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Report to Congressional Committees

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SECTION 8 TENANT-BASED HOUSING ASSISTANCE

Opportunities to Improve HUD's Financial Management

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Resources, Community, and
Economic Development Division

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Congressional Committees

This report responds to a mandate in the 1997 Emergency Supplemental Appropriations Act that we evaluate the accuracy of the Department of Housing and Urban Development's (HUD) estimate of unexpended budget authority in the Section 8 tenant-based program. Our report also responds to your request that we assess HUD's budget formulation process for this program. The report contains recommendations to the Secretary of Housing and Urban Development that are designed to improve the reporting of unexpended budget authority and the formulation of budget requests for the Section 8 tenant-based program.

We are sending copies to the appropriate congressional committees; the Secretary of Housing and Urban Development; and the Director, Office of Management and Budget. Copies are available to other interested parties upon request.

If you or your staff have any questions, please call me at (202) 512-7631. Major contributors to this report are listed in appendix III.

Judy A. England-Joseph
Director, Housing and Community
Development Issues

List of Committees

The Honorable Christopher S. Bond
Chairman
The Honorable Barbara A. Mikulski
Ranking Minority Member
Subcommittee on VA, HUD, and
Independent Agencies
Committee on Appropriations
United States Senate

The Honorable Jerry Lewis
Chairman
The Honorable Louis Stokes
Ranking Minority Member
Subcommittee on VA, HUD, and
Independent Agencies
Committee on Appropriations
House of Representatives

Executive Summary

Purpose

In fiscal year 1998, the Congress appropriated $25 billion in discretionary budget authority for the Department of Housing and Urban Development's (HUD) programs, which represented a 30-percent increase over the fiscal year 1997 level of $19.3 billion. HUD will use more than a third of this funding to assist low-income households to obtain decent housing under section 8 of the Housing Act of 1937. Section 8 of the act establishes two primary types of assistance for families to rent privately owned housing units: tenant-based assistance provided through contracts with housing agencies and project-based assistance provided through contracts with private landlords.[1] In 1997, HUD reported that enough budget authority had accumulated unneeded and unspent over the 24-year life of the tenant-based program to equal the amount expended to fully fund the program for fiscal year 1996. Before 1997, however, HUD's information systems could not identify and report the accumulation of such excess budget authority. Furthermore, HUD has not specifically identified the budget authority for the tenant-based program in its budget submission or in its consolidated financial statements, and therefore it was not subject to annual audit.

Expressing concern about HUD's lack of timeliness and precision in identifying the magnitude of unspent budget authority in the tenant-based portion of the Section 8 program, the Chairman of the Subcommittee on VA, HUD, and Independent Agencies, House Committee on Appropriations, asked GAO to review HUD's financial management of the tenant-based program. In response to that request and to a mandate in the 1997 Emergency Supplemental Appropriations Act (P.L. 105-18) that directs GAO to review HUD's budgeting and accounting systems for Section 8 rental assistance,[2] GAO's objectives for this report were to

- evaluate the accuracy of HUD's estimate of its unexpended funds in the Section 8 tenant-based program and the reasonableness of this amount and
- assess HUD's budget formulation process as it was carried out for the Department's fiscal year 1998 submission for the tenant-based Section 8 program.

[1]For the tenant-based program, HUD contracts with state and local public housing agencies to manage the program's certificates and vouchers, which assist 1.4 million households. These agencies make payments to private-sector landlords to subsidize the rent of certificate and voucher holders.

[2]This report is the first of three that GAO plans to issue in response to this mandate. The second report will address budgeting and accounting issues for the Section 8 project-based program, and the third report will address the Section 8 Moderate Rehabilitation Program.

Background

HUD's rental housing programs help about 4.7 million low-income households to obtain safe, decent, and affordable places to live. About two-thirds of these households rent units in the privately owned housing market under the Section 8 program. HUD's estimate for new budget authority to renew expiring Section 8 tenant-based and project-based[3] contracts grew from $3.6 billion in fiscal year 1997 to $8.1 billion in fiscal year 1998. Moreover, HUD estimates that because a significant number of the tenant-based contracts will expire over the next 5 years, the renewal needs for the tenant-based portion alone will increase from $2.5 billion in fiscal year 1997 to more than $10.5 billion in budget authority by fiscal year 2002. Nearly one-third of all assisted households, or 1.4 million, participate in the tenant-based program.

To offset the budget authority requirements for renewing the tenant-based portion of the Section 8 program, HUD began in 1995 to draw on unspent budget authority from previous years to extend contracts beyond their expiration dates. Because Section 8 budget authority is available to HUD's programs until expended, unspent Section 8 funding that accumulates over the years as reserves remains credited to the housing agencies. However, for years, HUD's information systems did not allow the Department to accurately identify such unexpended budget authority. In addition, since the early 1990s, the Office of Management and Budget and HUD's Office of the Inspector General have reported that the Department has been unable to submit accurate estimates of its contract renewal needs because its financial management systems have not contained adequate data on Section 8 contracts. This situation occurred because of serious deficiencies in the controls and procedures for maintaining contract and accounting data. In an effort to more accurately estimate contract renewal needs, HUD began an aggressive effort in February 1996 to quantify for all participating housing agencies the accumulated reserves available to extend contracts.

Results in Brief

In 1997, HUD estimated that $20.7 billion in unexpended budget authority existed in the Section 8 tenant-based program and that $9.9 billion of that amount was excess to known program needs. This is funding that housing agencies received under contracts with HUD but did not expend because the funding was not needed as planned to make housing assistance payments to landlords on behalf of low-income families. Because HUD

[3]For the project-based program, HUD contracts directly with and provides rental subsidies to the owners of private rental housing and state housing finance agencies. For both the tenant-based and project-based programs, assisted households generally pay 30 percent of their income for rent, although this percentage can vary depending on a family's income and the type of program.

based its estimate largely on the data in its tenant-based program's information system—which HUD's Office of Inspector General and an independent audit firm have tested and determined to be reliable—GAO believes that the estimate is reasonably accurate. After the Congress rescinded a total of $4.2 billion in June and October 1997 and HUD set aside $2.2 billion for unanticipated costs and to account for future transactions, the balance of $9.9 billion in excess unexpended budget authority was reduced to about $3.5 billion in October 1997 and placed in a congressionally established Reserve Preservation Account.

The budget formulation process that HUD used to prepare its fiscal year 1998 budget request for renewing Section 8 tenant-based contracts did not produce an accurate estimate of needs. Key HUD offices did not adequately oversee critical steps in the process, and the process did not require reasonable justification for substantial portions of the estimate—including several hundred million dollars proposed for contingency costs. In addition, although at the time of its fiscal year 1998 budget submission HUD had an estimate of the impact of welfare reform on the cost of the Section 8 program, more recent information caused the Department to conclude that including this estimate in the budget request was unnecessary. As a result, the Department eventually lowered by $1 billion (over 10 percent) its fiscal year 1998 budget estimate for renewing Section 8 contracts. To improve its process, HUD has further enhanced its tenant-based program's information system,[4] consolidated its budget development with strategic planning and financial management, and changed its budget process; HUD also plans additional changes in these areas but does not have a timetable for accomplishing them.

Principal Findings

Tenant-Based Program Accumulated Billions in Excess Unexpended Budget Authority

At the direction of the Congress and with an improved information system, HUD identified in 1997 $20.7 billion in unexpended budget authority in the Section 8 tenant-based program. HUD classified $9.9 billion of that amount as excess because it would not be needed to meet the current requirements of the tenant-based program. An independent review by Price Waterhouse LLP showed that these amounts were accurate. However, because the housing agencies that administer the program had not demonstrated in prior years a need for significant amounts of reserve

[4]HUD's central accounting and program system for the tenant-based program, called HUDCAPS, provides financial accounting, management control, and financial reporting capabilities.

funding, a reserve of $9.9 billion to address unexpected program costs was excessive. Therefore, after deducting $2.2 billion for contingencies and other adjustments, HUD took back $7.7 billion from the amounts formerly provided to housing agencies under contract to administer the Section 8 program. Of this amount, the Congress rescinded $4.2 billion and HUD placed the remaining $3.5 billion in a congressionally established account for excess Section 8 reserves.

Until HUD's actions in 1997 to identify and take back the excess unexpended budget authority in its Section 8 contracts, the Department had been unaware of the magnitude of the growing balances in these accounts. Furthermore, only after recent improvements to its information system does HUD now have the capacity to obtain accurate data on these balances. HUD does not currently distinguish, in either its budget justification materials or its consolidated financial statements, excess balances of budget authority from amounts that are needed to meet requirements. However, regular reporting of these balances would provide the Congress with a more accurate picture of the tenant-based program's cost. Such reporting also would better ensure that HUD's future budget requests recognize the availability of this funding to offset needs for new budget authority or for other purposes.

