AUDIT REPORT

NORTHWESTERN REGIONAL HOUSING AUTHORITY

PUBLIC HOUSING PROGRAMS

BOONE, NORTH CAROLINA

2003-AT-1001

JANUARY 9, 2003

OFFICE OF AUDIT, REGION 4

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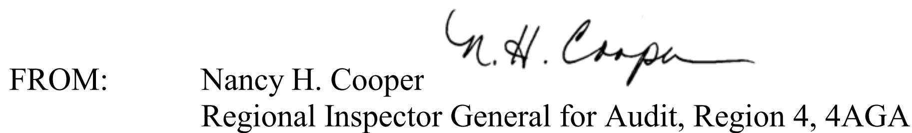
TO: Michael A. Williams, Director, Office of Public Housing, 4FPIH



FROM: Nancy H. Cooper
Regional Inspector General for Audit, Region 4, 4AGA

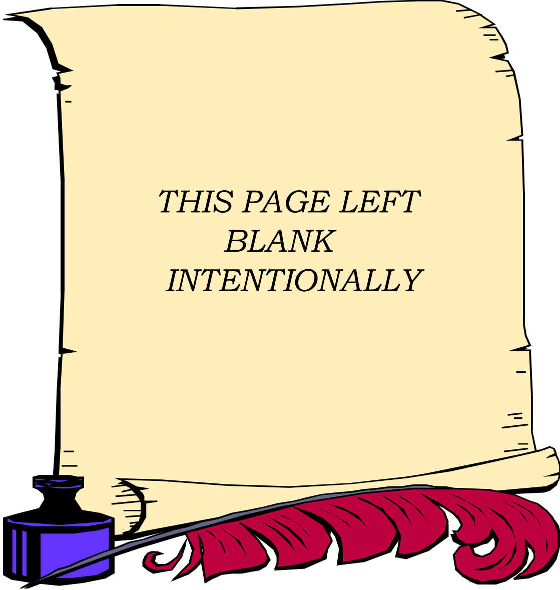
SUBJECT: Northwestern Regional Housing Authority
Public Housing Programs
Boone, North Carolina

We completed an audit of the public housing programs of the Northwestern Regional Housing Authority in Boone, North Carolina. This report presents the results of our audit and includes seven findings with recommendations for corrective action.

In your September 27, 2002, memorandum to me (Appendix B), you stated general concurrence with our draft findings and recommendations. For the three recommendations in which you did not agree, we have revised or deleted them. In accordance with the Department of Housing and Urban Development (HUD) Handbook 2000.06 REV-3, within 60 days, please provide us, for each recommendation without management decisions, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Additional status reports are required at 90 and 120 days after report issuance for any recommendation without a management decision. Also, please furnish us copies of any correspondence or directives issued because of the audit.

We provided a copy of this report to the auditee.

We appreciate your cooperation during the audit. Should you or your staff have any questions, please contact me at (404) 331-3369, or Gerald Kirkland, Assistant Regional Inspector General for Audit, at (865) 545-4368.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Executive Summary

Pursuant to a citizens' complaint and congressional inquiry, we conducted an audit of the Northwestern Regional Housing Authority (NRHA or Authority) in Boone, N.C. We audited activities generally for the period July 1, 1998, to June 30, 2001. Our objectives were to determine whether: (1) the citizens' allegations were valid, (2) the Authority had adequate controls to properly safeguard its assets, and (3) the Authority complied with applicable laws, regulations, and Department of Housing and Urban Development (HUD) requirements in operating its public housing programs.

Many of the allegations proved valid. We found the Authority repeatedly violated regulatory requirements, its Consolidated Annual Contributions Contract (ACC) for low-income public housing, and its Consolidated Section 8 ACC with HUD.

Management violated its ACC's with HUD when it inappropriately pledged Authority assets as collateral for unauthorized bank loans. The loans helped offset development cost overruns and pay operating costs for five privately owned rental properties, pay pre-development costs for another privately owned property, and construct a homeownership project. Management also misused $584,858 of HUD Section 8 and public housing funds for development activities. As a result of payments and advances by the Authority, Northwestern Housing Enterprises, Inc. (NHE) and the developments owed the Authority at least $4,224,342. Management advanced another $45,324 for development of a property owned by another non-profit company. Management and the Board put the Authority at further risk by guaranteeing repayment of private development loans and exposing the Authority to potential liabilities. These actions not only violated the ACC's, but also reduced funds available for public housing operations. Management and the Board's disregard for HUD requirements left the Authority in a precarious financial condition and led to the selling of 18 public housing units.

