Department of Veterans Affairs

Office of Inspector General

EVALUATION OF VETERANS HEALTH ADMINISTRATION MANAGEMENT OF EMPLOYEE QUARTERS AT VA MEDICAL CENTERS

The VHA quarters program is not needed and should be phased out. Until this is done, VHA should increase rental income, comply with Federal policy on tax deductions for quarters payments, ensure that utilities charges are correct, and prevent unneeded quarters capital investments.

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DEPARTMENT OF VETERANS AFFAIRS
Office of Inspector General
Washington DC 20420

Memorandum to the Under Secretary for Health (10)

Evaluation of Veterans Health Administration Management of Employee Quarters at VA Medical Centers

1. The Office of Inspector General (OIG) evaluated the Veterans Health Administration's (VHA's) management of employee housekeeping quarters at VA medical centers (VAMCs). Housekeeping quarters are typically single-family homes or apartments that are rented by employees who perform their own housekeeping services. As of October 1997, 96 VAMCs had a total of 1,114 housekeeping quarters units. The remaining 77 VAMCs did not have quarters. In Fiscal Year (FY) 1997, VHA reported quarters income (rent and utilities payments) of about $5.45 million and estimated expenses (such as the costs of utilities and repairs) of about $4.55 million. VHA's Real Property Management Office (RPMO) is responsible for monitoring the quarters program and for developing quarters policy. VAMC Directors are responsible for the operation of quarters at their facilities.

2. VHA should phase out the quarters program because quarters are not needed for VAMCs to accomplish their missions. To begin the phaseout of unneeded quarters and to ensure that the program is operated effectively until the phaseout is completed, VHA management should address the four issues discussed below.

3. VHA needed to discontinue implementation of the Quarters Management Information System (QMIS) and return to using appraisals to set rents. For most VAMCs, the use of QMIS would yield lower rents than those already set by appraisals. As a result, VHA's overall quarters rental income would be significantly reduced and most rents would not be consistent with prevailing community rates as required by Federal policy. We estimated that using QMIS would decrease VHA's overall rental income by about $962,000, which is 17.7 percent of the FY 1997 reported income of $5.45 million. The $962,000 loss would exceed the reported FY 1997 quarters program profit of $900,000, and the program would be operating at a loss.

4. VHA needed to end the practice of deducting the rent and utilities payments from the taxable compensation of certain employees. This practice did not meet the intent of Federal policy because the employees receiving the deduction were not required to live in quarters and because there was no mission-related need for those employees to occupy quarters.

5. VAMCs also needed to ensure that quarters tenants were properly charged for utilities and services such as lawn maintenance and garbage removal. We estimated that VHA-wide annual undercharges for utilities and services totaled about $582,000.

6. To begin the process of phasing out the quarters program, VHA should end the practice of making capital improvements on quarters that are not mission-essential. This would lead to the gradual phasing out of unneeded quarters as they reached the point that they were no longer marketable without new capital investments. At the same time, it would allow existing quarters to be rented so that some of the capital investments that have already been made could be recovered from rental income. Based on the cost of completed and planned capital improvements identified by our evaluation, we estimated that over a typical 10-year period (the payback period VHA uses) VAMCs would spend about $38.25 million on quarters improvements. To prevent unnecessary quarters capital investments, VHA should require that proposed improvements be justified based on capital programming principles. This would help ensure that improvements would be authorized only if the quarters were mission-essential and the improvements were economically sound.

7. We recommended that VHA: (i) discontinue the implementation of QMIS and return to using appraisals to set rents; (ii) require VAMCs that have outdated or questionable appraisals to obtain new appraisals and set rents accordingly; (iii) end the tax deduction practice; (iv) require VAMCs to install utility meters and to charge tenants for metered usage; (v) issue guidance on charging for unmetered utilities and for other VA-furnished services; (vi) issue guidance requiring that quarters improvements be justified based on capital programming principles; and (vii) impose a moratorium on such improvements until the new guidance is issued.

8. The Under Secretary for Health generally concurred with the recommendations and provided acceptable implementation plans or proposed acceptable alternative corrective actions. In May 1999, as a first step toward improving quarters management, VHA issued an Information Letter which alerted VAMCs to the program changes that will be made as a result of our evaluation and which indicated that quarters should be phased out when they are no longer self-sustaining without making excessive capital improvements. We consider all evaluation issues resolved and we will follow up on the implementation of planned actions.

(Original signed by:)
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Table of Contents

Results and Recommendations

Improving Quarters Management Practices Would Increase Rental Income, Eliminate an Unjustified Tax Deduction for Certain Employees, Ensure that Utilities Charges Are Correct, and Begin the Phaseout of Quarters by Preventing Unneeded Capital Investments

The Veterans Health Administration (VHA) needed to phase out the quarters program because quarters are not essential for VA medical centers (VAMCs) to accomplish their missions. Our evaluation identified four issues that warranted VHA management attention to ensure that the phaseout of the quarters program is begun and that, in the interim, the program is operated effectively:

- The use of the Quarters Management Information System (QMIS) to set quarters rents would unnecessarily decrease annual rental income by an estimated $962,000 and, at most VAMCs, would reduce rents below prevailing community rates.
- VHA's practice of deducting the quarters rent and utilities payments of certain employees from their taxable compensation did not meet the intent of Federal policy.
- Many VAMCs undercharged tenants for utilities and other services. These undercharges totaled an estimated $582,000 a year.
- VAMCs made capital improvements on quarters that were not mission-essential. Over a typical 10-year period VAMCs could spend an estimated $38.25 million on questionable quarters improvement projects. Ending capital improvements on unneeded quarters would lead to the phasing out of these quarters as they reach the point that they are no longer marketable without capital improvements.

To address these issues, VHA needed to: return to using the appraisal method for setting rents; revise VHA policy to specify that quarters occupancy is voluntary; install utility meters on quarters and charge tenants for metered usage; and require that proposed capital improvements be justified based on capital programming principles.

The Planned Use of the Quarters Management Information System Will Decrease Rental Income and Reduce Rents Below Community Rates

Federal Policy on Quarters Rents. Office of Management and Budget (OMB) Circular A-45 requires that Federal agencies set charges for rents, utilities, and other services at levels equal to those prevailing for comparable private housing located in the same area. Agencies may set rents by using either appraisals or regional surveys. An appraisal determines an appropriate rent by comparing the subject Government housing unit to similar private rental housing located in the same community. A regional survey establishes rental rates by creating economic models based on a survey of the cost of private rental housing in a defined geographical region.

VHA's Proposal to Use QMIS for Setting Quarters Rents. In May 1997, the Real Property Management Office (RPMO) sent the Under Secretary for Health an Executive Decision Memorandum recommending that VHA stop using appraisals for setting rents and begin using the Quarters Management Information System, a regional survey method developed by the Department of Interior (DOI). DOI uses QMIS to set rents and utilities charges for some 11,000 DOI housing units (most of which are operated by the National Park Service). A number of other agencies also use QMIS. DOI charges using agencies a service fee of about $15 per unit per year. In June 1997, based on the information in the RPMO decision memorandum, the Under Secretary for Health approved the use of QMIS. Implementation was scheduled for completion by April 1998.

In November 1997, after we began our evaluation, we alerted VHA officials that our preliminary work indicated that using QMIS would significantly decrease quarters rental income, and at many VAMCs, would reduce rents below prevailing community rates. However, VHA decided to proceed with QMIS implementation. Starting in April 1998, the RPMO allowed individual VAMCs and/or Veteran Integrated Service Networks (VISNs) to decide whether to adopt QMIS or to continue using appraisals. As of August 1998, 76 of 96 VAMCs with quarters were using QMIS and the other 20 VAMCs were using appraisals.

Rental Income Losses Resulting from QMIS. Our evaluation focused on quarters operations in VISNs 18-22. These 5 VISNs had a total of 17 VAMCs with quarters, and these 17 VAMCs had a total of 203 units (18.2 percent of VHA's total 1,114 units). To assess the impact of implementing QMIS, we obtained from the 17 VAMCs data showing the appraised rental income versus the income that would be received under QMIS. For the 17 VAMCs, the total annual appraised income was about $1.38 million. QMIS would decrease rental income at 11 of the 17 VAMCs and would increase income at the remaining 6 VAMCs. At the 11 VAMCs, QMIS would decrease income by a total of $228,000 a year. At the other 6 VAMCs, QMIS would increase income by $57,000 a year.[1] For the 17 VAMCs taken together, QMIS would reduce net annual income by $170,000 (12.3 percent of the $1.38 million total income).

To further evaluate the impact of QMIS, we analyzed rental income data from a "pilot study" that the RPMO had conducted before recommending the use of QMIS. The data covered VAMCs Long Beach, Milwaukee, Fort Howard, and Biloxi. The data showed that using QMIS would decrease income at all four VAMCs. The total annual appraised rental income for the four VAMCs was $379,200. QMIS would decrease this income by $94,700, or 25.0 percent.

Taken together, our evaluation and the RPMO pilot study provided data on the impact of QMIS on rental income for 20 VAMCs.[2] In our opinion, these 20 VAMCs were reasonably representative of all 96 VAMCs with quarters. The data for the 20 VAMCs persuasively indicated that implementing QMIS at all 96 VAMCs would significantly decrease VHA's overall income. For the 20 VAMCs taken together, QMIS would decrease annual incomes by about

[1] At two of the six VAMCs where QMIS would increase rental income, this would occur only because the appraised rents were too low as a result of outdated or questionable appraisals.
[2] One VAMC, Long Beach, was included in both samples.

$209,000, which is a 12.7 percent decrease in the $1.64 million income these VAMCs would receive using appraised rents.

Based on the income losses at these 20 VAMCs, we estimated that using QMIS VHA-wide would result in an overall loss of about $962,000 ($209,000 loss ÷ 242 units at 20 VAMCs = $864 loss per unit × 1,114 units VHA-wide = $962,496). In Fiscal Year (FY) 1997, VHA quarters income (employee payments for rent and utilities) totaled about $5.45 million.[3] The $962,000 loss would decrease income by 17.7 percent ($962,000 ÷ $5.45 million = 17.65 percent). The loss would also wipe out the reported profit from quarters income. In FY 1997, this profit totaled about $900,000 ($5.45 million in income – $4.55 million in reported expenses = $900,000).

Impact of QMIS Losses on Justifications for Quarters. The effect of the QMIS losses on quarters income and profit is important because it calls into question VHA's justifications for the continued operation of quarters. Managers at both the VAMC and the VHA Central Office level generally acknowledged that quarters were not needed for the three reasons specified in VA policy -- 24-hour service, security, or lack of community housing. Since these mission-related reasons could not be cited as justifications for quarters, VHA managers cited two non-mission related justifications: (1) The quarters program may yield a small profit that can be used to meet various operational needs, and (2) Even if there is no profit, the quarters program is "self-sustaining" (income covers expenses) and therefore it is reasonable to retain quarters as a convenience for employees who wish to rent them. Implementing QMIS would eliminate these two justifications for quarters. The $962,000 loss would wipe out the reported profit, and the housekeeping quarters program as a whole would be operating at a loss of about $62,000 a year ($900,000 reported profit – $962,000 QMIS loss = $62,000 overall operating loss).

QMIS Rents Lower Than Prevailing Community Rents. The most basic policy in OMB Circular A-45 is that rental rates for Government quarters must be based on their "reasonable value to the employee" and must be set "at levels equal to those prevailing for comparable private housing located in the same area." (OMB Circular A-45, 5.b.1) For DOI housing, QMIS reportedly yields rents that are comparable to community rates. However, QMIS would not have this result for VA. Instead, for most VA quarters QMIS would result in rents that are below community comparables. This would occur because DOI has structured QMIS to "cap" rents at the average rent for the survey region. This means that no quarters rents would be higher than the regional average. According to the DOI Quarters Program Manager, the QMIS cap has worked well for DOI because most of its housing is located in or near lower rent rural communities.

The situation is quite different for VHA's quarters, most of which are located in or near large, established communities and many of which are located in higher-rent urban areas. (At least 38 percent of VHA's quarters are located in cities with populations of 50,000 or more.) These communities typically have higher rents than the QMIS regional averages, and therefore QMIS

[3] This is the amount that VA payroll records show was withheld from employee salaries to pay rents and utilities.

rents for VHA quarters will usually be below community rates. Our analysis of this problem was confirmed by the DOI Quarters Program Manager, who wrote:

> "…to the extent that [the QMIS cap] relates to the distribution of VA housing, it will obviously produce lower rents for VA quarters that are located in communities where the average level of private market rents is higher than the average level of rent prevailing in the survey region (the regional 'cap')." (June 17, 1997, response to OIG questions, page 3)

The following examples illustrate how, from a common sense perspective, QMIS would not result in reasonable rents for quarters located in cities or large towns:

- **VAMC San Francisco.** QMIS reduced the rent for the Director's quarters, a 3,400 square foot house, from $1,640 to $797, a 51.4 percent decrease.

