U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-5000

ASSISTANT SECRETARY FOR
PUBLIC AND INDIAN HOUSING

AUG - 7 2007

VIA UPS AND FACSIMILE

Hon. Carlos Alvarez
Mayor
Miami-Dade County, Florida
Stephen P. Clark Center
111 N.W. First Street
Suite 2910
Miami, FL 33128-1994

Hon. Bruno A. Barreiro
Chairman of the Board of County Commissioners
Miami-Dade County, Florida
Stephen P. Clark Center
111 N.W. First Street
Suite 2910
Miami, FL 33128-1994

Subject: Declaration of Substantial Default – Public Housing Annual Contributions Contract

Dear Mayor Alvarez and Chairman Barreiro:

I have received a letter dated May 15, 2007, from the Miami-Dade County Manager, George M. Burgess, on behalf of the Miami Dade Housing Agency (MDHA), responding to the Notice of Substantial Default of the Annual Contributions Contract (Public Housing ACC). On April 24, 2007, the Department provided notice to MDHA that it was in substantial default of the Public Housing ACC. In accordance with the Public Housing ACC and HUD regulations, MDHA was afforded an opportunity to demonstrate that HUD's determination was not substantively accurate or to cure the substantial default. The Department has carefully reviewed MDHA's response to the Notice of Substantial Default. HUD has concluded that MDHA's financial records remain inaccurate and unreliable, as demonstrated by the need for additional material adjustments reported in its audited financial statements filed in June 2007. Accordingly, for the reasons set forth herein, HUD hereby affirms that MDHA is in substantial default of its Public Housing ACC.

VIOLATIONS SUPPORTING FINDING OF SUBSTANTIAL DEFAULT

1) <u>Material Accounting Errors in Annual Financial Statements from 2003 to 2006</u>

Section 15(A) of the ACC requires MDHA to "maintain complete and accurate books of account for the projects of the [MDHA] in such a manner as to permit the preparation of statements and reports in accordance with HUD requirements, and to permit timely and effective audit." Additionally, under section 9(C) of the ACC, MDHA must "maintain records that identify the source and application of funds in such a manner as to allow HUD to determine that all funds are and have been expended in accordance with each specific program regulation and requirement."

MDHA does not dispute that it reported adjustments in its fiscal year (FY) 2003-2006 audited financial statements. These adjustments corrected prior year statements because MDHA had failed to submit accurate financial statements to HUD. The prior period adjustment reported in the FY 2003 audited financial statements was $76,451,702 (representing a 539% adjustment) from its FY 2002 unaudited financial statements.[1] The prior period adjustment reported in the FY 2004 audited financial statements was $1,502,149 (representing a 25% adjustment) from its FY 2003 audited financial statements. The prior period adjustment reported in the FY 2005 audited financial statements was $97,006 (representing a 1% adjustment) from its FY 2004 audited financial statements. The prior period adjustment reported in the FY 2006 unaudited financial statements was $909,668 (representing a 6% adjustment).[2]

Additionally, MDHA asserted that, in its upcoming FY 2006 audited financial statements, it would correct the material accounting errors identified by the Department in the Notice of Substantial Default. In MDHA's FY 2006 audited financial statements, which were submitted to HUD on June 26, 2007,[3] MDHA was forced to report significant prior period adjustments in the majority of its programs. The adjustment in the low rent public housing program alone exceeded $65 million (representing a 128% adjustment). Thus, while the size of the prior period adjustments appeared to decline through FY 2005, they have begun to increase again.

MDHA argues only that certain adjustments were immaterial in light of the total expenditures of its public housing programs. MDHA's argument is unpersuasive. First, prior period adjustments are, by definition, made for material errors in past financial statements.[4] Second, prior period adjustments are made to the ending balances of prior year net assets (equity) to correct past errors, and are unrelated to current year expenditures. Materiality should be calculated in

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[1] MDHA never filed acceptable audited financial statements for FY 2002. MDHA's two attempted submissions of its FY 2002 audited financial statements were rejected for numerous accounting errors in the Low Rent and HOPE VI programs, among others, and because amounts reported on the Balance Sheet or Statement of Net Assets were not consistent with amounts reported on the Financial Data Schedule.

[2] Moreover, on June 27, 2007, MDHA requested permission to make additional corrections to its FY 2004 and FY 2005 audited financial statements due to errors reported in Tenant Rental Revenue that directly affect MDHA's operating subsidy calculation.

[3] MDHA submitted its FY 2006 audited financial statements to the Department on June 2, 2007. This submission was rejected and a resubmission was made on June 26, 2007. The Department is still in the process of reviewing the resubmitted financial statements to determine whether they will be accepted or again rejected.

[4] Prior period adjustments need only be made for material errors, which rarely occur in modern financial accounting. (See Accounting Principles Board Opinion (APB) 9, paragraphs 17 (as amended by APB 30 and Financial Accounting Standards Board Statement (FAS) 111) and 18 (as superseded by FAS 16)).

comparison to the amount that is actually being adjusted, which was the method used for calculating the percentage adjustment set forth in HUD's Notice of Substantial Default. As such, the prior period adjustments reported by MDHA over the course of several years were material.

In any event, MDHA's financial position was not properly reported to the Department, resulting in MDHA undertaking the constant reporting of prior period adjustments, which reporting has continued through the FY 2006 audited financial statements submitted on June 26, 2007.[5] MDHA is required to maintain and submit accurate financial information and it has not.

