



Issue Date	March 9, 2007
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Audit Report Number	2007-AT-1004
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TO: Michael A. Williams, Director, Office of Public Housing,
Greensboro, North Carolina, 4FPH

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

SUBJECT: The Wilmington Housing Authority, Wilmington, North Carolina,
Needs to Improve Internal Controls over Its Programs

HIGHLIGHTS

What We Audited and Why

As part of the U.S. Department of Housing and Urban Development (HUD), Office of the Inspector General's (OIG) strategic plan, we audited the Wilmington Housing Authority (Authority) located in Wilmington, North Carolina. Our audit objective was to determine whether the Authority inappropriately used federal funds to support other programs or entities in violation of requirements.

What We Found

Authority management did not implement adequate internal controls to ensure that program funds were used only for eligible program activities or that costs were properly allocated and supported. Further, the Authority did not have policies governing employee use of Authority vehicles. As a result, in violation of its annual contributions contract (contract) with HUD, the Authority inappropriately used \$744,916 in operating subsidies to pay expenses of other federal and nonfederal programs. In addition, the Authority could not support that it appropriately spent more than \$880,000 in accordance with requirements. Further, it did not follow

Internal Revenue Service requirements to determine and report the value of fringe benefits received by employees from use of employer-provided vehicles.

What We Recommend

Our recommendations include requiring the Authority to (1) repay ineligible costs of \$744,916 to its low-income public housing reserve account; (2) provide support for more than \$880,000 of costs; (3) develop and implement procedures to ensure that program expenditures are eligible and properly supported in accordance with requirements, thereby putting an estimated \$563,908 to better use; and (4) develop and implement policies and procedures governing employee use of Authority-owned vehicles.

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 and HUD officials during the audit. We provided a copy of the draft report to Authority officials on January 30, 2007, for their comments and discussed the report with the officials at the exit conference on February 20, 2007. The Authority provided its written comments to our draft report on February 23, 2007.

The Authority generally disagreed with finding 1 and the resulting recommendations, but substantially agreed with the remaining findings and recommendations. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report. Attachments to the Authority's comments were too voluminous to include in the report, but are available for review upon request.

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BACKGROUND AND OBJECTIVES

The Housing Authority of the City of Wilmington, North Carolina (Authority), was incorporated December 9, 1940, pursuant to the North Carolina Housing Authorities Law. The Authority's primary objective is to provide decent, safe, and sanitary housing for eligible families in a manner that promotes serviceability, economy, efficiency, and stability of the projects and the economic and social well-being of the tenants. The Authority administers 1,163 units funded under the public housing program and more than 1,700 housing choice vouchers. It also administers Public Housing Capital Fund grants and receives funds from homeowners pursuant to the Homeownership Opportunity Program for Low-Income Families (Turnkey III) program.

A nine-member board of commissioners appointed by the mayor of Wilmington governs the Authority.

Our audit objective was to determine whether the Authority inappropriately used federal funds to support other programs or entities in violation of requirements.

RESULTS OF AUDIT

Finding 1: The Authority Inappropriately Used More Than \$215,000 in Operating Subsidies for Other Programs

In violation of its annual contributions contract (contract) with the U.S. Department of Housing and Urban Development (HUD), the Authority inappropriately advanced more than \$215,000 in operating subsidies to pay expenses for programs and entities that were not under its contract with HUD. It also cannot ensure that funds subject to a contract or other agreement with HUD were not used to pay more than \$500,000 of unsupported costs. This occurred because Authority management did not implement adequate internal controls to ensure that program funds were used only for eligible program activities. As a result, the Authority did not have more than \$215,000 available to operate its public housing program.

The Authority Used Operating Subsidies to Pay Nonprogram Expenses

Part A, section 9(C), of the Authority's contract with HUD allows the Authority to use general fund cash only for (1) the payment of the costs of development and operation of projects under contract with HUD, (2) the purchase of investment securities approved by HUD, and (3) such other purposes as may be specifically approved by HUD. Program funds are not fungible, and withdrawals cannot be made for a specific program in excess of the funds available on deposit for that program.

The Authority did not implement adequate controls over disbursements to ensure that it complied with the contract requirements. As a result, it inappropriately advanced operating subsidies to pay expenses for programs and entities that were not under its contract with HUD. While the programs periodically made reimbursements, the advances were never fully repaid during our review period, and no funds were repaid to a public housing reserve account. According to the Authority's general ledger, at March 31, 2006, the various programs and entities owed public housing \$215,737 for the ineligible disbursements. In its response to our draft report, the Authority advised us that the balances included accrued expenses, which were subsequently paid on April 5, 2006. While the Authority did not agree with all of the amounts that we stated are owed in the following chart, it substantially agreed with the recommendations. See Appendix B for further details.

Amounts owed as of March 31, 2006

Program/entity	Amount owed by federal program	Amount owed by nonfederal program
HOPE VI demolition grant-Taylor Homes	\$ 8,930	
HOPE VI development grant-Jervay Place	24,860	
Public Housing Capital Fund 2003-2005	26,387	
Section 8 program	46,266	
Glover Apartments		\$ 16,265
Housing and Economic Opportunities, Inc.		93,021
Total	\$ <u>106,443</u>¹	\$ <u>109,286</u>

The Authority Paid Costs in Excess of Amounts on Deposit for Some Programs

Before April 1, 2006, the Authority deposited its operating subsidies into its low-income public housing general fund and maintained separate bank accounts for all of its programs. Beginning April 1, 2006, the Authority pooled funds from all of its programs/entities into a central account. At that time, the Authority reclassified the \$215,737 as amounts owed to the central account, and began paying all expenses from the central account. The Authority's contract with HUD allows the Authority to pool funds; however, it cannot withdraw funds for any project in excess of the amount then on deposit for the specific project.²

We found that, in violation of its contract, from April 1, 2006, to September 30, 2006, the Authority paid \$509,206 from the central account for expenses of programs in excess of the amounts those programs had on deposit. Funds were deposited into the central account from public housing operating subsidies, public housing rent receipts, as well as other programs. We were unable to determine the amount of public housing funds that may have been used to pay expenses of programs that did not have adequate funds on deposit. However, given the Authority's historical use of operating subsidies to fund other programs, we question whether the Authority used operating subsidies or other funds subject to a contract or agreement with HUD to pay the \$509,206 of excess costs.

