audit report

Issue Date July 6, 2005	
Audit Case Number 2005-AT-1012	

TO: Karl H. Kucen, Director, Office of Public Housing, Memphis Hub, 4KPH

James D. McKay

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

SUBJECT: The Town of Crossville, TN, Housing Authority Improperly
Used Public Housing Funds for Other Activities

HIGHLIGHTS

What We Audited and Why

Because of indications of violations of U.S. Department of Housing and Urban Development (HUD) requirements, the Office of the Inspector General reviewed the Town of Crossville Housing Authority's (Authority) housing development activities. Our primary objective was to determine whether the Authority used public housing funds for development activities in violation of its annual contributions contract or other requirements. Our second objective was to determine whether the Authority's cost allocation procedures complied with Office of Management and Budget requirements.

What We Found

The Authority spent $583,800 from its public housing programs for ineligible activities. In violation of its annual contributions contract, the Authority used the funds to support its affordable housing development activities, including several tax credit properties substantially owned by other entities. As a result, the funds were not available for operation or modernization of the Authority's public

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housing units. This occurred because management mistakenly believed it was allowed to use the funds for the development activities.

The Authority did not adequately support costs allocated to its federal programs as required by Office of Management and Budget Circular A-87. The Authority estimated cost allocations but did not reevaluate the accuracy of the estimates and make necessary adjustments. In addition, it did not prepare required certifications. This occurred because the Authority was not aware of the requirements. Without adequate support, the Authority cannot assure that its various programs, including HUD programs, paid only their fair share of costs.

What We Recommend

We recommend that the director of the Office of Public and Indian Housing require the Authority to reimburse its conventional public housing program $417,800, recapture $130,000 in capital funds, provide guidance to the Authority regarding proper disposition of $36,000 from the sale of public housing land, and periodically review the Authority's use of public housing funds to verify that the funds are not used for ineligible purposes. The director should also require the Authority to develop cost allocation procedures that are in compliance with Office of Management and Budget Circular A-87.

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 the findings with the Authority during the audit and at an exit conference on June 8, 2005. The Authority did not agree with our recommendation to recapture $130,000 in capital funds.

The complete text of the Authority'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 Town of Crossville Housing Authority (Authority) was organized in 1952 pursuant to the Tennessee Housing Authorities Law. The Authority's mission is to serve low-income families within its jurisdiction through the provision of safe and sanitary affordable housing. The Authority operates 329 units of conventional public housing and administers 333 housing choice vouchers. The Authority also manages and serves as general partner in several properties it developed using low-income housing tax credits. The limited partner investors who purchased the tax credits substantially own these properties, but the Authority retained the right to purchase the properties after the tax credit compliance period. The Authority also provides affordable housing, including homeownership opportunities through properties acquired and/or developed through the U.S. Department of Housing and Urban Development's (HUD) HOME Investment Partnerships Program (HOME) and housing programs of the U.S. Department of Agriculture.

A five-member board of commissioners appointed by the mayor of Crossville governs the Authority. J. Robert Mitchell is the board chairperson, and Donald R. Alexander is the executive director.

HUD's Knoxville, Tennessee, Office of Public and Indian Housing is responsible for overseeing the Authority.

Our primary objective was to determine whether the Authority used public housing funds for development activities in violation of its annual contributions contract or other requirements. Our second objective was to determine whether the Authority's cost allocation procedures complied with Office of Management and Budget requirements.

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RESULTS OF AUDIT

Finding 1: The Authority Spent $583,800 in Public Housing Funds for Ineligible Activities

The Authority inappropriately used $583,800 from its public housing general fund to support its affordable housing development activities, including several tax credit properties substantially owned by other entities. As a result, the funds were not available for operation or modernization of the Authority's public housing units. This occurred because management mistakenly believed it was allowed to use the funds for the development activities.

Ineligible use of $583,800

As of December 31, 2004, the Authority's books and records showed accounts receivable totaling $583,800 due from 21 related funds or entities. We reviewed the six largest receivables totaling $451,592, or about 77 percent of the total. Most of the receivables arose out of the use of public housing funds for non-public-housing development.