- **VAMC Long Beach.** QMIS reduced the rent for the Director's quarters, a 4,000 square foot townhouse, from about $1,063 to $568, a 46.6 percent decrease.

- **VAMC Cheyenne.** QMIS reduced the rent for the Director's quarters, a 1,700 square foot house, from $796 to $450, a 43.5 percent decrease.

Economic Impact of QMIS Not Evaluated Before Implementation. The RPMO did not adequately assess the economic effect of implementing QMIS and did not provide VHA top management with reliable information for making a decision about QMIS. Any proposal to significantly change the operations of a VA program or business activity should be grounded in cost-benefit analysis. During the evaluation, RPMO officials acknowledged that they did not perform a cost-benefit analysis of the effect of QMIS on overall rental income. In fact, no such analysis was attempted until July 1998, 1 year after the RPMO had recommended implementation of QMIS.

As mentioned on page 2, the RPMO conducted a pilot study that obtained data on the effect of QMIS on rents at four VAMCs. However, the RPMO did not fully analyze this data to determine if QMIS would have a negative impact on rental income. The data showed that QMIS would reduce rents at all four VAMCs. In addition, during the pilot study the DOI Quarters Program Manager, who had calculated QMIS rates at the pilot VAMCs, sent at least three letters alerting the RPMO that QMIS would produce rents below community rates. This is illustrated by the following excerpt from a letter on rents at VAMC Fort Howard:

> "These base rental charges are based upon our regional survey. In analyzing the comparables data, we found that the average actual rental charge for houses in the Baltimore area were $262 a month <u>higher</u> than the average level of rents in the survey region, generally.…[As] you know, when quarters rents are established under the regional survey method, the quarters rents are 'capped' at the average level of rents prevailing in the survey region. Thus, our system is producing rents that are $262 <u>lower</u> than the market rents for comparable housing in the

> Baltimore area." (November 8, 1995, letter from DOI Quarters Program Manager to RPMO; emphasis in original)

In their decision memorandum recommending the use of QMIS, the RPMO emphasized three perceived advantages of QMIS over appraisals: (1) QMIS was more convenient to use; (2) The cost of QMIS fees would be $50,000 a year less than the cost of appraisals; and (3) OMB Circular A-45 encouraged the use of the regional survey method. In our opinion, the RPMO overemphasized these advantages. First, although QMIS is easier to use than appraisals, the savings in staff time would be negligible and there would be no actual resource savings because QMIS would not result in the elimination of any of the staffing devoted to quarters operations. Second, the cost of QMIS fees would be less than the cost of appraisals, but any savings would be more than offset by the decreased rental income that would result from using QMIS. Furthermore, the savings would not be $50,000 a year as claimed in the decision memorandum. We analyzed available data and found that QMIS fees would be about $20,000 a year less than appraisal costs. (In July 1998, the RPMO reexamined their data and confirmed that our analysis was correct.) Third, although OMB Circular A-45 encourages the use of the survey method, this is not required and agencies may use the method that best meets their needs. The overriding concern is not the method used but assurance that rent and utility charges are based on their reasonable value to the employee and are consistent with prevailing community rates.

RPMO's July 1998 "Rent Analysis" Not Reliable. As mentioned above, the RPMO did not attempt a cost-benefit analysis of QMIS implementation until July 1998, after we had briefed VHA management on the results of our evaluation. At that time, the RPMO prepared a "rent analysis" which appeared to show that QMIS would produce higher income than appraisals.

We reviewed the RPMO analysis and found that it contained significant conceptual and factual errors. The most important conceptual error was the inclusion of utilities payments as part of rental income. It is not possible to accurately determine the effect of QMIS on rents unless utilities payments are separated from rent payments. The most significant factual error was that, for some VAMCs, the analysis compared biweekly appraised rent payments to monthly QMIS rent payments, which gave the false impression that QMIS produced more rental income. When this error was corrected so that both payments were compared on a monthly basis, QMIS rents were lower than appraised rents. We concluded that the RPMO analysis did not provide reliable information for making decisions about QMIS.

The analysis did, however, contain information that VHA managers could use to identify VAMCs whose quarters operations warranted management attention. If the analysis data showed that QMIS would increase a VAMC's rental income, then this was an indicator that the VAMC might be using an outdated or questionable appraisal and/or might be undercharging for utilities and other services. The analysis indicated that this might be an issue at 23 of the 96 VAMCs with quarters. (These 23 VAMCs are listed in Appendix III, page 31.)

QMIS Not a Prudent Method for Setting VA Rents. Implementing QMIS would decrease rental income, eliminate quarters profits, make the "self-sustainability" of quarters questionable, and reduce rents below community rates. There is no reason to adopt a system that would reduce rents that have already been established by appraisals using direct comparisons with properties in the community. These appraised rents are, by definition, reasonable because tenants are willingly paying them instead of seeking alternatives. Furthermore, in our view the continued implementation of QMIS presented a risk of adverse publicity because, from a common sense perspective, there is little justification for reducing quarters rents when rents and housing prices are stable or rising in most communities and when maximal rental income is needed for quarters maintenance and repair so that medical care funds will not be used for this purpose.

Ending the Quarters Tax Deduction Will Ensure Compliance with Federal Policy

Federal and VA Policy on Deducting Quarters Payments from Employee Compensation. For many years, VHA has allowed a small number of employees to receive a tax deduction for living in quarters.[4] Federal law authorizes agencies, under certain circumstances, to deduct quarters payments (rent and utilities) from employee compensation reported to the Internal Revenue Service. This deduction is, in effect, a tax break. By reducing taxable income, the deduction reduces taxes paid and thus indirectly reduces the employee's true cost for housing. For example, if the employee was in the 31 percent tax bracket and paid $10,000 a year for quarters, then the employee's true housing cost would be $6,900 because the employee would not pay $3,100 in taxes on the $10,000 of earnings that was used to pay for housing.

The VAMC employees who received the deduction were those covered by a provision of VA policy stating that it "has been administratively determined" that specified key employees "must be assigned to quarters, if available, and live on the facility grounds." (VA Policy Manual, M-1, Part I, 2.07) The specified key employees were a management representative, a clinical representative, and an engineering representative. The employees receiving the deduction were usually higher-level managers such as VAMC directors, associate directors, chiefs of staff, and clinical and administrative service chiefs. (The policy does allow substitutions, so not all the employees receiving the tax deduction are executives or managers.) According to VA payroll records, 136 VHA employees received the tax deduction during FY 1997.

Federal policy allows agencies to deduct housing payments from an employee's taxable compensation if (1) the employee is <u>required</u> to live in quarters as a condition of employment and (2) this requirement is based on a <u>need</u> to provide services or to protect property. We concluded that VHA's practice did not meet these two policy requirements.

VAMC Employees Not Required to Live in Quarters. During the evaluation, both VHA Central Office and VAMC managers acknowledged that for many years VHA had not enforced the requirement that key employees live in quarters. Instead, whether to live in quarters was usually a voluntary decision made by the employee, a decision based not on the VAMC's needs but on the employee's personal preferences, needs, and circumstances. Key employees who did not wish to live in quarters could usually get an exemption. As one VAMC director who lived in

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[4] In this report we use the term "deduction" for ease of reading and because this is the term commonly used within VA. Technically, the "deduction" is an exclusion from income, not a tax deduction.

quarters told us, an exemption could be obtained "in a heartbeat." The voluntary nature of the decision to occupy quarters was well-illustrated by the following situation, which came to our attention during the evaluation:

> **VAMC Little Rock.** Since April 1994, when he arrived at Little Rock, the VAMC Director had owned a house in the community. In 1998, he decided to move into VAMC quarters, with occupancy scheduled for October 1998. He told us that he had designated himself to receive the tax deduction because this was allowed under VHA's current practices. He acknowledged that he had not been required to move into quarters and that there was no mission-related need for him to live at the VAMC.

VHA managers have long recognized that key employees were not truly required to occupy quarters. Our 1985 audit reported this problem and recommended that VHA enforce its policy on required occupancy (1985 Audit Report, pages 3-5). In 1992, VHA established a Quarters Task Force to address various quarters issues, including the tax deduction. The Task Force also concluded that employees were not required to live in quarters. The Task Force draft report noted that: "…the three key employees (or their formally designated replacements) required to live in housekeeping quarters were not always evident." (Task Force Draft Report, page 5) The Task Force found that 61 of 102 VAMCs with quarters did not have one or more designated key employees living in quarters (17 VAMCs did not have a management representative, 24 did not have a clinical representative, and 42 did not have an engineering representative). Six VAMCs with quarters did not have any key staff living in these quarters.

Our survey of 17 VAMCs in VISNs 18-22 also found that key employees were generally not required to occupy quarters. Sixteen of the 17 VAMCs reported that they did not require any employees to occupy quarters for the security and service reasons cited in VA policy. Only VAMC Miles City required any employees to live in quarters, and that requirement pertained to only one physician who was needed to deal with after-hours medical emergencies. Furthermore, only 1 of the 17 VAMCs reported that all three key employees were living in quarters. Of the remaining 16 VAMCs, 7 did not have a management representative living in quarters; 12 did not have a clinical representative; and 11 did not have an engineering representative.

No Need for Employees to Live in Quarters. Even if VHA's current practice could meet the test that employees be required to occupy quarters, it could not meet the other test that the requirement must be based on a need for employees to live in quarters. The VHA tax deduction practice was a relic of a past when there was a need for employees to live on station to protect VAMC property and to provide 24-hour service to patients. This need no longer exists, except perhaps in a few rare circumstances. All VAMCs now have 24-hour security services, and all VAMCs have 24-hour nurse and physician coverage provided through various means (such as residents, staff physician on-call rotations, and medical officer of the day contracts). Most VAMCs also have 24-hour engineering coverage to deal with plant and equipment emergencies.

There are five additional evidence points that clearly demonstrate that there is no need for employees to live in quarters:

- As discussed above, VHA has not enforced the policy requiring key employees to live in quarters. If there had been a need, the requirement would have been enforced.
- A high proportion of VAMCs operate effectively without any quarters -- 77 (44.5 percent) of the 173 VAMCs. These 77 VAMCs include some of the largest, busiest, and most prestigious of VHA's facilities (for example, VAMCs Boston, Dallas, San Antonio, Memphis, Portland, Birmingham, and Seattle). Furthermore, one entire VISN, Number 8, which encompasses the six VAMCs in the State of Florida, has no quarters.
- For several years VHA has been restructuring its operations to emulate successful private sector health care organizations. These organizations typically do not find it necessary to provide onsite housing for their employees.
- The 1992 VHA Quarters Task Force also reported that many VAMCs had concluded that there was no need for employees to occupy quarters because key staff could find housing within a reasonable commuting distance or because "normal on-duty staff" could deal with emergencies. (Task Force Draft Report, page 5)
- The 17 VAMCs surveyed generally acknowledged that they had 24-hour security and clinical coverage and that there was no need for staff to occupy quarters to provide protection or service.

The main beneficiaries of the tax deduction were senior VAMC staff, such as directors and associate directors. Continuing to allow the deduction for a small number of mostly senior staff was not justified. VHA, in effect, allowed selected high-level managers to receive a deduction that could be construed as a housing subsidy. This problem can be illustrated by the following examples:

- **VAMC Long Beach.** The Director paid an already low QMIS rate of $847 a month for rent and utilities. The tax deduction effectively lowered this cost to only about $584 a month ($847 QMIS rent less 31 percent tax rate = $584).
- **VAMC Chicago Lakeside.** The Director occupied a 2,600 square foot apartment on the 17th floor of the hospital building. He paid a QMIS rate of $732 a month for rent and utilities. The deduction lowered this cost to only about $505.

In addition, some employees received the deduction even though they were not entitled to it under the most liberal interpretation of VHA policy. This problem can be illustrated by the following examples:

- **VAMC Perry Point.** The Director of VISN 5 received the deduction while residing in quarters at VAMC Perry Point, which is located about 45 miles away from the VISN office.

The deduction reduced the rent and utilities cost for a 5,375 square foot mansion from $924 to about $638.

- **VAMC Long Beach.** Both the Director and the Associate Director received the deduction, even though VHA policy states that the deduction should be granted to only one management representative. (This situation also occurred at eight other VAMCs.)

- **VAMC West Los Angeles.** VHA policy indicates that the deduction may be given to an engineering representative. At VAMC West Los Angeles, the Chief of Engineering Service, who was an engineer, lived in quarters but did not receive the deduction. Instead, management granted the deduction to the Facility Manager, who was not an engineer.