¹ We excluded \$8 owed by the Authority's Youthbuild grant.

² Annual Contributions Contract, part A, section 10(A).

We are recommending the Authority provide HUD a reconciliation of the funds used to pay the \$509,206 and repay any amounts representing inappropriate use of federal funds. Also, since the Authority has historically used operating subsidies to pay expenses of programs and entities not under contract with HUD, and continues to have inadequate controls over its cash management, we are recommending that the Authority exclude all public housing funds from its central account and implement adequate controls over the use of those funds.

In its response to the draft report, the Authority stated that the amount in excess of the amounts programs had on deposit was \$459,135 rather than \$509,206. It also stated that it had sufficient unrestricted cash to cover the deficit balances and had taken measures to resolve some of the deficit. The Authority did not provide any evidence supporting its calculation of \$459,135, or any evidence that public housing funds were not used to pay expenses of deficient programs.

Recommendations

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

- 1A. Develop and implement procedures which ensure that program funds are used only for eligible program activities.
- 1B. Repay \$109,286, or the current balance owed, to the low-income public housing reserve account representing amounts owed by nonfederal programs.
- 1C. Repay \$46,266 to the low-income public housing reserve account from its Section 8 administrative reserve account.
- 1D. Repay \$26,387, or the current balance owed, to the low-income public housing reserve account from its Public Housing Capital Fund program. Funds owed for any grants that are closed must be repaid from nonfederal funds. For any grants for which funds were not obligated within two years and spent within an additional two years, repayment should be made to HUD.
- 1E. Repay \$24,860, or the current balance owed, to the low-income public housing reserve account from its HOPE VI development grant-Jervay Place, or from nonfederal funds.
- 1F. Repay \$8,930, or the current balance owed, to the low-income public housing reserve account from its HOPE VI demolition grant-Taylor Homes, or from nonfederal funds.

- 1G. Reconcile the source and provide support for funds used to pay \$509,206 of excess costs and repay any amounts determined to be ineligible or unsupported.
- 1H. Exclude all public housing funds from its central account until such time as the director is assured that the Authority has adequate internal controls over its cash disbursements.

Finding 2: The Authority Did Not Properly Allocate Costs

The Authority did not properly allocate indirect costs and could not properly support some allocations of salary and benefit costs as required by Office of Management and Budget Circular A-87. This occurred because Authority management did not implement adequate internal controls to ensure that it properly allocated or supported indirect costs. It did not have a cost allocation plan in place until March 15, 2005, and did not fully implement the plan until April 1, 2006. In addition, the cost allocation plan was insufficient because it did not require personnel activity reports or equivalent documentation to support salary and benefit costs. As a result, the Authority paid \$529,187 from its operating subsidies for ineligible salaries and other indirect costs and could not support another \$138,963 of indirect costs allocated to its Section 8 and Public Housing Capital Fund programs.

The Authority Did Not Properly Allocate Costs

In response to the independent public accountant's report for the Authority's fiscal year ending March 31, 2004, the Authority's board approved a cost allocation plan on March 15, 2005. However, rather than fully implementing the plan when it was approved, the Authority's executive director decided to partially implement the plan. Beginning October 1, 2005, the Authority allocated salary costs but continued to pay other indirect costs primarily from operating subsidies.

Federal regulations at 24 CFR [*Code of Federal Regulations*] 85.22(b) require the Authority to follow Office of Management and Budget Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments," which states that such governments shall establish principles to provide that federal awards bear their share of costs.³ It further provides that to be allowable under federal awards, costs must be necessary and reasonable for proper and efficient performance and administration of federal awards and be allocable to federal awards.

According to the Authority's cost allocation plan, indirect costs, such as salary and benefit costs of the executive director, management staff, finance department staff, and other centralized staff, would be allocated based on the direct labor method. To determine the percentages of indirect costs to be allocated to each program, the Authority calculated each program's direct costs as a percentage of the Authority's total direct costs. The resulting percentages were to be used to allocate indirect costs to each program. For example, the Authority determined that the direct costs for the public housing program were 49 percent of the total Authority costs. Thus, 49 percent of the indirect costs should be allocated to the public housing program. Indirect costs were divided among other programs as follows: Section 8 program - 19 percent, HOPE VI demolition grant - 10 percent,

³ Office of Management and Budget Circular A-87, attachment A, paragraph A1.

Housing and Economic Opportunities, Inc. - 7 percent, Public Housing Capital Fund program - 7 percent, HOPE VI revitalization grant - 6 percent, and Glover Plaza, Inc. - 2 percent⁴. The Authority should have allocated all indirect costs beginning April 1, 2005, using these percentages.

From April 1, 2005, to March 31, 2006, the Authority did not allocate costs in accordance with its plan. Rather, it paid the indirect costs primarily from its operating subsidies. Authority officials stated that the plan was being implemented over a one-year period. Until the plan was fully implemented on April 1, 2006, the Authority based the allocations on each program's available funds. Since the public housing program had the most available funds, the Authority paid 82.4 percent of the indirect costs from operating subsidies for the period April 1, 2005, to March 31, 2006. The total indirect cost for the period was \$1,584,189, of which the public housing program should have paid 49 percent, or \$776,434. However, the program paid \$1,305,623. The difference of \$529,189 is not an eligible program cost in accordance with the Authority's contract with HUD.⁵ The following chart shows the amounts paid by each program, the allocable indirect cost amounts that should have been paid, and the differences.

