



U.S. Department of Housing and Urban Development
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District Inspector General for Audit

August 31, 2001

**Audit Memorandum
No. 2001-PH-1803**

MEMORANDUM FOR: Malinda Roberts, Director, Office of Public Housing,
Pennsylvania State Office, 3APH

for J. Phillip Schiff

FROM: Daniel G. Temme, District Inspector General for Audit, Mid-Atlantic, 3AGA

SUBJECT: Assessment of Problems at the:
Housing Authority of the County of Chester (HACC)
30 W. Barnard Street, 1st Floor
West Chester, PA 19382

INTRODUCTION

HUD became aware of the financial problems of HACC when the staff of the Office of Public Housing, Pennsylvania State Office, met with representatives of HACC on October 2, 2000. HACC requested the meeting to discuss its declining Public Housing and Section 8 reserves and a shortfall in Hope VI funds. A HUD technical review was performed in October 2000 and the results were discussed with the HACC on November 20, 2000. At that time HACC was advised to immediately stop funding the private development company with Public Housing and Section 8 funds. On February 26, 2001 HACC advised HUD that it defaulted on a \$500,000 line of credit/loan, which was taken out for the private development company, and the bank seized the \$400,000 Certificate of Deposit (Comprehensive Grant Funds) that was used as collateral for the loan. By letter dated February 28, 2001, HUD notified HACC to take several actions that included to discontinue making payments to HACC's development projects, its consultants and to reimburse the Section 8 and Low Income Public Housing Programs.

On August 3, 2001 OIG assistance was requested and Management provided copies of HUD's Troubled Agency Recovery Center North (TARC) detail assessment report, dated June 20, 2001, on the HACC's operation, and KPMG's Consulting Draft Assessment Report, dated August 10, 2001, on the nature and depth of the private developments' problems.

SUMMARY

We completed a limited review of the Office of Public Housing, Pennsylvania State Office, and TARC assessments of HACC operations. We also reviewed KPMG Consulting Draft Assessment of HACC's private developments problems. In brief, we found the HACC is in substantial default of its Consolidated Annual Contribution Contracts (Low Rent and Section 8). Specifically, contrary to Section 7 of the Annual Contribution Contract (Low Rent), HACC pledged assets covered under its Annual Contribution Contract as collateral for loans for its private developments. HACC defaulted on a \$500,000 loan and a local bank seized a \$400,000 Certificate of Deposit. It appears other collateralized loans may be in jeopardy. Also, in violation of Section 11 of its Section 8 Annual Contribution Contract, HACC used Section 8 funds to pay interest and principal on a \$4 million bond issue in June 2001. Furthermore, under its present structure, it appears the HACC no longer has the financial resources to meet its immediate and long-term debt obligations. Consequently, in accordance with Section 17 of the Annual Contribution Contract (low rent) and Section 15 of the Section 8 Annual Contribution Contract, we recommend HUD take immediate action in declaring the HACC in substantial default of its contracts, and take appropriate actions it deems necessary to cure the substantial default.

SCOPE AND PURPOSE OF REVIEW

We reviewed reports, files, and records related to HACC and interviewed appropriate HUD staff. The following documents were included in the review.

- Report on the Financial Technical Assistance Visit October 23-25, 2000 transmitted to the Housing Authority of the County of Chester on February 28, 2001
- Report by HUD's Trouble Agency Recovery Center North dated June 20, 2001
- KPMG Consulting Draft Assessment Report dated August 10, 2001
- Request for Audit dated August 3, 2001
- Independent Auditor Report dated September 22, 2000 received by HUD on February 2, 2001.

OBSERVATIONS AND RECOMMENDATIONS

HACC pledged assets covered by the Low Income Public Housing Annual Contribution Contract to collateralize loans in violation of Section 7 of that contract; and, paid interest and principal on a bond issue from Section 8 funds in violation of Section 11 of the Section 8 Annual Contribution Contract. HACC defaulted on a \$500,000 line of credit/loan, which was used for private development, held by Allied Irish Bank and the bank seized a \$400,000 Certificate of Deposit used to collateralize the loan. The Certificate of Deposit was comprised of 1999

