated 2008 subcontract costs^
a	**b**	**c=a/b**	**d**	**e=d*c**
$ 11,038,870	$ 14,382,440	76.8%	$ 22,405,367	$ 17,196,660

Budgeted 2008 subcontract costs	Budgeted 2008 basic fee	Budgeted 2008 subcontract percentage	Budgeted subcontract costs^	Cost savings for rebidding the subcontract^
f	**g**	**h=f/g**	**i=d*h**	**j=e-i**
$ 9,170,000	$ 18,060,250	50.8%	$ 11,376,211	**$ 5,820,449**

^Differences are due to rounding.

These amounts do not include any additional savings HUD could achieve by restructuring the contracts and limiting the incentive fee to 15 percent as recommended in a 2007 independent contractor's assessment report. As noted in the finding, the assessment report stated that the contract contained incentives that were actually baseline tasks. This practice rewarded contract administrators for meeting contract requirements and complying with expected outcomes. HUD paid $107 million in incentive fees, which was more than $90.9 million in excess of the recommended 15 percent. However, we could not estimate the amount of savings that would accrue since restructuring the contracts could also affect the level of the basic fees. Any increases in the basic fee portion of the contract would offset the reduced incentive fee portion.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation | **Auditee Comments**

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

OFFICE OF HOUSING

OCT 2 6 2009

MEMORANDUM FOR: Joan S. Hobbs, Regional Inspector General for Audit, 0AGA

FROM: Carol J. Galante, Deputy Assistant Secretary for Multifamily Housing Programs, HT

SUBJECT: Draft Audit Report – HUD's Performance-Based Contract Administration Contract was not cost effective

This response is in follow-up to your memorandum dated September 21, 2009, transmitting the subject draft report and the subsequent exit conference addressing the same on October 8, 2009. We are providing formal written comments to the draft report for your consideration as provided and discussed at the exit conference.

Comment 1

The Office of Multifamily Housing Programs (Office) has carefully reviewed the recommendations set forth in the draft Audit Report. As the Office of Inspector General's (OIG's) objective of this audit which was to determine whether the performance-based contract administration contract was cost effective, it is important to note that this was not the primary focus of this program when it was established. Approximately 10 years ago, the OIG issued an audit that stated that the Office of Multifamily Housing was not adequately monitoring the project-based Section 8 portfolio. To address those concerns, the Office acknowledged that we did not have the in-house resources to conduct the necessary monitoring and developed this program.

Comment 2

However, as the program has been in existence over 10 years, the Office concurs with the OIG that there are programmatic changes that need to be made as well as changes to the Annual Contributions Contract to more accurately reflect the current program requirements. As you are aware, we have already initiated these efforts and look forward to receiving future feedback from the OIG as we proceed through this process.

The Office does have specific comments on the findings for your review:

HUD did not adequately control costs:

Comment 3

The draft report should include the following clarifications of the Performance-Based Annual Contribution Contract (PB-ACC); (1) incentive fees were provided for completing work timely and (2) there was no requirement in the contract that the work performed is accurate and disincentives could only be applied if the number of on-time submissions fell below 95%. Incentive fees are paid for performance that exceeds the acceptable quality level for the specific tasks as defined in the PB-ACC which would require performance to reach 100% completion.

www.hud.gov espanol.hud.gov

Comment 4

In terms of the work quality, the statement of work, Section 3 of Exhibit A, provides a complete description of the work to be performed for each task and the timeframes for submission which varies and impacts the disincentive component. Therefore, the Office believes that the PB-ACC contract provides for both a quantitative and qualitative performance component for each task.

Risk –Based Approach:

The draft report states it is not cost effective to perform monitoring reviews every year on low-risk projects.

Comment 5

The requirement that contractors conduct annual reviews seeks to achieve the same objective as the requirement of the owner to submit annual Financial Statements, to fairly represent the owner's performance to critical stakeholders and ensure that eligible families are receiving program benefits in the appropriate amount. These annual reviews provide the owner, management agent and HUD staff with information on the owner's performance of HUD Project-Based Section 8 program requirements. This is similar to the way that auditors rely on project specific primary and secondary sources of information to complete audits. This annual review is an essential source of information for HUD decision making because it captures information and reports knowledge that is not readily available in any other HUD system or program review.

Comment 6

In addition, the Department has seen a substantial improvement in the physical condition of this portfolio and increased financial performance that has resulted in a lower default rate, in part, due to these annual reviews. However, the Office will look at the potential to mirror the physical inspection protocol (which requires fewer inspections if certain scores are achieved) for the management and occupancy review process.