Program	Amount paid	Allocable indirect costs⁶	Difference
Public housing	\$ 1,305,623	\$ 776,434	\$ 529,189
Section 8 program	97,077	306,614	-209,537
HOPE VI demolition grant	38,106	156,607	-118,501
HOPE VI revitalization grant	8,183	93,964	-85,781
Housing and Economic Opportunities, Inc.	48,743	109,624	-60,881
Public Housing Capital Fund program	79,890	109,624	-29,735
Glover Plaza, Inc.	<u>6,569</u>	<u>31,321</u>	<u>-24,752</u>
Total	<u>\$ 1,584,189</u>	<u>\$ 1,584,189</u>	<u>\$ 0⁷</u>

⁴ Indirect costs of \$18,124 for the Authority's newsletter are allocated equally between the public housing and Section 8 programs rather than the stated percentages.

⁵ Annual contributions contract, part A, section 9(C).

⁶ Adjusted for the allocation of \$18,124 between only the public housing and Section 8 programs.

⁷ Differences in the total amount are due to rounding of individual amounts.

The Authority Did Not Support Allocated Costs

Office of Management and Budget Circular A-87 requires an allocation of salary supported by documentation, such as activity reports or equivalent documentation.⁸ The documentation must reflect an after-the-fact distribution of the actual activity of each employee, account for the total activity, be prepared at least monthly, and be signed by the employee. 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.

While the Authority began allocating salaries on October 1, 2005, its policies and procedures did not require personnel activity reports to support salary and benefit allocations or quarterly adjustments based on actual percentages. Thus, no personnel activity reports were prepared, and the Authority had not performed any analyses of the existing cost allocation percentages to determine their accuracy.

Because the Authority is in the process of implementing project-based asset management accounting, HUD permits it to use its management fees to pay salaries and benefits. The total budgeted for salaries and benefits for the period April 1 through September 30, 2006, was \$625,960. For the period, 65.3 percent of the funds collected to pay indirect costs were from public housing management fees. Of the remaining 34.7 percent, or \$217,208, 11.2 percent, or \$70,107 was from the Section 8 program, and 11 percent, or \$68,856, was from the Public Housing Capital Fund program. The remaining \$78,245 was from nonfederal programs. Because the Authority did not require staff to complete activity reports and did not adjust the amounts to actual percentages, it cannot support its allocation of \$138,963 in salary and benefit costs to its Section 8 and Public Housing Capital Fund programs (\$70,107 and \$68,856, respectively).

Recommendations

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

- 2A. Develop and implement procedures to ensure that salary and benefit cost allocations are properly supported.

⁸ Office of Management and Budget Circular A-87, attachment B, section h (4).

- 2B. Repay \$209,537 to the low-income public housing reserve account from its Section 8 administrative reserve account.
- 2C. Repay \$118,501 to the low-income public housing reserve account from its HOPE VI demolition grant or from nonfederal funds.
- 2D. Repay \$85,781 to the low-income public housing reserve account from its HOPE VI implementation grant or from nonfederal funds.
- 2E. Repay \$29,735 to the low-income public housing reserve account from its Public Housing Capital Fund program. Funds owed for any grants that are closed must be repaid from nonfederal funds. For any grants for which funds were not obligated within two years and spent within an additional two years, repayment should be made to HUD.
- 2F. Repay \$85,633 to the low-income public housing reserve account from nonfederal funds representing ineligible indirect costs paid for Housing and Economic Opportunities, Inc., and Glover Plaza, Inc.
- 2G. Provide support for \$138,963 in allocated salary and benefit costs or repay any unsupported costs to its Section 8 and Public Housing Capital Fund programs as applicable.
- 2H. Conduct quarterly reviews of its cost allocation plan percentages and make any necessary adjustments to the percentages based on actual costs.

Finding 3: The Authority Could Not Support Its Use of More Than \$239,000 in Turnkey III Funds

The Authority did not properly track its use of funds received from HUD's Turnkey III program. As a result, it could not support that it used more than \$239,000 in Turnkey III funds for eligible activities. This occurred because Authority management did not implement adequate controls over disbursements and because the director of finance was not aware of requirements. By implementing procedures that ensure accountability of its Turnkey III funds, the Authority will put its remaining Turnkey III mortgages receivable balance of \$563,908, as of September 30, 2006, to better use for eligible activities.

The Authority Did Not Properly Track the Use of Turnkey III Funds

The Turnkey III program was established to help approved public housing residents become homebuyers. The Authority entered into the program in the 1970s. Initially, it returned funds it received from Turnkey III home sales to HUD. HUD permitted the Authority to keep some funds as operating reserves. The Authority established an operating reserve account for these funds as required by 24 CFR [*Code of Federal Regulations*] 904.112. In 1992, HUD entered into a use agreement with the Authority that authorized the Authority to retain proceeds it received from the sale of the Turnkey III units. In 1993, the Authority elected to purchase rights to the remaining unsold Turnkey III units and began collecting the monthly mortgage payments from the homebuyers until the properties were sold or the mortgages were refinanced. The Authority was required to separately account for the funds and could only use them for low-income housing purposes.

From April 1, 2004, through September 30, 2006, the Authority received proceeds totaling \$239,420 from its Turnkey III program. It deposited the funds into its special projects fund. However, it also deposited funds from other sources, including funds received from the Governor's Crime Commission Grant, property management revenue, and money market investment income. Once these funds were deposited into the special project fund, the Authority considered them unrestricted funds and did not separately account for how they were used. This violated the Turnkey III use agreement.

Total expenditures from the special project fund during our review period exceeded \$2 million. This included some expenditures for low-income housing activities but also included expenditures for items such as flowers, annual banquets, interest expenses, and utilities. Since the Authority did not track its use of Turnkey III funds, it cannot ensure that all of the funds were used for

low-income housing activities. Thus, the Authority cannot ensure that it complied with the use agreement and could not support its use of \$239,420 in Turnkey III funds.

While we only reviewed transactions from April 1, 2004, through September 30, 2006, the director of finance stated that when she became the director in 2002, she continued the practice that was already in place, depositing the Turnkey III funds into the special project fund. She stated that she was unaware of the use agreement. We determined that the Authority was depositing the Turnkey III funds into the special projects fund as early as 1993.