Flaws in HUD's Budget Process for the Tenant-Based Program Led to Significant Overestimates of Contract Renewal Needs; HUD Plans Improvements

Despite improvements to the Section 8 tenant-based program's information system, in its fiscal year 1998 budget submission to the Congress, HUD overstated its $9.2 billion estimate of tenant-based contract renewals by over $1 billion because of (1) fundamental flaws in its budget development process and (2) states' experience with welfare reform showing that welfare recipients' incomes were not falling as anticipated. The flaws in the budget process included the following:

- A lack of oversight by appropriate offices allowed HUD to double-count the administrative fee that is paid to housing agencies for operating the Section 8 program, thus adding approximately $700 million to the estimate of new budget authority needed to renew tenant-based contracts.
- Insufficient use of supporting historical data caused HUD to request unneeded additions to its estimate of the annual cost per unit of assisted housing, which added $444 million to HUD's total request for contract renewal. HUD also provided insufficient support for a requested $162 million for contingencies, an amount that it could not justify with information from prior years.

Recognizing these budgeting inaccuracies and that the $179 million that it had budgeted to address the impact of welfare reform on tenants' incomes would not be necessary, HUD submitted a revised budget estimate for renewing Section 8 contracts to the Congress prior to the enactment of HUD's fiscal year 1998 appropriations bill. HUD reduced its estimate by $1 billion—from $9.2 billion to $8.2 billion—by, among other actions, reducing the average unit cost, eliminating its request for funds to address unspecified contingency costs, and increasing its use of unused funding from prior years.

To address the problems that GAO and HUD identified in its budget process, HUD plans to make additional improvements to its information system and reorganize the offices responsible for preparing and reviewing the Department's budget estimates. Recognizing a need to improve its budget process with better oversight and documentation, HUD recently moved the Office of Budget under the control of the Office of the Chief Financial Officer and plans to base future budgets on documented historical program costs and data. HUD officials plan to adopt other changes—such as no longer using excess budget authority to extend expiring contracts—to make their requests for new budget authority more accurately reflect the needs of the Section 8 program. Because many of these changes have not been fully implemented, GAO cannot determine whether they will positively affect the budget process for fiscal year 1999 and beyond.

Recommendations

To improve HUD's financial management of its tenant-based program and the soundness of the budget estimates for fiscal year 2000 and beyond, GAO recommends that the Secretary of Housing and Urban Development

- direct the Office of the Chief Financial Officer to modify the agency's consolidated financial statements so that they (1) identify the portions of the unexpended appropriations for the Section 8 program that are attributable to the tenant-based and project-based programs and (2) disclose the accumulated amounts of budget authority in each program that are excess to current needs and therefore available for other uses and
- annually assess the balance of excess unexpended budget authority credited to housing agencies and take back amounts that accumulate above what is prudently needed to address contingency costs.

Agency Comments

GAO provided a draft of this report to HUD for its review and comment. In commenting on the report, HUD's Chief Financial Officer said that HUD agreed with the report's major findings, conclusions, and recommendations. HUD's Office of Public and Indian Housing said that the report presents a balanced assessment. To provide a more factual representation and to ensure clarity, HUD provided additional comments. For example, HUD's principal concern was that GAO had characterized HUD's initial estimate of the impact on welfare reform as unjustified. HUD believes that while more recent conditions and information show the estimate to be obsolete and unnecessary, the estimate included as part of the fiscal year 1998 budget estimate was based on the best information available at the time. GAO agrees and has made appropriate changes in its report to reflect HUD's concerns.

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Abbreviations

CFO	Chief Financial Officer
FY	fiscal year
GAO	General Accounting Office
HUD	Department of Housing and Urban Development
OIG	Office of Inspector General
OMB	Office of Management and Budget

Introduction

In fiscal year 1998, the Congress appropriated $25 billion in discretionary budget authority for the Department of Housing and Urban Development's (HUD) programs, which represented a 30-percent increase over the fiscal year 1997 level of $19.3 billion. HUD provides rental housing assistance-about $21 billion in fiscal year 1996—that enables about 4.7 million low-income households to obtain safe, decent, and affordable housing. HUD assists about two-thirds of these households through its Section 8 housing assistance program.[1] HUD's estimate of new budget authority to renew expiring Section 8 tenant-based and project-based contracts[2] increases from $3.6 billion in fiscal year 1997 to $18.1 billion in fiscal year 2002. For the tenant-based portion of the Section 8 program, HUD provides housing subsidies through nearly 4,300 contracts with local housing agencies and state housing finance agencies. Housing agencies receive a fee from HUD for administering the tenant-based program and working with households to determine eligibility, verify income, and ensure that units meet quality standards. Because a significant number of the Section 8 tenant-based contracts will expire over the next 5 years, the estimated cost to renew contracts in the tenant-based program alone will rise from about $2.5 billion in fiscal year 1997 to $10.5 billion in fiscal year 2002. To identify unexpended funding that could offset this growing renewal cost, HUD recently undertook aggressive efforts to reconcile its records in the tenant-based program.

1.4 Million Households Benefit From HUD's Tenant-Based Rental Assistance

Tenant-based assistance is an important part of the federal government's commitment to providing safe, decent, and affordable housing to low-income people. In fiscal year 1996, HUD spent about $7 billion to provide tenant-based rental assistance. HUD's tenant-based assisted housing programs—the Section 8 certificate and voucher programs—provide direct rental assistance to about 1.4 million households. These programs are designed to allow low-income households to live in decent and affordable private rental housing of their choice, as long as the units meet HUD's rent and quality standards. Generally, under the certificate program, an assisted household pays 30 percent of its

[1]The Section 8 housing assistance program, named for the revised section 8 of the U.S. Housing Act of 1937, was originally established by the Housing and Community Development Act of 1974 (P.L. 93-383). It includes project-based assistance for specific properties and tenant-based assistance for specific households.

[2]For the project-based program, HUD contracts directly with and provides rental subsidies to the owners of private rental housing and state finance agencies. In the Moderate Rehabilitation Program, HUD contracted with landlords to rehabilitate their multifamily properties and also provided project-based Section 8 assistance to make them affordable for low-income households. For each program, assisted households generally pay 30 percent of their income for rent, although this percentage can vary depending on a family's income and the type of program.

adjusted income for rent. In contrast, households with vouchers may elect to pay more or less than 30 percent of their income for rent, depending on the rent charged for the unit in which they elect to live. In turn, the voucher program assists the household by making a subsidy payment to the landlord equal to the difference between 30 percent of the household's adjusted income and a payment standard for the housing unit based on the fair market rent for a unit of a similar size in the area.

To operate the certificate and voucher programs, HUD enters into contracts with local and state housing agencies, including public housing agencies. These housing agencies certify applicants for eligibility, inspect units found by the tenant for compliance with housing standards, and verify that the lease terms meet HUD's requirements. In addition, the housing agencies pay the rent subsidies to owners of private rental housing for the assisted households. HUD also pays the housing agency a statutorily determined administrative fee for managing the program.

Section 8 Tenant-Based Contracts

When the Section 8 program began in 1974, HUD entered into long-term contracts with housing agencies to provide tenant-based assistance. Initially, contract terms for tenant-based assistance were for 15 years. As the federal budget deficit grew larger, HUD reduced contract terms to reduce the amount of budget authority it needed to set aside to fully fund the contracts over their whole terms.[3] HUD subsequently shortened the contract terms to 5 years and, later, to 3 years. Finally, beginning in fiscal year 1995, Section 8 tenant-based contracts were written for 1-year terms, thus minimizing the amount of budget authority HUD needs to fund contract renewals. HUD's actions have resulted in contract lengths ranging from as long as 15 years to as short as 1 year.

