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November 1, 2004
Audit Case Number
2005-AT-1001

TO: Boyce Norris, Jr., Director, Office of Public Housing, 4APH

James D. McKay

FROM: James D. McKay, Regional Inspector General for Audit, 4AGA

SUBJECT: The Housing Authority of the City of Carrollton
Carrollton, GA

HIGHLIGHTS

What We Audited and Why

We reviewed the Housing Authority of the City of Carrollton's (Authority) administration of its housing development activities as part of our audit of the U.S. Department of Housing and Urban Development's (HUD) oversight of Public Housing Agency development activities with related non-profit entities.

Our primary objective was to determine whether the Authority had advanced or encumbered resources subject to an Annual Contributions Contract (Contract) or other agreements or regulation to the benefit of other entities without specific HUD approval.

What We Found

The Authority advanced more than $316,495 to its private housing program, Little River Management, without specific HUD approval. The advances were made because the private housing program did not have sufficient income to pay its obligations and reimburse the Authority. HUD required the Authority to repay the funds and discontinue the advances. The Authority repaid the HUD program $249,247, the amount owed at May 31, 2002, however; it continued to advance funds. As of May 31, 2004, the Authority had advanced an additional $43,309. The repayment included the cash payment and an adjustment of $120,993 the Authority did not support. As a result, $359,804 of ineligible advances reduced funds for its public housing program needed to serve its low-income residents. In addition, the Authority failed to realize approximately $15,116 of interest income because the funds were not available for investment.

The Authority did not support its allocation of administrative and maintenance salary costs with activity reports or equivalent documentation as required. Thus, it did not have a record of the time spent on various activities and some activities may have paid a disproportionate share of the costs. As of June 30, 2003, the Authority had allocated $1,062,846 to its Federal programs.

The Authority executed five loan agreements for the purchase of private property that put $1,489,819 of its HUD funds at risk. The agreements included set-off provisions that allowed the lender to withdraw the HUD funds on deposit if the loan payments were not made.

What We Recommend

We recommend that HUD require the Authority to repay the $43,309 balance and the $15,116 interest lost from non-Federal sources, ensure that no further advances are made without prior HUD approval, and provide documentation to support the $120,993 adjustment, or reimburse its public housing program.

We recommend that HUD ensure the Authority uses activity reports to support its allocation of costs and makes appropriate adjustments to the $1,062,846 allocation.

Further, we recommend that HUD require the Authority to take immediate action to terminate the agreements that have the $1,489,819 of HUD funds at risk by either seeking a wavier of the set-off provisions, closing its accounts with the local lender, or refinancing the loans with another lender.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06 REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We discussed our review results with the Authority and HUD officials during the audit. We provided a copy of the draft report to the Authority officials on September 24, 2004 for their comments and discussed the report with the officials at the exit conference on October 8, 2004. The Authority provided written comments on October 14, 2004.

The complete text of the auditee's response, along with our evaluation of that response can be found in Appendix B of this report.

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BACKGROUND AND OBJECTIVES

The Housing Authority of the City of Carrollton (Authority) was organized pursuant to the Housing Act of 1937 and the laws of the State of Georgia. Its primary objective is to provide low-income housing to the citizens of Carrollton, Georgia and surrounding areas in compliance with its Annual Contributions Contract (Contract) with the U. S. Department of Housing and Urban Development (HUD).

A five-member Board of Commissioners (Board) governs the Authority with members appointed by the mayor of the City of Carrollton. Harlan Carroll is the Board chairman and Sandra Morris is the executive director.

The Authority's major program activities included administering 280 conventional low-income units, 104 Section 8 units, and 390 private units. The private housing units are identified as Little River Management and include single and multifamily units. Little River Management, however, is not a separate entity. It is governed by the Authority's Board, and its assets and liabilities are included in the Authority's general ledger.

HUD's Georgia State Office of Public Housing in Atlanta, Georgia, is responsible for overseeing the Authority.