The Authority incurred travel costs that were unnecessary and ineligible. It paid lavishly for meals, hotels, and tips, made frequent out-of-region trips, and paid travel expenses for family members of management and the Board. This violated the ACC's and occurred because the Authority's travel policy did not set spending limits and was not comparable with local public practice. Also, the Authority did not maintain adequate records to track amounts due and reimbursements received for expenses it paid on behalf of individuals. As a result, the Authority overspent its travel budget by $50,000 for the review period, and those funds were not available for its programs.

The Authority incurred other unnecessary and ineligible expenses. It spent $114,302 for miscellaneous items, half of which was for entertaining and pampering its Board members and employees, their spouses and guests at Board meetings, a beach retreat, a Christmas party, and with theater tickets, jewelry, bath products, libations, and other personal gifts. The Executive Director used public money to pay for alterations of his business suit. This misuse occurred because the Authority did not establish adequate controls to ensure expenses complied with its low rent public housing and Section 8 ACC's. Consequently, the programs were deprived of needed operating funds. These actions also demonstrated the Authority's disregard of its duty to uphold the public trust.

Our inspection of the public housing units and grounds revealed health and safety concerns needing immediate attention. We observed trash and debris around the property and playground equipment in disrepair. Railing or fences were needed to prevent tenants from failing down hazardous embankments. Each of the 23 units we inspected also required maintenance. The Authority needed to improve its procedures to ensure deficiencies are promptly corrected in order to provide decent, safe, and sanitary housing.

The Authority did not maintain accurate accounting records. Costs were not properly allocated, accounts were out of balance, complicated journal entries were not adequately explained, and other accounting deficiencies existed. Funds advanced to privately owned developments were understated. An Independent Public Accountant (IPA) reported similar conditions in his audits of the Authority's fiscal years ended June 30, 2000, and 2001. With accounting records that were unreliable and unauditable, the Authority could not adequately administer its programs.

The Authority did not follow Section 8 fund requisition requirements. It did not perform reviews of its estimated annual needs and often withdrew excess funds. The Authority also did not maintain the excess funds in an interest-bearing account as required. Rather, it used them for other activities. As a result, it paid almost $11,000 in interest to HUD and had to borrow $240,000 to repay its excess withdrawals because it no longer had the money on deposit.

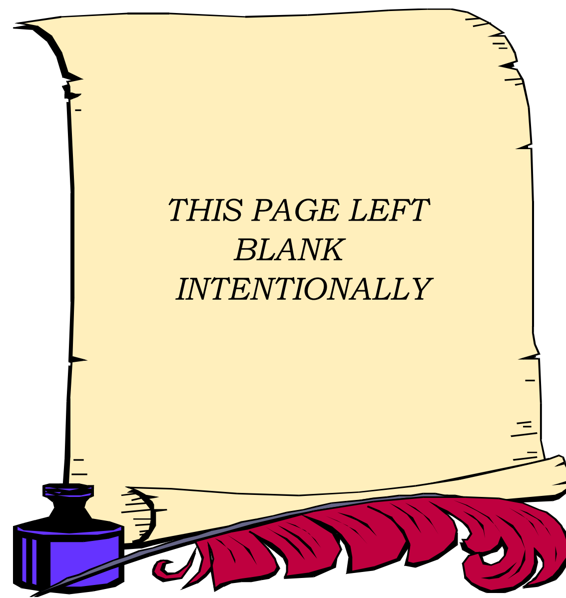
We noted weak procedures in other areas of Authority operations. Management did not properly segregate tenant escrow funds, adequately pursue collection of tenant rents, or follow its own nepotism policies. This occurred because management did not implement adequate controls and elected not to comply with its written policies. As a result, (1) tenant funds were not fully available for disbursement, (2) the Authority could not assure it consistently enforced rent collection efforts or assure tenants received fair and equitable treatment, and (3) the Authority hired relatives of employees in positions that violated its nepotism policy.