To comply with Federal policy, VHA should discontinue the tax deduction practice. It would not be feasible to attempt to enforce the existing policy, which implies that key employees can be required to occupy quarters, because any employee who did not wish to live in quarters could appeal the requirement and could easily show that there was no need for employees to occupy quarters and that the requirement had not been enforced in the past. To end the deduction practice, we suggested that VHA take the approach that was successfully used by the U.S. Bureau of Prisons. In January 1991, the Bureau addressed the deduction issue by sending all employees a letter informing them that as of December 31, 1991, the occupancy of quarters would be voluntary and that accordingly no employee would be eligible for the deduction.

VAMCs Need to Correctly Charge for Quarters Utilities and Services

Federal and VA Policy on Utilities Charges. Federal and VA policy require that quarters tenants be charged for the costs of utilities and other services furnished by VA. The utilities that VAMCs typically furnish include electricity, gas, and water. The other services furnished vary but usually include lawn maintenance and garbage removal and may include amenities such as cable television. OMB Circular A-45 recommends that utility charges be based on metered usage wherever possible. Charges for other services should be based on the prevailing rates for such services in the community (when the appraisal method is used) or in the region (when the survey method is used).

Undercharges for Utilities and Services. The 1985 audit found that many VAMCs were undercharging for utilities and services. Our evaluation found that VHA had made little progress in correcting this problem. To determine if VAMCs were properly charging for utilities and services, we asked the 17 VAMCs surveyed to provide data comparing the amounts they currently charged to the amounts that would be charged using QMIS. QMIS calculates utilities and service charges based on prevailing rates in the survey region. Unlike the rent component of QMIS, there is no "cap" on the utilities component. In addition, QMIS includes charges for all services used by tenants. While not as precise as metered utility usage, QMIS does provide a reasonable estimate of the actual costs of utilities and services used by tenants.

The data provided by the 17 VAMCs showed that 13 were undercharging for utilities. The annual undercharges ranged from 76.5 percent below QMIS rates at VAMC West Los Angeles to 5.8 percent below QMIS rates at VAMC Roseburg. The total amount of undercharges was about

$106,000 a year, which was 33.1 percent of the estimated $320,000 that the 13 VAMCs should have charged based on QMIS rates. (The remaining four VAMCs had utility charges that were slightly above QMIS rates. These VAMCs were properly metering or measuring utility charges.)

The undercharges occurred because the 13 VAMCs had not installed utility meters, were not using meters if installed, or were not following VA policy on estimating utility charges. The following examples illustrate egregious practices in undercharging for utilities:

> **VAMC West Los Angeles.** In FY 1997, the tenants in the 11 quarters units at VAMC West Los Angeles paid a total of only $6,900 for all utilities and other services. QMIS calculated a utilities and service cost of $29,400 for the 11 units. The amount paid was so low because for many years the VAMC had charged tenants a flat rate of $25 per household member per month for utilities and services. To illustrate, the VISN 22 Director, whose household consisted of two persons, paid $50 a month for utilities and services which consisted of electricity, gas, water, trash removal, lawn care, and cable television. QMIS calculated a charge of $278 a month for these services.
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> **VAMC Sepulveda (Southern California Clinic System).** The quarters at this VAMC had functioning electricity meters, but tenants were charged significantly less than the metered amounts. To illustrate, the VAMC Director was charged $80 a month for electricity even though the electric bills for his quarters averaged about $330 a month.

In our opinion, the occurrence of utility undercharging at 13 of the 17 VAMCs indicates that undercharging is widespread among all VAMCs. Based on the undercharges identified for these 13 VAMCs, we estimated that VHA-wide the annual undercharge for utilities and services totaled about $581,000 ($106,000 utilities undercharge for 17 VAMCs surveyed ÷ 203 quarters units at the 17 VAMCs = $522 average annual undercharge per unit × 1,114 units VHA-wide = $581,508).

When a VAMC undercharges for utilities and services, the difference is paid out of medical care funds. The undercharge is, in effect, a subsidy for employee housing. The best way to correct this problem is to install utility meters and to charge tenants for metered usage.

To Begin the Phaseout of Quarters, VHA Should End Unnecessary Quarters Capital Improvements

Quarters Not Mission-Essential. The most problematic issue for VHA's quarters program is the continued expenditure of medical care funds for capital improvements on quarters that are not mission-essential. Capital improvements are renovation or remodeling projects that increase the value and extend the useful life of the quarters through the completion of structural changes, additions, alterations, conversions, and modernizations. Large capital improvement projects generally require the award of a construction contract. However, we found that VAMCs also used station-level projects and work orders to gradually complete quarters capital improvements.

The 1985 OIG audit of quarters operations recommended that VHA eliminate capital improvements on quarters. VAMCs did not need quarters to accomplish their missions and, as quarters aged and deteriorated, more and more capital improvement projects would be needed to keep them marketable. Today the thrust of the 1985 audit recommendation is more valid than ever. During our evaluation both VAMC and VHA Central Office officials generally acknowledged that most quarters were not mission-essential and were not needed for security, patient care coverage, or because of a lack of housing in the community. Because quarters are not mission-essential, the quarters program should be phased out. The most practicable way to accomplish a phaseout is to end the practice of making capital improvements on unneeded quarters. This would lead to the gradual phasing out of unneeded quarters as they reach the point that they are no longer marketable without new investments.

The issue of quarters improvements is important because the "upfront" cost of improvements is typically paid out of medical care funds, not out of quarters profit.[5] At the VAMC, VISN, and VHA levels these medical care funds are needed to meet many competing, unfunded medical care requirements. Because of this, there is little justification for investing medical care funds in quarters that are not mission-essential. However, in recent years VAMCs have continued to make capital investments in unneeded quarters. At the same time many unneeded quarters have continued to deteriorate, so there is a risk that VAMCs will make additional unnecessary capital investments in quarters.

Cost of Future Quarters Capital Improvements. The potential cost of future quarters improvements could not be precisely estimated because most VAMCs did not keep reliable records on the costs of completed projects or on the estimated costs of planned projects. However, it was possible to make a reasonable estimate of future costs based on the costs of completed and planned projects at the 17 VAMCs surveyed. During the 5-year period FY 1993-1997, the 17 VAMCs spent at least $2.58 million on quarters improvements. For FY 1998 and beyond, the 17 VAMCs reported that they planned to spend $4.39 million on future improvements. This level of spending indicated that over a 10-year period (the payback period VHA uses for quarters investments) the 96 VAMCs with quarters would spend about $38.25 million on improvements ($2.58 million + $4.39 million = $6.97 million ÷ 203 units at 17 VAMCs = $34,335 per unit × 1,114 units VHA-wide = $38.25 million).

Quarters Improvements Not Justified on Capital Programming Principles. In recent years, OMB and Congress have established new guidelines and requirements for agencies to use in planning and budgeting for capital assets. The most definitive guidance is OMB's July 1997 <u>Capital Programming Guide</u>, which lays out a comprehensive set of principles for managing capital investments. VA has begun applying capital programming principles to high cost capital projects controlled by VA Central Office. In addition, VHA has accepted OIG recommendations to develop a capital programming framework for lower cost capital investments controlled at the

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[5] Quarters improvements are usually paid for with VAMC operating funds or nonrecurring maintenance funds. These funds are from the Medical Care Appropriation and can be used for other medical care needs.

VISN level, which would include investments in quarters improvements.[6] Most quarters capital improvements could not be justified if capital programming principles were applied.[7] Two principles are especially pertinent to quarters improvements -- linkage to mission and return on investment.

Linkage to Mission. The first and most basic capital programming principle is that proposed capital projects should be linked to the organization's mission, core functions, objectives, and strategic plan and should also be needed to eliminate a "performance gap." If this principle were applied to proposed quarters capital investments, then proponents would need to demonstrate that: (1) quarters were necessary for the VAMC to perform its mission and (2) the proposed improvement was needed to address a "performance gap" discussed in the VAMC or VISN performance plan. There would be few, if any, proposed quarters improvements that could meet these two tests.

Since almost one-half of all VAMCs have no quarters, it would be difficult to reasonably argue that a quarters improvement was mission-essential or was needed to close a performance gap. Similarly, it would be difficult for a VISN to argue that one of its VAMCs needed to make quarters improvements when other VAMCs in the same VISN operated effectively without any quarters. (For example, VISN 22 could not reasonably argue that VAMCs West Los Angeles, Long Beach, or Sepulveda needed quarters improvements when VAMCs Loma Linda and San Diego meet their missions without quarters.) The following example illustrates the difficulty of justifying a quarters capital improvement based on linkage to mission and strategic plan:

> **VAMC West Los Angeles.** In FY 1996, the VAMC spent about $95,000 to enlarge and renovate a house that was subsequently rented by the VAMC's Chief of Staff. The renovations included a 677 square foot addition and new wiring, plumbing, windows, skylights, and kitchen and bathroom cabinets.
>
> The VAMC did not have any documentation showing the justification for this project. If the VAMC had been required to justify the project using the principle of linkage to mission it would have had to show that renovating the house was necessary in order for the VAMC to meet its mission or close a performance gap. However, it would have been difficult to demonstrate that it was necessary for the Chief of Staff to live on station because: (1) the previous Chief of Staff had served for many years without living at the facility; (2) at any given time, 24 hours a day, this large VAMC had numerous physicians and residents on duty to meet patient care needs; and (3) the nearby VAMCs San Diego, Long Beach, Loma Linda, and Sepulveda met their missions without Chiefs of Staff living on station.

[6] Evaluation of VA Capital Programming Practices and Initiatives, Report No. 8R8-A19-161; January 28, 1998.
[7] For a concise explanation of capital programming principles, see the May 1998 VA publication entitled Capital Investments: Survey of Best Practices, pages 2-3 through 2-5.

Return on Investment. Capital programming principles require that proposed capital investments should have a well-defined return on investment and be supported by cost-benefit analysis. The investment return should be measurable in terms of improved customer service, reduced costs, or increased revenues. For most VAMC investments, a return can be measured in these terms. For example, the expected return on a proposed new clinical building or on the purchase of new medical equipment can be measured in terms of increased or improved delivery of care to veterans. However, quarters investments typically would not have this type of return. These investments cannot be reasonably linked to significantly improved patient care or administrative operations, and they do not reduce a VAMC's operating costs or significantly increase its revenues.

VHA's current process for approving quarters capital improvements did not consider the issue of return on investment. Instead, the process focused on return of the investment. To justify an investment, a VAMC needed only to show that (1) the quarters unit would be "self-sustaining" if the investment were made, and (2) the cost of the investment could be recovered from rental income over a 10-year payback period. The use of this approval process meant that, by definition, investments in quarters were generally expected to be nonproductive investments -- that is, there was no expected return on the investment.

Furthermore, VHA did not use a sound method for calculating how long it would take to recover a quarters investment. VHA's method of cost-benefit analysis is called the payback method. This is not a reliable way of determining either the true cost of an investment or the real return on an investment because it ignores the time value of money. The OMB Capital Programming Guide encourages the use of net present value (NPV) as the criterion for deciding whether a proposed investment is economically sound. Applying NPV cost-benefit analysis to proposed quarters improvements would mean that many of these projects, especially higher cost projects, could not be approved because they would show a loss over the 10-year payback period.[8] This can be illustrated by the VAMC West Los Angeles example discussed above:

> Under existing VHA policy, before making the $95,000 investment the VAMC should have performed a cost-benefit analysis using the payback method. The VAMC could provide no evidence that this had been done. If an analysis had been done, it would have shown that over the 10-year payback period the $95,000 investment would have been recovered and a $20,400 profit would have been realized. However, a more correct analysis would have used NPV to account for the time value of both the original investment and the stream of rental income. This analysis would have shown that the $95,000 would not be recovered in 10 years and that, in fact, there would be a loss of $24,000. In summary, in this case the investment could not have been justified if capital programming principles had been applied. As it was, the VAMC made a losing

[8] For more information on payback versus NPV cost-benefit analysis see Capital Investments: Survey of Best Practices, pages 3-3 through 3-5.

investment in a quarters unit that was not needed for the VAMC to meet its mission.

As the example discussed above shows, the application of capital programming principles could help prevent the expenditure of medical care funds on unneeded quarters improvements. During the evaluation, VHA officials acknowledged that most quarters were not mission-essential but they were reluctant to require VAMCs to phase out unneeded quarters that were self-sustaining. If VHA required that proposed quarters investments be justified based on the principles of linkage to mission and return on investment, most would not win approval. The application of capital programming principles and the resultant elimination of unjustified capital improvements would lead to the gradual phasing out of unneeded quarters as they reach the point that they are no longer marketable without new investments. However, VAMCs could continue to operate some quarters for many years because many significant capital improvements had already been made. The continued operation of these quarters would allow the recovery of prior capital investments from rental income.