Nearly a Fivefold Increase in Section 8 Tenant-Based Assistance Is Expected Within 5 Years

HUD estimates that the cost of Section 8 contract renewals for the tenant-based program alone will increase from $2.5 billion in fiscal year 1997 to $10.5 billion in fiscal year 2002—nearly a fivefold increase in the amount of budget authority needed to fund Section 8 tenant-based contract renewals. The increase in budget authority is attributable to the large growth in the number of expiring Section 8 tenant-based contracts. This growth reflects the renewal of the initial expiration of long-term contracts, as well as the re-renewal of shorter term contracts begun in the 1990s. To offset the budget authority requirements for Section 8 contract

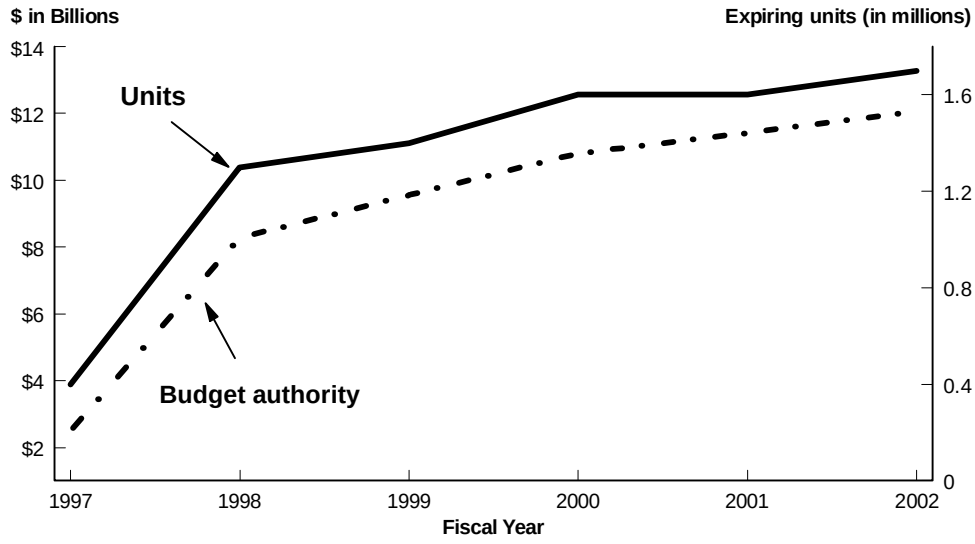
[3]Budget authority is the authority provided by federal law to incur financial obligations that will result in outlays. Appropriations are the most common means of providing budget authority. Outlays are the measure of federal spending and are payments to liquidate obligations.

renewals, the Congress encouraged HUD in 1995 to begin using available unexpended budget authority that had accumulated over the years in the housing agencies' program reserve accounts to extend the funding of expiring Section 8 contracts.

The Congress provides budget authority for HUD's Section 8 tenant-based assistance to (1) renew expiring contracts to maintain existing subsidies (called contract renewals), (2) create new contracts to increase the number of assisted households (called incremental assistance), and (3) provide additional funds for existing contracts when the remaining contract funds are insufficient to pay subsidies over the remaining life of the contract (called contract amendments). Renewal assistance represents the vast majority of Section 8 tenant-based assistance.

HUD and the Congress have worked together during recent years to renew every expiring contract. However, renewing these contracts will require a sharp increase in budget authority over the next few years because the number of expiring contracts is increasing dramatically. The sharp growth in expirations has two causes. First, the number of contracts expiring for the first time will increase sharply in the coming years. These consist of 15-year contracts issued in the late 1970s and early 1980s and short-term (5 years or less) tenant-based contracts issued since the early 1990s. Second, HUD must renew an increasing number of contracts that it has renewed at least once previously, a circumstance that has begun to occur more frequently as contract terms have grown shorter. Renewing expiring contracts will require a sharp increase in budget authority over the next several years, as shown by figure 1.1.

Figure 1.1: Estimated Budget Authority and Expiring Units for Section 8 Tenant-Based Contract Renewals, Fiscal Years 1997-2002



Note: HUD applied $1.6 billion of excess budget authority to its fiscal year 1998 Section 8 tenant-based contract renewal request, thereby reducing it to $6.7 billion.

Source: Congressional Justifications for 1998 Estimates, HUD.

In 1995, the Congress encouraged HUD to use available unexpended funds in the Section 8 program to offset the budget authority requirements for contract renewals. Budget authority appropriated for Section 8 tenant-based contract renewals is "no-year" money and does not expire if it is not expended. These unexpended funds have been obligated to the housing agencies but will not be needed to meet planned requirements; the funds are, in effect, credited to housing agencies' program reserve accounts. In fiscal year 1995, HUD began to draw on unused budget authority from previous years to extend the terms of expiring contracts.

To identify unexpended balances to help offset the cost of Section 8 contract renewals, HUD began in February 1996 an extensive examination, called "reconciliation," of the Section 8 tenant-based program's reserve accounts at all housing agencies. The results of this examination were not completed until 1997. In addition, in November 1996 HUD identified approximately $1.6 billion that had not been obligated to the tenant-based program—and therefore was also unexpended. HUD called this amount "carryover" and used it to offset the Department's fiscal year 1998 contract renewal needs. Identifying this carryover occurred too late in the budget process to have an impact on HUD's fiscal year 1997 budget request.

Therefore, HUD reflected it in the Department's fiscal year 1998 budget request by reducing the estimate of Section 8 tenant-based contract renewals by $1.6 billion.

At the request of the Chairman of the Subcommittee on VA, HUD, and Independent Agencies, House Committee on Appropriations, we reviewed HUD's fiscal year 1998 budget request for Section 8 contract renewal funding. In February 1997, we briefed the Subcommittee and provided testimony for the Subcommittee's hearing on March 18, 1997. [4] We informed the Congress that HUD had a significant amount of unexpended funds in the Section 8 tenant-based program and that once HUD completed its examination of the housing agencies' accounts, the likely total amount of available unexpended funds would far exceed the $1.6 billion that HUD disclosed in its fiscal year 1998 budget request. In chapter 2, we discuss HUD's actions to further identify the unexpended budget authority in the tenant-based program.

Accumulation of Unexpended Budget Authority in the Section 8 Tenant-Based Program

The accumulation of unexpended funds in housing agencies' reserve accounts resulted from HUD's method of estimating budgets since the beginning of the program. According to HUD officials, at the outset of the Section 8 tenant-based program, HUD intentionally established program reserves during the early years of a multiyear housing assistance contract to help fund the program in the later years. This practice was, in part, required by law.[5]

To build up reserves, HUD based its estimate of the amount of budget authority needed to fund the program on two conservative assumptions. First, HUD assumed that tenants would make a contribution of zero toward their rent. Therefore, as tenants had income and contributed to their rent the amount of budget authority the housing agency drew down from the program was less than budgeted, and program reserves began to grow. Second, HUD assumed that all certificates were in constant use, even though the leasing of housing units would necessarily take some time to accomplish while prospective tenants shopped for housing and the housing agencies determined the tenants' eligibility and ensured that the selected units met quality standards. Thus, reserves accumulated during

[4]HUD's FY 1998 Budget Request: Some Requests for Funding May Be Unnecessary (GAO/T-RCED-97-108, Mar. 18, 1997).

[5]To address the effect of inflation in the early years of the program, a provision in section 8 of the Housing Act of 1937 required HUD to provide each housing agency with 115 percent of the estimated amount of housing assistance that would be required to assist a family receiving a 5-year housing voucher. HUD adopted this provision for certificates as well.

the time housing units were not leased because housing agencies did not make housing subsidy payments for unleased units. As a result, the larger housing agencies, especially those receiving new certificates every year, developed significant reserves.

While HUD began to consider tenants' income in its contract renewal budget requests for fiscal year 1991, it continued to assume that all units were fully leased. For instance, currently, a statutory requirement exists that once a household discontinues its need for and use of a certificate or voucher and returns it to the housing agency, the housing agency must wait 3 months before reissuing that certificate or voucher to another eligible household. However, HUD does not factor the effect of this requirement into its budget estimates for Section 8 tenant-based assistance. Therefore, during this 3-month period, reserves accumulate in the housing agencies' reserve accounts because the agencies do not make housing assistance payments to landlords for housing units not under lease.

Long-Standing Problems With HUD's Budget Estimating Process

The build-up of reserves in HUD's Section 8 tenant-based program is indicative of long-standing problems with HUD's budget estimating process. According to HUD's Office of Inspector General (OIG), HUD, for years, has been unable to estimate accurately the budget authority it needs for Section 8 contract renewals and amendments. Historically, HUD's accounting and information systems did not contain reliable, complete, or accurate data on Section 8 contracts. This situation occurred because of poor systems design and serious deficiencies in the controls, policies, and procedures associated with the input and maintenance of Section 8 contract and accounting data. As a result of these problems, HUD had to continually revise its Section 8 estimates and often request additional funding. While HUD has taken action to correct these problems, budget estimating problems still remain.

