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Audit Report Number	2006-CH-1016
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TO: Thomas S. Marshall, Director of Public Housing Hub, 5DPH

FROM:  Heath Wolfe, Regional Inspector General for Audit, 5AGA

SUBJECT: Pickaway Metropolitan Housing Authority, Circleville, Ohio, Improperly Used Homeownership Sales Proceeds to Fund Its Nonprofit Development Activities

HIGHLIGHTS

What We Audited and Why

We audited the Pickaway Metropolitan Housing Authority's (Authority) activities with its related nonprofit organization. The review of housing authorities' development activities is set forth in our fiscal year 2006 annual audit plan. We selected the Authority for audit because it was identified as having high-risk indicators of nonprofit development activity. Our objective was to determine whether the Authority diverted resources subject to its annual contributions contract, other agreement, or regulation for the benefit of non-U.S. Department of Housing and Urban Development (HUD) developments.

What We Found

The Authority improperly loaned nearly \$256,000 in 5(h) Homeownership Plan (program) sales proceeds to its nonprofit, Building Affordable Housing Corporation (Corporation). The two loans occurred without HUD approval and did not follow federal requirements regarding the use of the program proceeds. Because of the Authority's improper use of these proceeds, its program also lost more than \$60,000 in interest income that would have been realized if the proceeds had been invested.

Further, the Authority paid more than \$22,000 in expenses that would not have been incurred if it had conducted the Corporation's development activities. The

improper expenses included real estate taxes, accounting fees for the Corporation's tax returns, and directors' and officers' liability insurance for the Corporation. The Corporation used nearly \$2,400 in program proceeds to pay legal expenses related to its development activities that were not adequately supported by detailed invoices.

What We Recommend

We recommend that the director of HUD's Cleveland Office of Public Housing require the Authority to reimburse its program from nonfederal funds for the improper use of program funds, provide documentation or reimburse its program from nonfederal funds for the unsupported payments cited in this report, and implement adequate procedures and controls to correct the cited weaknesses.

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 issued because of the audit.

Auditee's Response

We provided schedules of the improper use of program proceeds and lost interest income cited in this audit report to the Authority's executive director and the director of HUD's Cleveland Office of Public Housing during the audit. We also provided the discussion draft audit report to the Authority's executive director, its board chairman, and HUD's staff during the audit. We held an exit conference with the executive director on September 5, 2006.

We asked the Authority's executive director to provide comments on our discussion draft audit report by September 18, 2006. The Authority provided its written response dated September 18, 2006. The Authority generally agreed with our finding, but disagreed with the interest income not realized and the recommendation regarding implementing procedures and controls. The complete text of the auditee's written response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVE

The Pickaway Metropolitan Housing Authority (Authority) was established under Section 3735.26 of the Ohio Revised Code. The Authority contracts with the U.S. Department of Housing and Urban Development (HUD) to provide low- and moderate-income persons with safe and sanitary housing through rent subsidies. The Authority provides 108 public housing units and 635 Section 8 Housing Choice Voucher units. A five-member board of commissioners governs the Authority. The Authority's books and records are located at 176 Rustic Drive, Circleville, Ohio. The Authority established the Building Affordable Housing Corporation (Corporation), a 501(c)(3) nonprofit, to further affordable housing and family self-sufficiency for low- and very low-income families in Ohio.

In accordance with its agency plan, a public housing agency may form and operate wholly owned or controlled subsidiaries or other affiliates. Such wholly owned or controlled subsidiaries or other affiliates may be directed, managed, or controlled by the same persons who constitute the board of directors or similar governing body of the public housing agency, or who serve as employees or staff of the public housing agency, but remain subject to other provision of laws and conflicts of interest requirements. Further, a public housing agency, in accordance with its agency plan, may enter into joint ventures, partnerships, or other business arrangements with or contract with any person, organization, entity, or governmental unit with respect to the administration of the programs of the public housing agency such as developing housing or providing supportive/social services subject to either Title I of the United States Housing Act of 1937, as amended, or state law.

We selected the Authority for audit because it was identified as having high-risk indicators of nonprofit development activity. Our objective was to determine whether the Authority diverted resources subject to its annual contributions contract, other agreement, or regulation for the benefit of non-HUD developments.

RESULTS OF AUDIT

Finding: The Authority Improperly Loaned More Than \$255,000 to Its Nonprofit

The Authority improperly loaned \$255,665 of its 5(h) Homeownership Plan program (program) proceeds to the Corporation. The Authority received \$313,320 in proceeds from seven program properties sold between May 1996 and January 1998. The sales proceeds were pooled and invested in bank accounts and certificates of deposit, accumulating interest until 2000 when the proceeds were loaned to the Corporation. The loans occurred contrary to the Authority's program agreement with HUD and without HUD approval. The loans occurred because the Authority believed the program's plan was completed when the properties were sold and the proceeds could be used for any housing purpose. As a result, fewer funds were available to serve the Authority's low-income residents.