We recommend HUD declare the Authority in substantial default of its ACC's and take possession and control of all Authority operations and assets. We also recommend HUD:

- Take administrative actions against the Executive Director, Deputy Director, and the Board Chairman.
- Instruct the Authority to discontinue using funds for development activities.
- Seek release of encumbered Authority assets and recovery of all amounts owed.
- Inspect the Authority's units for structural safety.
- Require the Authority to: (1) repay ineligible expenses of $4.3 million and provide support for $68,508, (2) maintain its accounting records as required, (3) revise its travel policy, (4) discontinue purchasing gifts, and (5) eliminate nepotism and appearances thereof.

We provided the draft audit report to the Board Chairman and Executive Director on September 10, 2002, and held an exit conference on September 18, 2002. The Chairman provided preliminary written comments on September 27, 2002, and final written comments on October 11, 2002. The Authority's preliminary comments were voluminous. Its final comments were basically a summary of the preliminary comments. Thus, we did not include the preliminary

comments in the report. The preliminary comments and OIG's response to each of the comments are available upon request. We included the Authority's final comments within each applicable finding and in their entirety in Appendix C. We incorporated OIG's responses to the final comments within the body of the Authority's comments. The Authority disagreed with the majority of the draft report, but did not provide supporting documentation or other evidence to dispute the findings. We considered the Authority's and HUD's comments in preparing the final report.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Abbreviations

ACC	Annual Contributions Contract
CFR	Code of Federal Regulations
FSS	Family Self Sufficiency Program
GFCI	Ground Fault Circuit Interrupters
HUD	Department of Housing and Urban Development
IPA	Independent Public Accountant
LP	Limited Partnership
LLC	Limited Liability Company
NCHFA	North Carolina Housing Finance Agency
NHE	Northwestern Housing Enterprises, Inc.
NRHA	Northwestern Regional Housing Authority
OIG	Office of Inspector General
OMB	Office of Management and Budget
QHWRA	Quality Housing and Work Responsibility Act of 1998
REAC	Real Estate Assessment Center

Introduction

The Authority was created by authority of the laws of the State of North Carolina on July 1, 1979. It serves families in a 7-county region covering Allegheny, Ashe, Avery, Mitchell, Watauga, Wilkes, and Yancey Counties of North Carolina.

A seven-member Board of Commissioners governs the Authority with members appointed by the Board of County Commissioners of the respective county represented. Lewis McEntyre, Jr., was the Board Chairman during our audit period. Edward G. Fowler, Jr., has served as the Authority's Executive Director since its creation. The Executive Director, Deputy Director, and Finance Officer managed the Authority's day-to-day operations.

The Authority administered 2 low-income housing developments, consisting of 83 public housing units under ACC Number A-3989, and over 1,500 Section 8 vouchers/certificates. It also administered several other programs including a Comprehensive Grant Program, a Family Self Sufficiency (FSS), Program, and Housing Counseling Programs. HUD's Greensboro, North Carolina, Office of Public Housing is responsible for overseeing the Authority.

According to its budget, in fiscal year ended June 30, 2001, the Authority managed HUD grants, fees, and operating income of about $7.3 million as follows:

Section 8 Housing Assistance Payments	$5,921,108
Section 8 Administrative fees	746,588
Low-income public housing funds	253,203
Comprehensive Grant Program	207,138
Other Operating	137,250
Family Self Sufficiency Program	34,913
Housing Counseling	13,492
Total	$7,313,692

In May 1995, the Authority created a non-profit organization, NHE, that partnered with low-income tax credit syndicators to form a limited partnership (LP) and four limited liability companies (LLCs). The Authority then developed five low-income housing developments, which were owned by the LP or the LLCs. The Authority was the general contractor for four of the developments and managed all five developments.

The Authority's financial records were maintained primarily at its central office located at 869 Highway 105 Extension, Suite 10, Boone, North Carolina 28607.

Audit Objectives

Pursuant to a citizens' complaint, we reviewed activities of the Authority as they related to the Authority's administration of HUD assisted activities. The complainants expressed many concerns including:

- Development cost overruns;
- Complex and questionable organizational arrangements for the developments that placed Authority assets at risk;
- Large expenditures for travel, entertainment, and gifts;
- Excessive Section 8 fund withdrawals;
- Misappropriation of Authority assets; and,
- Fictitious housing counseling files.

Our objectives were to determine whether: (1) the allegations were valid, (2) the Authority had adequate controls to ensure its assets were properly safeguarded, and (3) the Authority complied with applicable laws, regulations, and HUD requirements.