In response to congressional concerns about HUD's budget estimating problems, HUD and the Office of Management and Budget (OMB) formed a joint team to evaluate HUD's fiscal year 1992 contract renewal and cost amendment estimates and to find ways to improve the process in the future. The team determined that HUD was unable to accurately estimate Section 8 contract renewal and amendment needs because HUD's data systems were inadequate for the timely retrieval of accurate information.[6]

[6]Final Report on Management of Section 8 Housing Assistance Programs, Department of Housing and Urban Development and Office of Management and Budget Joint SWAT Team (Nov. 1991).

Furthermore, the team reported that estimating the number of expiring Section 8 contracts—and the budget authority required to renew them—had been a recurring problem for HUD since 1989. For example, HUD had to re-estimate its contract renewal needs for fiscal years 1990 and 1991 because of inadequate financial management systems and inaccurate forecasting. Specifically, HUD's financial management systems did not provide summary information to determine the number of expiring Section 8 contracts. In addition, HUD's cost estimates for contract renewal were based on assumptions about average costs that proved to be inaccurate.

In 1992, HUD's OIG reported that the Department continued to experience problems in submitting reliable Section 8 budget requests to the Congress.[7] Specifically, the OIG concluded that serious deficiencies existed in (1) the controls and procedures in HUD's Section 8 accounting and budgeting systems and (2) the input and maintenance of contract and accounting data in the Department's information systems. As a result, HUD could not assure the Congress that its Section 8 budget requests for fiscal years 1992 and 1993 were reasonably accurate. Because HUD's management relied on the Department's inadequate Section 8 financial management systems to develop the budget requests and because the estimate of the cost to fund expiring contracts turned out to be inaccurate, HUD had to increase its Section 8 contract renewal estimates for fiscal years 1992 and 1993. In addition, the OIG reported that HUD's original estimates for Section 8 amendments for fiscal years 1992 and 1993 may have been materially overstated. However, the OIG believed that the accuracy of the Department's tenant-based contract renewal estimate for fiscal year 1993 appeared improved over the fiscal year 1992 estimate.

To determine HUD's progress in improving its Section 8 budgeting systems and processes, HUD's OIG conducted a follow-up audit in 1995.[8] The OIG found that HUD's program offices had developed and implemented interim budgeting procedures that had improved the Department's ability to formulate Section 8 contract renewal budget estimates. Nevertheless, the OIG found that HUD continued to experience problems developing accurate and reliable Section 8 contract renewal and amendment estimates. For example, the OIG found that because of a breakdown in the budgeting process, the Department's budget office did not use more reliable

[7]Review of HUD's Fiscal Year 1992 and 1993 Budget Estimating Processes for Section 8 Contract Renewals and Amendments (Audit Report No. 92-TS-103-0008), HUD Office of the Inspector General (Apr. 1992).

[8]Audit of Section 8 Accounting and Budgeting (Audit Report No. 97-FO-103-0001), HUD Office of Inspector General (Mar. 1995).

estimates developed by the program offices for the Department's initial fiscal year 1996 budget submission to OMB. The OIG also concluded that HUD's fiscal year 1994 amendment estimate was materially overstated and believed that the estimates for fiscal years 1995 and 1996 also appeared to be overstated. In response, the Assistant Secretary for Public and Indian Housing pointed out that the tenant-based program had included a "cushion" in its amendment estimates to cover shortfalls in budget authority that could not be estimated by the Department's systems.

To help correct the deficiencies with its accounting and budgeting for Section 8 contracts, HUD implemented a new Section 8 tenant-based information system in fiscal year 1995.[9] Besides containing primary information for estimating contract renewal needs, the system contains the actual cost incurred by each housing agency for providing rental assistance. The system also provided the amount of unspent budget authority credited to each housing agency at the end of the agency's fiscal year.

Objectives, Scope, and Methodology

The Chairman of the Subcommittee on VA, HUD, and Independent Agencies, House Committee on Appropriations, has expressed concern about HUD's financial management of the Section 8 tenant-based program—specifically, HUD's lack of timeliness and precision in identifying the magnitude of unspent budget authority in the Section 8 tenant-based program. As a result, the Chairman asked us to review HUD's financial management of the Section 8 tenant-based program. In addition, the 1997 Emergency Supplemental Appropriations Act (P.L. 105-18) directed us to determine whether HUD's systems for budgeting and accounting for Section 8 rental assistance ensure that unexpended funds do not reach unreasonable levels and that obligations are spent in a timely manner. Our objectives for this report, therefore, were to

- evaluate the accuracy of HUD's estimate of its unexpended funds in the Section 8 tenant-based program and the reasonableness of this amount and
- assess HUD's budget formulation process for the Section 8 tenant-based program.

To evaluate the accuracy of HUD's estimate of its unexpended funds in the Section 8 tenant-based program and the reasonableness of this amount, we

[9]This is HUD's tenant-based central accounting and program system, called HUDCAPS, that provides financial accounting, management control, and financial reporting capabilities.

reviewed documentation and discussed HUD's examination of unexpended balances in housing agencies' reserve accounts with HUD officials. We reviewed and discussed the results of Price Waterhouse LLP's independent evaluation of available unexpended funds in the tenant-based program with officials from Price Waterhouse LLP and with HUD officials in the Offices of Public and Indian Housing, the Chief Financial Officer, and Inspector General. We contacted national associations representing housing agencies and discussed the need for retaining unexpended funds in housing agencies' program reserve accounts. These organizations were the Council of Large Public Housing Authorities, the National Association for Housing and Redevelopment Officials, and the Public Housing Authority Directors Association.

To assess HUD's budget formulation process for the Section 8 tenant-based program, we reviewed HUD's process for developing the contract renewal estimates and evaluated supporting documentation for HUD's fiscal year 1998 budget request. We also reviewed federal laws and regulations, OMB policies, and HUD's guidance. We analyzed the impact that HUD's budgeting processes had on its fiscal year 1998 budget submission to the Congress. In addition, we discussed programmatic, budgeting, and financial management issues with HUD officials from the Offices of Public and Indian Housing, Budget, the Chief Financial Officer, Policy Development and Research, and Inspector General.

While we did not systematically verify the accuracy of HUD's data or conduct a reliability assessment of HUD's databases as part of this assignment, we relied upon the work of HUD's OIG and our review of the OIG's audit of the consolidated financial statement, which shows that the information in HUD's tenant-based information system is generally reliable. As part of its audit of HUD's fiscal year 1996 financial statements, HUD's OIG analyzed a statistical sample of HUD's contracts. For those contracts that were Section 8 tenant-based contracts, the OIG traced the information in the original contract files first to HUD's Department-wide accounting system and then to HUD's Section 8 tenant-based information system. The OIG concluded that, for the sample reviewed, the amounts reserved and obligated in the Section 8 tenant-based information system were correct.[10] As part of our audit of the federal government's consolidated financial statement, we selected a subset of this sample and performed similar tests at two field offices. On the basis of these tests, we concurred with the OIG's findings.

[10]Audit of the U.S. Department of Housing and Urban Development's Fiscal Year 1996 Financial Statements (Audit Report No. 97-FO-177-0003), HUD Office of Inspector General (Apr. 10, 1997).

We provided a draft of this report to HUD for review and comment and we address HUD's comments at the end of each applicable chapter.

We performed our work from May 1997 through December 1997 in accordance with generally accepted government auditing standards.