Conclusion -- VHA Needed to Improve Quarters Management Practices

VHA had made little progress in addressing the issues raised by the 1985 audit of quarters operations. The issues discussed in this report are essentially the same as those found by the 1985 audit. VHA had not established effective controls to ensure that rents were in line with community rates, that the tax deduction was authorized only for key employees required to live in quarters based on a real need to provide service or to protect property, that tenants were properly charged for utilities and services, or that quarters capital investments were justified based on mission-related needs. Based on these results, we concluded that VHA had not adequately complied with Federal and VA policies on quarters rents, utility and service charges, and the deduction of quarters payments from employee taxable compensation.

VHA needed to improve internal controls and overall quarters management by taking action on the four issues discussed in this report. To ensure that rental income is sufficient to meet quarters operating expenses and that quarters rents are consistent with community rates, VHA should discontinue the implementation of QMIS and return to the use of appraised rents. VAMCs that had based their rents on outdated or questionable appraisals should be required to obtain new appraisals. To comply with Federal policy on the tax deduction, VHA should issue policy clearly stating that quarters occupancy is voluntary. To ensure that utility and service charges are more correct, VHA should require VAMCs to install utility meters on all quarters where technically feasible and to charge renters for metered usage. VHA should also reemphasize the importance of following existing guidance on charging for other services and on charging for utilities where meters are not technically feasible.

To prevent unnecessary spending on quarters capital improvements, VHA should issue guidance requiring that proposed improvements be justified on capital programming principles. This guidance should state that it is VHA's policy not to make capital improvements on quarters unless the improvement is mission-related and has an operational or economic return based on NPV cost-benefit analysis. The guidance should specify that non-essential quarters should be phased out when they reach the point that they cannot be made marketable without additional capital improvements. Until this guidance is issued, VHA should impose a moratorium on quarters improvement projects. VAMCs should be instructed not to begin any such projects. This would not present a hardship since it is unlikely that any quarters project is urgently needed. The moratorium can include an appeals process. If a VAMC believes that a particular project is urgent, then it can justify it on capital programming principles and submit it to VHA Central Office for approval and funding.

For More Information

- Prior OIG reviews, Federal and VA quarters policy, the QMIS methodology, and other background information are discussed in Appendix I, pages 19-24.

- Appendix II, pages 25-26, discusses the evaluation objectives, scope, and methodology.

- More detailed information on the impact of QMIS, undercharges for utilities, quarters capital improvements, the June 1997 Executive Decision Memorandum, and the July 1998 RPMO rent analysis is provided in Appendix III, pages 27-36.

Recommendation 1

We recommend that the Under Secretary for Health:

a. Discontinue the implementation of QMIS and direct VAMCs that have changed rents based on QMIS to return to previous appraised rents, obtain new appraisals if scheduled, and make appropriate Consumer Price Index increases.

b. Require VAMCs that have been using questionable or outdated appraisals to obtain new appraisals and to set rents accordingly.

c. End the practice of allowing the tax deduction by issuing VHA policy specifying that quarters occupancy is voluntary.

d. Require VAMCs to install utility meters on all quarters where technically feasible and to charge tenants for metered usage.

e. Issue guidance emphasizing the importance of following existing VA policy on charging for utilities that cannot be metered and on charging for other VA-provided services.

f. Issue guidance requiring that quarters capital improvement projects be justified based on the capital programming principles of linkage to mission and return on investment. The guidance should (1) specify that non-essential quarters should be phased out when they are no longer marketable without additional capital improvements and (2) include a definition of quarters capital improvements, a dollar-cost threshold for projects that must be justified on capital programming principles, and a requirement to use the NPV method to analyze the cost-benefit of proposed projects.

g. Place a moratorium on quarters capital improvements until the new guidance is issued.

The associated monetary benefits for Recommendation 1 are shown in Appendix IV, page 37.

Under Secretary for Health Comments

The Under Secretary for Health agreed with the evaluation findings and concurred with the intent of the recommendations. On the QMIS issue, the Under Secretary agreed that VHA's planned use of QMIS, with the cap on rental rates, yielded rents that were lower than prevailing community rents. However, he proposed that instead of using appraisals to set rents as we recommended, VHA would ask DOI to remove the QMIS cap for VHA quarters rents.

On the tax deduction issue, the Under Secretary agreed to end the deduction for all employees except a few who may be required to live in quarters to provide needed services. He generally concurred with the recommendation to install utility meters on all quarters where technically feasible. He also concurred with the recommendation to issue policy requiring that proposed quarters capital improvements be justified based on capital programming principles. He concurred in principle with the recommendation to impose a moratorium on quarters capital improvements. However, instead of a moratorium, he proposed requiring VHA Headquarters review and approval of most proposed quarters improvements. The Under Secretary agreed with the $38.8 million monetary impact associated with the recommendations pertaining to capital improvements and to utility charges. However, he disagreed with the $962,000 monetary impact of the recommendation on QMIS, stating that VHA's proposal to remove the QMIS cap would nullify the monetary impact. (See Appendix V, pages 39-45, for the full text of the Under Secretary's comments and implementation plan.)

Implementation Plan

Recommendations 1a and 1b. To address the issue of quarters rents, VHA's implementation plan stated that instead of returning to the use of appraisals, VHA will ask DOI to remove the QMIS rate cap, to include VA quarters locations in the rental rate surveys that DOI uses for QMIS rates, and to apply positive location adjustments (rate increases) to quarters located in higher rent areas. If the efforts to work with DOI were unsuccessful, VHA will pursue three options. First, VHA will consider using QMIS except in areas where positive adjustments are required to increase rents. Second, VHA will consider using QMIS plus a price/rent index for areas where positive adjustments were necessary. Third, VHA will consider reverting to the use of appraisals to set rents for all VHA quarters. The implementation plan did not include a target date for resolving the QMIS issue and establishing a definitive method of setting quarters rents.

Recommendation 1c. To address the issue of the quarters tax deduction, VHA will revise its policy to indicate that quarters occupancy is voluntary, except for a small number of employees who may be appropriately required to live in quarters. The target date for issuing this policy was March 31, 1999.

Recommendations 1d and 1e. To ensure that utility charges are correct, VAMCs will install meters where feasible and charge tenants for metered usage. Where meters are not feasible, tenants will be charged QMIS utility rates. Policy requiring that tenants be charged for metered usage will be reemphasized. VAMCs will be required to report to quarters program management on their utilities collection efforts until it is demonstrated that the policy objectives are achieved. VHA will also revise quarters policy to emphasize the importance of following existing VA policy on charging for utilities that cannot be metered and for other VA-provided services. The target date for implementation of these corrective actions was March 31, 1999.

Recommendations 1f and 1g. To address the issue of quarters capital investments, VHA will issue policy requiring that proposed quarters projects be reviewed using the OMB Capital Programming Guide. Instead of placing a moratorium on quarters capital improvements, VHA will issue guidance reminding VAMCs that current policy requires Headquarters approval for projects costing $4,600 during a fiscal year or $12,000 over a 5-year period.

Office of Inspector General Comments

The planned actions pertaining to the quarters tax deduction and to utilities charges are acceptable and, if properly implemented, should correct these two problems. The implementation plan for the QMIS issue is generally acceptable. We have no objection to VHA pursuing the option of removing the cap on QMIS rental rates, and we agree that "uncapped" QMIS rates should yield appropriate rents for VHA quarters. During the evaluation, we discussed this option with both RPMO officials and DOI Quarters Program officials. At that time, the RPMO was opposed to uncapping QMIS because at some VAMCs this would increase rents significantly above appraised rents. DOI Quarters Program officials were also opposed, because uncapping QMIS would require significant modifications to their rate-setting methodology.

We were concerned that VHA's implementation plan for the QMIS issue did not include a target date for completing corrective actions. When we discussed this with VHA officials, they explained that they could not know when DOI would respond to their request to remove the QMIS cap. (The request was made in February 1999. As of May 31, 1999, DOI had not responded.) While we recognize that VHA has no control on the DOI decision process, we believe that VHA should work aggressively to resolve the QMIS issue and to establish a definitive method for setting quarters rents.

As discussed on page 2, in April 1998 most VAMCs began using QMIS to set rents. This action had two adverse consequences. First, it decreased quarters rental income and therefore increased the risk that medical care funds would be inappropriately used to cover quarters expenses (such as maintenance and repair) that would normally be paid out of quarters income. Second, it lowered rents below community comparables, which meant that VHA's quarters program was not in compliance with OMB Circular A-45. As of May 1999, these two problems had not been corrected, and VHA did not have a target date for increasing quarters rents that had been unnecessarily reduced.

We disagree with VHA's position that there is no better use of funds associated with our recommendations on the QMIS issue. VHA's adoption of QMIS resulted in a $962,000 annual loss of rental income. If we had not performed the evaluation, VHA would not have been aware of the problem with the QMIS cap and losses would have occurred into the future. The monetary benefit is valid because as a result of the evaluation future losses will be prevented and rental income will be restored.

VHA's implementation plan did not adequately address the issue of quarters capital improvements. We were concerned that neither the Under Secretary's comments nor the implementation plan addressed the need to phase out the quarters. Although the Under Secretary concurred with the recommendation to issue new guidance on quarters capital improvements, the implementation plan did not specifically state that the new guidance would address the phaseout of nonessential quarters and the use of capital programming principles to review proposed quarters capital improvements. Instead of imposing the recommended moratorium on quarters improvements, VHA proposed "reminding" VAMCs that current policy required VHA Headquarters approval for most quarters projects. In our opinion, this approach would not have been effective because the policy had been largely ignored and many quarters improvements had been completed without VHA Headquarters approval.

After receiving the implementation plan, we worked with VHA officials to develop a more decisive approach to the issue of quarters capital improvements. As a first step, on May 20, 1999, VHA issued an Under Secretary for Health Information Letter entitled "VHA Quarters Management Changes" (IL 10-99-007). The purpose of this letter was to alert VAMCs to the program changes that will be implemented as a result of our evaluation. (We have incorporated the letter as part of VHA's implementation plan. See pages 44-45.) On quarters improvements and the phaseout of unneeded quarters, the letter states:

> "VHA's goal is to make quarters self-sustaining. VHA will phase out quarters once they are no longer self-sustaining without making excessive capital improvements. Therefore, capital improvements must be based upon sound capital programming principles, linking mission and return on investment. Capital improvements should be put on hold until implementing policy is issued."

VHA will follow up the letter with more detailed guidance on quarters capital improvements. We will work with VHA to ensure that this guidance is effective. As our report makes clear, most quarters are not needed and should be phased out. The best way to do this is to strictly limit new capital improvements. Quarters should continue to be operated so long as rental income covers operating expenses. However, once a quarters unit reaches the point that it cannot be rented without making new capital improvements, it should be phased out. We consider the evaluation issues to be resolved and we will follow up on the implementation of planned actions.

Background

Program Data on VHA Quarters

Number of Housekeeping Quarters. As of October 1997, the RPMO reported that 96 VAMCs had a total of 1,114 housekeeping quarters units. However, RPMO staff acknowledged that they could not be certain that this data was absolutely correct. They described the data as "fluid" because of inconsistent reporting by VAMCs. Based on the available data, it is apparent that the number of quarters has declined in recent years. The 1985 OIG audit reported that 118 VAMCs had 1,293 housekeeping quarters. This suggests that 22 VAMCs that had quarters have since eliminated them. Since 1985, the total number of quarters has decreased by 179 units, a 13.8 percent decrease (1,293 units in 1985 - 1,114 units in 1997 = 179 fewer units).

The 1992 VHA Quarters Task Force also noted the decrease in the number of quarters. The Task Force found that several VAMCs were planning to decrease or eliminate their quarters. The Task Force cited three reasons for this: (1) The demand for quarters had declined; (2) Critical space needs could not be satisfied unless quarters were converted to administrative or clinical space; and (3) Quarters could not be economically operated at VAMCs with only a few quarters. (VHA 1992 Quarters Task Force Draft Report, page 8) The Task Force specifically linked the decline in the demand for quarters to the increased availability of affordable and convenient housing in the community and to the deterioration of the quarters to the point that they were unattractive to potential tenants. (Quarters Task Force Draft Report, page 8) Our evaluation also identified instances of quarters being discontinued for similar reasons during FYs 1993-1997:

- VAMC Fort Lyon sold two quarters units because they were unserviceable.
- VAMC Grand Junction converted a unit to administrative space.
- VAMC Roseburg leased a unit to the Area Health Education Center.

Quarters Income and Expenses. The RPMO depended on VAMCs to annually report quarters income and expenses on a form titled "Report of Operation of Personnel Quarters" (VA Form 10-1173). Based on our review of these forms for the 17 VAMCs surveyed, we concluded that it was likely that many VAMCs had reported inaccurate and incomplete income and expense data. To obtain more reliable income data, we reviewed VA payroll records to determine the total amount of employee quarters rent and utilities payments withheld from employee paychecks. The payroll records showed that FY 1997 income from housekeeping quarters was $5.45 million.

