audit report

Issue Date: August 17, 2006
Audit Report Number: 2006-AT-1017

TO: Don Clem, Director, Office of Public Housing, 4IPH

FROM: James D. McKay

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

SUBJECT: The Housing Authority of Lawrence County, Kentucky, Spent More Than $71,000 for Questionable Purchases

HIGHLIGHTS

What We Audited and Why

We audited the Housing Authority of Lawrence County, Kentucky (Authority), to determine whether the Authority managed its procurement and financial management systems in accordance with U.S. Department of Housing and Urban Development (HUD) requirements. We conducted the review pursuant to a request by the director of the Office of Public Housing, Louisville, Kentucky.

What We Found

The Authority spent more than $71,000 for questionable purchases and travel expenses. This occurred because it did not follow Office of Management and Budget requirements that expenses be reasonable and necessary, did not have sufficient management controls to ensure adequate segregation of duties or adequate board oversight, and did not follow its procurement policies or federal procurement requirements. The Authority and HUD's Office of Public Housing, Louisville, Kentucky, entered into an improvement plan and memorandum of

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agreement on April 18, 2006, to address deficiencies in the Authority's operations, but additional actions are needed.

What We Recommend

We recommend that the director of the Office of Public Housing

1. Require the Authority to provide support for $71,741 in questionable costs or repay any ineligible or unsupported amounts from nonfederal funds.

2. Revise the improvement plan and memorandum of agreement with the Authority to include actions that ensure that the Authority

    - Adequately segregates its accounts payable processes,
    - Provides adequate supervisory oversight over credit card purchases and travel advances to include review of supporting documents by a board member before signing checks, and
    - Complies with its procurement policies and federal procurement regulations.

3. Reevaluate the corrective actions at a later date to determine whether the actions were appropriate.

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 finding with Authority and HUD officials during the audit. We provided a copy of the draft report to Authority and HUD officials on July 14, 2006, for their comments and discussed the report with the officials at the exit conference on July 21, 2006. The Authority provided its written comments to our draft report on July 28, 2006. The Authority agreed with the finding and the recommendations.

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

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BACKGROUND AND OBJECTIVES

The Housing Authority of Lawrence County, Kentucky (Authority), is organized under the laws of the Commonwealth of Kentucky for the purpose of engaging in the development, acquisition, leasing, and administration of a low-rent housing program. The Authority owns and operates 87 public housing units, 130 Section 8 units, and Public Housing Capital Fund program grants.

The Authority was awarded $627,849 in operating subsidies and $542,070 in Public Housing Capital Fund program grants for 2002 through 2005. For 2006, the Authority was awarded $195,326 in operating subsidies. A five-member board of commissioners governs the Authority. The executive director resigned during our review, and the executive director of the Catlettsburg, Kentucky, Housing Authority is serving as the interim executive director.

We initiated the audit at the request of the director of the Office of Public and Indian Housing, Louisville, Kentucky.

Our objective was to determine whether the Authority managed its procurement and financial management systems in accordance with U.S. Department of Housing and Urban Development (HUD) requirements.

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RESULTS OF AUDIT

Finding 1: The Authority Spent More Than $71,000 for Questionable Purchases

The Authority spent $71,741 without adequately supporting that the funds were used to operate its housing programs. It also could not support its decisions to noncompetitively award contracts. This occurred because the Authority did not follow Office of Management and Budget requirements that expenses be reasonable and necessary, did not have sufficient management controls to ensure adequate segregation of duties or adequate board oversight, and did not follow its procurement policies or federal procurement requirements. As a result, the $71,741 was not available to support the Authority's housing programs. The questionable purchases contributed to the Authority's decrease in operating funds and investment balances from $223,295 on March 31, 2002, to $68,715 on December 31, 2005.