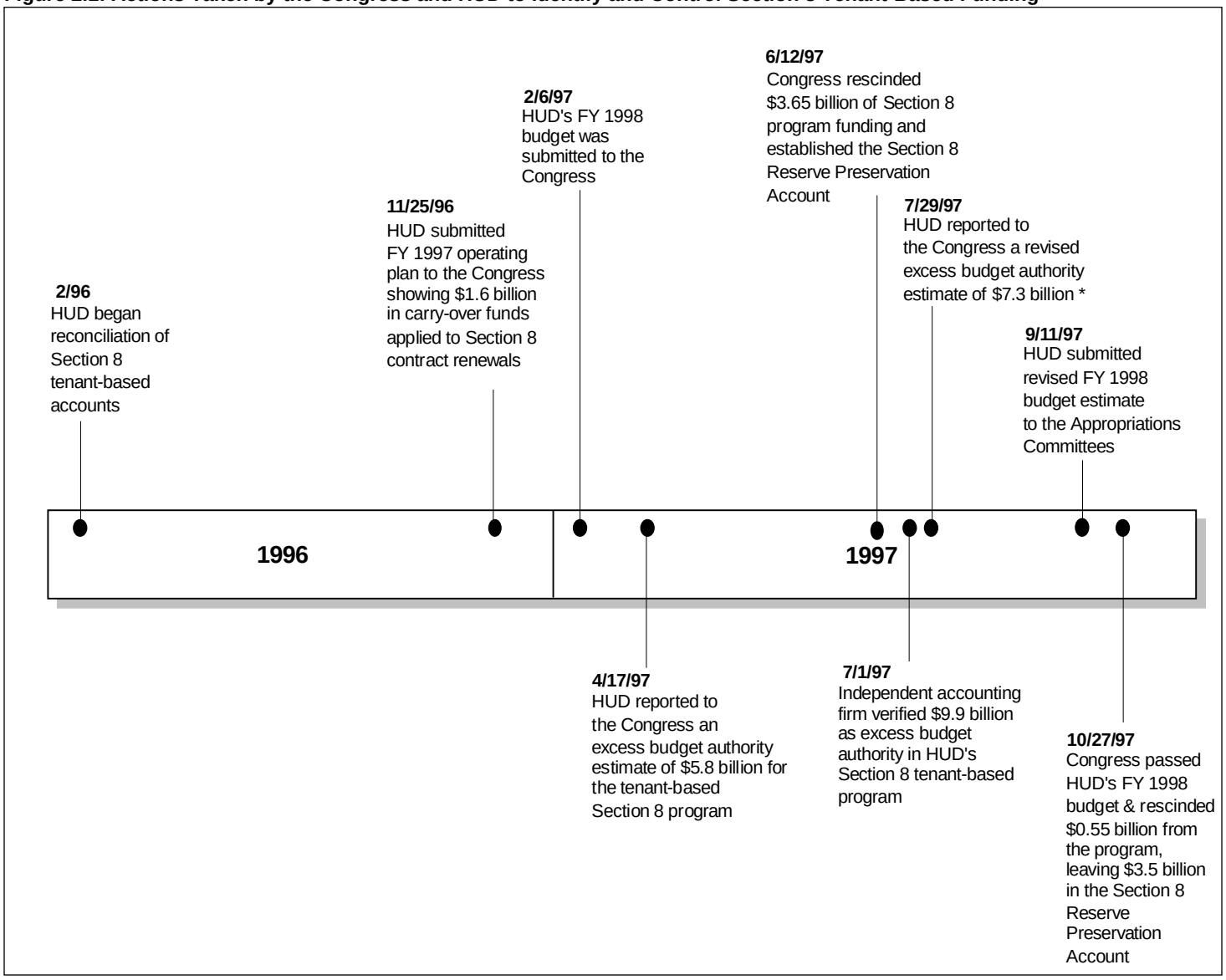
HUD Identified Billions in Excess Unexpended Budget Authority

Over the more than 20 years that HUD has provided housing assistance through the Section 8 tenant-based program, approximately $9.9 billion of budget authority excess to program needs has accumulated in housing agencies' reserve accounts. This is funding that housing agencies received under contracts with HUD but did not expend because the funding was not needed as planned to make housing assistance payments to landlords on behalf of low-income families. After HUD reported this large unexpended balance, the Congress rescinded $4.2 billion, and after other adjustments of about $2.2 billion, the current balance is about $3.5 billion, which remains in a congressionally established Section 8 Reserve Preservation Account. To identify this programwide unexpended balance, HUD conducted in 1996 and 1997 a financial data reconciliation of all of its tenant-based housing assistance contracts. Until completing the reconciliation process and making recent improvements to its information system, the Department could not accurately report its excess balances in the tenant-based program. However, with improved systems and better data, HUD has the opportunity to report in more detail its unexpended Section 8 funding and the potential availability of this funding to offset needs for new budget authority or for other uses.

About $10 Billion of Excess Budget Authority Accumulated in the Section 8 Tenant-Based Program

In March 1997, HUD completed an extensive accounting reconciliation and data verification process that it had begun in February 1996. With the results of the reconciliation, HUD updated its Section 8 tenant-based information system and subsequently determined that the unexpended budget authority in the tenant-based program was $20.7 billion and that $9.9 billion of that amount was not needed to meet current program needs. Because this $9.9 billion of excess budget authority was not needed to fund current obligations, it therefore was available to meet future Section 8 or other needs. HUD recaptured $7.7 billion of this excess balance and retained the difference of $2.2 billion to cover contingencies and to account for future transactions. The $9.9 billion that had accumulated as excess exceeded the $7.4 billion that housing agencies expended on payments to landlords during fiscal year 1996. Figure 2.1 provides a chronology of the actions taken by the Congress and HUD to identify and control Section 8 tenant-based funding.

Figure 2.1: Actions Taken by the Congress and HUD to Identify and Control Section 8 Tenant-Based Funding



*The difference between the independently verified number of 9.9 billion and the $7.3 billion reported to the Congress is an amount set aside to meet various contingencies.

$9.9 Billion of Excess Budget Authority Had Accumulated in the Tenant-Based Program

In May 1997, HUD estimated that the amount of unexpended budget authority that exceeded the amount needed to meet contract requirements in the tenant-based program was $9.9 billion. This was HUD's second attempt to estimate this figure; the Department revised its initial estimate

after an independent accounting firm determined that critical data used could not be verified because they were maintained manually at HUD's field offices. HUD's revised estimate of $9.9 billion has been verified by an independent accounting firm. In contrast to the first estimate, HUD calculated its revised estimate by using data exclusively from its Section 8 tenant-based information system to compare total unexpended budget authority with the housing assistance requirements for that budget authority. By subtracting projected program requirements of $10.2 billion and other adjustments of $0.6 billion from the total unexpended budget authority of $20.7 billion, HUD concluded that the amount of unexpended budget authority that was not needed to meet existing housing assistance needs at the beginning of fiscal year 1998 would be $9.9 billion, as shown in table 2.1.

Table 2.1: Unexpended Budget Authority in the Tenant-Based Program That Is Excess to Current Program Needs as of October 1, 1997

Dollars in billions	
Total unexpended budget authority under contract as of April 22, 1997	$20.7
Less:requirements to fund all active housing units under contract on April 22, 1997, through the expiration of those contracts	(10.2)
Total excess budget authority under contract as of April 22, 1997	$10.5
Less:adjustments needed to project the balance through the end of fiscal year 1997 (September 30, 1997)	(0.6)
Projected excess budget authority as of October 1, 1997	$9.9

Source: HUD's Office of Public and Indian Housing.

Price Waterhouse LLP assisted HUD in evaluating its revised estimate and determined the estimate to be accurate. During its work, Price Waterhouse LLP performed tests on a statistical sample of 158 housing agencies to confirm the accuracy of HUD's $9.9 billion estimate of excess unexpended budget authority. For this sample, the accounting firm compared information in HUD's tenant-based information system with information in the housing agencies' most recent year-end settlement statements.[1] By extrapolating the results from the test sample to the information system as a whole, Price Waterhouse LLP found that the totals differed from HUD's by 5 percent or less and on that basis concluded that HUD's estimate of $9.9 billion was accurate.

[1]HUD field office officials review and approve housing agencies' year-end settlement statements. The statement documents the cost incurred by the housing agency to run the program for the fiscal year and the corresponding number of unit-months under leases supported by those funds.

HUD Ultimately Recaptured $7.7 Billion of the $9.9 Billion

In the June 1997 Emergency Supplemental Appropriations Act, the Congress directed HUD to recapture unexpended budget authority that was not needed to meet the current obligations of the Section 8 tenant-based program. In the act, the Congress also established the Section 8 Reserve Preservation Account as an accounting repository for recaptured excess budget authority. In response to this direction, HUD recaptured $7.7 billion of the excess budget authority and placed it in the Preservation Account. Of the $2.2 billion not recaptured, about $1.2 billion was left in the participating housing agencies' accounts as a reserve for contingencies equal to about 2 months of assisted housing payments to landlords. The remaining $1 billion was not recaptured because it represented amounts that had not yet been credited to housing agencies' reserve accounts at the time of the recapture.[2] As shown in table 2.2, after two congressional rescissions totaling $4.2 billion, GAO has calculated on the basis of data obtained at the end of fiscal year 1997 that about $3.5 billion remains in the Reserve Preservation Account. (However, more recent financial information maintained by HUD shows that this balance may be closer to $3.7 billion.)

Table 2.2: Budget Authority Remaining in the Section 8 Reserve Preservation Account

Dollars in billions	
Projected excess contracted budget authority as of October 1, 1997	$9.9
Less: 2-month reserve for contingencies	(1.2)
Less: amount not yet accumulated at the time of the recapture	(1.0)
Excess contracted budget authority recaptured and placed in the Section 8 Reserve Preservation Account	$7.7
Less:budget authority rescinded ($3.65 billion in June 1997 and $0.55 billion in Oct. 1997)	(4.2)
Budget authority remaining in the Section 8 Reserve Preservation Account	$3.5

Source: GAO calculation based on data from HUD's Office of Public and Indian Housing.