Our overall objective was to determine whether the Authority had advanced or encumbered resources subject to its Contract or other agreement or regulation to the benefit of other entities without specific HUD approval.

RESULTS OF AUDIT

Finding 1: The Authority Improperly Advanced Federal Funds to Its Private Housing Program

The Authority violated its Contract with HUD by advancing more than $316,495 of its public housing funds to its private housing program, Little River Management, without HUD's approval. HUD required the Authority to repay the funds and discontinue the advances. The Authority repaid the HUD program $249,247, the amount it owed at May 31, 2002, however; it continued to advance funds. As of May 31, 2004, the Authority had advanced an additional $43,309. The repayment included the cash payment and an adjustment of $120,993 that the Authority did not support. The Authority advanced the funds to subsidize the operating costs of its private housing program, because the private housing program did not have sufficient income to pay its obligations. As a result, $359,804 of ineligible advances reduced funds for its public housing program needed to serve its low-income residents. In addition, the Authority failed to realize approximately $15,116 of interest income because the funds were not available for investment.

Private Housing Program Could Not Pay Its Expenses

Over the years, Little River Management had paid its own expenses. However, it started experiencing financial difficulties when one of its projects, Brookwood Apartments, could not produce the income it needed to break even. Little River Management purchased the 318-unit project in April 1999. The project needed repairs when it was purchased and many of the units were not available for lease. In addition, unexpected sewer problems caused one of the buildings to be closed. Because of the reduced rental income, Little River Management could not pay its expenses or reimburse the Authority's advances to pay its administrative and maintenance salary costs. This caused the amount due the Federal program to increase monthly. By June 30, 2001, the Authority had advanced Little River Management $316,495 of public housing funds. The Authority's 2001 financial statement audit report cited the Authority for violating its Contract, by using its public housing funds to pay the expenses of Little River Management. Section 9 (C) of the Contract, states the housing authority may withdraw funds from the general funds only for: (1) the payment of costs of development and operation of projects under Contract with HUD; (2) the purchase of investment securities as approved by HUD; and (3) such other purpose as may be specifically approved by HUD.

HUD Asked The Authority To Pay Funds Back

In response to the financial statement audit report, HUD asked the Authority to follow the recommended corrective actions. The report recommended the Authority take steps necessary to pay back the outstanding debt to the Federal program. During an August 2002 HUD management review, the Authority assured HUD the practice of advancing Federal funds to the non-Federal program would stop.

Repayment Included an Adjustment That Was Not Supported and Interest Income Of $15,116 Was Lost

On June 27, 2002, the Authority borrowed $265,000 to pay back the amount due the Federal program and to provide operating funds for its private housing program. The loan did not encumber the Authority's low-income housing assets. On June 28, 2002, Little River Management settled the balance due of $249,247. The Authority's fee accountant determined the amount of the settlement based on the amount Little River Management owed on May 31, 2002. The settlement, however, included a $120,993 adjustment that the Authority could not support. The fee accountant's computation did not include reimbursement for interest income of $15,116 the Authority lost because the funds were not available for investment.

Authority Continued To Fund Private Housing Program

Little River Management was able to reimburse the Federal program monthly during fiscal year 2003. However, during fiscal year 2004, it was unable to fully reimburse the Federal program for funds advanced. The amount owed increased from a negative balance of $3,029 on July 31, 2003, to $43,309 on May 31, 2004.

Authority Is Trying To Sell Brookwood Apartments

The Authority's fee accountant and auditor recommended the Authority sell Brookwood Apartments to improve its financial position. The Authority agreed with the recommendation and is in the process of selling the apartments. The Authority has received several offers from both public and private entities. Once Brookwood is sold, the private housing program should become self-sufficient again.

Recommendations

We recommend that HUD:

1A. Require the Authority to repay its public housing program the $43,309 or current balance owed from non-Federal sources.

1B. Require the Authority to repay its public housing program, from non-federal sources, $15,116 for lost interest accrued as of May 31, 2002, as well as the lost interest to date of payment.