Because we could not identify a more reliable source of data, we accepted the expense data reported on the Forms 1173. These forms showed that reported expenses for housekeeping quarters were about $4.55 million ($4,748,845 reported expenses for both housekeeping and nonhousekeeping quarters – $197,778 estimated expenses for nonhousekeeping quarters = $4,551,067 expenses for housekeeping quarters). In our opinion, it is likely that actual expenses were higher than $4.55 million. From reviewing the forms it was apparent that VAMCs were not accurately reporting expenses for administration, utilities and services, maintenance and repair, and capital improvements.

The estimated profit from quarters operations was $900,000 ($5.45 million income – $4.55 million expenses = $900,000). However, because expenses were probably underreported, the actual profit was probably less than $900,000. To illustrate, the Forms 1173 typically reported utilities expenses as the amounts charged the tenants, but we found that many VAMCs were undercharging for utilities. This means that actual utility expenses were higher than those reported on the Forms 1173.

Program Responsibility. The RPMO, which is part of VHA's Office of Facilities Management, is responsible for monitoring VHA's quarters program. RPMO staff provide guidance on issues related to quarters operations, administer the rent establishment process, and develop quarters policy in coordination with the Office of the Chief Network Officer. VAMCs that operate quarters are expected to assume the customary responsibilities of a landlord and are expected to assess rents based either on appraisals or regional surveys. VAMCs are also responsible for making annual Consumer Price Index (CPI) rent adjustments. In addition, they are expected to implement effective quarters management practices that ensure the designation of a housing officer representative, the identification of nonessential quarters for other uses (including disposal), and the maintenance of safe and sanitary quarters.

Prior OIG Audits and Special Inquiries

1985 Audit of Quarters Rental Operations. The last OIG audit of the quarters program was completed in September 1985. The audit found that improvements were needed to ensure that quarters were justified and were operated economically. Most quarters did not serve a functional need and, in many instances, were not self-sustaining. Financial records on quarters operating expenses and income were not reliable. At most VAMCs quarters rental and utility rates were set below rates for comparable private housing in the community. The policy requiring key employees to live in quarters was not being enforced. The audit report made several recommendations to address these issues.

VHA management concurred with some of the recommendations and deferred on others. They stated that a task force would be formed to study the issues of closing unprofitable, nonessential quarters and eliminating capital improvements on quarters. The task force was eventually formed, but it did not effectively address the audit issues. The task force prepared a draft report on its findings, but this report was never finalized, and VHA made little progress in improving quarters operations. Our evaluation concluded that the deficiencies found by the 1985 audit still existed in 1998. (Quarters Rental Operations, Report No. 5R5-A03-111; September 9, 1985)

Special Inquiry, VAMC Pittsburgh. This special inquiry resulted from a complaint that the VAMC Director had authorized wasteful spending on his VA quarters. The inquiry found that the VAMC had spent approximately $201,000 for repairs and renovations to the Director's residence. This expenditure was $79,000 more than could be recovered from rental income over the 10-year payback period.

The inquiry concluded that four factors contributed to the overspending: (1) responsible officials approved the project without assuring that its cost could be recovered from rental income; (2) RPMO staff told VAMC officials that they could authorize significantly higher quarters expenditures than allowed by VA policy; (3) RPMO staff did not give the VAMC an accurate model for determining quarters spending limits; and (4) VA had not implemented uniform design standards required by OMB.

The inquiry also found that the RPMO had permitted the VAMC to make reductions in quarters rents that were not consistent with OMB guidance. In addition, the VAMC did not promptly obtain new appraisals on renovated quarters, and, as a result, employees benefited from rents that appeared to be below market rates.

The inquiry report made several recommendations to address the problems identified. The Under Secretary for Health agreed with the recommendations and stated that VHA would develop guidance to address the concerns raised by the inquiry. As of September 1998, this guidance had not been issued, partly because VHA was awaiting the results of our evaluation. (<u>Special Inquiry: Alleged Mismanagement of the Housekeeping Quarters at University Drive, VA Medical Center, Pittsburgh, Pennsylvania</u>, Report No. 7PR-A19-027; January 10, 1997)

Special Inquiry, VAMC Tuskegee. This special inquiry included allegations that the VAMC Director had improperly spent funds to make improvements on his and the Associate Director's quarters. The inquiry concluded that: (1) the cost of the improvements was excessive; (2) proper approvals were not obtained; and (3) the quarters were not reappraised to reflect post-improvement values.

The total amount spent on the two quarters between September 1996 and August 1997 was about \$178,000. The economic analysis for each project required to ensure that costs would be recovered over 10 years had not been completed prior to making the improvements. The analyses were done after the work was completed and disclosed that over the 10-year payback period, there would be a total deficit of \$83,522 (a \$43,562 deficit on the Director's quarters and a \$39,960 on the Associate Director's quarters).

The special inquiry report made several recommendations to address the problems identified. However, VHA management deferred action on the problems pending issuance of our evaluation report. (<u>Management, Clinical, and Administrative Issues at the VA Central Alabama Veterans Health Care System</u>, Report No. 8PR-G03-144; September 29, 1998)

Federal and VA Policy on Quarters

OMB Circular A-45. Federal policy on Government-furnished employee housing is set forth in OMB Circular A-45, <u>Rental and Construction of Government Quarters</u>. The most fundamental policies discussed in the circular are:

- Federal agencies should rely on the private housing market to provide housing for civilian employees.

- Quarters rents and charges for utilities and other services should be set at levels equal to those prevailing for comparable private housing located in the same area.

- Rents and other charges should not be set so as to provide a housing subsidy, to serve as an inducement in the recruitment or retention of employees, or to encourage the occupancy of existing quarters.

- Rental rates should be fair as between the agency and the employee and should be consistent for employees occupying similar housing in the same location.

VA Policy. VA quarters policy generally parallels Federal policy as set forth in OMB Circular A-45. VA's most recent policy statement is VA Directive 7631, Quarters Management (August 14, 1997). This directive specifies that housing may be made available to employees provided one or more of three conditions are met:

- The need to provide service to the community or to VA beneficiaries on a 24-hour basis.

- When Government property cannot be adequately protected unless specific employees are required to live in quarters.

- When the available supply of Government and private housing within a reasonable commuting distance will not meet necessary housing requirements.

VA policy is also set forth in VA Manual M-1, Part I, Chapter 2, Quarters and Subsistence (revised June 3, 1992). This manual provides guidance on various administrative procedures such as collecting rents, calculating utility charges, and obtaining appraisals.

Two Approved Methods for Setting Rents. OMB Circular A-45 and VA Directive 7631 state that the reasonable value of Government rental quarters will be based on an impartial study of comparable private rental housing. The Circular allows agencies to determine reasonable value and to set rents by using either of two methods -- appraisals or regional surveys. An appraisal involves a direct comparison between the Government housing unit and similar private rental properties located in the local community. A regional survey establishes rental rates by creating a series of economic models based on a survey of comparable private rental housing in a particular geographic region. OMB Circular A-45 encourages agencies to use the regional survey method in order to reduce the costs and administrative burdens associated with conducting appraisals. However, there is no requirement to use the regional survey method, and agencies are allowed to use the method that best meets their needs and circumstances.

To ensure that quarters rents keep current with prevailing community rents, OMB Circular A-45 requires agencies to obtain new appraisals or to update regional surveys every 5 years. In addition, agencies must adjust rents every year to reflect changes in the Consumer Price Index.

VHA Use of Appraisals to Set Rents. Historically, VAMCs have used appraisals to set rents. In accordance with OMB Circular A-45, VHA policy has required VAMCs to obtain new appraisals every 5 years, to get a new appraisal if a quarters unit was significantly upgraded or remodeled, and to make annual CPI adjustments to rents.

VAMCs usually obtain appraisals by contracting with an independent professional appraiser. The appraiser is required to evaluate the VAMC quarters against comparable rental properties in the community and to recommend reasonable rents. The recommended rents should reflect the appraiser's opinion of the value of each quarters unit. The appraiser's recommended rents may include adjustments (increases or decreases) to account for unusual circumstances. (For example, the appraiser may decrease the recommended rent because the VAMC housing has less privacy than comparable community housing.)

VAMC Directors who believe that appraised rents are too high or too low can request that appraisers reconsider their recommendations. If this does not resolve the disagreement, then a Director can appeal the issue to the RPMO. The RPMO makes the final decision on rental charges.

Proposed Use of QMIS to Set Rents for VHA Quarters

In 1997, the RPMO recommended that VHA begin using the Quarters Management Information System to establish rents for VHA quarters. QMIS is a computerized regional survey program that analyzes market rents and the cost of utilities and other services for comparable private rental properties located near concentrations of Government housing. To obtain the rental and utilities cost data needed for the computerized program, DOI divides the United States into 14 geographical regions. (For example, the North Central Region includes the States of Minnesota, Wisconsin, Michigan, Iowa, Missouri, Illinois, Indiana, and Ohio.) DOI then hires independent contractors to survey communities to gather data on rents and on other costs associated with rental properties (utilities, appliances, furnishings, and various other services). For each community surveyed, QMIS prepares a "community coefficient" that reflects rental market conditions in the community. QMIS then analyzes the rental property data to produce a schedule of base rents for the entire region. The rent schedule reflects physical differences in structures and economic differences in the communities.

QMIS "Cap" on Rents. The QMIS community coefficients can be used to adjust the base rental rates upward or downward to account for rental market conditions in particular locations. However, to set rents for its quarters, DOI has structured QMIS to "cap" rents at the regional average. This means that rents for DOI quarters will be no higher than the regional average. The QMIS cap does, however, allow for decreases (negative adjustments) in base rents if the housing is located in or near a community where the community coefficient indicates that rents are lower than the regional average.

According to the DOI Quarters Program Manager, the capped QMIS program has worked well for DOI because most of its housing is located in or near lower rent rural communities. In fact, according to the Program Manager, the capped QMIS program increased DOI's rental income because for many quarters the capped rents, even with negative adjustments, were higher than the previous appraised rents.

The situation is quite different for VHA's quarters, most of which are located in or near large, established communities and higher rent urban areas. For such communities, applying the QMIS cap will usually produce rents that are below prevailing community rates. According to DOI Quarters Program Manager, in this situation the community coefficient data could be applied to increase the capped QMIS rent to a level more in line with prevailing community rates. To illustrate, the capped QMIS rent for the Director's quarters at VAMC San Francisco was $797. Applying the community coefficient would increase the rent by $747 to $1,544 (which would still be below the appraised rent of $1,640).

QMIS Implementation Process in VHA. In May 1997, the RPMO prepared an Executive Decision Memorandum recommending that VHA implement QMIS. The memorandum reported that four VAMCs had completed RPMO's pilot study and had found it easier to use than appraisals. On June 2, 1997, the Under Secretary for Health approved the implementation of QMIS. Later that month, the VHA Chief Facilities Management Officer asked each VISN to appoint a Coordinator for implementing QMIS. From July through December 1997, the RPMO provided the VISN Coordinators with training on QMIS. After receiving training, the VISN Coordinators began preparing for implementation in their VISNs.

In November 1997, shortly after we began our evaluation, we alerted RPMO officials that our preliminary work indicated that implementing QMIS would significantly decrease the income that VHA received from quarters rents. We also pointed out that for VAMCs located in urban areas QMIS would usually reduce quarters rents below prevailing community rates. We questioned the prudence of implementing QMIS, particularly since there was no urgent need to do so. However, RPMO officials decided to go forward with QMIS implementation.

As implementation proceeded, most VAMCs found that QMIS reduced rents below the previous appraised rates. However, QMIS did increase rents at some VAMCs. Managers at some of these VAMCs were reluctant to implement QMIS. To address this issue, RPMO gave VAMCs the option of using either QMIS or appraisals. As of August 1998, 76 of the VAMCs with quarters were using QMIS and the remaining 20 VAMCs were using appraisals. Generally, most VAMCs decided to use QMIS because it was easier and because the VAMCs wanted to give employee-tenants the benefit of the lower rents resulting from QMIS. The VAMCs that continued to use appraisals generally did so because: (1) they were concerned that the lower QMIS rents would create adverse publicity; (2) they did not want lower QMIS rents to hurt their ability to recover the costs of prior capital improvements from rental income; or (3) in the few instances where QMIS rates were higher, they did not want to raise rents.

Objectives, Scope, and Methodology

Objectives

The purpose of the evaluation was to assess VHA's management of the employee housekeeping quarters program. The OIG initiated this evaluation to more comprehensively address program management issues disclosed by the OIG Special Inquiries pertaining to mismanagement of quarters operations at VAMCs Pittsburgh and Tuskegee. The objectives of the evaluation were to determine if:

- VHA had effectively addressed the issues identified by the 1985 audit of quarters operations.
- The proposed use of QMIS to set quarters rents was cost-effective and resulted in rents that were in line with prevailing community rates.
- The practice of allowing a tax deduction for certain quarters tenants was justified.
- VAMCs were properly charging tenants for utilities and other services.
- Capital improvements on quarters were justified based on the application of Government capital programming principles and on consideration of whether quarters were needed for the three reasons cited in VA policy -- 24-hour service, security, or lack of housing within a reasonable commuting distance.