Since the Authority was unaware of the requirement to track the Turnkey III funds and it had historically failed to properly track the funds, it is reasonable to conclude that it will continue to deposit the funds into the special project account unless it implements procedures that are in compliance with the use agreement. By implementing procedures that ensure that it properly tracks its use of Turnkey III funds, the Authority will be able to support that future expenditures of program funds are tracked in accordance with requirements and are spent only for eligible activities. Thus, it will ensure that it puts proceeds from its remaining Turnkey III mortgages receivable balance of \$563,908, as of September 30, 2006, to better use for eligible activities.

Recommendations

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

- 3A. Develop and implement procedures which ensure that it complies with its Turnkey III use agreement, including accounting separately for the funds and only using the funds for low-income housing purposes, thereby putting the remaining mortgages receivable balance of \$563,908 to better use.
- 3B. Provide support that the \$239,420 in Turnkey III funds was used for eligible activities or repay the funds to the public housing reserve account from nonfederal funds.

Finding 4: The Authority Did Not Comply with Internal Revenue Service Requirements

The Authority did not comply with Internal Revenue Service requirements to determine the value of the fringe benefits to employees from their use of employer-provided vehicles. The Authority permitted the executive director and other management staff to use Authority-owned vehicles to commute daily without accounting for and reporting the taxable employee fringe benefits. Although the Authority did not have policies governing employer-provided vehicle use, the director of finance questioned the practice, and management elected not to comply with the requirements. Because the Authority failed to follow requirements, it subjected the employees to potential tax consequences.

The Authority Did Not Follow Internal Revenue Service Requirements

Internal Revenue Service Publication 15-B, “Employer’s Tax Guide to Fringe Benefits,” states that employers are required to report all fringe benefits they provide to employees, including the value of employer-provided vehicles, unless the law specifically excludes it. The publication details the methods used to value personal use of employer-provided vehicles. Under the cents-per-mile rule, employees are required to keep a record of the personal mileage, and the employer determines the value by multiplying the personal miles by the Internal Revenue Service standard mileage rate, which was 44.5 cents per mile for calendar year 2006. The value of the fringe benefit is subject to employment taxes and must be reported by the employer on Internal Revenue Service Form W-2, Wage and Tax Statement.

The Authority did not have policies governing employer-provided vehicle use. However, it provided vehicles to the executive director and three managers.

According to the executive director’s current employment agreement, the Authority agreed to provide him a vehicle or a monthly automobile allowance. The executive director elected to purchase a vehicle, which the Authority agreed could be the vehicle of his choice. In April 2005, the Authority purchased a vehicle for the executive director’s daily use. However, the Authority did not require the executive director to keep track of mileage he incurred for personal use. The executive director confirmed that he used the vehicle for both business and personal use. Further, the Authority did not record the value of the fringe benefit in his income reported on Form W-2. Thus, the Authority understated his taxable income.

Further, in 2001, the Authority authorized the assistant executive director, Section 8 program director, and operations director to have full-time use of Authority vehicles. The Authority's justification for providing the vehicles was that the employees could be called after regular work hours seven days a week. However, Authority management confirmed that only one or two work emergencies have occurred since 2001. Again, the Authority did not require the employees to keep track of mileage incurred for personal use and did not record the value of the fringe benefit as income on their Forms W-2. Thus, their taxable incomes were underreported to the Internal Revenue Service.

We discussed these issues with an Internal Revenue Service tax specialist, who confirmed the requirements for the employees to keep track of the mileage and the Authority to report the value of the fringe benefit as taxable income to the employees. Because the Authority failed to follow requirements, it subjected the employees to potential tax consequences.

We also question whether the three program managers should be provided Authority vehicles since they are seldom required to report to work after duty hours. Alternatively, the Authority could reimburse them for any work-related use of their personal vehicles.

Recommendations

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

- 4A. Either discontinue allowing staff to use Authority-owned vehicles for daily commuting or comply with Internal Revenue Service requirements to establish the value of the benefits and report the value as taxable income.
- 4B. Develop and implement policies and procedures governing employee use of Authority-owned vehicles.

SCOPE AND METHODOLOGY

Our audit objective was to determine whether the Authority inappropriately used federal funds to support other programs or entities in violation of requirements. To accomplish our objective, we

- Reviewed applicable laws, regulations, and other HUD program requirements, including applicable sections of 24 CFR [*Code of Federal Regulations*], the annual contributions contract, Office of Management and Budget Circular A-87, and Internal Revenue Service Publication 15-B.
- Interviewed HUD and Authority management and staff.
- Reviewed various Authority documents, including financial statements, bank statements, minutes from board meetings, policies and procedures, accounting books and records, and the cost allocation plan.

We estimated that the Authority could put \$563,908 to better use by implementing procedures that ensure accountability of its remaining Turnkey III mortgages receivable (recommendation 3A). Our review showed that the Authority could not support its use of \$239,420 in Turnkey III funds that it received from mortgage payments from April 1, 2004, through September 30, 2006. We also determined that the Authority had been depositing the mortgage proceeds in an unrestricted account as early as 1993. Further, the Authority was unaware of the requirements of its use agreement to track the funds and use them for low-income housing purposes. Therefore, we concluded that without improved procedures, it would likely continue its previous practices. Thus, it would continue to fail to properly track or support its use of future receipts of \$563,908.

The reported amounts of the recommendation that funds be put to better use do not reflect any offsetting costs to implement the recommendations.

We conducted our audit from June through December 2006 at the Authority's offices in Wilmington, North Carolina. Our audit period was from April 1, 2004, through September 30, 2006. We expanded our audit period as needed to accomplish our objectives.

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

INTERNAL CONTROLS

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

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

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

Relevant Internal Controls

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

- Compliance with laws 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.
- Reliability of data - Policies and procedures that management has implemented to reasonably ensure that output of data and information is accurate and reliable.

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 have adequate policies and procedures to reasonably ensure that HUD funds were used in accordance with requirements or that its practices complied with HUD and other federal requirements.
- The Authority lacked assurance that its various activities were paying their fair share of costs because its cost allocation plan and practices did not comply with federal requirements.