While a reserve for contingencies is prudent, it is not clear that a reserve of $1.2 billion is reasonable and necessary. A report from HUD's tenant-based information system shows that, in fiscal year 1996, housing

[2]Some of the $9.9 billion in excess unexpended budget authority had not yet been placed in housing agencies' reserve accounts at the time of the recapture because some housing agencies' accounts had not been closed via the year-end settlement process. During this process, HUD determines the difference between the amount of budget authority that the housing agency is entitled to under contract and the amount of budget authority that the housing agency actually used during the year. Once this difference is determined, HUD places the amount in the housing agency's reserve account.

agencies used $353 million[3] in excess budget authority to cover contingencies, far less than the amount that HUD has reserved for this purpose. Moreover, during fiscal year 1996, an additional $1.4 billion[4] in excess budget authority accrued. HUD plans to adjust its reserve level after it examines in more detail housing agencies' actual use of available unexpended budget authority in fiscal years 1996 and 1997. However, given housing agencies' experience in fiscal year 1996, much less than $1 billion likely will be needed to meet unanticipated costs during a 1-year period.

Opportunities Exist for Better Reporting of Excess Budget Authority

April 1997 was the first time that HUD identified and reported to the Congress the excess unexpended budget authority associated with the Section 8 tenant-based program. Until HUD's recent improvements to its information system, such reporting could not be done accurately. However, better data and improved systems now offer HUD the opportunity to use its (1) budget justification materials and (2) financial statements as a means to report the status of unexpended funds and their availability to offset needs for new budget authority or for other uses.

HUD is not required to and does not currently report in its annual budget justifications the aggregate amount of excess unexpended budget authority credited to housing agencies' reserve accounts. By doing so, however, the Department could ensure that the Congress is informed about the funding on hand before appropriating new budget authority. Moreover, according to OMB's guidance on budget formulation, agencies should consider available funding on hand before requesting new funding.

A second means for HUD to improve its reporting of excess unexpended budget authority in the Section 8 tenant-based program is through its financial statements. HUD's consolidated financial statements comply with the federal accounting requirement to disclose unexpended budget authority by major budget account—the entire Section 8 program, for example. However, the statements do not currently show the amount of unexpended budget authority for programs that are at the level of the tenant-based and project-based Section 8 programs or whether unexpended budget authority is needed to meet program requirements or is available for other purposes. The federal accounting standards established by the Financial Accounting Standards Advisory Board require

[3]The $353 million includes excess budget authority used for the Section 8 Moderate Rehabilitation Program.

[4]The $1.4 billion includes excess budget authority accrued in the Section 8 Moderate Rehabilitation Program.

that agencies disclose the status of budgetary resources, including the amount obligated. The standards do not, however, require agencies to disclose such information below the major budget account level. Each agency should disclose information that is most useful to the users of their financial statements.

In a note to its fiscal year 1996 consolidated financial statements, HUD disclosed unexpended appropriations by major program type. The note explained that unexpended appropriations include obligated, committed, and reserved as well as excess funds. It further said that HUD had unexpended appropriations of $43 billion in the Section 8 program (tenant-based and project-based) at the end of fiscal year 1996. While the note fulfills the advisory board's requirement to report on the status of budgetary resources, the note does not identify the portion of the $43 billion attributed to the two Section 8 assisted housing programs or the amount in excess of the programs' needs. By reporting excess budget authority in the two programs in its consolidated financial statements, HUD would instill greater confidence in the accuracy of these balances because they also would be reviewed as part of the annual consolidated financial statement audit required by the Chief Financial Officers Act of 1990. Moreover, clearly identifying the existence and amount of excess unexpended budget authority is important if the Congress is to have confidence in HUD's capacity to effectively manage the funding provided for the Section 8 tenant-based program.

Conclusions

We believe that to adequately address economic contingencies—such as rising rental rates or falling tenant incomes—HUD should maintain a reasonable level of excess budget authority; however, excess budget authority that exceeds a full year of housing assistance payments is excessive. To ensure that excess unexpended budget authority does not reach unreasonable levels, HUD would need to annually review each tenant-based housing assistance contract it has with housing agencies with the intent of recapturing amounts above the level prudently needed to cover the unexpected but potential costs of administering the contract. Furthermore, now that HUD has corrected the data in its tenant-based information system, the Department has several means—including its financial statements and budget submissions—to keep the Congress better informed in the future of the amount of excess unexpended budget authority in the Section 8 tenant-based program.

Recommendations

To improve HUD's fiscal responsibility to the Section 8 program and to ensure that the Congress is adequately informed about the amount of excess unexpended budget authority at HUD in the future, we recommend that the Secretary of HUD

- direct the Office of the Chief Financial Officer to modify the agency's consolidated financial statements so that they (1) identify the portions of the unexpended appropriations for the Section 8 program that accrued during the year and are attributable to the tenant-based and project-based programs, respectively and (2) disclose the amounts of budget authority in each program that are excess to current needs and therefore available for other uses;
- include in HUD's annual budget justification documents the amount of unexpended budget authority in the Section 8 assisted housing program that is in excess of current obligations and recapture amounts that accumulate above what is prudently needed to address contingent costs.

Agency Comments

In commenting on a draft of this report, HUD's Chief Financial Officer said that HUD agreed with the report's major findings, conclusions, and recommendations. In addition, HUD's Office of Public and Indian Housing said that the report presents a balanced assessment. The CFO and officials of the housing office provided several comments to improve the report's clarity, and we incorporated them as appropriate.

HUD Plans Changes to Improve Its Budget Formulation Process

Accurate budget estimates are essential to federal agencies meeting their fiscal responsibilities because such estimates facilitate sound policy decisions and effective funding trade-offs. In support of agencies being fiscally responsible, OMB requires them to submit reasonably accurate budget estimates. However, HUD has long-standing problems in submitting accurate estimates—since 1989, its estimates of Section 8 contract renewals have been either too low or too high. This inability to accurately forecast budget needs persisted into fiscal year 1998. We found that HUD had problems with its budget submission; but we also found that HUD had corrective actions planned or in process to improve its budgeting process. Specifically, we found the following:

- The budgeting process HUD used in fiscal year 1998 produced excessive estimates of key cost factors that, once discovered, led to HUD's reducing its request for tenant-based contract renewal funding by about $1 billion.
- In its budget projection for fiscal years 1999 through 2002, HUD overestimated its need for funding to amend existing housing assistance contracts because accurate data were not available from its accounting system at the time.
- HUD has acknowledged many of its problems with its budgeting process and has begun implementing corrective actions that include changing its organizational structure to improve oversight among the staff responsible for formulating budget estimates. However, many of the changes HUD is making or has planned were not implemented in time to affect HUD's initial formulation of its fiscal year 1999 estimate, and HUD has not prepared a timetable for implementing these changes.

Ineffective Budget Process Caused Errors and Resulted in Revised Budget Request

HUD's fiscal year 1998 budget request contained errors and insupportable estimates that led to HUD's overstating funding needs for its tenant-based contract renewals by over $1 billion. This error was caused by an ineffective internal budget process that lacked adequate oversight and did not make effective use of actual expenditure data for the program. For example, insufficient review of the estimating methodology led to double-counting a large component of the average cost per assisted housing unit. Because this cost is a key variable in determining HUD's contract renewal needs, the double-counting caused HUD to greatly overstate its estimate for renewing expiring contracts. In addition, HUD's estimate contained contingency costs that could not be justified on the basis of program experience.

Budget Process Erred in Developing Unit Cost

In its fiscal year 1998 budget submission of February 1997, HUD used a value of $6,386 as the average unit cost for renewing tenant-based housing assistance contracts.[1] Although this value is based on the program's actual expenditure data for fiscal year 1996, it also includes several supplementary amounts for

- administrative fees paid to housing agencies,
- contingent or unexpected costs, and
- increased program expenditures caused by residents losing their welfare assistance in 1997 and 1998.