HUD did not ensure compliance with laws and regulations:

Comment 7

The draft report states HUD did not define nor had an opinion on what activities in the contract could not be contracted out to subcontractors.

An IG auditor requested this information from the Office of General Counsel on January 27, 2009, regarding contracting out inherently governmental activities and HUD's program counsel responded that there is no reason to have a legal opinion since it would assume that HUD's PB-ACC is a procurement contract. The attorney further stated the following:

> "It is not procurement as that term is used under the FAR and under A-76. A procurement contract by its nature requires an analysis under section A-76, and this does not. The use of the phrase "inherently governmental" is misleading and mischaracterizes the contract. As I said below the statutory scheme specifically calls for the use of public housing authorities as contract administrators - similar to the use of PHAs under the public housing or other Section 8 programs - procurement is not required in order to make use of PBCAs. If this has not been helpful please further clarify your request in a request for an opinion."

HUD did not emphasize quality in performance standards:

Comment 8

Based on the practical experience now learned with the program being in existence a number of years, the Office agrees with the OIG that although the the incentive fees include quality, they favor timeliness and/or quantity. However, based on the improved performance of the entire portfolio and the actual on-site reviews conducted of the PBCAs, the Office believes that we have received a high degree of quality work.

HUD did not adequately develop the intended result:

Comment 9

The Office does agree that the Department should be promoting goals such as self-sufficiency, housing preservation and independence for elderly and disabled populations. However, unlike the Office of Public and Indian Housing's self-sufficiency program that is part of the public housing program, the project-based Section 8 Housing Assistance Payments (HAP) program does not have a specific program or goal for self-sufficiency for the tenants. Although we encourage owners to promote self-sufficiency at the properties in this portfolio, it has not been a specific goal for the Office of Multifamily Housing Programs. If it was to be considered a goal in the future, it would be a goal for the HUD staff to work with the owners to achieve, not the PBCAs.

HUD needs to determine the most cost effective method of obtaining contract administrative services:

There are three options provided to address cost effective delivery of contract services:

Option 1 recommends reversion of the function of contract administration back to the Department. This option requires significant resources for contract administration oversight and considerable time to implement which would require critical resources including but not limited to hiring authority, travel, internal and external training. It is the Department's view that it is a better use of time and money to build on the lessons of the PBCAs but not go back to a time when the Department was not providing the level of oversight needed.

Comment 10

In addition, the report states that the Department's Financial Management Center could handle some of the tasks performed by the PBCAs. Please be advised that the Financial Management Center no longer services this portfolio for voucher reviews and the Office would have to address the lack of in-house staff to complete these tasks with a very limited budget.

Comment 11

Lastly, in regards to the issue paper, "Contracting Out at HUD," the Department did hold an A-76 competition for a properties that were not included in the PBCA portfolio but that initiative was never funded. In regards to a small pilot program, this Office has no budgetary authority to hire 100 full-time equivalent HUD employees for such a program.

Option 2 recommends outsourcing as an open competition to commercial for- profit entities and follows the Federal Acquisition Requirements (FAR). This option would require a statutory change to the authority granted to PHAs to provide contract administration services for the HAP contracts entered under Section 8 of the United States Housing Act of 1937 42 U.S.C. 1437f, Section 8. Additionally, this option has similar impediments as in Option 1 including resources and significant implementation delays.

Option 3 could address all of the issues identified by the audit without any structural changes in the manner in which the oversight of the HAP program is being administered through the outsourcing to PBCAs. The principal solution to resolve the audit issues is underway through the revision of the PB-ACC and conducting a new round of competition to administer HAP contracts. The revised PB-ACC scope will include the following:

1. Streamlined both in administration tasks and fee payment to reflect essential tasks and weight the fee structure to reflect commensurate fee payable to workload.
2. Cost proposals will be required of all applicants to assess reasonable fee and associated profit margin.
3. Provide contract language that provides for recompeting the contract periodically to ensure market competition.
4. Include quantity and quality performance standards.
5. Ensure resources are used consistent with HUD's mission.

Comment 12

At this time, the Office believes that pursuing Option 3 is the most beneficial and fruitful way to move forward on this program. Based on our programmatic experiences over the last 10 years, it is important and most cost effective and efficient to build from the foundation of the current program and make the necessary changes to realize cost savings through the recompeting of the PBCA program as follows:

1. Market driven as evidence by recent competitions.
2. Increase in potential applicants.
3. PBCAs operational in various geographical service areas can provide cost efficiencies with economies of scale.
4. Current and potential applicants have experienced personnel and readily available resources to perform the service.
5. Strengthen Departmental monitoring and oversight of the program through provision of revised comprehensive guidance and staff training.