APPENDIXES

Appendix A

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

Recommendation	<u>Ineligible 1/</u>	<u>Unsupported 2/</u>	<u>Funds to be put to better use 3/</u>
1B	\$ 109,286		
1C	46,266		
1D	26,387		
1E	24,860		
1F	8,930		
1G		\$ 509,206	
2B	209,537		
2C	118,501		
2D	85,781		
2E	29,735		
2F	85,633		
2G		138,963	
3A			563,908
3B		<u>239,420</u>	
Total	<u>\$ 744,916</u>	<u>\$ 887,589</u>	<u>\$ 563,908</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.

3/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings which are specifically identified. In this instance, if the Authority implements our recommendations, it will avoid ineligible expenditures and will be able to properly

support its use of funds obtained from its remaining Turnkey III mortgages receivable (recommendation 3A).

Appendix B


AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

BENJAMIN J. QUATTLEBAUM, II
EXECUTIVE DIRECTOR

DEPARTMENTS:
EXECUTIVE
FINANCE
HUMAN RESOURCES
OPERATIONS
RESIDENT SERVICES
SECTION 8/TENANT SELECTION



COMMISSIONERS
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MACY McRAE, VICE CHAIRMAN
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LENWOOD S. DEAN, JR.
LORI A. GAINES
DEBRA H. QUARANTA
MARGARET S. ROGERS
LEE D. WEDDLE, SR.

February 23, 2007

VIA EMAIL AND CERTIFIED U.S. MAIL

Mr. James D. McKay
Regional Inspector General for Audit
U. S. Department of Housing & Urban Development
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Atlanta, GA 30303-3388

Re: Response to Draft Audit Report


Dear Mr. McKay:

In response to your letter of January 30, 2007, we submit the attached response to the Draft Audit Report, which includes our written comments and supporting documentation.

We understand that draft audit reports do not necessarily contain final conclusions and are subject to revision. We respectfully request that you indicate in your final report the measures we have already taken to implement some of the policies and procedures as outlined in the audit report.

We will be happy to provide you with any additional information you may require.

Sincerely,



Benjamin J. Quattlebaum, II
Executive Director

Attachments

c: Board of Commissioners
Richard A. James, Assistant Executive Director
Michelle Kerwin, Director of Finance
Gerald R. Kirkland, Assistant Regional Inspector General
Jerica Hamilton, Auditor, Office of Inspector General
Michael A. Williams, Director, Office of Public Housing

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WHA's Response

The Housing Authority of the City of Wilmington ("WHA") appreciates this opportunity to respond to the draft audit report received by Office of Inspector General ("OIG") on February 14, 2007. Since the audit is subject to change after the deadline for our comments, WHA will quote the draft audit provided to us.

Finding 1: The Authority inappropriately used more than \$215,000 in operating subsidies for other programs

Comment # 1: The Authority used Operating Subsidies to pay Non program expenses. The report states "*The Authority used operating subsidies to pay non program expenses and did not have adequate controls over disbursements to ensure that it complied with the contract requirements. As a result it inappropriately advanced more than \$215,000 in operating subsidies to pay expenses for programs and entities that were not under the contract with HUD.*"

Comment 1

WHA response: During the audit, OIG was provided a breakout of the LIPH accounts receivable from other programs/funds. The breakout detailed the fund owing as well as the use of the funds owed. Ninety-four percent of the balance owed was accrued salary and benefit for the fiscal year ended March 31, 2006. The salary and benefits were not cash entries during the fiscal year ended March 31, 2006, but a fiscal year end accrual adjusting entry to record the expenses in the proper accounting period. The actual cash disbursement for payroll was made on April 5, 2006.

On April 1, 2006 WHA switched software programs. In anticipation of Project Based Asset Management, the Authority changed to a revolving interfund system and a single checking account. At the conversion of the chart of accounts and trial balance, the cash, inter program accounts receivable and inter program accounts payable were netted into one interfund due to/due from (1156) account. The netting out of the receivables and payables into the cash accounts essentially "paid back" the LIPH program on April 1, 2006. See attached schedule, exhibit A.

Recommendations

1A. Develop and implement procedures which ensure that program funds are only used for eligible program activities.

WHA Response: The Authority, in connection with implementation of new software is working on developing procedures and policies to ensure that cash disbursements are made only when sufficient funds are available in the respective programs/funds.

1B. Repay \$109,286, or the current balanced owed to the low income public housing reserve account representing amounts owed by non federal programs.

Comment 2

WHA Response: The \$109, 286 represents monies owed by the Authority's affiliate Housing and Economic Opportunities, Inc ("HEO") and a multifamily project, Glover Plaza, Inc. Of the \$93,021 owed by the affiliate HEO, \$44,718 was repaid on April 5,

2006 and the balance was repaid in full on December 11, 2006 (see attached copy of checks, exhibit B). The Authority agrees that Glover Plaza is operating in a deficit cash flow and has transferred sufficient funds from Glover Plaza unrestricted investments to cover the cash deficit.

1C. Repay \$46,266 or the current balance owed to the low income public housing reserve account from its Section 8 administrative reserve account.

Comment 3

WHA Response: Although the Section 8 program owed LIPH \$46,266 for accrued salary and benefit at fiscal year end, the Section 8 Program had \$502,037.91 in cash to offset this payable. At March 31, 2006, these were year end accrued expenses and no LIPH cash was used. The Section 8 Program had sufficient funds at year end to reimburse LIPH; it was a matter of timing following year end when the reimbursement was made. At the conversion of the chart of accounts and trial balance, the cash, inter program accounts receivable and inter program accounts payable were netted into one interfund due to/due from (1156) account. The netting out of the receivables and payables into the cash accounts essentially "paid back" the LIPH program on April 1, 2006.

1D. Repay \$26,387 or the current balance owed to the low income public housing reserve account from its public housing capital fund program. Funds owed for any grants that are closed must be repaid from nonfederal funds. For any grants for which funds were not obligated within two years and spent within an additional two years, repayment should be made to HUD.