Scope and Methodology

To meet the evaluation objectives we focused on housekeeping quarters operations in VISNs 18 through 22, which cover Washington, Oregon, California, Arizona, Utah, Idaho, Montana, Nevada, Wyoming, Colorado, New Mexico, Hawaii, Alaska, and western Texas. These 5 VISNs had a total of 28 VAMCs, of which 17 had quarters. These 17 VAMCs had a total of 203 housekeeping quarters units, which was 18.2 percent of VHA's total of 1,114 units. We considered quarters operations for these 17 VAMCs to be reasonably representative of VHA's overall quarters program. The 17 VAMCs provided a reasonable framework for assessing the need for quarters and the effectiveness of quarters operations in a wide range of circumstances. The 17 VAMCs included large and small facilities, facilities located in small towns and in major cities, and facilities with different missions.

The evaluation covered housekeeping quarters and did not cover nonhousekeeping quarters. We took this approach because housekeeping quarters accounted for about 96 percent of the reported costs associated with VHA's quarters program.

To obtain information on quarters operations, we sent each of the 17 VAMCs an extensive questionnaire requesting various types of information such as explanations of the need for quarters and data on quarters income and expenses (including the effect of QMIS on quarters income). As necessary, we followed up with telephone interviews to clarify questionnaire responses or to obtain additional information. Based on our review of the questionnaires, we performed onsite evaluations of quarters operations at VAMCs Long Beach, West Los Angeles, and Prescott. During these evaluations we inspected the quarters and reviewed pertinent documents, including appraisal files, capital improvement contract files, quarters maintenance and repair records, and various other records pertaining to quarters income and expenses. We discussed quarters operations with appropriate VAMC management and staff. In assessing the feasibility of implementing QMIS we obtained pertinent information from 9 VAMCs in addition to the 17 VAMCs surveyed (VAMCs Milwaukee, Little Rock, Chicago-Lakeside, Cleveland, Bath, Perry Point, Biloxi, Fort Howard, and Pittsburgh).

We also reviewed pertinent Federal and VA policy and procedures, quarters program management reports, and DOI information on QMIS. We discussed program operations, policy interpretations, and our evaluation methodology with officials of VHA's Office of Facilities Management and Office of the Chief Network Officer. We reviewed RPMO files pertaining to the quarters program and to the decision to implement QMIS. We also discussed QMIS with the DOI Quarters Program Manager.

The evaluation covered quarters program operations for FY 1997 and included assessments of program internal controls and compliance with applicable laws, regulations, and Federal and VA policies. The evaluation was done in accordance with generally accepted government auditing standards for staff qualifications, independence, and due professional care; field work standards for planning, supervision and evidence; and reporting standards for performance audits.

Details of Evaluation

QMIS Would Significantly Decrease Quarters Rental Income

Effect of QMIS on Quarters Rental Income in VISNs 18-22. To assess the impact of QMIS on the 17 VAMCs in VISNs 18-22 that had quarters, we obtained from the VAMCs data showing the rental income they had received using appraisal-based rents versus the income they would receive using QMIS. The data showed that the total annual appraised rental income for the 17 VAMCs was about $1.38 million. QMIS would decrease income at 11 of the 17 VAMCs and would increase income at the remaining 6 VAMCs. The total income loss at the 11 VAMCs would be about $228,000, and the total income gain at the 6 VAMCs would be about $57,000. As Table 1 shows, the net income loss for the 17 VAMCs would be $170,000, or 12.3 percent of the $1.38 million in total income:

Table 1. Effect of QMIS on Rental Income for 17 VAMCs in VISNs 18-22

11 VAMCs Where QMIS Decreased Rents	Appraised Rental Income	QMIS Rental Income	Difference	Percent Change
Long Beach	$120,607	$64,926	-$55,681	-46.2%
Cheyenne	17,640	9,688	-7,952	-45.1
San Francisco	45,250	26,604	-18,646	-41.2
Prescott	168,386	110,952	-57,434	-34.1
Grand Junction	24,304	18,263	-6,041	-24.9
American Lake	91,130	75,084	-16,046	-17.6
Palo Alto	121,385	100,244	-21,141	-17.4
Sheridan	133,379	116,208	-17,171	-12.9
Walla Walla	83,400	73,355	-10,045	-12.0
Sepulveda	54,742	49,008	-5,734	-10.5
West Los Angeles	126,270	114,640	-11,630	-9.2
Subtotal	**$986,493**	**$758,972**	**-$227,521**	
6 VAMCs Where QMIS Increased Rents				
White City	$122,428	$151,716	$29,288	+23.9%
Fort Lyon	147,052	165,564	18,512	+12.6
Miles City	32,870	35,791	2,921	+8.9
Roseburg	16,509	17,946	1,437	+8.7
Fort Harrison	46,584	50,209	3,625	+7.8
Big Spring	26,724	28,236	1,512	+5.7
Subtotal	**$392,167**	**$449,462**	**$57,295**	
Combined	**$1,378,660**	**$1,208,434**	**-$170,226**	**-12.3%**

For at least two of the six VAMCs where QMIS would increase rents, this increase would occur only because rents at the two VAMCs were based on questionable or outdated appraisals:

- QMIS increased rents at VAMC Fort Lyon by 12.6 percent. However, these rents were based on an outdated 1990 appraisal. The VAMC had not obtained the new appraisal that was required in 1995. In addition, the VAMC had not made the required CPI adjustments to rents for the years 1995, 1996, and 1997.

- QMIS increased rents at VA Domiciliary White City by 23.9 percent. However, these rents were based on a questionable appraisal in which the appraiser used single family residences and duplexes in the community as comparables for the domiciliary's apartment-like quarters and then applied a series of negative adjustments to set the quarters rents. RPMO staff acknowledged that the amounts of these negative adjustments were questionable.

Effect of QMIS on Rental Income at VAMCs Covered by RPMO Pilot Study. Before reaching the decision to recommend implementing QMIS, the RPMO conducted a pilot study. The study originally included 10 VAMCs. Each VAMC was supposed to work with DOI to calculate the QMIS rents for their quarters and then send the RPMO a report on their experience using QMIS versus using the appraisal method. Of the 10 VAMCs starting the pilot study, only 4 completed it by calculating the QMIS rents and writing the requested report. These four VAMCs were Long Beach, Milwaukee, Fort Howard, and Biloxi.

The RPMO's June 1997 decision memorandum emphasized that these four VAMCs had found QMIS easier to use than appraisals. However, the memorandum contained little information on the effect that implementing QMIS would have on rental income at the four VAMCs. Our analysis of pilot study data found that QMIS would decrease income at all four VAMCs. As Table 2 shows, this decrease would total $94,680, or 25.0 percent of the current income of $379,206:

Table 2. Effect of QMIS on Rental Income at Four Pilot Study VAMCs

VAMC	Appraised Rent	QMIS Rent	Amount of Decrease	Percent Decrease
Long Beach	$120,607	$64,926	-$55,681	-46.2%
Biloxi	31,806	25,660	-6,146	-19.3
Milwaukee	134,039	111,854	-22,185	-16.6
Fort Howard	92,754	82,086	-10,668	-11.5
Combined	**$379,206**	**$284,526**	**-$94,680**	**-25.0%**

July 1998 RPMO "Rent Analysis." After we had briefed VHA management officials on our conclusion that QMIS would decrease rental income, they asked the RPMO to perform an additional study in an attempt to determine the impact of QMIS. The RPMO asked VAMCs to provide information that would allow a comparison of QMIS rental income with appraised rental income. The RPMO then prepared a "rent analysis" which appeared to show that QMIS would produce more income than appraisals. However, our review of the rent analysis found numerous and significant errors, both conceptual flaws and factual mistakes. We concluded that the RPMO analysis was not useful for making decisions on the QMIS issue. The three most significant errors are discussed below.

- **Utility Payments Not Separated from Rent Payments.** The major conceptual flaw was that the RPMO analysis did not truly compare QMIS rents to appraised rents. Instead, it compared combined QMIS rents and utilities charges to combined appraised rents and utilities charges. It is not possible to make a valid assessment of the effect of QMIS on rental income unless rent and utility payments are separated. Utility payments should be thought of as recovery of costs, not as income. For every dollar of utilities and services provided to renters, VAMCs should recover the same amount in payments. For some VAMCs, combining rent and utility payments gave a false impression that QMIS would increase income. However, the purported increases would usually occur only because the VAMCs were undercharging for utilities and/or services. If the utility charges had been correct, then the appraisal method would have yielded higher combined rents and utilities.

  This error can be illustrated by the data for VAMC Cleveland. The RPMO analysis showed that for all four of the VAMC's quarters QMIS would increase combined rent and income. However, data we obtained from the VAMC showed that for all four units QMIS would <u>decrease</u> rents, but would significantly <u>increase</u> charges for utilities and services. The magnitude of these increases strongly indicates that the VAMC had been undercharging for these services. For example, QMIS decreased the rent for one unit from $566 to $423, a 25.3 percent decrease. QMIS increased utility charges from $158 to $217, a 37.3 percent increase, and increased charges for other services from $10 to $85, a 750.0 percent increase. Based on the data provided by the VAMC, the correct monthly charge for this unit would be $868 ($566 appraised rent + $217 QMIS-estimated utilities + $85 QMIS-estimated other services). The correct charge of $868 would be $143, or 19.7 percent, more than the combined QMIS charge of $725.

- **Invalid Comparison of Monthly QMIS Rates to Biweekly Rent Payments.** For a number of VAMCs, the RPMO analysis mistakenly compared <u>monthly</u> QMIS rent and utilities charges to <u>biweekly</u> appraised rent and utility charges. This, of course, gave the incorrect impression that QMIS would result in significantly increased income. When this error was corrected, the appraised charge was higher than the QMIS charge.

  To illustrate, for a unit at VAMC Cheyenne the RPMO analysis showed a monthly QMIS charge of $541 versus an appraised charge of $341, which gave the impression that QMIS would yield $200 a month more than appraisals. However, data we obtained from the VAMC showed that the $341 appraised charge was the amount withheld from the employee's biweekly salary payment. Correcting this error made the monthly appraised charge $739, which is $198, or 36.5 percent, more than the QMIS charge of $541 ($341 × 26 pay periods ÷ 12 months = $739 appraised charge – $541 QMIS charge = $198).

- **Outdated or Questionable Appraised Rents Incorrectly Compared to QMIS Rates.** For a number of VAMCs covered by the RPMO analysis, the appraised rent and utility charges were so low that it is likely these VAMCs were improperly charging rents that were based on outdated or questionable appraisals. This error can be illustrated by the rents shown for quarters at VAMC Perry Point. For this VAMC, the RPMO analysis compared QMIS rent and utility charges to rent and utility charges that were based on a 1993 appraisal. However, a new appraisal was completed in May 1998, and this appraisal significantly increased rents. By comparing current QMIS charges to outdated appraised charges, the RPMO analysis gave the false impression that QMIS would significantly increase rental income at VAMC Perry Point.

  To illustrate, for one unit the RPMO analysis showed that appraised charges would be about $400 versus QMIS charges of $859, so QMIS would yield $459, or 114.7 percent more. However, the May 1998 appraised charge for this unit was $687. When this charge is compared to the QMIS charge of $859, the difference is only $172, not the $459 shown in the RPMO analysis. Incidentally, the RPMO analysis noted that VAMC Perry Point had decided not to use QMIS because it produced rents that were slightly higher than the appraised rents.

In addition to the major types of errors discussed above, the RPMO rent analysis probably contained many factual errors that could only be determined by performing a unit-by-unit review of data from the VAMCs. For example, for the VAMC Cleveland unit discussed above the RPMO analysis showed an appraised monthly charge of $508 versus a QMIS charge of $678. However, the data that we obtained from the VAMC showed an appraised charge of $734 versus a QMIS charge of $725.

RPMO Analysis Confirmed that QMIS Decreases Rents for Quarters Located in Cities. Although the RPMO rent analysis contained many errors, one component of it did confirm a concern raised by our evaluation -- for quarters located in cities, QMIS would tend to produce rents that are below appraised rents. The RPMO completed a separate rent analysis covering the 25 largest metropolitan areas. This analysis showed that QMIS would reduce combined monthly rent and utility charges for quarters located in these metropolitan areas by a total of about $9,321 which would be a 10.5 percent decrease from total monthly appraised charges of $88,427. The decrease would actually be greater because this analysis contained the types of errors discussed above. For example, it showed QMIS increasing rents at VAMC Cleveland, when in fact QMIS charges would be less than appraised rents plus properly calculated utility and service charges.