Recommendations:

Page 20, recommendations:

1A. Perform a detailed analysis to determine the most cost effective option for performing the contract administration tasks and initiate that method.

1B. Ensure accountability for results and include appropriate, cost effective controls so that at least $7.6 million in funds is put to better use or eliminated.

Comment 12

Option 3 provided above will address both recommendations and resolve the issue of the provision of cost effective outsourcing of contract administration services, cost efficiencies and controls realized through PB-ACC revisions.

We appreciate the thorough review of the program and look forward to a vastly improved and cost efficient system.

If you have any questions, please contact Deborah Lear, Director, Office of Housing Assistance Contract Administration Oversight at (202) 402-2768.

OIG Evaluation of Auditee Comments

Comment 1 Although the initial intent of the contract was not focused on cost effectiveness, at this time, cost effectiveness is important to prevent waste.

Comment 2 While we commend HUD for acknowledging changes are needed, HUD first discussed the fact that the contract needed to be revised in August of 2004. In February of 2005, the United States General Accountability Office (GAO) issued a report on HUD's "Challenges in Measuring and Reducing Improper Rent Subsidies." The report stated "HUD is rewriting its PBCA contract requirements and will address GAO's issue that more consistent reporting of monitoring results is needed as a basis for measuring, analyzing, and resolving compliance and performance problems."

More than a year later, HUD hired an independent contractor for an assessment of the program and the existing contract at a cost of about $360,000. The assessment report stated that it would take approximately six to eight months to revise and finalize a new contract. While HUD received the assessment report February 9, 2007, it still has not drafted a revised contract.

On June 7, 2007, OIG issued an audit report that identified three tasks the PBCAs were no longer required to perform but for which they were paid. HUD stated that it had already begun the process of revising the annual contributions contract.

On September 19, 2008, we followed up with the Acting Deputy Assistant Secretary for Multifamily Housing to determine whether HUD was still on target to meet the October 31, 2008, final action target date for revision of the annual contributions contract. The Acting Deputy stated, "…based on limited staff and travel resources, a working group has not yet been established to revise the contract. We are anticipating forming a working group in the late first quarter of FY [fiscal year] 2009."

We followed up again on January 15, 2009. The Acting Deputy Assistant Secretary for Multifamily Housing stated, "…the Office that handles the PBCA program also handles the funding of the project-based Section 8 program and over the last 24 months that Office's priority has been dealing with inadequate funding and poor management for that program."

The original contract developed and awarded in the early 2000s was initially a three year contract with two renewal years. However, HUD did not begin to develop a new contract until early in 2009 and the contract is now not scheduled to be implemented until January of 2011. While HUD has significantly delayed developing and implementing a new contract the department has unnecessarily paid hundreds of millions of dollars in basic and incentive fees that will hopefully not be paid once the contract is revised.

Comment 3 We clarified the sections of the report to better explain how quantity and timeliness of the performance standards relates to incentive fees and disincentive deductions.

Comment 4 Qualitative components are included in the narrative section of Exhibit A to the contract. However, with the exception of task 3, the IBPS Performance Requirements Summary table, in which the calculations for disincentives are explained, does not include qualitative components. The defined acceptable quality level for each of the tasks, with the exception of task 3, is based on quantity or timeliness, not quality.

Comment 5 We are encouraged by HUD's agreement to consider mirroring the physical inspection protocol implemented by REAC. However, since REAC plays a significant role in the review of physical and financial reviews, we are hesitant to agree that the annual management reviews are the reason for the improvement in the physical condition of the portfolio and increased financial performance. If the physical condition of the portfolio can increase with performing fewer inspections on low risk properties, it makes sense that it would work with management reviews as well.

Comment 6 We agree that the Department should look at the potential for mirroring the physical inspection protocol which would require fewer management and occupancy reviews if certain scores are achieved.

Comment 7 We received a formal legal opinion on what inherently governmental activities are contained in the contract from HUD's Office of General Counsel on March 31, 2009. The opinion stated that since executing the housing assistance payment contract is inherently governmental it must be performed by HUD or the PHA, not the subcontractor. Further, if HUD executed the housing assistance payment contract it could contract out all of the contract administrator functions that are not inherently governmental. If the PBCAs continue to act as the contract administrators and sign the housing assistance payment contracts they are ultimately responsible for overall contract administration.