Comment 4

WHA response: Although the Capital Fund Program owed LIPH \$26,387 for accrued salary and benefit at fiscal year end, the Capital Fund Program had \$12,166.94 in cash to offset this payable. At March 31, 2006, these were year end accrued expenses and no LIPH cash was used. The true balance owed to the LIPH program at March 31, 2006 was \$14,220.04. The balance owing LIPH was a simple matter of timing of requesting and drawing down LOCCS vouchers at fiscal year end. These funds have since been requested.

1E. Repay \$24,860 or the current balance owed to the low income public housing reserve account from its HOPE VI demolition grant - Jervay. Funds owed for any grants that are closed must be repaid from nonfederal funds.

WHA response: Although HOPE VI – Jervay Place owed LIPH \$24,860 for accrued salary and benefit at fiscal year end, the HOPE VI – Jervay Place had \$39,311.51 in cash to offset this payable. At March 31, 2006 there was no true balance owing LIPH. At March 31, 2006, these were year end accrued expenses and no LIPH cash was used. The HOPE VI – Jervay Place had sufficient funds at year end to reimburse LIPH it was a matter of timing following year end when the reimbursement was made. At the conversion of the chart of accounts and trial balance, the cash, inter program accounts receivable and inter program accounts payable were netted into one interfund due to/due from (1156) account. The netting out of the receivables and payables into the cash accounts on April 1, 2006 essentially "paid back" the LIPH program.

1F. Repay \$8,930 or the current balance owed to the low income public housing reserve account from its HOPE VI demolition grant – Taylor Homes. Funds owed for any grants that are closed must be repaid from nonfederal funds.

WHA response: Although HOPE VI – Taylor owed LIPH \$8,930 for accrued salary and benefit at fiscal year end, the HOPE VI– Taylor had \$3,374.43 in cash to offset this payable. The true balance owed to the LIPH program at March 31, 2006 was \$5,555. The balance owing LIPH was a simple matter of timing of requesting and drawing down LOCCS vouchers at fiscal year end. These funds have since been requested.

Comment # 2: The Authority paid cost in excess of amounts on deposit for some programs. The report states *“In violation of its contract, from April 1, 2006 to September 30, 2006, the Authority paid \$509,206 from the central account for expense of programs in excess of the amounts those programs had on deposit.”*

Recommendation

IH. Reconcile the source and provide support for funds used to pay \$509,206 of excess costs and repay any amounts determined to be ineligible or unsupported.

WHA response: WHA contends all costs were appropriately allocated and eligible expenses to each program charged. The Authority has reconciled the 1156 balances as of September 30, 2006. The Authority does not agree with OIG on the balance of \$509,206. The Authority calculates that there are programs carrying insufficient cash balances totaling \$459,135 on September 30, 2006.

Of the \$459,135, the Authority agrees that two funds/programs, Glover Plaza and Eastbrook, show deficit cash balances, but were assisted with unrestricted funds. The Authority had sufficient unrestricted cash available on September 30, 2006 to cover the \$459,135 in deficit cash balances. As stated in the response to recommendation 1B, the Authority has already taken measures to resolve the cash deficit in the Glover Plaza project. According to the Authority’s records \$150,764 of the \$459,135 is month end timing issues with LOCCS drawdowns on HOPE VI, Capital Fund, Youthbuild, and ROSS grants. Also, as stated in the response to recommendation 1B, the Authority has already received reimbursement by the affiliate HEO.

Recommendation

II. Exclude public housing funds from its central account.

WHA response: *PIH Notice 2006-33, Changes in Financial Management and Reporting Requirements for Public Housing Agencies Under the New Operating Fund Rule (24 CFR Part 990); Interim Instructions* addresses bank accounts under 4.2 Project Based Accounting. The CFR states “PHA’s are not required to establish separate bank accounts for each amp. However, the accounting records are to be sufficient in detail to determine the cash balances of each AMP, the COCC, and any other PHA program.” The Authority contends that the accounting software provides ample detail to determine the cash balances for each program/fund. Per conversation with HUD field office staff, it

Comment 5

Comment 6

is common practice by HA's to do fund accounting and use a single revolving fund cash account. WHA's independent auditor has also recommended moving to a revolving fund cash account.

Comment # 3: The Authority violated HUD requirements restricting the use of Section 8 Reserves. The report states *"The Authority purchased a vehicle for the Executive Director's daily use. The vehicle was purchased using \$31,357 in Section 8 reserve funds. While the Authority's purchase of the vehicle may have been authorized, Public and Indian Housing Notice 2004-7 prohibited the Authority from using Section 8 reserves."*

Recommendation

1G. Reimburse \$31, 357 to its Section 8 reserve account.

Comment 7

WHA response: Public and Indian Housing Notice 2004-7 states that *"Any administrative fees from FFY 2004 funding that are subsequently moved into the administrative fee reserve account at year end may not be used for "other housing purposes permitted by state and local law" and must only be used for the provision of Section 8 rental assistance, including related development activity."* The Authority's Section 8 Voucher for Payment of Annual Contributions and Operating Statement for the fiscal year ending March 31, 2004 (FFY 2003) reflected an administrative fee reserve balance of \$528,878. The Authority contends that the Section 8 program had sufficient pre FFY 2004 unrestricted administrative fee reserves to cover the purchase of this vehicle and was therefore an eligible use of the Section 8 reserves. See attached statement, exhibit C.

Finding 2: The Authority did not properly allocate costs

Comment # 1: The Authority did not properly allocate costs. The report states *"The Board approved a cost allocation plan on March 15, 2005, however, the plan was partially implemented the plan beginning October 1, 2005, only allocating salary costs."*

Recommendations

2B. Repay \$209,537 to the low-income public housing reserve account from its Section 8 administrative reserve account.

Comment 8

WHA response: WHA agrees that the cost allocation plan was not fully implemented in a timely manner. WHA will make repayment agreements for Section 8 reserves to reimburse the public housing reserve account.