Audit Scope and Methodology

To meet our objectives, we:

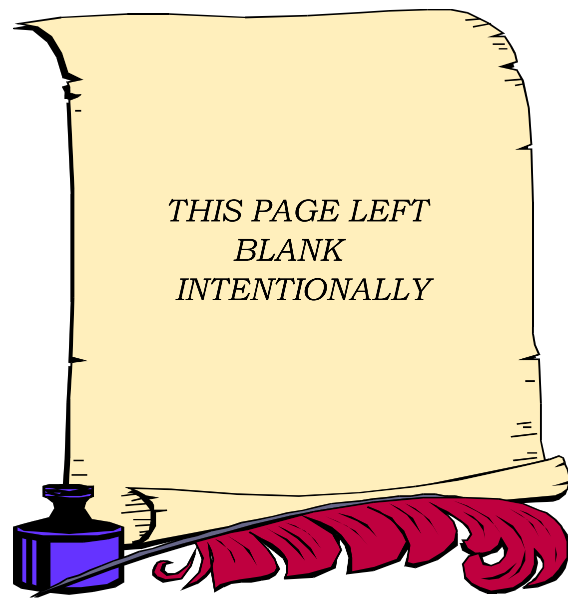
- Interviewed HUD North Carolina State Office officials.
- Interviewed Authority management, staff, tenants, an IPA, and vendors.
- Reviewed Authority books and records.
- Reviewed the minutes from Board meetings.
- Reviewed disbursements for travel and miscellaneous expenses.
- Inspected 23 of the Authority's 83 public housing units.
- Reviewed Forms HUD-52663, Requisition for Partial Payment of Annual Contributions.
- Reviewed nine tenant files.
- Reviewed five housing counseling files.

For our review of travel and miscellaneous expenses, we reviewed 100 percent of the transactions for the period July 1, 1998, through June 30, 2001. We also reviewed one trip in September 2001.

We selected the public housing units for inspection from the tenant rental register by selecting every fifth unit from a predetermined starting point. We also inspected all vacant units. Our results should not be projected to the universe.

We reviewed five housing counseling files that were alleged to contain discrepancies. We were unable to substantiate the allegations, thus we did not expand our review.

Our review generally covered the period July 1, 1998, through June 30, 2001. We performed our on-site work between September 2001 and May 2002. We conducted our audit in accordance with generally accepted government auditing standards.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Management Inappropriately Pledged Authority Assets

Management violated its ACC's with HUD when it inappropriately pledged Authority assets as collateral for unauthorized bank loans. The loans helped offset development cost overruns and pay operating costs for five privately owned rental properties, pay pre-development costs for another privately owned property, and construct a homeownership project. Management also misused $584,858 of HUD Section 8 and public housing funds for development activities. As a result of payments and advances by the Authority, NHE and the developments owed the Authority at least $4,224,342. Management advanced another $45,324 for development of a property owned by another non-profit company. Management and the Board put the Authority at further risk by guaranteeing repayment of private development loans and exposing the Authority to potential liabilities. These actions not only violated the ACC's, but also reduced funds available for public housing operations. Management and the Board's disregard for HUD requirements left the Authority in a precarious financial condition and led to the selling of 18 public housing units.

Criteria

The Consolidated ACC for low rent public housing, Part 2, Section 401 (D), allows the Authority to withdraw monies from the general fund only for (1) public housing development costs, (2) operating expenditures, (3) purchase of investment securities as approved by the Government, and (4) other purposes specified in the contract or specifically approved by the Government. The ACC prohibits obtaining unauthorized loans and pledging or encumbering assets. The ACC specifies that any such pledges or encumbrances constitute a substantial default of the agreement. Further, the ACC does not permit use of public funds for privately owned development expenses.

Section 11 of the Section 8 Consolidated ACC provides that the Authority must use program receipts to provide decent, safe, and sanitary housing for eligible families. The Authority may only use program receipts to pay program expenditures.

Background

The Authority began assisting in developing and managing privately owned housing in 1995. Through June 2002 it had completed five developments (Appendix D). The developments were privately owned by either a LP or LLC, which were substantially owned by investors. The

Authority's Executive Director created NHE, a non-profit corporation, in May 1995 to take a token ownership interest in each entity and serve as the general partner. The Authority sponsored NHE, but had no ownership interest in any of the entities. However, the Authority's Executive Director, Deputy Director, and Human Resource Manager were officers of NHE. Three Authority Board members were also on the Board of NHE. Other than one employee hired in late 2001, NHE did not have any staff. Thus, Authority staff performed the day-to-day business of NHE. Although none of the developments were operated as public housing, low-income tenants, whose rents are subsidized with HUD Section 8 funds, occupied them. Also, the Authority managed the completed properties through management contracts with each entity. The entities paid the Authority management fees and deferred developer fees when cash was available.