Comment 8 OIG disagrees. As discussed in comment 4, the defined acceptable quality level for each of the tasks, with the exception of task 3, is based on quantity or timeliness, not quality. In addition, our September 1, 2009 audit reported that HUD did not adequately monitor the PBCAs' performance with respect to the Section 8 Performance-Based Contract Administration initiative. Consequently, HUD lacked assurance that Section 8 rental subsidies were correctly calculated and paid; project-based Section 8 housing assistance payments contracts were administered consistently; and that it received quality work.[14]

Comment 9 According to performance based contracting best practices the contract should include goals for performance and then develop performance objectives to obtain

[14] OIG Report 2009 SE 0003, HUD's Monitoring of the Performanced-Based Contract Administrators was inadequate, dated September 1, 2009.

those goals. The current goals in the contract emphasize the quantity and timeliness of PBCA submissions rather than encouraging quality performance. However, one of the goals of the PBCA is to earn one hundred percent of the basic and incentive fees. Consequently, HUD's determination of common goals and objectives across the entire PBCA Program would greatly benefit the program and every affected HUD field office.

Comment 10 While HUD does not have current budgetary authority, the contracts will not expire until January of 2011. Therefore, HUD should determine what is the most cost effective and efficient method of performing these services and determine if funds could be reappropriated accordingly.

There are current initiatives within the Federal government to bring work previously contracted out back in house. For example in September of 2008 the Internal Revenue Service canceled a multimillion contract and brought 700 jobs back in house. The Department of Homeland Security recently made the decision to bring 3,200 jobs back in house. The Department of Defense comptroller recently stated that outsourced contractor jobs have ended up being more expensive than government workers.

When HUD decided to contract out the administrative of project-based contracts it had little or no choice due to mandatory downsizing within the Federal Government during the Clinton Administration. Further, HUD was just in the process of creating its Real Estate Assessment Center and the Financial Management Center. HUD needs to re-examine its current environment to determine the most efficient and cost effective method of providing the contract administration services.

Comment 11 Option 2 would not require a statutory change because the tasks that cannot be contracted out would be performed by HUD as discussed in Comment 7 above. Most of the work being performed under the current contract for the largest PBCAs is not performed by the PHA but rather by the commercial subcontractor. In addition, the contract currently being developed could be used for Option 2. HUD would only need to do a minor modification to bring the inherently governmental activities back in house. Additional FTEs could be attained with cost savings on the contracts and HUD has until 2011 to negotiate the change.

Comment 12 As stated in our report, since Option 3 has multiple layers of management and profit it may not result in the most cost effective and efficient contract. As recommended, HUD should perform a detailed analysis to determine what option is the most cost effective rather than selecting an option it wishes to perform without any analysis of the cost. This will ensure that the method selected is the most cost effective.

Appendix C

CRITERIA

A. OMB Circular A-123, attachment I. Introduction. The proper stewardship of Federal resources is a fundamental responsibility of agency managers and staff. Federal employees must ensure that government resources are used efficiently and effectively to achieve intended program results. Resources must be used consistent with agency mission, in compliance with law and regulation, and with minimal potential for waste, fraud, and mismanagement.

B. Federal Acquisition Regulation 15.000. This part prescribes policies and procedures governing competitive and noncompetitive negotiated acquisitions. A contract awarded using other than sealed bidding procedures is a negotiated contract.

C. Federal Acquisition Regulation 15.101. Best value continuum. An agency can obtain best value in negotiated acquisitions by using any one or a combination of source selection approaches. In different types of acquisitions, the relative importance of cost or price may vary. For example, in acquisitions where the requirement is clearly definable and the risk of unsuccessful contract performance is minimal, cost or price may play a dominant role in source selection. The less definitive the requirement, the more development work required, or the greater the performance risk, the more technical or past performance considerations may play a dominant role in source selection.

D. Federal Acquisition Regulation 15.101-1. Tradeoff process. (a) A tradeoff process is appropriate when it may be in the best interest of the Government to consider award to other than the lowest priced offeror or other than the highest technically rated offeror. (b) When using a tradeoff process, the following apply: (1) All evaluation factors and significant subfactors that will affect contract award and their relative importance shall be clearly stated in the solicitation; and (2) The solicitation shall state whether all evaluation factors other than cost or price, when combined, are significantly more important than, approximately equal to, or significantly less important than cost or price. (c) This process permits tradeoffs among cost or price and non-cost factors and allows the Government to accept other than the lowest priced proposal.