2C. Repay \$118,501 to the low-income public housing reserve account from its HOPE VI demolition grant or from nonfederal funds.

WHA response: WHA agrees that the cost allocation plan was not fully implemented in a timely manner. The HOPE VI demolition grant is obligated and there are insufficient funds to repay this allocation. At this time HUD is holding \$318,000 of Hope VI money

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to complete the Community Center at Jervay. Upon approval of a revision from HUD, the Authority will use \$118, 501 to repay public housing reserve.

2D. Repay \$85,781 to the low-income public housing reserve account from its HOPE VI implementation grant or from nonfederal funds.

WHA response: WHA agrees that the cost allocation plan was not fully implemented in a timely manner. WHA has a remaining balance of \$318,000 in the HOPE VI grant. Once released from HUD, we recommend these funds be used to repay these costs.

2E. Repay \$29,735 to the low-income public housing reserve account from its Public Housing Capital Fund program. Funds owed for any grants that are closed must be repaid from nonfederal funds. For any grants for which funds were not obligated within two years and spent within an additional two years, repayment should be made to HUD.

WHA response: WHA agrees that the cost allocation plan was not fully implemented in a timely manner. The Capital Fund Program will repay \$29,735 to the public housing reserve account.

2F. Repay \$85,633 to the low-income public housing reserve account from nonfederal funds representing ineligible indirect costs paid for Housing and Economic Opportunities, Inc. and Glover Plaza, Inc.

WHA response: WHA agrees that the cost allocation plan was not fully implemented in a timely manner to HEO and will have HEO reimburse the WHA public housing reserve account. WHA will make repayment agreements for HEO to reimburse the public housing reserve account.

Comment 9

WHA has a management agreement with Glover Plaza, Inc., which states that WHA shall receive 9% of receipts as a management fee to cover indirect costs. The \$6,569 charged to Glover Plaza is the prorated cost for a shared office clerk. The calculated management fee from Glover Plaza exceeds the calculated indirect costs. During FYE 3/31/06, these management fees were received in the Public Housing Fund as income and in the current fiscal year, in the COCC. Therefore, WHA disputes the \$31,321 charge to Glover Plaza.

2G. Provide support for \$138,963 in allocated salary and benefit costs or repay any unsupported costs to its Section 8 and Public Housing Capital fund programs as applicable.

WHA response: The authority believes the \$138,963 allocated to Section 8 and Public Housing Capital fund programs have been allocated properly and will provide a schedule supporting the \$138,963. If necessary, any unsupported costs will be repaid to the Section 8 and Public Housing Capital Fund programs.

Comment # 2: The Authority did not support allocated costs. The report states "*The Authority's policies and procedures did not require personnel activity reports to support salary and benefit allocations or quarterly adjustments based on actual percentages.*"

Recommendations

2A. Develop and implement procedures to ensure that salary and a benefit cost allocations are properly supported.

WHA response: WHA now requires indirect staff, as well as direct staff, to complete a timesheet noting time spent by program. These timesheets will be submitted to the Finance Department for review to ensure that staff salaries and benefits are properly allocated.

2H. Conduct quarterly reviews of its cost allocation plan percentages and make any necessary adjustments to the percentages based on actual costs.

WHA response: A sampling of the timesheets for each program/fund submitted to the Finance Department will be reviewed on a quarterly basis to determine the appropriateness of the allocations. If necessary, adjustments will be made to the cost allocation plan percentages.

Finding 3: The Authority could not support its use of more than \$239,000 in Turnkey III Funds

Comment # 1: The Authority did not properly track the use of Turnkey III funds. The report states *"From April 1, 2004 through September 30, 2006, the Authority received proceeds totaling \$239,420 from its Turnkey III program. It deposited these funds into its Special Projects account. Once these funds were deposited into the special project funds, the Authority considered them unrestricted funds and did not separately account for how they were used. This violated the Turnkey III use agreement."*

Recommendations

3A. Develop and implement procedures which ensure that it complies with its Turnkey III use agreement, including accounting separately for the funds and only using the funds for low-income housing purposes, there by putting the remaining mortgages receivable balance of \$563,908 to better use.

WHA response: Since the use agreement for Turnkey III funds was completed in 1992, current WHA staff were unaware of the use agreement's existence. The Turnkey III mortgage principal balance has been moved from the special projects fund to a completely separate restricted use fund. A reconciliation of current fiscal year receipts will be prepared and the appropriate cash will be moved as well.

3B. Provide support that the \$239,420 in Turnkey III funds was used for eligible activities or repay the funds to the public housing reserve account from non federal funds.

WHA response: Although, WHA contends the majority of the TKIII funds were used appropriately, the Authority will prepare a schedule of all Turnkey III funds expended during the period April 1, 2004 through September 30, 2006. Support for all eligible

expenditures will be provided to the OIG. Repayment will be made of all Turnkey III ineligible expenditures made during April 1, 2004 through September 30, 2006 period.

Finding 4: the Authority did not comply with Internal Revenue Service Requirements

Comment # 1: The Authority did not comply with Internal Revenue Service Requirements. The report states *"The Authority did not have policies governing employer-provided vehicle use. However, it provided vehicles to the executive director and three managers. The Authority did not record the value of the fringe benefit in their income reported on Form W-2. Thus, the Authority understated their taxable incomes."*

Recommendations

4A. Either discontinue allowing staff to use Authority-owned vehicles for daily commuting or comply with Internal Revenue Services requirements to establish the value of the benefits and report the value as taxable income.

WHA response: For the calendar year ended December 31, 2006, WHA did calculate a taxable income for each staff member who was issued an authority provided vehicle. This taxable income was reported to the IRS on the 2006 W-2 for each employee. WHA implemented procedures requiring these employees submit mileage logs to the Finance department on a quarterly basis.

4B. Develop and implement policies and procedures governing employee use of Authority-owned vehicles.

WHA response: The WHA Personnel Policy addresses employer-provided vehicle use. WHA will amend the current policy to address the taxable fringe benefit and the requirement to submit mileage logs.