RPMO Analysis Identified VAMC Quarters Operations Needing Management Attention. Although the data in the RPMO analysis was highly unreliable and certainly did not support the decision to implement QMIS, it could be useful for identifying VAMC quarters operations that warrant VHA or VISN management scrutiny. As the example of VAMC Perry Point demonstrates, if the RPMO analysis showed that QMIS would significantly increase rent and utility charges, then this was a good indicator that the VAMC may have been undercharging for utilities and/or basing rents on outdated or questionable appraisals. The RPMO data indicated that these problems may exist at the following 23 VAMCs:[9]

Northampton	Pittsburgh	Lexington	Leavenworth	Waco
Bath	Fort Howard	Chillicothe	Shreveport	Fort Lyon
Batavia	Salisbury	Indianapolis	Little Rock	White City
Brooklyn	Dublin	Saginaw	Alexandria	
Clarksburg	Tuskegee	Milwaukee	Biloxi	

RPMO Executive Decision Memorandum Did Not Adequately Evaluate the Feasibility of Implementing QMIS

VHA's decision to implement QMIS was based on an Executive Decision Memorandum prepared by the RPMO. The memorandum cited three major reasons for implementing QMIS: (1) OMB Circular A-45 states that the regional survey method is preferred over the appraisal method; (2) QMIS would cost $50,000 a year less than appraisals; and (3) QMIS is more administratively convenient and requires less staff time. Our analysis of these three issues is discussed below:

RPMO Overemphasized OMB Circular A-45 Preference for Survey Method. In their decision memorandum, the RPMO correctly stated that OMB Circular A-45 encourages agencies to use the regional survey method in order to reduce the costs and administrative burdens associated with conducting appraisals. However, OMB Circular A-45 does not require the use of the regional survey method, and agencies are allowed to use the method that best meets their needs and circumstances. The overriding concern is not the method used but assurance that charges for rent, utilities, and other services should be based on their "reasonable value…to the employee…in the circumstances under which the quarters and facilities are provided, occupied, or made available" (5 United States Code, Section 5911(c), quoted in VA Directive 7631, 2c). Reasonable value to the employee should be determined by the "rule of equivalence," which means that charges for rent and related services, when practicable, should be set at levels equal to those prevailing for comparable private housing located in the same area (OMB Circular A-45, 5.b.1 and VA Directive 7631, 2c).

During the evaluation we discussed QMIS with DOI officials who were responsible for operating the program. They told us that although OMB Circular A-45 preferred the regional survey method, this was secondary to the goal of comparability with community rental rates.

RPMO Overstated Savings on QMIS Fees Versus Appraisal Costs. The only economic analysis that the RPMO did before recommending QMIS was a comparison of the cost of QMIS fees versus the cost of appraisals. In their June 1997 decision memorandum, the RPMO stated

[9] This is not intended as a complete list of VAMCs that may need management attention. It should be recognized that even at VAMCs where QMIS would decrease combined rent and utilities charges, the VAMCs could still be undercharging for utilities. We found this condition at 12 of the 17 VAMCs surveyed (VAMCs West Los Angeles, Long Beach, Palo Alto, Sepulveda, Grand Junction, Big Spring, Prescott, Miles City, San Francisco, Cheyenne, Fort Harrison, and Roseburg).

that implementing QMIS would save $50,000 a year in appraisal costs (Executive Decision Memorandum, page 4). However, our analysis found that the $50,000 savings was significantly overstated. The RPMO based their estimate on information from 12 VAMCs that had obtained appraisals in FY 1996. The 12 VAMCs had a total of 135 quarters units appraised at a total cost of $22,290, or an average cost of $165 per unit. This indicates that VHA's annual costs for appraisals would be about $37,000 per year ($165 average appraisal cost per unit × 1,114 units ÷ 5-year appraisal cycle = $36,762). VHA's annual cost for using QMIS would be about $17,000. Therefore, the annual savings on appraisal costs would be only about $20,000 a year, not $50,000 as claimed in the decision memorandum ($37,000 annual appraisal cost – $17,000 QMIS cost = $20,000).

In July 1998, at the request of VHA management, the RPMO performed another analysis of QMIS costs versus appraisal costs. This analysis used somewhat different data than that discussed above, but it had results similar to our analysis. The RPMO concluded that QMIS would save about $18,000 a year in appraisal costs, which is in line with our estimate of $20,000.

If the RPMO officials had done a more thorough analysis of the economic impact of QMIS, they would have realized that any benefit gained by reducing the cost of appraisals would be more than offset by the cost of lost rental income. To illustrate, the four VAMCs covered by the RPMO's pilot study would lose about $95,000 a year in rental income under QMIS. This is almost twice the $50,000 appraisal cost savings claimed by the RPMO decision memorandum and more than four times the $18,000 - $20,000 actual savings on appraisal costs.

RPMO Overemphasized Convenience of QMIS. In their June 1997 decision memorandum, the RPMO emphasized that VAMCs would find QMIS easier to use than the appraisal method and that QMIS would reduce the staff time required to obtain appraisals, set rents, make CPI adjustments and otherwise administer quarters. We agree that QMIS is easier to use than the appraisal method and may save some staff time. However, quarters are supposed to be operated on a businesslike basis, which means that the overriding concern must be whether QMIS increases or decreases rental income. The issues of convenience and staff time are not relevant for two reasons:

- There is no requirement for any VAMC to have quarters, and quarters are usually not needed for a VAMC to meet its mission. If a VAMC finds quarters administrative requirements too costly or burdensome, then it should eliminate its quarters.

- Quarters are supposed to be self-sustaining. If a VAMC is administering its quarters properly, it should be recovering administrative costs from rental income, regardless of whether that income is appraisal-based or QMIS-based. Administrative costs may be lower using QMIS, but rental income will also be lower. Similarly, administrative costs may be higher using appraisals but income will also be higher. Regardless of the method used, administrative costs will have about the same effect on bottom-line profit or loss.

In our opinion, the RPMO overemphasized the issue of the staff time that could be saved by using QMIS:

- The process of setting rents does not require significant staff time. A VAMC only has to obtain an appraisal once every 5 years. One appraisal contract typically covers all the VAMC's quarters. No additional appraisals are required unless significant capital improvements are made. However, there is almost no justification for a VAMC to make such improvements and therefore almost no reason to have an appraisal more often than once every 5 years. VAMC staff also have to make annual CPI adjustments, but these can be easily calculated using a personal computer.

- The rent-setting process is a minor part of the work and staff time costs involved in managing quarters. The resources and time needed to obtain appraisals and make CPI adjustments is not significant when compared to the staff time and costs associated with other quarters management functions, such as maintaining buildings, responding to tenant complaints, and tracking quarters income and expense data. All these functions would have to be done with or without QMIS.

The RPMO decision memorandum did not contain an estimate of the amount of staff time that would be saved using QMIS. However, the fact that setting rents and making CPI adjustments does not require significant staff time can be illustrated by information from VAMC Long Beach. In February 1997, the VAMC's Chief of Engineering Service sent the VAMC Director a memorandum recommending the use of QMIS. In his memorandum, the Chief estimated that his staff spent about 60 hours a year setting and adjusting rents for the VAMC's 13 quarters units and that QMIS would reduce this time to 8 hours a year.

If the Chief's estimate is accepted as reasonable, then it can be further estimated that VHA-wide the staff time associated with setting and adjusting appraised rents would be about 5,124 hours a year. This equates to only 3.5 full-time equivalent employees (60 hours per year ÷ 13 units at VAMC Long Beach = 4.6 hours per unit × 1,114 units VHA-wide = 5,124 hours ÷ 1,456 direct hours per FTEE = 3.5 FTEE).

Using the Chief's estimate, QMIS would require .5 FTEE VHA-wide for setting and adjusting rents (8 hours per year ÷ 13 units at VAMC Long Beach = .62 hours per unit × 1,114 units VHA-wide = 691 hours ÷ 1,456 direct hours per FTEE = .5 FTEE). Therefore, implementing QMIS would save staff time equal to only about 3.0 FTEE VHA-wide (3.5 FTEE using appraisals – .5 FTEE using QMIS).

Furthermore, it should be understood that even if QMIS saved staff time it would not save staff costs. The savings in staff time (equivalent to about 3.0 FTEE) would be spread across 96 VAMCs, so it would not be possible to eliminate any of the staff devoted to quarters operations.

DOI Letters Alerting VHA that QMIS Rents Were Below Community Rates. During the RPMO pilot study, DOI sent the RPMO at least three letters which, in our opinion, should have alerted them that QMIS might produce rents that were below prevailing community rates. The

DOI letter on VAMC Fort Howard is cited on page 4. Pertinent excerpts from the other two letters are shown below:

- **VAMC Murfreesboro** -- "These base rental charges are based upon our regional survey. In analyzing the comparables data, we found that the actual rental charges for houses in Murfreesboro, TN were $.148 per square foot higher than the average level of rents in the survey region, generally. This means that if the rents at the medical center were set by an appraisal, they would be increased by 14.8 cents per square foot of finished floor space. However, as you know, when quarters rents are established under the regional survey method, the quarters rents are 'capped' at that average level of rents prevailing in the survey region. Thus, our system is producing rents that are $.148 per square foot lower than the market rents for comparable housing in Murfreesboro, TN." (November 8, 1995, letter from the DOI Quarters Program Manager to the RPMO; emphasis in original)

- **VAMC Lincoln --** "…on average $333 would have to be added to the Plains survey formula in order to predict rents reflecting the actual market in Lincoln, Nebraska. As you know our Plains survey formula 'caps' rents at the average for this region. The Plains survey region, which includes North Dakota, South Dakota, Kansas, and Nebraska, has some of the lowest rents of our 14 survey regions. Again, because the survey method 'caps' rents at the regional average, the survey formula understates rents for Lincoln, NE by $333." (April 22, 1996, letter from the DOI Quarters Program Manager to the RPMO) With the letter another DOI official enclosed a note which stated: "Your Lincoln tenants will believe in Santa Claus when they see these rents."

VAMCs Undercharged for Utilities and Services

Our evaluation found that 13 of the 17 VAMCs we surveyed were undercharging for utilities and services. We determined this by comparing the amounts the VAMCs charged to the amounts calculated by the utilities component of QMIS. Although not as precise as metering for utilities, QMIS provides a reasonable estimate of utility charges based on utility cost data for the QMIS survey region.

As Table 3 shows, utility charges for the 13 VAMCs ranged from 76.5 percent (VAMC West Los Angeles) to 5.8 percent (VAMC Roseburg) below QMIS rates:

Table 3. 13 VAMCs in VISNs 18-22 that Undercharged for Utilities and Services

VAMC	QMIS Utility Charge	FY 1997 Actual Utility Charge	Undercharge	Percent Below QMIS Charge
West Los Angeles	$29,384	$6,900	$22,484	76.5%
Long Beach	28,573	12,548	16,025	56.1
Palo Alto	31,541	14,260	17,281	54.8
Sepulveda	11,601	7,273	4,328	37.3
Grand Junction	8,120	5,241	2,879	35.5
Big Spring	16,050	11,434	4,616	28.8
Prescott	53,721	41,031	12,690	23.6
Fort Lyon	89,199	69,697	19,502	21.9
Miles City	14,954	12,430	2,524	16.9
San Francisco	7,980	6,704	1,276	16.0
Cheyenne	4,055	3,480	575	14.2
Fort Harrison	19,891	18,408	1,483	7.5
Roseburg	5,077	4,784	293	5.8
Total	**$320,146**	**$214,190**	**$105,956**	**33.1%**

Completed and Planned Capital Investment in Quarters

We estimated that over a typical 10-year period VAMCs could spend as much as $38.25 million on quarters capital improvements. This estimate was based on information we obtained from the 17 VAMCs surveyed. It was necessary for us to make an estimate because there are no VHA-wide databases showing either completed or planned quarters improvement projects. Even at the VAMC level this information may be difficult to obtain. For example, VAMC West Los Angeles provided documents containing conflicting project costs for quarters improvements. However, we could not reconcile the differences because of inadequate records and the turnover of key VAMC management and Engineering Service staff.

We believe that our estimate is based on reasonably accurate information reported by the 17 VAMCs. However, it is possible that the 17 VAMCs did not report all planned and completed improvements. To illustrate, in response to our survey questionnaire VAMC Sheridan initially reported no completed or planned projects. However, when we questioned this the VAMC acknowledged that $152,000 had been spent in 1996 to install fire sprinklers in the quarters and that a $170,000 project to reroof the quarters was planned for FY 2001.