According to the budgets, planned funding for the five completed developments included a combination of financing sources as shown in Appendix E. The primary source was proceeds from selling Low Income Housing Tax Credits that NHE received from the North Carolina Housing Finance Agency (NCHFA). The tax credits were provided to NHE and had no effect on Authority operations. Other financing sources included HOME Program funds provided by HUD through the State of North Carolina. Plans also included limited funds from the Authority, such as deferred developer fees. The Authority was not authorized to use any HUD program funds for the developments.

As discussed in Appendix F, the Authority also developed the White Laurel II Homeownership project for NHE. Unlike the tax credit projects, White Laurel II was financed entirely by the Authority, primarily with funds the Authority received from a $2.48 million bank loan. The project had not been completed as of April 30, 2002.

In addition to these developments, in August 2002 the NCHFA awarded tax credits to NHE for another privately owned development, Historic Elk Park School. The Authority planned to be the developer and renovate this historic school into low-income housing for the elderly. The budgeted cost for this development was $3,763,615.

As of April 30, 2002, NHE had paid $13,335 in pre-development expenses for this project.

Further, the Authority was developing another privately owned project, Rock Haven. Unlike the other developments, Rock Haven did not involve NHE. Rather, the Authority was developing it for Hospitality House of the Boone Area, Inc., a non-profit that administers homeless programs. The Authority's Executive Director was a Board member of the Hospitality House.

Cost overruns of almost $5.2 million

The Executive Director was responsible for preparing the development budgets. We found that costs for the five completed developments exceeded planned budgets by a total of almost $5.2 million. The overruns ranged from 4 to 89 percent of budgeted amounts. In addition, White Laurel II will likely suffer a cost overrun of about $1 million upon completion (Appendix F).

The Executive Director offered several explanations for the cost overruns. He said he understated the budgets because the NCHFA told him to understate them on the tax credit applications. Otherwise, due to substantial competition among applicants, NHE would not be awarded tax credits. The Executive Director also said that high construction costs in the area, weather delays, labor costs, unexpected site problems, development oversights, and unexpected regulatory requirements imposed by local government contributed to the overruns. We did not verify these claims. He also admitted that some overruns resulted from poor planning. The Authority, as developer and general contractor, should have performed adequate research to enable it to reasonably estimate the costs.

The Authority served as general contractor for all developments except Woodland Hills, the first development. Woodland Hills had the least cost overrun, about $70,000. The Executive Director explained that the Authority served as general contractor for the other developments to save the contractor's fees. Given the cost overruns, we question whether any cost savings occurred. For example, the Executive Director budgeted a per unit cost of $69,900 for White Laurel. However, actual per unit cost was $132,000, about 89 percent over budget.

Both management and the Board knew, or should have known, there were insufficient funds to cover the inevitable budget shortfalls. Thus, they should not have proceeded with the developments. Even though the Authority deferred its developer fees to help reduce costs, and in some cases obtained additional financing, funding was still inadequate. When this occurred, management and the Board made up the shortfalls by pledging Authority assets as collateral for loans and guaranteeing repayment of some private development loans.

Management inappropriately pledged assets and misused funds

As of March 31, 2002, the Authority owed four banks a total of $2,521,518 for five loans it obtained without authorization (Appendix G). In at least three cases, the Executive Director and Deputy Director signed various agreements pledging Authority assets to obtain loans.

- On June 24, 1999, management pledged three certificates of deposit to obtain a $500,000 loan. Two of the certificates, one for $134,987 and one for $100,462, represented tenant FSS funds the Authority was supposed to hold in trust.

- In order to reduce debt, the Authority decided to rehabilitate the Valley View public housing units and sell them in the private market as condominiums. On January 22, 2001, HUD's Special Applications Center approved the Authority's application to sell the units. In order to sell them and pledge the sales proceeds, the Authority requested HUD release the Valley View units from the Declaration of Trust.[1] On September 28, 2001, HUD released the units. However, on March 22, 2001, prior to obtaining the release, Authority management executed an amended loan agreement whereby it pledged $522,000 of the anticipated sales proceeds as collateral for a $500,000 loan NHE obtained from the Fannie Mae Foundation. NHE obtained this loan to fund development cost overruns.