Inappropriate Use of Federal Funds

The Authority inappropriately loaned its program proceeds to pay the expenses of development activities for the Corporation. The proceeds were received from the sale of seven program properties from May 1996 through January 1998. The Authority inappropriately loaned \$255,665 in sales proceeds to the Corporation in February 1999 (\$150,000) and September 2000 (\$105,665).

According to 24 CFR [*Code of Federal Regulations*] Part 906, program sales proceeds may be used for sale and administrative costs that are necessary and reasonable for carrying out a homeownership plan and/or retained by a public housing authority and used for housing assistance to low-income families. Contrary to the program's requirements and its agreement with HUD, the Authority loaned sales proceeds to the Corporation. The funds were loaned to the Corporation without HUD approval and the Authority did not follow federal requirements regarding the use of the funds. The Authority's former executive director and its board of commissioners believed that HUD's approval was not needed. They also believed the Authority was using the proceeds in accordance with its approved program plan when the funds were loaned to the Corporation.

Interest Income Not Realized

The Authority's program lost \$60,604 in interest income that should have been realized. In February 1999, the Authority executed a demand note agreement with the Corporation for the repayment of \$150,000 with no interest due. The Authority entered into another demand note agreement with the Corporation in September 2000 for \$107,000 at a 6 percent annual interest.

When the Corporation was dissolved in May 2005, the Authority's board passed a resolution to forgive the September 2000 loan's accrued interest. We determined the imputed interest for the February 1999 loan using the Corporation's checking account interest rate and when the Corporation dissolved, the Authority's other business activity general account interest rate. As of July 2006, the Authority's program had lost the benefit of the imputed interest of \$31,802 and the accrued interest of \$28,802 that the board resolved to forgive on the September 2000 loan.

Returned Program Assets Not Accounted for Properly or Restricted for Future Program Use

When the Corporation dissolved, it owned a parcel of vacant land and had cash remaining from the loaned program funds it received. The Corporation owed the Authority an outstanding balance on the loans and transferred the land and cash (\$42,322) back to the Authority's other business activity account rather than the program account. Additionally, the Authority accepted an appreciated value (\$155,194) that was \$44,121 more than the Corporation paid for the land (\$111,073), using the improperly loaned program funds. Since the program funds were inappropriately used, the Corporation should not benefit from the land's appreciation, and the program's participants should not lose the future use of the program funds.

According to 24 CFR [*Code of Federal Regulations*] Part 906 and the Authority's approved program, the assets should have been returned to the Authority's program to be used for sales and administrative costs that are necessary and reasonable for carrying out a homeownership plan and/or retained by the Authority and used for housing assistance to low-income families.

Unnecessary Expenses Incurred by the Authority

HUD has encouraged the formation of new and innovative private and public partnerships to ensure the long-term sustainability of public housing developments. A housing authority must determine the best way to accomplish this development using its available resources in the most effective and efficient manner while avoiding violations of existing requirements. As previously mentioned, the Authority loaned its program sales proceeds to the Corporation to develop low-income housing contrary to its approved program plan. By reviewing the Authority's and the Corporation's general ledgers, invoices, and bank statements, we determined that the Corporation incurred \$22,158 in additional expenses that would not have been incurred if the Authority had conducted the development activity. The improper expenses included real estate taxes, accounting fees for the Corporation's tax returns, and directors and officers' liability insurance for the Corporation. The Corporation used nearly

\$2,400 in program proceeds to pay legal expenses related to its development activities that were not adequately supported by detailed invoices.

The Authority's program requires the sales proceeds be used in an economical and efficient manner without excessive administrative overhead costs. By incurring unnecessary expenses, the Authority had fewer funds to benefit low-income residents.

Recommendations

We recommend that the director of HUD's Cleveland Office of Public Housing require the Authority to

- 1A. Reimburse its program \$236,157 (\$31,802 in imputed interest, \$28,802 in forgiven interest, \$111,073 for the land purchase, \$42,322 in cash, and \$22,158 in improper expenses) from nonfederal funds for the inappropriate use of its sales proceeds for the Corporation.
- 1B. Provide supporting documentation or reimburse its program \$2,350 from nonfederal funds for the unsupported legal expenses cited in this finding.
- 1C. Implement procedures and controls to ensure that its use of program proceeds meet federal requirements.

SCOPE AND METHODOLOGY

We conducted the audit at HUD's Columbus Office of Public Housing and the Authority's office from March to June 2006.