Account no.	Account description	Amount
1129.1900	Braun St. Apts.	$180,915
1129.3200	Accts Rec HOMES[1] (CFP)	130,000
1129.1000	Accounts Rec. HOMES Other	40,568
1129.2800	Mutual Self Help	37,449
1129.8000	A/R HOMES (Sale of Braun)	36,000
1129.1400	Rec. Day Care	26,660
Total		$451,592

In April 2001, the Authority loaned $180,915 from its public housing operating account to Braun Cove Apartments LP to fund development cost overruns for a tax credit property. The Authority was both the project developer and general partner but was not authorized to use HUD funds for the property.

The Authority also used $130,000 from its Public Housing Capital Fund program to help finance several non-HUD developments including other tax credit developments. It used $100,000 from its year 2000 grant and $30,000 from its year 2001 grant. Management agreed it misused the funds but said that at the time, it believed such use of capital funds was permissible. Management recently realized such use was improper.

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[1] The Authority maintained a "HOMES" account. This account included both HUD HOME funds and other funds for development of homes.

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The U.S. Housing Act of 1937, as amended, Section 9(j), provides penalties for slow expenditure of capital funds. Public housing agencies shall obligate any assistance received under this section not later than 24 months after the date on which the funds become available to the housing agency for obligation for modernization or the date the housing agency accumulates adequate funds to undertake the modernization, substantial rehabilitation, or new construction of units. Any assistance must be spent not later than four years after the date the funds become available to the agency for obligation. Section (j)(6) provides HUD the right to recapture amounts for violation of the requirements. Because the $130,000 was not available for authorized capital fund activities, the Authority failed to obligate it within 24 months as required. Thus, HUD should recapture the funds.

The $36,000 account receivable pertains to sales proceeds for land the Authority sold to a tax credit partnership. HUD released the Declaration of Trust to permit the Authority to use the surplus land for the tax credit development. Since the Authority obtained HUD's approval, we did not take exception to the land sale. However, rather than depositing the $36,000 in sales proceeds into its public housing operating account, the Authority deposited it into its HOMES account. Management stated that it asked HUD how it should dispose of the sales proceeds, such as using the funds for public housing or submitting the funds to HUD. The Authority agreed that it should return the funds to its public housing account but awaits instructions as to whether it can use the funds or whether they should be returned to HUD.

The remaining receivables we reviewed consisted largely of nonreimbursed expenses, paid with public housing operating funds to benefit various other programs or entities, or nonreimbursed cost allocations. While the other programs or entities often reimbursed the public housing general fund within about a month, in some cases, balances were not paid in full, resulting in the accounts receivable balances. The receivable balance of $40,568 in "Accounts Rec. HOMES Other" represents the amount owed the public housing general fund from the Authority's HUD HOME program grants. The balance of $37,449 due from "Mutual Self Help" represents nonreimbursed expenses for startup costs for a Farmers Home Administration Section 523 homeownership project.

The $26,660 account receivable pertained to funds owed public housing by a daycare center owned by the Authority's resident council through a nonprofit corporation. The daycare center provided discounted services to public housing residents but also served the general public.

Numerous small accounts make up the remaining receivable balance of $132,208. Because the individual amounts were small, we did not review them in detail, but our cursory review showed the balances included nonreimbursed cost allocations. We also noted some unpaid development fees owed by tax credit partnerships.

The executive director confirmed the amounts were paid from the public housing operating account.

Part A, section 9(C), of the annual contributions contract between the Authority and HUD allows the Authority to use general fund cash only for (1) the payment of the costs of development and operation of projects under an annual contributions contract with HUD, (2) the purchase of investment securities approved by HUD, and (3) such other purposes as may be specifically approved by HUD. The housing authority may use the general fund to make payments for other activities but only to the extent those activities have cash on deposit in the general fund.

The executive director acknowledged the payments were improper and agreed the funds should be repaid.

Recommendations

We recommend the director of the Office of Public and Indian Housing

1A. Require the Authority to repay its conventional public housing program account $180,915 or the current balance due from Braun Cove Apartments from nonfederal funds.

1B. Recapture $130,000 in capital funds that the Authority failed to obligate within the 24-month requirement.

1C. Require the Authority to repay its conventional public housing program account $236,885 or the current balance due for the remaining receivables from nonfederal funds.

1D. Advise the Authority as to whether it should submit to HUD the $36,000 it received for the sale of public housing land or use the funds for eligible public housing activities, thereby putting the funds to better use.

1E. Periodically review the Authority's use of public housing funds to verify that the funds are not used for ineligible purposes.