[1] The Declaration of Trust is a legal binding document that protects HUD's interest in the public housing units. It prohibited the Authority from pledging or encumbering its public housing developments.

- Management pledged the 18 Valley View units as collateral for a \$1.35 million debt consolidation loan.[2] In addition, management pledged some of the Valley View sales proceeds to obtain the loan and agreed to repay the loan by December 7, 2003. The Authority anticipated selling all the units by December 31, 2001, and hoped to realize \$1.8 million from the sales. However, before the Authority could close any sales, it must have pre-sold at least nine. As of April 30, 2002, the Authority had not pre-sold any of the units.

Monthly debt service on the loans was \$18,000.

Having pledged assets for the loans, management misused the loan proceeds and other Authority funds to pay for development activities. They used \$310,610 of HUD Section 8 funds and \$274,248 of public housing funds. Management generally provided the funds to the developments through NHE, but also paid some development expenses, and advanced some funds directly to the developments. As a result of payments and advances, NHE and the developments owed the Authority at least \$4,224,342 (Appendix H). This included \$503,277 owed the Authority for deferred developer fees. The entities likely owed more; however, because of the Authority's poor accounting records (Finding 5) we could not fully assess additional amounts. In any event, since NHE and the developments had few funding sources, substantial recovery of funds was unlikely. In his report for fiscal year ended June 30, 2001, the IPA reported:

> "The NRHA made a loan to the Northwestern Housing Enterprises, Inc. for its gap financing of Woodland Hills, LP of \$25,796.00. The NRHA considers the \$25,796.00 to be a permanent loan to the Northwestern Housing Enterprises, Inc. and has no intent of collecting the loan unless the Northwestern Housing Enterprises, Inc. has the available funds although the NRHA may change these terms at any time. The note carries an interest rate of 5.24% but no accrued interest expenses is calculated on this note since collection is doubtful.

[2] The Authority received \$755,000 of the \$1.35 million on December 7, 2001, (Appendix G). The remaining \$595,000 had not been received, but was available. The Authority executed a Promissory Note for the full \$1.35 million.

> "The NRHA made loans to the Northwestern Housing Enterprises, Inc. for its gap loans to Boone-White Laurel, LLC of $1,034,569.00. The note carries an interest rate of 5.24% and is due and payable in full on December 31, 2017. The Northwestern Housing Enterprises, Inc. passed the terms of this note through to Boone-White Laurel, LLC. No security has been pledged on these loans. Accrued interest receivable associated with these notes has not been recorded since collection is questionable."

Further, management inappropriately advanced $45,324 of Authority funds for the Rock Haven project. Repayment was contingent upon the owners obtaining a construction loan.

Management and the Board inappropriately guaranteed loans and exposed the Authority to potential liabilities

In at least two cases, management and the Board put the Authority further at risk by guaranteeing repayment of private development bank loans. These agreements guaranteed NHE's performance and gave the banks the right to seize Authority assets should NHE fail to pay. One Guaranty Agreement, signed by the Executive Director and the Board Chairman, stated: "The undersigned is Bank's debtor for all indebtedness, obligations and liabilities for which this Guaranty is made, and Bank shall also at all times have a lien on and security interest in all stocks, bonds and other securities of the undersigned . . . Bank shall also at all times have the right of set-off against any deposit account of the undersigned with Bank. . . ."

In order to induce limited partners to invest in three developments, management unconditionally exposed the Authority to potential liabilities of unknown magnitude. Management committed the Authority to funding cost overruns and operating deficits should NHE fail to perform. In two cases, it guaranteed NHE's liability to the investors for loss of tax credits, if any.

The Authority also agreed in one instance to buy out the limited partners' interests if necessary. Typical language from guarantee agreements stated: "The liability of the Guarantor (Authority) under this guarantee shall be direct and immediate and not conditional or contingent upon the pursuit of any remedies against the Managing Member

(NHE) or any other person. . . ."[3] Further, according to its June 30, 2001, audit report; NHE was responsible for any cost overruns. However, as shown in the finding, the Authority paid for a significant portion of the cost overruns.