To accomplish our objective, we reviewed

- Applicable laws; regulations; and HUD program requirements at 24 CFR [*Code of Federal Regulations*] Parts 85 and 906, HUD Handbook 7475.1, and Office of Management and Budget Circular A-87;
- The Authority's accounting records; general ledgers; bank statements; annual audited financial statements for 2003, 2004, and 2005; board meeting minutes and resolutions for 2005 and 2006; policies and procedures; organizational chart; cost allocation plans for 2005 and 2006; program plan implementation agreement; and annual contributions contract with HUD;
- The Corporation's accounting records, general ledgers, bank statements, board meeting minutes and resolutions for 1999 through 2005, articles of incorporation, organizational bylaws, and organizational chart; and
- HUD's files for the Authority.

We also interviewed Authority, Corporation, and HUD staff.

The audit covered the period from January 1, 2005, through February 28, 2006. This period was adjusted 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,
- Compliance with applicable laws and regulations, and
- Safeguarding resources.

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 objective:

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

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

Significant Weakness

Based on our audit, we believe the following item is a significant weakness:

- The Authority lacked procedures and controls to ensure that program funds were used in accordance with federal requirements (see finding 1).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible	Unsupported
1A	<u>\$236,157</u>	
1B		<u>\$2,350</u>
Totals	<u>\$236,157</u>	<u>\$2,350</u>

- 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 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.

Appendix B

AUDITEE COMMENTS AND OIG's EVALUATION

Ref to OIG Evaluation

Auditee Comments

176 Rustic Drive
Circleville, Ohio 43113
740-477-2514
FAX 740-477-7456
e-mail: pmha@frognet.net
TTY/TDD Customers:
Contact Ohio Relay Services
@711 or 1-800-750-0750



PICKAWAY METROPOLITAN HOUSING AUTHORITY

Commissioners:
Kim E. Schieber
Daniel M. Litzinger
Stanley Stevens
Hewitt Harmount
Atwood Jones

Kim Hartinger
Executive Director

September 18, 2006

Mr. Ronald Farrell, Assistant Regional Inspector General for Audit
United States Department of HUD-Office of Inspector General
200 North High Street, Room 334
Columbus, Ohio 43215-2499

Re: Pickaway Metropolitan Housing Authority

Mr. Farrell:

Thank you for the opportunity to respond to the recent Office of Inspector General audit of the Pickaway Metropolitan Housing Authority. The Pickaway MHA has held discussions with the Columbus HUD office to establish resolution of the issues as determined by the OIG. It is our opinion that those issues have been verbally resolved.

As you are aware, the Pickaway MHA Board of Commissioners and former Director Greg Bigam had determined prior to OIG involvement with our office that activity as conducted by the non-profit organization, Building Affordable Housing, should cease. This was realized not only because the goal of the non-profit to develop homeownership programs was not successful, but also because the Pickaway MHA had obtained information that establishing non-profit organizations by loaning public housing funds may be outside the scope of business intended by HUD when they encouraged agencies to develop such non-profits for the purpose of expanding housing activity in local communities.

As a result, in December, 2005, the Pickaway MHA dissolved Building Affordable Housing, and transferred all assets thereof back to the Pickaway MHA. These assets were recorded in an Other Business Activity account, a new sub-account within PMHA, as recommended in a year end financial close out. The Pickaway MHA recognizes that the OIG audit requires that these funds, in addition to payment previously credited to the Building Affordable Housing loans, be returned to the originating funding source, not the Other Business Activity fund. These funds will therefore be transferred, in the amount of \$212,887.26 to Pickaway MHA by a series of inter-fund transfers within 60 days of this letter. Upon the sale of the Juhl Road property, the proceeds of this sale will also be paid into the correct fund and documentation will be forwarded to the OIG and to Mr. Thomas Marshall, HUD Director of Public Housing, therein documenting that the entire required repayment of \$236,157.00 has been met. Included in this transaction will be any excess proceeds resulting from the property sale. It is our intent to secure the annexation of Juhl Road into the City of Circleville, and then offer the land for sale within the next twelve months.

The Pickaway MHA does wish to state that they feel the audit findings are overstated in the amount of \$66,625.48. It is the opinion of the Board of Commissioners and former Director Bigam that tax forgiveness on the Juhl Road property would not have been granted if requested prior to development of the property. This opinion is based on experience in developing other housing properties. It is also the opinion of the Board and the former Director that the interest

Comment 1

Comment 2



equal housing opportunity

Comment 3

calculated as part of this finding is not appropriate. Had the development of the property occurred within the Pickaway MHA, the funds upon which these calculations are based would have been used in that development and therefore would not have existed to earn interest.