Questionable Credit Card Purchases of More Than $64,000

Office of Management and Budget Circular A-87 requires that costs be necessary and reasonable for proper and efficient performance and administration of federal awards to be allowable. Our review of more than $99,000 in credit card purchases determined that $64,852 was spent for questionable purchases that did not have supporting receipts or did not appear to be needed to operate housing programs. Without the supporting documentation, the Authority cannot show it complied with requirements. Further, many of the purchases that did have supporting documentation were not for program operations. This occurred because the Authority did not separate accounts payable duties, board members did not review supporting documents before signing checks, and in violation of the Authority's policy, the deputy director sometimes signed checks instead of a board member.

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Examples of questionable and unsupported purchases included

- More than $2,100 for airline tickets, reservations, and fees for a Caribbean Cruise.

- Purchases of $1,155 between October 9 and 10, 2004, at stores such as Dillards, the GAP, Too Incorporated, and New York & Company. Receipts supported none of these purchases, and none appear to be for program operations.

- Purchases of more than $2,000 from March 17 to 19, 2005, at stores such as Kroger, Gymboree, Target, and Home Depot, including playground equipment for $731. The playground equipment was not located at the Authority's complexes.

- Purchases of more than $800 from stores such as Kroger, Target, Marshalls, and Ronk's Uniform Center. The credit card statement was annotated that the purchases were for the Authority's Resident Management Corporation. Officials of the Resident Management Corporation informed us they did not receive these items.

Unsupported Travel Advances

The Authority could not provide support that $6,889 it paid as travel advances was spent for Authority business or was repaid to the Authority. Our review of 40 travel advance checks from June 2002 through December 2005 found that the Authority did not have the required vouchers or receipts to support 32 of the travel advances. This occurred because the Authority's travel policy did not include procedures for reviewing the executive director's travel expenses. The Authority's travel policy required travelers to submit a voucher and receipts for expenses over $5 to the executive director, who would then sign the voucher as the approving official. Any unused travel advance funds were to be repaid by personal check and deposited into the Authority's bank account. However, there was no procedure for the independent review of the executive director's travel expenses. Without the supporting vouchers and receipts, the Authority cannot show the $6,889 in travel advances was spent in accordance with Office of Management and Budget Circular A-87 requirements.

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Procurements Not in Accordance with Requirements

Our review of seven procurements found that the Authority did not follow its policies and procedures or federal procurement requirements for four procurements totaling $41,864. Both the Authority's procurement policy and 24 CFR [*Code of Federal Regulations*] 85.36(C) require that all procurement transactions be conducted in a manner that provides full and open competition and that the Authority document its procurement decisions. The Authority's procurement policy states that it shall seek full and open competition for all procurements and that sealed bidding is the preferred method for construction procurements. For contracts over $1,000 but less than $20,000 small purchase procedures could be used. However, at least three quotes were required.

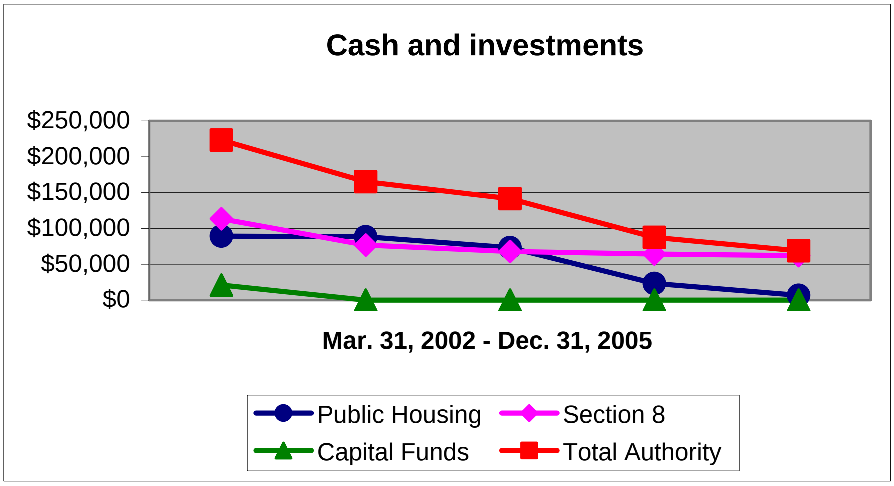
The Authority paid $13,228 for the renovation of its office. Since this was a construction project, the preferred procurement method was sealed bidding; however, since the procurement was less than $20,000, small purchase procedures could have been used, according to the Authority's procurement policy. There was no evidence in the files that sealed bids were received or that there was any competition. The Authority paid the same contractor $9,886 for heating and cooling services. Again, there was no evidence of any competition. Similarly, the Authority paid $4,058 to a consultant without competition.