However, we and HUD determined that adding these three amounts to the average unit cost either could not be justified or was not necessary. For the first amount—the administrative fee—HUD officials had already included this fee in the baseline unit cost; adding it again resulted in double-counting it.[2] Specifically, the program's fiscal year 1996 expenditure data that HUD obtained from the accounting system represented the total cost to HUD of providing rental assistance and, therefore, necessarily included the administrative fee. However, to develop the final fiscal year 1998 average unit cost, HUD added the fee again, resulting in raising the contract renewal estimate by approximately $700 million. We found, and program officials agree, that better coordination and oversight among the officials in the program office, the office of the comptroller, and the departmental budget office could have prevented this error. For example, the program office's comptroller reviewed the actual disbursement data obtained from the accounting system but did not review the final average unit cost calculation until after HUD submitted its budget to the Congress. Moreover, departmental budget officials accepted the program office's estimate without an independent review of the added costs and underlying basis for the estimate.[3]

The second supplementary amount was for covering unknown costs or contingencies. For this supplement, HUD added approximately $204 to the unit cost, or 2 weeks of disbursements.[4] However, at the time that HUD

[1]Appendix I shows HUD's calculation of the $6,386 average unit cost used to estimate the amount of budget authority that would be needed to renew housing assistance contracts in fiscal year 1998.

[2]The value that HUD used for the fee was $561 per unit.

[3]In 1995, HUD's Inspector General reported that the departmental budget office was responsible for determining the reasonableness of all estimates provided by the program offices for the agency's budget request.

[4]The added cost for contingencies increased the contract renewal estimate by approximately $265 million.

developed this estimate, almost all housing agencies participating in the tenant-based program already had individual reserve accounts equal to at least 2 months of disbursements. These reserves could be used to cover contingencies such as rent increases and decreases in tenants' income. Section 8 program officials stated that they added the 2-week reserve as another safeguard against the risk that families might lose rental assistance because of unexpected increases in program costs. The officials said, however, that they could not determine whether housing agencies actually needed additional funding or were using available reserves for unanticipated costs. They said that because the tenant-based information system could give them only 1 year's worth of complete and reliable information on the use of reserves, a sufficient basis did not exist for making informed decisions about the need for contingency funding.

The third supplementary amount that HUD used to develop its fiscal year 1998 unit cost was for mitigating the anticipated impact of welfare reform on Section 8 costs. For 1998, HUD valued the welfare supplement at $138 per unit ($46 in 1997 and $92 in 1998).[5] However, after submitting its budget estimate to the Congress in February 1997, HUD determined that this amount was unnecessary. HUD found that its assumption that housing agencies would begin to feel a significant impact from welfare reform starting in 1997 was not borne out by what was happening across the country. Instead, the states' early experiences with the impact of welfare reform showed little or no increased cost to the program as a result of the falling incomes of assisted housing residents. As a result, adding a cost factor to address the impact of welfare reform was not necessary.

In addition to the inflated unit cost estimate, HUD's fiscal year 1998 contract renewal estimate contained a line item requesting a contingency allowance of $162 million. Although program officials said that the funding was needed to cover unanticipated costs in the program, they could not provide supporting information to justify their request. Subsequently, HUD adjusted its fiscal year 1998 budget request and removed this request for funding. HUD's Deputy Assistant Secretary confirmed that because HUD would use historical data as the basis for future budget estimates, HUD would make no future requests for contingency funding for the tenant-based program.

[5]The welfare factor increased the contract renewal estimate by approximately $179 million.

Because of Budget Estimating Errors, HUD Lowered Its Fiscal Year 1998 Contract Renewal Request

As a result of misestimating the unit cost and using cost estimates in its February budget submission that HUD later determined to be unnecessary, in September 1997 HUD proposed—and the Congress accepted—changes in its contract renewal estimate that lowered the average unit cost by approximately 14 percent, from $6,386 to $5,499.[6] As shown in table 3.1, for the 1,265,625 Section 8 housing certificates, vouchers, and moderate rehabilitation units being renewed, this change represented a decrease of $1.123 billion in the budget authority requested by HUD for its tenant-based program.

Table 3.1: HUD's Changes to Its Fiscal Year 1998 Tenant-Based Contract Renewal Budget Estimate

	Original estimate submitted in February 1997	New estimate proposed in September 1997	Change to fiscal year 1998 budget request (in billions)
Average unit cost	$6,386	$5,499	–$1.123
Allowance for Contingencies	$162,000,000	$0	–$0.162
Total			**-$1.285**

HUD's revised unit cost estimate produced the most substantial reduction to the original contract renewal estimate. According to HUD's Deputy Assistant Secretary responsible for the tenant-based program, HUD developed the revised unit cost using only the program's historical expenditure data from the tenant-based information system.[7] She also stated that in the future HUD would not supplement the average unit cost with additional amounts even if they made sense from a policy standpoint unless the supplementary amounts could be supported with historical or other data. Two of these supplements were an amount to reflect the impact of welfare reform and an amount to cover contingent costs. An official from HUD's Office of Policy Development and Research stated that the amount to reflect welfare reform's impact was removed from the average unit cost because states' early experiences with welfare reform did not show an increased cost to the program.

[6]Appendix II shows the complete list of changes that HUD made to the fiscal year 1998 contract renewal request and that HUD added some costs to the revision as well.

[7]The actual disbursements were inflated by 4.4 percent over the 2-year period in accordance with the OMB-established factor of 2.2 percent per year.

HUD's Funding Request for Future Years' Contract Amendments Is Not Well Supported

As part of its fiscal year 1998 budget request, HUD predicted an annual need of $150 million for fiscal years 1998 through 2002 to amend its contracts with public housing agencies that administer its Section 8 tenant-based and moderate rehabilitation assisted housing programs.[8] Generally, amending contracts refers to the process of changing specific housing assistance contracts to add more funding. These contracts might need additional funding because the budget authority initially obligated to them—as long ago as 15 years—may not have been sufficient to provide adequate rental assistance over the life of the contract. In addition to the fiscal year 1998 budget request for amendment funding, HUD's budget submission also predicted that the need for amendments to the tenant-based contracts through the year 2002 would be approximately $600 million.

Although HUD has supporting documentation for its need for amendment funding for fiscal year 1998, the Department's prediction of needing future amendment funding is not consistent with the significant changes HUD has made to its contracting practices. In fiscal year 1995, HUD began reducing the terms for renewed expiring contracts from 3 to 5 years to 1 year. Therefore, under this policy HUD will renew the contracts receiving amendment funding in fiscal year 1998 for 1 year after their expiration. This change to shorter contract terms has made estimating contract renewal needs more certain because changes in housing costs or tenants' incomes could be predicted more easily over the shorter period. In addition, a HUD official told us that the tenant-based information system more accurately estimates funding needs 1 year at a time and, therefore, greatly lowers the risk of underfunding contracts and could ultimately eliminate the need for amendment funding. They also said most of the tenant-based contracts should have 1-year terms by fiscal year 2003. Therefore, because of the greater certainty about the future costs of a program operating under contracts with mostly 1-year terms, HUD does not appear to need additional funding for tenant-based amendments beyond fiscal year 1998.

[8]Although the budget line item for amendments was $850 million, HUD officials said that informally they earmarked $150 million for the Office of Public and Indian Housing to fund the needs of the tenant-based and moderate rehabilitation programs. The remaining $700 million was planned for the project-based program.

HUD Plans to Improve Its Process for Estimating Contract Renewals

HUD officials have made or plan to make several important changes to HUD's information system and organization to address the problems that they and we have identified in HUD's budgeting process. In response to the fiscal year 1995 Financial Statement Audit prepared by HUD's OIG,[9] HUD recently enhanced its tenant-based information system and plans changes to related procedures to improve the accuracy of its budget estimates. Also recognizing the need for improving coordination and oversight among the HUD officials involved in preparing and reviewing the budget submission, HUD moved the Office of Budget under the control of the Office of the Chief Financial Officer. HUD officials believe that these improvements will correct past problems and enhance their efforts to more accurately estimate their Section 8 budget needs.

Enhancements to Accounting System and Procedural Changes Could Improve Budget Estimate

HUD is enhancing the Section 8 tenant-based information system by automating and integrating the "reservation pricing" used to estimate the amount of budget authority each housing agency is likely to need annually to operate its tenant-based program. In the past, HUD field offices deducted tenants' expected contributions to rent (generally about 30 percent of a tenant's family income) from the local fair market rent to develop an estimate of the cost to HUD of assisting low-income families to live in decent housing during the coming year. However, after obtaining the estimated costs, HUD did not compare these estimates with the actual cost of that assistance for the most recently completed year. As a result, HUD overfunded many tenant-based contracts, and the excess funding contributed to the accumulation of program reserves. By creating a "reservation pricing" subsystem within the information system, HUD now will use the actual historical cost data to evaluate the fair market rents and tenants' contributions. HUD officials believe that this process will eliminate overfunding and improve the accuracy of the budget estimating for contract renewals.