Table 4 shows the cost of capital improvements reported by the VAMCs:

Table 4. Cost of Completed and Planned Quarters Capital Improvements at 17 VAMCs in VISNs 18-22

VAMC	Completed Capital Improvements FY 1992-FY 1997	Planned Capital Improvements FY 1998 and Future	Estimated 10-Year Capital Improvement Cost
Long Beach	$291,187	$1,182,800	$1,473,987
Fort Lyon	302,203	600,000	902,203
White City	86,786	625,600	712,386
Walla Walla	124,076	581,900	705,976
Sheridan	152,311	170,000	322,311
Prescott	310,990	364,000	674,990
West Los Angeles	500,964	165,742	666,706
Palo Alto	209,541	264,900	474,441
Big Spring	257,583	-0-	257,583
Grand Junction	-0-	215,000	215,000
Roseburg	6,047	206,000	212,047
Sepulveda	103,889	-0-	103,889
San Francisco	89,444	-0-	89,444
Miles City	80,056	-0-	80,056
Fort Harrison	65,815	-0-	65,815
American Lake	-0-	19,000	19,000
Cheyenne	2,374	-0-	2,374
Total	**$2,583,266**	**$4,394,942**	**$6,978,208**

Monetary Benefits in Accordance with IG Act Amendments

Report Title: Evaluation of Veterans Health Administration Management of Employee Quarters at VA Medical Centers

Project Number: 8R8-060

Recommendation Number	Category/Explanation of Benefits	Better Use of Funds	Questioned Costs
1a-b	Increase quarters rental income by discontinuing the use of QMIS and returning to the use of current, accurate appraisals to set rents.	$962,000	
1d-e	Increase the recovery of quarters utilities costs by installing utility meters and by improving VAMC compliance with VA policy on charging for utilities and other VA-provided services.	$582,000	
1f-g	Restrict or eliminate quarters capital improvements by issuing guidance requiring that they be justified on capital programming principles. Until this guidance is issued, place a moratorium on quarters capital improvements.	$38.25 million	

Under Secretary for Health Comments

Department of Veterans Affairs **Memorandum**

Date: MAR 8 1999

From: Under Secretary for Health (10/105E)

Subj: OIG Draft Report, *Evaluation of VHA Management of Employee Quarters at VA Medical Centers*

To: Assistant Inspector General for Auditing (52)

1. The appropriate VHA program offices have reviewed the subject report. We generally agree with your findings. We also agree that the problems identified, several of which have not been corrected since your 1985 audit, need to be corrected now.

2. To that end we will, where feasible, install meters on quarters and charge tenants for metered usage. There are, we believe, some instances where even though it is technically possible to meter, the cost to do so is prohibitive. We plan to identify those facilities where this is the case and will document the decision to meter or not meter, including a cost analysis to support our decision. For these facilities and at those medical centers where it is not technically feasible to meter, we will issue guidance stating that the Quarters Management Information System (QMIS) utility rates shall be used. This directive will also emphasize that charges for other VA-provided services need to be appropriately billed to employees occupying housekeeping quarters.

3. Quarters improvement projects should be planned and justified based on the capital programming principles of linkage to mission and return on investment. Guidance is currently being drafted that will require review at the VISN level, using the principles in OMB's Capital Programming Guide, of capital investments that fall below the threshold established for Capital Investment Board approval. Quarters improvement projects typically fall into this category.

4. QMIS complies with Office of Management and Budget (OMB) directives to annually adjust rent with the Consumer Price Index, charges for utilities that are metered or unmeasured, and for other services provided by the Government. Appraisals do not offer the same benefits and are costly to acquire and manage. Although we agree with your finding that rents were significantly and inappropriately lowered when using the capped QMIS rates, we do not agree that QMIS should be discontinued in favor of appraisals. With the exception of the problem with the cap, QMIS provides accurate rent and utility information with greater ease of application that we would prefer not to relinquish. When the QMIS rate cap is removed and a positive location adjustment is

VA Form 2105
MAR 1989

Under Secretary for Health Comments (Continued)

2. Assistant Inspector General for Auditing (52)
   (EDMS Folder 36295)

made to quarters located in higher rent districts, the rates are equivalent to rates using appraisals. We are pursuing using QMIS without the rate cap with the Department of Interior (DOI). A formal request to DOI to work with VHA to provide the necessary information was sent February 23, 1999. If our proposal is successful, once it is implemented we will closely monitor the results to ensure that the rates charged are appropriate.

5. If our proposal is not successful, there are several options that we will pursue. First, we would continue to use QMIS as it is currently structured, except for those areas where a positive adjustment is required to increase rents. In those instances, we would use fee appraisals. A second option would be to use QMIS as it is currently structured, and, where positive adjustments are needed, the amount of the adjustment will be derived through the use of a price/rent index supplied by a consultant services contract. Finally, should neither of these options provide satisfactory results, we would consider reverting back to the use of appraisals for all VHA quarters.

6. We agree that quarters occupancy should be voluntary. There are, however, a small number of facilities; e.g., Miles City, MT, where occupancy is necessary to provide for needed services. We will reissue the policy covering the tax exemption. The policy will be revised to clarify that quarters occupancy is voluntary except under certain conditions, which will be specifically stated. The 136 quarters occupants affected by the change in the tax exemption justification will be notified in writing as to their status upon implementation of the revised policy.

7. Finally, we agree with your estimates of better use of funds associated with recommendations 1d-g. We do not agree with the estimate associated with recommendations 1a-b because we believe that if we are able to remove the rate cap from QMIS it will provide an acceptable alternative action to these recommendations, which will nullify the estimate of better use of funds.

8. Attached is a detailed action plan for each of the recommendations. We believe these actions are responsive to the recommendations and will resolve these longstanding issues. Thank you for the opportunity to review the draft report. If you have any questions please contact Paul C. Gibert, Jr., Director, Management Review and Administration Service (105E), Office of Policy and Planning, at 202.273.8355.

(*Original signed by:*)
Kenneth W. Kizer, M.D., M.P.H.

Attachment

Under Secretary for Health Comments (Continued)

Action Plan in Response to OIG/GAO/MI Audits/Program Evaluations/Reviews

Name of Report: *Evaluation of VHA Management of Employee Quarters at VA Medical Centers*
Project No.: None
Date of Report: Undated draft report

Recommendations/ Actions	Status	Completion Date

We recommend that the Under Secretary for Health:

a. Discontinue the implementation of QMIS and direct VAMCs that have changed rents based on QMIS to return to previous appraised rents, obtain new appraisals if scheduled, and make appropriate Consumer Price Index increases.

b. Require VAMCs that have been using questionable or outdated appraisals to obtain new appraisals to set rents accordingly.

Concur with modification

We do not believe that returning to appraisals is the best way to ensure appropriate rents are charged is the most effective means to use. VHA is pursuing an alternative option. We prepared a request to the Department of Interior (DOI) to remove the QMIS rate caps, assure that VA locations are included in DOI surveys and apply positive location adjustments to quarters located in higher rent districts. VHA's review of the effect of this proposal on the quarters included in the OIG report shows that QMIS would result in a net annual increase of $23,331 or 1.69 percent of the $1.38 million in total income using rental rates OIG cites. If our proposal is accepted and implemented, the Asset and Enterprise Development Service (AEDS) will establish a monitoring mechanism to ensure that QMIS rates are appropriately calculated and applied. The AEDS will report its oversight findings annually to the Under Secretary for Health.

If our efforts to work with DOI to remove the rate cap are unsuccessful, we have several alternative options we will pursue. First, we would consider using QMIS except in areas where positive adjustments are required to increase rent. In those areas we will use fee appraisals. Second, we would consider using QMIS and use a price/rent index provided by a consultant services contract for those areas where a positive adjustment is necessary. Our third option would be to consider reverting back to the use of appraisals for all VHA quarters.

2. Action Plan *Evaluation of VHA Management of Employee Quarters at VA Medical Centers*

Under Secretary for Health Comments (Continued)

2. Action Plan *Evaluation of VHA Management of Employee Quarters at VA Medical Center*

	In process	On-going

c. End the practice of allowing the tax deduction by issuing VHA policy specifying that quarters occupancy is voluntary.

Concur

VHA will revise its policy to indicate that occupancy of quarters is voluntary. There are, however, a small number of quarters occupants which even OIG recognizes are appropriately required to live in quarters. The policy will clarify for this minority the specific conditions where the tax exemption will apply. All of the 136 quarters occupants currently receiving the tax exemption will be notified upon issuance of the policy as to their status regarding the tax exemption.

	In process	3/31/99

d. Require VAMCs to install utility meters on all quarters where technically feasible and to charge tenants for metered usage.

Concur with modification

VHA will install meters and charge tenants for metered usage where feasible. For those facilities where this is not feasible, QMIS utility rates will be charged. Policy requiring that tenants be charged for metered usage will be reemphasized. Facility follow-up reporting that metered/QMIS rates are being collected will be reported to the AEDS and CNO on a quarterly basis until it is demonstrated that the policy objectives are achieved.

	In process	3/31/99 and on-going

e. Issue guidance emphasizing the importance of following existing VA policy on charging for utilities that cannot be metered and on charging for other VA-provided services.

Concur

Policy revision will be accomplished as part of the other planned revisions to the quarters policy.

Under Secretary for Health Comments (Continued)

3. Action Plan *Evaluation of VHA Management of Employee Quarters at VA Medical Centers*

In process	3/31/99

f. Issue guidance requiring that quarters capital improvement projects be justified based on the capital programming principles of linkage to mission and return on investment. The guidance should (1) specify that non-essential quarters should be phased out when they are no longer marketable without additional capital improvements and (2) include a definition of quarters capital improvements, a dollar-cost threshold for projects that must be justified on capital programming principles, and a requirement to use the net present value (NPV) method to analyze the cost-benefit of proposed projects.

Concur

Policy is being prepared that will require review using the OMB Capital Programming Guide. It will require that VISNs review capital investments that fall below the threshold established for the Capital Investment Board (CIB) review in a manner similar to the CIB.

In-process	06/30/99

g. Place a moratorium on quarters capital improvements until the new guidance is issued.

Concur in principle

Until the policy in recommendation f. is implemented, we will issue guidance reminding field facilities that current policy requires Headquarters approval for any project estimated to cost $4,600 during a fiscal year or $12,000 during a five-year period. We believe this action will achieve the desired result without actually imposing a moratorium.

In process	06/30/99

Under Secretary for Health Comments (Continued)

DEPARTMENT OF VETERANS AFFAIRS
Veterans Health Administration
Washington, DC 20420

IL 10-99-007
In Reply Refer To: 181B

May 20, 1999

UNDER SECRETARY FOR HEALTH'S INFORMATION LETTER

VHA QUARTERS MANAGEMENT CHANGES

1. This Information Letter provides medical facilities with planned changes in the future management of Veterans Health Administration (VHA) rental quarters. Implementation directives will be issued in the near future.

2. Recently, quarters have been the focus of several studies, including three by the Office of the Inspector General. As a result of these studies and careful, ongoing review by VHA program offices, several initiatives are underway that will change the current quarters management culture. VHA is planning the following:

a. VHA will develop a system that will better ensure that rents are comparable to those found in the nearest appropriate community. Increases in rent will be necessary at many sites to ensure market value rent is being collected. VHA is working with the Department of Interior to modify the Quarters Management Information System (QMIS) for this purpose. Where necessary, appraisals may be justified to determine market values.

b. VHA will be ending the practice of allowing the Federal tax deduction for employees living in quarters except in limited cases where the agency requires occupancy at certain locations.

c. VHA will adopt the policy that utility metering is the most effective method to determine utility charges and plans should be developed to install meters where they do not exist. In those instances where metering is not technically feasible or cost prohibitive, alternative methods of rate setting will be used. In the interim, VHA emphasizes the importance of following existing Department of Veterans Affairs (VA) policy on charging for utilities that cannot be metered and on charging for other VA-provided services (VHA Supplement to MP-3, Ch. 3, and App. 3A). For quarters already furnished with meters, occupants will pay actual charges based upon utility consumption.

d. VHA's goal is to make quarters self-sustaining. VHA will phase out quarters once they are no longer self-sustaining without making excessive capital improvements. Therefore, capital improvements must be based upon sound capital programming principles, linking mission and return on investment. Capital improvements should be put on hold until the implementing policy is issued. VHA recognizes the need for emergency maintenance and repair and emphasizes the importance of following existing VA policy on restrictions in the use of operating funds (VHA Supplement to MP-3, Ch. 3, Sec. IV, par.

Under Secretary for Health Comments (Continued)

IL 10-99-007
May 20, 1999

3.20). ***NOTE:*** *The Veterans Integrated Service Network (VISN) Directors' approval of funding is required before submitting requests to VHA Headquarters (10N/181B) to proceed with projects that exceed the thresholds of $4,600 per fiscal year and $12,000 over a 5-year period, per housekeeping unit.*

S/ by Melinda Murphy for
Kenneth W. Kizer, M.D., M.P.H.
Under Secretary for Health

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