The Authority also paid $14,692 to a former Authority employee for financial services that were not fully needed because the Authority's fee accountant was already providing some of the same services such as bank reconciliations. Again, there was no evidence in the files that this procurement was made in accordance with the Authority's policies or federal regulations.

Without documented competitive procurements, the Authority cannot ensure that it obtained goods and services at a price that was most advantageous.

Funds Not Available for Housing Programs

The questionable purchases contributed to the Authority's decline in operating funds and investment balances. On March 31, 2002, the Authority had $223,295, but by December 31, 2005, the balance had decreased to $68,715 and consisted primarily of Section 8 reserves. The Authority's cumulative balance, along with those for the public housing, Section 8, and Public Housing Capital Fund programs, are shown in the following chart.



Improvement Plan Revision Needed

The Authority and HUD's Office of Public and Indian Housing, Louisville, Kentucky, entered into an improvement plan and memorandum of agreement on April 18, 2006, to address deficiencies in the Authority's operations. The agreed-upon actions include general actions designed to improve the Authority's Public Housing Assessment System financial scores. However, additional actions are needed to address the deficiencies we identified.

Recommendations

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

1A. Require the Authority to provide support for $71,741 in questionable costs or repay any ineligible or unsupported amounts from nonfederal funds.

1B. Revise the improvement plan and memorandum of agreement with the Authority to include actions that ensure that the Authority

- Adequately segregates its accounts payable processes,
- Provides adequate supervisory oversight over credit card purchases and travel advances to include review of supporting documents by a board member before signing checks, and

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- Complies with its procurement policies and federal procurement regulations.

1C. Reevaluate the corrective actions at a later date to determine whether the actions were appropriate.

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SCOPE AND METHODOLOGY

Our audit objective was to determine whether the Authority managed its procurement and financial management systems in accordance with HUD requirements. To accomplish our objectives, we

- Obtained and reviewed applicable reference materials,
- Interviewed HUD program staff and reviewed HUD files,
- Reviewed documents provided by the independent public accountant,
- Interviewed Authority staff and board members,
- Reviewed minutes of board meetings,
- Reviewed the Authority's controls related to the administration of its procurement and financial management procedures,
- Reviewed the Authority's financial operations, and
- Reviewed other documents as needed to accomplish our objectives.

Because we identified questionable purchases during our review, we reviewed all American Express statements and available supporting documents during our audit period to determine whether they appeared to be for eligible Authority purchases. Our review showed that the Authority did not have sufficient documentation to support that these purchases were eligible.

Because we identified unsupported travel advances to an employee, we reviewed $7,925 of the $14,774 advanced to that employee between June 2002 and December 2005. The Authority did not have sufficient documentation to support almost $6,900 in advances.

We reviewed the Authority's check registers for July 1, 2003, and December 31, 2005. From this, we selected a nonrepresentative selection of payments to payees based on payment patterns and auditor experience to determine whether the procurements were in accordance with requirements. The review showed the Authority did not follow procurement guidance when contracting with four vendors.

We limited our review of the Public Housing Capital Fund program to procurement activities.

We conducted our audit from February through June 2006 at the Authority's offices in Louisa, Kentucky. Our audit covered the period April 1, 2002, through March 31, 2006. We expanded our audit period as needed to accomplish our objectives.

We conducted the 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:

- Program operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.

- Controls over the validity and reliability of data – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.