Comment 10

The Authority contends the unsupported or questioned costs to be less than \$700,000.

OIG Evaluation of Auditee Comments

Comment 1

We recognize that the balance due the public housing program as of March 31, 2006, included accrued expenses that were subsequently paid on April 5, 2006. We revised the finding appropriately. However, we do not agree with the Authority's comments that the netting of accounts at the time of the conversion to a revolving interfund system represents essentially paying back the public housing program. The Authority makes similar statements in its response to recommendations 1C and 1E. Our reasoning applies to each of the Authority's uses of this or similar statements.

Netting of accounts receivable and accounts payable between interfund accounts should always result in a net balance of zero. However, that does not mean that the programs that owed funds actually paid them. In order to reimburse the public housing program, the Authority needs to obtain reimbursement from the various programs. Further, depositing the reimbursed funds into the revolving fund to be used again to pay various expenses does not constitute reimbursement to the public housing program. Any reimbursements should be deposited into a public housing reserve account, not into the revolving fund. Similarly, for any recommendations where the Authority claims that it has made, or will make, reimbursements, it should provide evidence to the director of the Office of Public Housing that the funds were deposited into a public housing reserve account.

The Authority also makes several statements in its response that it will provide support for several matters. The Authority should coordinate with the director of the Office of Public Housing for clearance of the recommendations and submit any support to that office.

Comment 2

The recommendation pertains to amounts owed by Glover Plaza prior to the Authority converting to the revolving fund, after which Glover Plaza had a negative balance in the revolving fund. This issue is addressed as part of the Authority's comments to recommendation 1H of the draft report. The Authority must provide evidence to the director of the Office of Public Housing that the payments received from its affiliate, as well as any other reimbursements, were deposited into a public housing reserve account.

Comment 3

In its response to recommendation 1C, as well as in its responses to recommendations 1D, and 1E, the Authority claims that the amounts owed were for accrued expenses and that no public housing cash was used.

While, the balance due to the public housing general fund may have included accrued payroll expenses, ultimately the payroll was paid with public housing funds. Our review showed that payroll and some other expenses for other programs were paid from the public housing general fund. While some of the amounts were eventually repaid, it is clear from the Authority's comments and our review that the repayments were not timely and were not fully repaid. Thus, the Authority needs to repay the remaining balances to a public housing reserve account, or provide evidence that it has already deposited repayments into a reserve account. Further, while the Authority claims that no public housing cash was used, it also discusses amounts that were repaid, recommendation 1B, and amounts that are still owed, recommendations 1D and 1F. We question why amounts would be repaid or owed to public housing if no public housing cash was used.

Comment 4

In its response to recommendations 1D, 1E, and 1F, the Authority discusses cash the various programs had on hand to offset portions or all of the payables. For recommendation 1E, the Authority concludes that since Jervay Place has sufficient cash to offset the entire payable, there is no balance owed to public housing. Having cash to offset payables does not constitute repayment.

The Authority also discusses requesting a draw down of Capital Funds pertaining to recommendation 1D, and HOPE VI funds pertaining to recommendation 1F. Requesting a draw down does not constitute a repayment. The full amounts for the three recommendations must be reimbursed to a public housing reserve account.

Comment 5

According to the general ledger the Authority provided us, the total deficit balance was \$509,206. We do not know why the Authority's calculation differs. The Authority did not provide any documentation for its calculation.

The Authority admitted that two of its programs had deficit balances, but states that unrestricted funds were used to assist them. According to the general ledger we were provided, the only programs that did not have negative balances as of September 30, 2006, were the low-income public housing, Section 8, and Jervay Place HOPE VI programs. The funds used to pay the expenses of the deficit programs would seem to have been provided by one of the three programs that had funds available. If unrestricted funds were used, we are not aware of the source of these funds and the Authority did not provide any support for its claim. We were unable to determine the source of the funds during our review, thus we are recommending the Authority reconcile the source and provide support to the director of the Office of Public Housing.

Allocating expenses to the appropriate programs does not constitute repayment. The Authority must provide evidence to the director of the Office of Public Housing that no HUD funds were used to pay the expenses of the deficient programs.

Comment 6 While housing authorities are permitted to use a single revolving fund cash account, they are prohibited from withdrawing funds for any project in excess of the amount of Contract funds then on deposit for the specific project. The Authority clearly violated the requirement. Further, the Authority has historically used public housing funds to support its other programs. As such, we believe the Authority should maintain its public housing funds in separate accounts until such time that it demonstrates that it has adequate controls to ensure the funds are used appropriately.

Comment 7 Based on the Authority's comment and our further discussions with the Office of Public Housing, we removed the issues pertaining to the Authority's misuse of Section 8 administrative reserves from the finding.

Comment 8 For recommendations 2C and 2D, the Authority must reimburse a public reserve account regardless of whether or not HUD releases the HOPE VI funds. If the Authority does not have sufficient HOPE VI funds, repayment should be from nonfederal funds.

Comment 9 The Authority's cost allocation plan clearly states Glover Plaza is responsible for two percent of indirect costs. During the review, we discussed the indirect costs allocations on several occasions with Authority staff. We were not informed of a management agreement that excluded Glover Plaza from paying the amounts stated in the indirect cost plan. The Authority should provide documentation to the director of the Office of Public Housing showing that the management agreement includes provisions stating that fees include indirect costs, or repay the \$24,752 from nonfederal funds. If the Authority feels Glover Plaza should pay an amount different from that stated in its plan, it should revise the plan and obtain approval.

Comment 10 We do not agree with the Authority's determination of questioned costs. With the exception of the removal of \$31,357 of questioned costs in Finding 1 regarding use of Section 8 administrative fees, we did not make any additional changes to the questioned costs based on the Authority's comments. However, following issuance of the draft report, we revised the questioned costs pertaining to recommendation 1H of the draft report (now recommendation 1G) from \$441,935 to \$509,206. We discussed this change with the Authority prior to preparation of its response to the draft report.