In at least three cases management signed other documents obligating the Authority to guarantee completion of private developments. These documents, also part of the private development operating agreements, obligated the Authority to unconditionally guarantee the payment of such sums as necessary to complete the projects and discharge any liens. Further, management agreed to pay any private investor legal cost involved in enforcing the agreements.[4]

Section 8 administrative fee reserves

Title 24 Code of Federal Regulations (CFR), Section 982.155, under certain circumstances, permits the use of Section 8 administrative fee reserves for other housing purposes. The primary purpose of administrative fee reserves is for payment of Section 8 Program administrative expenses throughout the life of the applicable contract. In the interim, both the Section 8 ACC and HUD Notice 96-33 require the funds be invested in accordance with HUD requirements. The Authority can only use administrative fee reserves for other housing purposes if it performs an analysis showing it has reserve funds in excess of what is needed to administer the applicable Section 8 contracts throughout their remaining life. Both the regulations and the Authority's administrative plan require this determination. Both also require a separate Board resolution authorizing each disbursement of reserve funds above the amount set by the administrative plan. The Authority's administrative plan showed the Board set that amount at $1,000.

In its response to the draft report, the Authority claimed it used Section 8 administrative fee reserve funds to pay development costs. However, the Authority did not provide any documentation to support its claim. Further, we did not find any evidence the Authority performed analyses showing it had excess administrative reserves.

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[3] Operating agreement between Blue Ridge Housing of Sparta, LLC and the Authority dated December 17, 1999. Other agreements included similar language.

[4] Unconditional Construction Completion Guarantee Agreements for Blue Ridge Housing of Sparta, LLC; Blue Ridge Housing of Bakersville, LLC; and, Blue Ridge Housing of Jefferson, LLC.

Our review of Authority records, including IPA audits, budgets, 5-year and annual plans, and Section 8 year-end statements, showed no indication it expended Section 8 reserves for other housing purposes. Also, our review of Board resolutions did not show the Board authorized each disbursement over $1,000.

Of the $310,610, we reviewed $58,867 of Section 8 funds advanced to NHE, and $26,000 of Section 8 funds advanced to Blue Ridge Housing of Bakersville, LLC. The advances were made between July 1, 2001, and December 31, 2001. We found the Authority advanced all of the funds directly from monthly Section 8 payments HUD deposited into the Authority's bank account. Those funds were supposed to be used for housing assistance payments to Section 8 landlords and program administrative costs for the following month. These disbursements clearly did not come from reserve funds. In fact, we found no evidence of reserve funds on deposit at any time during the audit period. The general ledger did not even include the HUD-prescribed reserve accounts (Accounts 7016 and 2826).

Interestingly, the Authority's Section 8 settlement statements (HUD-52681s) for fiscal years ended June 30, 2001, and June 30, 2002, showed it had $585,776 and $769,850, respectively, of Section 8 administrative fee reserves. However, neither the Authority's accounting records nor its cash accounts showed the funds were on deposit. Further, the IPA audit reports for fiscal years ended June 30, 2000, and June 30, 2001, did not show any reserve funds on deposit.

We question both the Authority's claims that it expended Section 8 excess administrative fee reserves, and its claims that it had significant reserves on deposit.

The Authority continued developing despite its precarious financial condition

The Authority was in a precarious financial condition. It had $2.6 million in bank debt. Debt service alone was approximately $18,000 per month and the Authority had no funds with which to repay the principal. The Authority's financial condition led it to request HUD approval to sell 18 public housing units. The Authority had virtually no cash reserves and very little cash with which to operate. The Authority pledged tenant FSS funds for unauthorized operating loans. Also, by its own admission, it owed that

program another $35,000 it had used for other purposes. It was also carrying as an asset $4.2 million in receivables due from private entities for which collection was uncertain. During 2000 it obtained a bank loan to repay HUD overdrawn Section 8 funds (Finding 6). Further, it had not funded a separate tenant security deposit account, as required by HUD (Finding 7).

In a July 25, 2000, letter to the Board Chairperson, one Board member questioned the Authority's investments in new construction and housing projects. He recommended the Board propose to suspend investing in future projects until some of the debt and financing was more stable. Despite his recommendation and the Authority's precarious financial condition, the Authority continued to invest in new development activity such as Historic Elk Park School and Rock Haven.