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

- Safeguarding of 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 management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

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Significant Weaknesses

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

- Policies and procedures were not implemented to ensure a separation of accounts payable functions and the full review of travel vouchers.

- Policies and procedures were not followed to ensure that the Authority complied with procurement and cost allowability requirements.

- Policies and procedures for check signing and board oversight were not followed to ensure that the Authority safeguarded assets.

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FOLLOWUP ON PRIOR AUDITS

This was the first Office of Inspector General audit of the Authority. At the time of our review, the Authority's independent public accountant had provided draft audit reports to the Authority for its fiscal years ending March 31, 2003, 2004, and 2005. The draft reports expressed unqualified opinions on the Authority's financial condition but also reported findings on late audits, internal control weaknesses, and unallowed costs.

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APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation	Unsupported 1/
1A	$ 71,741
Total	$ 71,741

1/ 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 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.

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Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation | **Auditee Comments**

Housing Authority of Lawrence County

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July 28, 2006

Mr. James D. McKay
Regional Inspector General for Audit
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Region 4 Office of the Inspector General
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Atlanta, GA 30303-3388

Dear Mr. McKay,

Please consider this as our official response to the draft report of the inspector general's report issued to the Housing Authority of Lawrence County dated July 14, 2006. I am the new Interim Executive Director of the authority. My tenure here started on Friday, March 24, 2006. I will list our response to the audit and follow with the many accomplishments we have made since March 24, 2006.

Comment 1

Finding number 1 mentioned the authority spent more than $71,000 for questionable purchases. I agree with this finding, as I believe there were many questionable purchases that do not appear to be related to the housing authority that the authority paid for.

Concerning what your auditors found on the report, a large majority of this occurred with a credit card the agency had that had a $10,000 limit. This card has not been used since the former director resigned. The card was a small business card in the authority's name. We found that the former director had personally guaranteed the card and we could not cancel it ourselves as only the person who had guaranteed the card could. The card will cancel on its own when it goes six months without any activity. We shredded all cards the agency had in its possession in April 2006 and have not received any more bills from them since May 2006 as we had to pay some finance charges on prior purchases. I believe all **questionable purchases** that were reported are correct.

I also concur that there are several **unsupported travel advances**.

Procurements were definitely not handled per HUD regulations. Many procurements were not competitively bid out.

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Concerning your comment about **funds that were not available for Housing** programs, I totally agree.

Concerning the **recommendations suggestions** on the report, I agree with. We will forward our bonding company all the information we have after your report is finalized to insure that we collect on our bond.

We have already **segregated our accounts payable process** to include three employees and one board member. This was done in early April 2006.

The only **credit card** the agency now has is two Speedway cards to be used for gasoline purchases for the agencies two vehicles. Two employees' were given a letter with the cards that they were to be used for gasoline only for use of the agencies vehicles. No other purchases were to be made except for gasoline for any of our power equipment if we need to. We signed a contract with a commercial grass company to cut grass at both sites for one year so we don't expect that we will have many purchases, if any, for this. We usually have only two charges each month. One will be for the section 8 vehicle and the other for the maintenance truck.

Concerning the **significant weaknesses** you identified, we have already taken care of some of these. We have already separated the check signing procedure. Also, since January 1, 2006, the board has met nine times.

Our **audit** for the year ending March 31, 2006 field work was done on July 26 & 27, 2007. Four of the six findings have already been taken care of and the two others will be resolved as soon as possible. We are hopeful to get our audited financial statements into REAC by mid September 2006, well before our December 31, 2006 deadline.

For the period ending March 31, 2006, the Housing Authority had a reserved balance of ($5,709.47) in our low rent side. As of June 30, 2006 the reserve balance has increased to $59,851.81. All non housing authority spending has ceased. Financial information is sent out to our fee accountant on the last day of each month in an effort to get the financial report back in time to send to the Board prior to our regular meeting. Our board reviews our financial statements each month along with the Memorandum of Agreement (MOA) and the HUD response.