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Finding 2: The Authority Did Not Support Allocation of Costs

The Authority did not adequately support allocation of costs charged to federal programs as required by Office of Management and Budget Circular A-87. The Authority estimated cost allocations, but it did not reevaluate the accuracy of the estimates and make necessary adjustments. In addition, it did not prepare required certifications. This occurred because Authority management was not aware of the requirements. As a result, the Authority cannot assure that its programs, including its HUD programs, paid only their fair share of costs.

The Authority Did Not Adjust Cost Based on Actual Cost

The Authority failed to perform periodic evaluations and make necessary adjustments to estimated salary and wage costs for employees working on multiple federal programs. For each employee working on multiple federal programs, Office of Management and Budget Circular A-87 requires an allocation of salary supported by documentation reflecting an after-the-fact determination based on actual activity. Allocation percentages based on estimates determined before the services are performed do not qualify as support. Estimated percentages may be used for budgeting, but adjustments based on actual percentages must be made at least quarterly.

Further, although the Authority's cost allocation plan identified employees who were expected to work on a single federal program, the Authority did not prepare required certifications to support their salary and wage costs. Office of Management and Budget Circular A-87 requires that salary and wage charges for such employees be supported by periodic certifications prepared at least semiannually and signed by the employee or supervisory official.

The Authority also failed to reevaluate estimated indirect costs. The Authority prepared provisional (estimated) costs but did not compare them to actual costs incurred and make any necessary adjustments. Office of Management and Budget Circular A-87 allows the use of provisional rates only if they are later adjusted with final rates based on actual costs.

Recommendations

We recommend that the director of the Office of Public and Indian Housing require the Authority to

2A. Perform quarterly evaluations of actual time for employees who worked on multiple programs and adjust the estimated allocation percentages for variances as needed.

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2B. Complete the required semiannual certifications for employees who worked on a single federal program.

2C. Develop and apply a final indirect cost rate based on actual costs.

2D. Amend its cost allocation plan to comply with the requirements of Office of Management and Budget Circular A-87.

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SCOPE AND METHODOLOGY

To accomplish our audit objectives we reviewed the following:

- Applicable laws, regulations, and other HUD program requirements;
- Independent auditor reports and other data in HUD's Real Estate Assessment Center system;
- Applicable internal controls; and
- HUD's monitoring reviews.

We also reviewed various documents at the Authority offices, including various financial statements, general ledgers, minutes from board meetings, journal vouchers, loan documents, contracts, partnership agreements, and various documents pertaining to tax credit developments.

We interviewed Knoxville, Tennessee, Public and Indian Housing program officials and Authority management and staff.

We performed our audit from February 22, 2005, through May 9, 2005. Our audit covered the period from January 1, 2001, through December 31, 2004.

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

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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 assure that resource use is consistent with laws and regulations.
- Policies and procedures that management has implemented to reasonably assure that resources are safeguarded against waste, loss, and misuse.

We assessed the relevant controls identified above.

A significant weakness exists if management 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 ensure that HUD funds were used only for eligible activities (see finding 1).
- The Authority lacked assurance its various activities are paying their fair share of costs because its cost allocation plan and practices did not fully comply with federal requirements (see finding 2).

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APPENDIXES

Appendix A

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

Recommendation	Ineligible1/	Funds to be put to better use 2/
1A	$ 180,915	
1B	130,000	
1C	236,885	
1D		$ 36,000
Total	$ 547,800	$ 36,000

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/ "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, deobligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings.

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Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

<u>Ref to OIG Evaluation</u> **<u>Auditee Comments</u>**

CROSSVILLE HOUSING AUTHORITY

67 Irwin Avenue ~ P.O. Box 425 ~ Crossville, TN 38557
Phone 931-484-2990 ~ Fax 931-456-1513

EQUAL HOUSING OPPORTUNITY

June 15, 2005

James D. McKay
U.S. Department of Housing and Urban Development
Office of the Inspector General for Audit, Region 4
Richard B. Russell Federal Building
75 Spring Street, SW, Room 330
Atlanta, GA 30303-3388

Dear Mr. McKay,

Please find enclosed written responses to the findings from the audit your office conducted on the Town of Crossville Housing Authority.

If you need further information, please feel free to contact my office.