The second audit finding states that \$2,350.00 must be repaid to the Pickaway MHA by nonfederal funds. This finding includes payments in the amount of \$1750 made for legal services to Tom Tootle, a local attorney representing Pickaway MHA on matters related to the annexation. The remaining amount of \$600 was for incidentals related to the annexation that were paid for by Mr. Tootle's office, including payments for legal notices and copies of transcripts. These payments to Mr. Tootle were actually made from a grant received by Pickaway MHA through the Ohio Community Development Finance Fund (OCDF). For this reason, we are unsure why the Pickaway MHA should be reimbursed for these expenses, and would respectfully request review of this audit finding.

Comment 4

Concerning the final recommendation requesting implementation of procedures and controls to ensure that use of program proceeds meets federal requirements, we would offer the statement that this has been a learning experience for our agency. The intention of Building Affordable Housing was always the same of Pickaway MHA in that our goal was to develop housing for first time homeowners and low income families. When Building Affordable Housing was dissolved, it was dissolved because the Board of Commissioners and former Director Bigam recognized not only that the development of the property was unlikely in a time frame considered acceptable, but also that the development of non-profit agencies require more stringent guidelines and financial consideration than originally believed. Therefore, we feel confident that such procedures and controls had been implemented and will continue to be used in the management of programs through this agency.

As stated previously, our office appreciates the cooperation and understanding of day to day activity shown by the Inspector General staff while on site at the Pickaway MHA. We look forward to complete and satisfactory resolution of all issues related to this audit at the earliest possible opportunity.

Sincerely,


Kim Hartinger
Executive Director
Pickaway Metropolitan Housing Authority


Hewitt Harmount
Chairman, Board of Commissioners
Pickaway Metropolitan Housing Authority

OIG Evaluation of Auditee Comments

- Comment 1** Section 3735.34 of the Ohio Revised Code states that all property, both real and personal, acquired or owned by a metropolitan housing authority and used for the purposes of exercising the powers set forth in sections 3735.27 to 3735.50 of the Revised Code, shall be public property used exclusively for a public purpose within the meaning of Section 2 of Article XII, Ohio Constitution, and shall be exempt from all taxation. If the Authority had held the vacant land in its name, the land would have been exempt from taxes until such time as it was determined that the land was no longer for a public purpose.
- Comment 2** We agree with the position that had the property development occurred within the Authority that program funds would have been used and would not have been available to earn interest. However, the Authority loaned the program funds to the Corporation in accordance with loan agreements, including one loan agreement that called for the payment of interest. HUD's position is that agreements between public housing agencies and their related affiliates must be economically reasonable for both parties. The agreements must base the rates for services on those available in the open market. Additionally, the Authority was required to use its program sales proceeds in an economical and efficient manner. As of July 2006, the Authority's program had lost the benefit of \$60,604 in interest (imputed interest of \$31,802 and accrued interest of \$28,802) that the board resolved to forgive.
- Comment 3** We were aware that the Authority received Ohio Community Development Finance funds in 2002. These expenses were discussed with the Authority's finance director and at no time did she state the expenses were paid using Ohio Community Development Finance funds or provide documentation to support them being paid with Ohio Community Development Finance funds. If indeed the legal expenses were paid using Ohio Community Development Finance funds, the Authority needs to provide the supporting documentation to HUD.
- Comment 4** We agree with the Authority that procedures and controls may exist. However, the Authority did not provide documentation to support that written procedures and controls were implemented. Therefore, the Authority should implement procedures and controls to ensure that its future use of program sales proceeds meet federal requirements.

Appendix C

FEDERAL REQUIREMENTS

Section 3.1 of the program implementing agreement, between HUD and the Authority states that the Authority agrees that sales proceeds shall be used only in accordance with the plan and the requirements and provisions of the agreement and certifies that the plan complies with 24 CFR [*Code of Federal Regulations*] 905.15, as applicable, governing the use of sales proceeds. Section 3.6 requires the Authority to obtain HUD approval to modify any of the provisions of the plan.

According to 24 CFR [*Code of Federal Regulations*] 906.15(a), sales proceeds may, after provision for sales and administrative costs that are necessary and reasonable for carrying out a homeownership plan, be retained by the public housing authority and used for housing assistance to low-income families. Section 906.31 states that the public housing authority must use any net proceeds of any sales under a homeownership program remaining after payment of all costs of the sale for purposes relating to low-income housing and in accordance with its plan.

In accordance with Office of Management and Budget Circular A-87, costs must be necessary and reasonable for proper and efficient performance and administration of federal awards, be allocable to federal awards under the provisions of this circular, be authorized or not prohibited under state or local laws or regulations, and conform to any limitations or exclusions set forth in these principles, federal laws, terms and conditions of the federal award, or other governing regulations as to types or amounts of cost items.