A contract has been eliminated that the former director had with a former employee who did bookwork for the authority, as their fee accountant was doing the same work. The duplication of service was a waste of money and will save the authority $500.00 per month or $6,000 per year.

Two contracts have been signed this fiscal year. One is for replacing a retaining wall that poses a potential liability and replacement of some heat pumps that are 21 years old. Replacement of the heat pumps will save energy cost and reduce costly work orders from local heating and air conditioning companies. Both contracts were bid out. Seven bids were received on replacing the retaining wall and heat pumps. The contract was awarded

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to the lowest bidder who happened to have all of his bonding information and insurance requirements. This will be paid from our 501-04, 501-05 & 501-06 Capital Fund grants. The other contract was for grass cutting services for one year at both sites. The housing authority has only one maintenance employee at this time and it was more cost effective to bid out this mowing of grass. Three bids were received and the contract was awarded to the lowest bidder who met all of the liability insurance requirements and also had workers compensation.

Since January 2006, the board has met each month. In June 2006 they met three (3) times. Two new board members have been appointed with one being a resident board member. Up until May of 2006 a resident had never served on the board. The local newspaper was notified of the regular board meeting date and asked to make sure it is printed at an appropriate time each month to insure the public is notified of the meetings. The housing authority also started a newsletter that is published monthly that reminds residents of our meetings and encourages them to participate and get involved in what's going on. Additionally, the time of the meetings have been changed to encourage employees to attend the meetings.

In May 2006 we had our annual meeting naming a new Board Chairman and Vice Chairman. Board by-laws were updated and revised in July 2006.

The Housing Authority of Lawrence County is being monitored by the Housing Authority of Catlettsburg (KY-033) through March 31, 2007. The HAC is a high performing agency.

Our field audit work for the year ending March 31, 2006 was performed on July 25 & 26, 2006. Audited financial information is estimated to be completed and submitted to REAC by mid September 2006. REAC deadline for this submission is December 31, 2006.

We have also invalidated the scores for the 2003, 2004 and 2005 years in order to get the audited financial information entered. At this time all of this has been completed.

Four (4) of the six (6) audit findings for the year ending March 31, 2005 have been complete and we expect to satisfy the remaining findings as soon as possible.

Housing Authority policies are being updated each month.

The bonding company of the housing authority was notified in early April 2006 and later we asked for a sixty (60) day extension to insure we are covered for our agency's loss. We did that on July 12, 2006 and received approval on July 14, 2006 for the extension.

Bills are now being paid timely with late fees and over limit fees being stopped.

Wages have been adjusted to local comparable levels for all three (3) employees.

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All employees now have cable internet services available on their computers. Prior to this only the former Executive Director had this service.

Curb appeal has been improved at both sites. Parking lots have been stripped, guard posts around the dumpsters have been painted, bushes trimmed and handrails have been painted.

The staff has been educated on our lease and pet policies. They now know how much time is required to notify residents before they can enter their apartments for any reason, including emergencies. They are also more aware of the pet policy and how it should be monitored to assure compliance.

Our check writing policy involves the duties of three employees' and a board member. The low rent manager picks up the mail daily and gives all invoices to be paid to the Interim Executive Director to approve or disapprove payment. The Interim Director in tern gives all approved invoices to the Section 8 manager to prepare all agency checks. She will put the checks with the bills and return them to the Interim Executive Director to sign. After his signature a board member comes into our office to sign the check with a copy of the invoice we are paying. After both signatures are received they are then mailed out to the vendors.

These are just some of the things we have got accomplished since March 24, 2006. We still have along way to go but we will get there and our reserve should increase drastically this year from our low rent negative balance March 31, 2006.

Sincerely,

Rick L. Young
Interim Executive Director

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OIG Evaluation of Auditee Comments

Comment 1 The Authority's agreement with the finding and recommendations, along with its stated corrective actions to date, indicates its willingness to make necessary improvements to its operations.

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