2) <u>Allocation of Program Costs in Violation of 24 C.F.R. § 85.22 and OMB Circular A-87</u>

MDHA failed to present accurate cost allocations in accordance with 24 C.F.R. § 85.22 and OMB Circular A-87, for its HOPE VI program for FYs 2003 through 2006 and for its Capital Fund Program for FYs 2002, 2003, 2005 and 2006. MDHA did not address the issue of proper presentation of costs in its audited financial statements under Generally Accepted Accounting Principles (GAAP), and asserts only that it was unaware that its treatment of costs in its financial statements was improper until HUD informed MDHA of the problem. MDHA's failure to properly allocate costs in its audited financial statements is reflected by the adjustment made in MDHA's FY 2006 audited financial statements to correct the cumulative total of approximately $30 million worth of expenses that had been omitted since FY 2001. Specifically, in order to address the errors in its prior financial statements, in MDHA's FY 2006 audited financial statements submitted on June 26, 2007 it reported a prior period adjustment of $5,486,966 in its HOPE VI program and an adjustment of 24,780,826 in its Capital Fund Program. These expenses represent roughly 50 percent of MDHA's HOPE VI program revenue amount since 2001 and 38 percent of the Capital Fund program revenue amount since 2001.

3) <u>Failure to Account for HOPE VI Expenditures in Violation of 24 C.F.R. § 5.801</u>

MDHA's FY 2005 and 2006 audited financial statements were not presented in accordance with GAAP, in violation of 24 C.F.R. § 5.801. In its FY 2005 audited and FY 2006 unaudited financial statements, MDHA incorrectly reported "leasehold improvements" in its books of account, despite the fact that MDHA did not own the property associated with Ward Towers that it purportedly leased nor did it lease any property in connection with its HOPE VI program. Specifically, by the end of FY 2006, MDHA had improperly capitalized the cumulative total of $20 million as "leasehold improvements." MDHA argued that its reporting of $20 million in leasehold improvements was proper under HUD's Crosswalk Guide to the Financial Data Schedule, which authorizes reporting as leasehold improvements certain items associated with the HOPE VI grants. While the Crosswalk Guide would allow a PHA to report leasehold improvement assets, this authorization is limited to items properly capitalized as assets and that are actually owned by the public housing authority (PHA). MDHA did not own the Ward

[5] HUD also notes that over the past several years, such material and substantial errors have existed in MDHA's financial reporting that HUD, which conducts a necessarily limited review of the financial submissions of approximately 4,100 PHAs, rejected MDHA's submission of both unaudited and audited financial statements a total of 17 times since electronic reporting to HUD commenced in FY 1999. Each time HUD rejected MDHA's financial statement submission, HUD provided MDHA with a list of reasons for the rejection; however, MDHA continues to submit financial statements fraught with errors. This pattern of adjustments undercuts any confidence that HUD must, by necessity, place on the financial statements submitted by MDHA.

Towers property purportedly leased.[6] In its FY 2006 audited financial statements submitted to HUD on June 26, 2007, MDHA conceded that it did not have any leasehold improvements associated with its HOPE VI program.[7] In fact, following HUD's Notice of Substantial Default, MDHA determined that it had erroneously reported $330,865,209 in leasehold improvements throughout its programs, the entire amount of which had to be corrected in MDHA's FY 2006 audited financial statements submitted to HUD June 26, 2007, which correction amounted to 50% of the FY 2006 unaudited total asset balance.

CONCLUSION

The financial condition of a public housing authority operating a low rent housing program is one of the key indicators that HUD uses to determine whether a PHA is adequately performing essential housing operations pursuant to the Housing Act of 1937 (as amended) and the PHA's ACC. Specifically, a PHA's financial statements are one of the primary indicators used by HUD in order to ascertain a PHA's financial health. Moreover, all PHAs are obligated to maintain accurate books and records and submit financial statements in compliance with GAAP in order to assure that federal funds are expended lawfully and appropriately.

MDHA has failed to maintain accurate books and records over a course of years. It is impossible for HUD to determine the true financial condition of MDHA because its books and records are unreliable. MDHA's financial reporting has remained inaccurate throughout the periods cited herein and, thus, MDHA has substantially and materially violated its Public Housing ACC by failing to maintain its books and records accurately and in accordance with GAAP. Further, MDHA has not demonstrated that it is capable of correcting these violations and ensuring that they do not recur.[8]

Because of the material and substantial nature of these violations, HUD has determined that other remedies and procedures are not appropriate. Accordingly, HUD is hereby affirming its decision that MDHA is in substantial default of its Public Housing ACC.

Section 6(j)(3)(A)(iv) of the United States Housing Act of 1937 (the Act), 42 U.S.C. Section 1437d(j)(3)(A)(iv), authorizes HUD, upon substantial default by a PHA, to "take possession of all or part of the public housing agency, including all or part of any project or program of the agency, including any project or program under any other provision of this subchapter [42 U.S.C. § 1437 et seq.]." Accordingly, pursuant to the Act, HUD hereby takes possession of the assets, projects and programs of MDHA. Because of a previous stipulation in court proceedings, HUD will implement this decision ten business days from the date of this letter. Please be advised that

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[6] MDHA transferred ownership of the Ward Towers property to the MDHA Development Corporation, a for-profit Florida corporation over which MDHA had no legal control.

[7] Moreover, MDHA's attempts to fix this reporting error in its FY 2006 financial statements have not corrected the financial statements; the attempts to fix the error have only resulted in further mistakes being made. For example, MDHA improperly reclassified $4,242,375 from leasehold improvements to Notes, Loans and Mortgages Receivable-Non Current, even though this amount represents a note not owned by MDHA and the total balance should have been expensed as a passthrough grant.

[8] In fact, despite the review and assessment of operations conducted by MDHA's Management Assistance Team, MDHA did not identify the serious problems with its financial reporting.

this letter constitutes final agency action and there is no further right to administrative review by HUD.

Sincerely,

Orlando J. Cabrera
Assistant Secretary

cc: George M. Burgess, County Manager