1C. Ensure that no further advances of HUD funds are made on behalf of its non-Federal activities, without prior HUD approval.

1D. Require the Authority to provide documentation to support the $120,993 adjustment, or repay its public housing program from non-Federal funds.

Finding 2: The Authority Did Not Support Its Allocation of Costs

The Authority did not support its allocation of administrative and maintenance salaries and benefits with activity reports or equivalent documentation as required. Thus, the Authority did not have a record of the actual time spent on the various programs and some programs may have paid a disproportionate share of the costs. Of the $2,100,247 charged to its various programs for the fiscal years 2001 through 2003, the Authority allocated $1,062,846 to its Federal programs. The Authority's management was not aware the allocation was to be based on activity reports. As a result, the allocation of $1,062,846 was unsupported.

Budgets Were Used to Allocate Costs

The Authority operated several programs including conventional public housing, capital grant, Section 8, private housing, and several other grant programs. The Authority allocated 40 percent of its administrative and maintenance costs to the public housing programs, 44 percent to its privately owned housing program, 12 percent to a major health grant, and the remaining 4 percent to its other programs. The Authority developed its allocation from operating budgets that were based on the funds available for each program. As available program funds changed, it would adjust its allocation. The Authority did not compare the budgeted estimates to actual activity.

Total Salary and Wage Costs Were Supported

We reviewed the total salary and wage costs charged to the Authority's programs from October 1, 2001 through September 30, 2003. The Authority properly supported its salary and wage costs but did not adequately support its allocations.

Circular A-87 Requires Activity Reports To Support Allocation

The requirement to use activity reports to support the allocation of costs is included in Office of Management and Budget Circular A-87, Attachment B, paragraph 11 h (4). The paragraph states, in part, where employees work on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation. The activity reports must reflect an after the fact distribution of the activity of each individual employee.

Daily Time Records Are Being Kept

The Authority has implemented a system requiring its staff to keep a daily time record of their activities. The executive director said the Authority would start using these records to support the allocation of its administrative expenses. She said that work orders would be used to support the allocation of maintenance salaries and benefits.

Recommendations

We recommend that HUD:

2A. Require the Authority to obtain the assistance of its fee accountant or auditor in developing a justifiable method of supporting the allocated costs. The method could include daily activity reports prepared by its staff and work orders to support the allocation of costs.

2B. Require the Authority to provide documentation to justify the $1,062,846 costs allocation and ensure that it makes appropriate adjustments to the various activities.

2C. Require the Authority to develop a reasonable method for allocating its future costs, to include daily activity reports for services performed by its staff.

Finding 3: The Authority Executed Loan Agreements That Put Its HUD Funds at Risk

The Authority executed five loan agreements with the West Georgia National Bank (Bank) that put $1,489,819 of its HUD funds at risk. The loans were for the purchase of private properties and included set-off provisions allowing the Bank to withdraw loan payments from the HUD accounts if the loan payments were not made. These provisions allow HUD funds to be used for non-HUD activities, which violate the Authority's Contract. The Authority's management was aware of the set-off provisions, but was not aware of the impact they could have on the HUD funds.

Five Loans Included the Set-off Provisions

As part of its private housing program, the Authority entered into five loans with the Bank to purchase several properties, including single and multifamily properties and vacant land. The Authority secured the loans with the properties. However, it guaranteed the payment of the loans with HUD funds and other funds it had on deposit with the Bank. The guarantee was a set-off provision included in each loan.

Set-off Provisions Violated HUD Contract

The set off provisions violated Section 7 of the Contract, which provides that the Authority shall not, in any way, encumber any project covered under the Contact, or portion thereof, without the prior approval of HUD.

The set-off provision states that the Authority agrees that the Bank might set-off any amount due and payable under the note against any right the Authority has to receive any money from the Bank. Right to receive money means any deposit account balance the Authority has with the Bank.

Therefore, as of April 2004, $1,489,819 of the Authority's HUD funds were at substantial risk by guaranteeing the loans of its private housing program.