HUD also plans the following additional modifications to the tenant-based Section 8 information system and the budgeting procedures used to estimate contract renewal needs, although our work did not focus on evaluating the potential benefits of these actions:

- HUD plans to modify its information system to calculate the actual average cost per unit before completing the annual settlement process at each housing agency. This change will verify the reasonableness of the average

[9] HUD's Fiscal Year 1995 Financial Statements (Audit Report No. 96-FO-177-0003), Aug. 1996, HUD's Office of the Inspector General.

cost per unit before HUD settles all program costs at the end of the year with the housing agency.

- In response to the data access problems noted by HUD's OIG, HUD plans to improve the security over access to the unit tables within the information system and to compare monthly the number of contracted units in the system to the previous month's total to reconcile any differences.
- Finally, to maintain better control over the amount of program reserves, HUD plans to no longer extend expiring tenant-based contracts with excess budget authority within the program reserves.

HUD Plans Management Reforms to Improve Coordination and Oversight

HUD has recognized the need for improving coordination and oversight among program, budget, and financial management officials in order to achieve more reliable budget estimates, including estimates of Section 8 contract renewals. HUD's Management Reform Plan states that the Chief Financial Officer has lacked the ability to link budgeting with strategic planning and financial management because HUD's budget operations have been fragmented and disjointed, preventing clear accountability and the necessary coordination. As a result, HUD has recently placed all departmental budget operations under the Office of the CFO to ensure that budgeting is integrated with financial management oversight.

HUD also is in the process of implementing two changes directly related to the budget estimate. First, all program divisions are hiring a chief financial officer to mirror the operations of the Department's Office of the CFO. Previously, the program division's budget director and comptroller reported to a deputy assistant secretary. Under the new structure, the division's budget director and comptroller will report to the program's chief financial officer who will coordinate the agency's CFO and the program office to ensure adequate oversight. However, at the time of our review, a chief financial officer for the tenant-based program had not been hired and the program's comptroller had been detailed to the Department's Office of General Counsel. Second, the Office of the CFO is developing a model to analyze all budget submissions, including the contract renewal estimate. Previously, the departmental budget office accepted the cost estimates with only limited review of the supporting documentation that detailed how the estimates were developed.

Although the Office of the CFO also plans to develop budget estimating policies and procedures that build in enough time for adequate coordination, oversight, and communication, these plans have not been completed. HUD's CFO did state, however, that the planned improvements

should be operational in time for HUD's fiscal year 2000 budget submission. In addition, according to HUD's Director of the Office of Budget, HUD submitted its fiscal year 1999 contract renewal estimate to OMB in September 1997 with limited analysis. He also said that because of time constraints, his office was limited to reviewing the budget estimates for their numerical accuracy and could not question the estimates' reasonableness or their underlying basis. For example, he stated that the Budget Office was unaware of the program office's budgeting assumption that all tenant-based certificates are in constant use. This assumption, however, does not reflect the current practice of housing agencies that administer the tenant-based program. As stipulated by current appropriations law, after a certificate is turned in by the current holder, the housing agency must wait 90 days before reissuing it to a new household. But because the budget estimate assumes constant use, the effect is to estimate more funding than will actually be needed although HUD could recapture such excess funding when it analyzes the housing agency's reserve account at the end of the year.

HUD's Office of the CFO also is leading the effort to improve HUD's financial management performance by linking HUD's budget functions with performance measures and program delivery. Specifically, to improve financial management oversight, HUD will consolidate the 10 accounting divisions in HUD's field offices into one office responsible for all accounting operations. In addition, the Office of the CFO will develop management controls to ensure that employees are accountable for the Department's fiscal integrity. HUD also has implemented a risk management program, directed by the Office of the CFO, to protect resources from fraud, waste, and abuse and to maintain the agency's financial integrity. As part of this effort, the CFO has collected all financial management deficiencies identified by HUD's OIG, GAO, and others and is working to correct these deficiencies within all HUD programs. While these actions appear to be responsive to the problems identified, HUD has no specific time frames for their completion.

Conclusions

HUD's fiscal year 1998 budget process had inadequate oversight of procedures and insupportable estimates or assumptions underlying key values. Although HUD recognizes these problems and has plans to correct them, it is too soon to measure the effectiveness of the remedies because many have not been implemented. More importantly, HUD has a lengthy history of budget estimating problems and faces some uncertainty now about personnel to oversee and make policy for the budgeting function.

Therefore, we are concerned with the agency's ability to sustain such recent corrective actions and implement those it has planned. Furthermore, many of the actions that HUD has taken or plans to take were not completed at the time HUD prepared its initial contract renewal budget estimate for fiscal year 1999 and sent it to OMB in September 1997. We believe that HUD's Office of the CFO will need to exercise strong leadership to complete these changes and to develop specific budget procedures to guide the new organizational changes. Otherwise, HUD's fiscal year 2000 budget estimate—which HUD will begin to prepare in May 1998—and future estimates may also misestimate program funding needs.

Because HUD has recognized many weaknesses in its budget process for estimating contract renewal needs and has undertaken significant actions to improve its process, we are not making recommendations at this time. However, we will continue to monitor HUD's budget process and review its fiscal year 1999 budget submission to determine whether cost estimates are adequately supported.

Agency Comments

In commenting on a draft of this report, HUD agreed with the report's major findings and conclusions. HUD also provided several comments to improve the report's factual representation and to ensure clarity. In particular, HUD believed that we should recognize that its initial estimate of the impact of welfare reform on fiscal year 1998 budget needs was based on the best information available. We agreed and made changes to reflect this concern.

HUD's Development of Its Fiscal Year 1998 Average Unit Cost Estimate for Tenant-Based Contract Renewals

	Certificates	Vouchers	Mod Rehab
FY 1996 average disbursement			
Disbursements	$5,554,798,000	$1,874,533,000	$594,843,000
Divided by number of units	1,078,480	348,948	109,871
Average disbursements per unit	$5,151	$5,372	$5,414
FY 1997 average per unit calculation			
1996 average	$5,151	$5,372	$5,414
2-week reserve	198	207	208
Admn. fee	561	561	561
Subtotal	**$5,910**	**$6,140**	**$6,183**
Add 2.2% inflation	**130**	**135**	**136**
Add welfare reform	**46**	**46**	**46**
FY 1997 average unit cost	**$6,086**	**$6,321**	**$6,365**
FY 1998 average per unit calculation			
1997 average	$6,086	$6,321	$6,365
Add 2.2% inflation	134	139	140
Add welfare reform	92	92	92
FY 1998 average unit cost	$6,312	$6,552	$6,597
Weighted average calculation for FY 1998 estimate			
70% certificates	$4,418		
25% vouchers	1,638		
5% moderate rehabilitation	330		
Total	**$6,386**		

Source: HUD's Office of the Chief Financial Officer.

HUD's September 1997 Changes to the Section 8 Contract Renewal Estimate Originally Submitted in the February 1997 Budget Request

Fiscal Year 1998 original contract renewal estimate	**$9,232 million**
Reduction in the average per unit cost (from $6,386 to $5,499)	–1,123 million
Cost to convert tenant-based assistance from fiscal to calendar years[a]	+471 million
Cost due to increase in tenant-based unit estimate (from 1,265,625 to 1,321,230)[b]	+306 million
Deducting additional carryover to offset contract renewal costs (from $1,594 million to $1,800 million)[c]	–206 million
Allowance for contingencies (from $162 million to $0)	–162 million
Other changes related to project-based housing assistance	–338 million
Total change to estimate	**$1,052 million**
Fiscal year 1998 revised contract renewal estimate	**$8,180 million**

[a]HUD officials stated that the conversion from fiscal year financing to calendar year financing was necessary to ensure that all housing assistance contracts were funded on time. For example, they said that delays in receiving federal funding caused by government shutdowns or continuing resolutions could jeopardize the housing agencies' ability to provide the rental assistance payments.

[b]HUD officials also stated that the increase in units was necessary to fund the conversion from fiscal year financing to calendar year financing.

[c]In the February 1997 justification for the fiscal year 1998 contract renewal estimate, HUD reported approximately $1.6 billion in carryover that could be used to offset or decrease the amount of funding needed for Section 8 contract renewals. The carryover is previously appropriated budget authority that was not obligated to any housing agency for the provision of rental assistance. Once HUD determined the funding was not needed to meet current program needs, the funding was used to decrease the amount of budget authority needed for the next year's contract renewals.

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