Comprehensive Grant Funds. In addition, HACC has additional lines of credit/loans totaling \$1,703,578 with various banks, some of which are collateralized by Annual Contribution assets and a \$4,000,000 bond issue, both used to finance non-federal subsidized development activity. In June 2001, bond issue payments of approximately \$50,000 in interest and \$120,000 in principal were improperly paid from Section 8 funds. Before the end of the Fiscal Year, additional interest and principal payments will become due as well as the need to meet the everyday operating expenses. In May 2001 it was reported that HACC did not have sufficient cash to pay its accounts payable that totaled \$193,489. Currently, there are no known sources of funds available to meet the HACC's total obligations. The HUD subsidized programs are at risk since the HACC pledged assets covered by the Annual Contributions Contract as collateral for loans.

HUD notified HACC to take several actions including to discontinue making payments to HACC's development projects, its consultants and to reimburse the Public Housing and Section 8 Program. However, HACC continues to use Section 8 Program and Low Income Public Housing Program funds to pay other program/project expenses

Based on our review, we believe that the HUD's Pennsylvania State Office has taken appropriate action to identify the significant deficiencies that exist at HACC. We believe that sufficient reviews have been made to identify and support the major non-compliance issues with the provisions of the Annual Contributions Contracts. The following is a list of the problems that exist in the HACC's operation as supported by the various management and consultant reviews. We have included the various sections of the Annual Contributions Contract that were violated.

1. Pledged assets covered by the Annual Contributions Contract as collateral for private loans (Annual Contributions Contract, Part A, Section 7).
2. Section 8 Program and Low Income Public Housing Program funds were used to pay other program/project expenses with the knowledge/approval of HACC's Executives and staff. Three private developments were noted by KPMG Consulting that the "property will fail or continue to be propped up using HACC program funds." This further supports the improper use and continued use of Annual Contribution Contract funds (Low Income Public Housing Program Annual Contributions Contract, Part A, Section 9; and, Section 8 Program Annual Contributions Contract, Section 11).
3. Hope VI and private development funds are commingled with the Consolidated General Funds without an accounting system, which clearly separates receipts and disbursements by program (Annual Contributions Contract, Part A, Section 9).
4. Low Income Public Housing Program funds are being advanced to Hope VI and private development projects without board approval and/or without expectation of reimbursement (Annual Contributions Contract, Part A, Section 10).
5. HACC's development staff members were reimbursed for expenses in excess of its travel policy. Travel expenses were charged to the federally assisted programs for

items such as, travel expenses to various parts of the country, including hotels, meals, and drinks for multiple persons, incurred for the private development enterprises, and meals and hotel costs were paid for guests while they were in Chester County (OMB Circular A-87, Attachment B, Para. 41).

6. Expenses charged to the federally subsidized program are excessive. No time records or other evidence was available to support the amount of time spent or percentage charged to the various programs (OMB Circular A-87, Attachment B, Para. 11.h).
7. HACC's former Director of Development (who was also the former Executive Director) and the former Board Chairman were also the principals of the private development entities, which created a conflict of interest when deciding on the use of HACC funds for the development partnerships (Annual Contributions Contract, Part A, Section 19).
8. HACC approved the use of Section 8 Program and Low Income Public Housing Program funds that were not included or were in excess of the approved budget (Annual Contributions Contract, Part A, Section 11).
9. Records did not exist or were not made available for review (Low Income Public Housing Program Annual Contributions Contract, Part A, Section 15; and, Section 8 Program Annual Contributions Contract, Section 14).
10. Various questionable practices/needs were identified in the procurement of goods and services.
11. HACC contributed funds to the Mixed Finance Partnerships Entities in excess of what was required.
12. Although all the above problems existed during the period of time covered by the Independent Auditor's Single Audit Report, the report contained no findings or internal weaknesses or non-compliances with laws or regulations.

We recommend the Director, Office of Public Housing, Pennsylvania State Office take immediate action in declaring the HACC in substantial default of its contracts, and take appropriate actions deemed necessary to cure the substantial default.

We discussed the report with the Director, Office of Public Housing, Pennsylvania State Office, on August 30, 2001 who agreed with its content.

We wish to thank you and your staff for your cooperation in completing this review. If you have any questions, please call me at (215) 656-3401 ext. 3484 or George A. Datto at ext. 3491.

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