Sincerely,

Don Alexander
Executive Director

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Appendix B

Finding 1

Comment 1

The housing authority believed that the affordable housing development activities it was engaged in were an eligible method for housing development under Section 519 QHWRA. A good deal of the public housing receivables are inter fund transfer and have not been repaid as timely as they could have been. This practice will be stopped and we will stop using the public housing account as the " mother " account of the PHA. Since this audit the authority has already repaid the public housing account over $250,000 and will have reduced that receivable by over $300,000 by the end of the current fiscal year.

The authority on an as needed basis used public housing funds as a tool to expand affordable housing in our communities. We believed that this practice was not only allowed but encouraged under Section 519 of QHWRA. At no time were the PHA funds given away. All funds were advanced with the intent that they be replaced. In all cases the development activities were either for properties that were owned by the Crossville Housing Authority or were Section 42 properties in which the CHA was the General Partner thus having complete control over the entity and the entity funds. This leveraging of funds has allowed the Crossville Housing Authority to attract over $2 million in HOME funds, over $1 million in Federal Home Loan Bank AHP funds, and $5 million in private equity for affordable housing. We have developed properties with an estimated market value or over $12 million. We have added 267 non public housing units to our inventory. This expanded affordable housing allows the PHA to serve more clients, to increase the Section 8 voucher success rate, and to control the Section 8 housing assistance payment costs. If using a few hundred thousand dollars of public housing funds over a period of years can accomplish so much perhaps HUD should consider altering that rule.

Comment 2

On the audit recommendation that HUD recapture $130,000 in capital funds the Crossville Housing Authority strongly objects to such action. First the Authority believed that this was an eligible activity. Second, recapture goes completely against the stated concerns of the audit itself. The auditor states that use of the capital funds for development made the funds "not available for operations and modernization of the Authority's public housing units". If it is a real concern it is illogical to recapture these Capital Funds, thus taking the funds away from our public housing program. The purpose of the regulation about timely obligation of capital funds was to prevent PHAs from having Capital Funds "backing up" in the funding stream. This is not what happened here and recapture is not appropriate in this case. While the Authority still maintains the assertion that Mixed Financed housing development is an eligible activity under Section 519 of QHWRA; however, if it is not an eligible activity, 24CFR905 and 24CFR968 provide remedies other than the extreme measure of recapture.

Comment 3

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Finding 2

Cost Allocation

Comment 4

The Authority agrees that it is not in compliance with OMB A-87. We have already implemented the changes relative to documentation of salaries. We will work with the Knoxville Field office to develop an indirect cost allocation plan. We would like to state for the record that while not in compliance with letter of A-87 we feel we are in compliance with the intent of A-87. The Authority does charge maintenance costs as a direct charge of salary benefits and materials to all projects. The Authority allocated what we considered an equitable portion of administrative salaries and expenses to each entity of the Authority. We did not, however, make adjustments at year end.

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OIG Evaluation of Auditee Comments

Comment 1 The report recognized that management mistakenly believed it was allowed to use the funds for the development activities. The Quality Housing and Work Responsibility Act of 1998 does allow development of mixed-finance housing. However, authorities desiring to develop mixed finance public housing are required to follow HUD regulations at 24 CFR 941 Subpart F. The regulations require approvals by HUD Headquarters throughout the development process and require an amended annual contributions contract. The Authority did not obtain HUD approval or obtain an amended annual contributions contract.

Comment 2 Funds recapture does not contradict the concerns in the report. The Authority expended the funds for ineligible purposes which suggests it did not need them for operations or modernization of public housing units. Following recapture, HUD can redistribute the funds to high-performing public housing agencies needing them for operation and modernization of public housing.

Comment 3 24 CFR 905.120, paragraph (b) provides exceptions to obligation requirements for capital funds. A public housing agency may request and HUD may approve a longer timeframe, by *prior approval granted before the expiration of the 24 months*. The additional time period cannot exceed 12 months. Any extensions under 24 CFR 968 must be due to reasons beyond the Authority's control and the request must be made no later than 30 calendar days after the deadline date. The Authority did not request and HUD did not grant any extension. HUD will need to assess what, if any, remedies other than recapture are appropriate. If HUD determines other remedies might be appropriate, the OIG will discuss those with HUD as part of the management decision process.

Comment 4 We recognize the Authority did allocate costs, but that it was not in complete compliance with requirements. We believe the Authority will make the necessary changes to its procedures.

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