Recommendation

We recommend that HUD:

3A. Require the Authority to take immediate action to terminate the agreements that have $1,489,819 of HUD funds at risk by either (1) seeking waivers of the set-off provisions with the Bank, (2) closing its HUD-funded accounts with the Bank and transferring the funds to another financial institution, or (3) refinancing the loans with another financial institution.

SCOPE AND METHODOLOGY

To accomplish our audit objective we reviewed the following:

- Applicable laws, regulations, and other HUD program requirements;
- The Authority's Contracts; and
- HUD's and the Authority's program files.

We reviewed various documents including: financial statements, general ledgers, bank statements, minutes from Board meetings, check vouchers, invoices, loan documents, related guarantee agreements, and reports from the independent public accountant. In addition, we obtained an understanding of the Authority's accounting system as it related to our review objective.

We also interviewed the Georgia State Office of Public Housing program officials, and Authority management and staff.

We performed our audit from March through July 2004. Our audit covered the period from July 1, 2001, through June 30, 2003, but we extended the period as necessary.

We performed our audit in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined the following internal controls were relevant to our audit objectives:

- Compliance with laws, regulations, policies, and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

- Safeguarding resources, policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

We assessed the relevant controls identified above.

A significant weakness exists if internal controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

Based on our review, we believe the following items are significant weaknesses:

- The Authority did not have a system to ensure that Federal funds were properly used and the funds were not put at risk (see findings 1 and 3).

- The Authority did not have a system to ensure that costs charged among its various programs were properly supported (see finding 2).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

Recommendation Number	Ineligible 1/	Unsupported 2/	Funds To Be Put to Better Use 3/
1A	$43,309		
1B	15,116		
1D		$ 120,993	
2B		1,062,846	
3A			$1,489,819
Total	$58,425	$1,183,842	$1,489,819

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law, contract or Federal, State or local polices or regulations.

2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a future decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of Departmental policies and procedures.

3/ Funds to be put to better use are quantifiable savings that are anticipated to occur if an Office of Inspector General (OIG) recommendation is implemented resulting in reduced expenditures at a later time for the activities in question. This includes costs not incurred, de-obligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings.

Appendix B

AUDITEE COMMENTS

Auditee Comments

HOUSING AUTHORITY

Of The City of Carrollton
BOX 627
CARROLLTON, GEORGIA 30112
Phone
770-834-2046

October 14, 2004

Mr. James D. McKay
U.S. Department of Housing and Urban Development
District Office of the Inspector General
Office of Audit, Box 42
Richard B. Russell Federal Building
75 Spring Street, SW, Room 330
Atlanta, GA 30303-3388

Dear Mr. McKay:

We have reviewed the report dated September 24, 2004 and offer the following responses:

Finding 1.

We agree with the finding. We have paid back the funds due the Public Housing program and are currently clearing the balance at the end of each month. We will pay off the interest due as funds become available from non-federal sources. We will work with the Atlanta HUD Office in setting up a payment schedule if one is needed. We have contacted our fee accountant and requested that he provide the documentation needed to support the $120,993 adjustment. We will reimburse the public housing program from non-federal sources for any amount that cannot be supported. We will work with the HUD Office in resolving this matter.

Finding 2.

We agree with the finding. We have begun keeping daily activity reports that will meet the requirements of OMB Circular A-87. We will obtain assistance from our fee accountant to develop a method to justify the costs charged to the programs. We will obtain assurance from the HUD Office that this method will resolve the issue. Based on this method, we will make any adjustments necessary to assure that each program is correctly charged its share of the expense. We will obtain HUD's approval for any costs allocation method we develop for future charges to the HUD programs.

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Finding 3.

We agree with the finding. We have discussed the offsets with our bank and they have verbally agreed that all accounts that have HUD funds on deposit now and any future accounts will be exempt from the offset. We will obtain this agreement from the bank in writing and provide it to the Atlanta HUD Office when requested.

If you have questions or need more information I can be reached at 770-834-2046x291.

Sincerely,

Sandra Morris
Executive Director