Conclusion

Authority management and the Board did not fulfill their fiduciary responsibility to the residents, the public, and the Federal Government. Their unauthorized development activities took precedence over safeguarding Authority assets and meeting the Authority's primary mission of providing decent, safe, and sanitary housing to area citizens. The Authority will not likely recover any substantial funds since neither NHE nor the developments had available funds.

The National Housing Act of 1937, Section 6(j)(4) establishes methods for recovering diverted funds. It provides that HUD may terminate assistance, withhold allocations, reduce future assistance payments, and take other measures. Further, Section 6 provides that upon occurrence of a substantial default, HUD may take possession of the project. Title 24 CFR 24.305, provides causes for debarment. One such cause is the commission of an offense indicating a lack of business integrity or business honesty that seriously and directly affects the present responsibility of a person. Further, a person may be debarred for violating the terms of a public agreement so serious as to affect the integrity of an agency program.

The actions by the Board, Executive Director, and Deputy Director caused the Authority to violate the terms of the ACC, and seriously affected the Authority's operations.

Those actions warrant HUD taking steps to protect its interest and prevent further risk to Authority residents, the public, and the Federal Government.

Authority Comments

As more specifically detailed in Appendix C, NRHA replies as follows:

1. NRHA is a North Carolina public corporation whose overall activities are governed by its charter, its by-laws, and the North Carolina General Statutes. Its existence as a Housing Authority in no way means that HUD has oversight and control over every contract or other arrangement to which NRHA chooses to become a party.
2. The only improper pledge of NRHA assets was the inadvertent pledge of two CD's containing FSS funds, and the holding Bank has since agreed to release the collateral.
3. Absent a showing of improper use of HUD program funds, decisions lawfully and properly made by the NRHA Board about business risk, encumbrance of assets not subject to HUD's control, and the amount and type of loans and loan guarantees are not within OIG's purview.
4. NRHA is solvent, well-managed and at no time has it been in a precarious financial position. The IPA has rendered an unqualified opinion regarding NRHA's financial position and results of operations.
5. NRHA is not in Substantial Default of its Section 8 ACC in that the ACC authorizes use of excess administrative fee reserve funds for any housing activities otherwise lawful under state and local law, which was in fact the use of the $310,610.
6. NRHA is not in Substantial Default of its Conventional Public Housing ACC because changes to the US Housing of 1937 enacted by QHWRA permit the use of CPH funds in mixed finance developments such as NHE's tax credit projects. The amount in question, $37,531.40 and not $274,248, was used to pay a small portion of the construction costs of two tax credit projects and not salaries or other development costs.

7. HUD at all times was aware of the various developments and related activities, provided extensive support and encouragement, and consistently and timely rendered any HUD approvals that NRHA required in order to complete and operate the projects.
8. No loan agreement to which NRHA is a party was unauthorized, as all were approved by NRHA's Board and by HUD, where HUD approval was required. In particular, HUD fully reviewed and approved the release of Valley View units for sale to first time low-income home buyers before the property was encumbered. The Valley View loan is current, as are all NRHA loans, and the sales of four Valley View units have closed.
9. Of the $4.2 million that NHE owes NRHA, only the $347,000 in Section 8 and conventional housing funds are of concern to OIG, and as noted above their expenditure was proper. NHE owes the remaining $3.638 million to NRHA's development and general funds, which are not within OIG's ambit. The loaned funds will ultimately be recouped through payment of deferred developer fees to NRHA and through NHE's acquistion at the end of the tax credit period of real estate assets likely to be valued at far more than $3.5 million dollars.
10. The tax credit projects are solvent, cash-flow positive, well-managed and successful, operating precisely as intended. The tax credit projects regularly pay NRHA management fees, and the more mature projects are making payments on deferred developer fees balances.
11. The cost overrun assertions are based on the preliminary cost estimates generated several years before project completion. If one uses the standard industry practice of comparing actual cost against final budgets, the overruns are $1.327 million and not the $5.2 million asserted in the report.
12. The IPA did not state that collection of $1.03 million from NHE was questionable, only that the collection of the accrued interest was questionable.
13. NRHA has a formal repayment agreement with the Rock Haven owner, who has repaid NRHA the $45,324 advance.

14. NRHA lawfully and with proper Board approval entered into limited and not unbounded guaranty agreements, most of which have been extinguished. At no time was NRHA unconditionally exposed to millions of dollars of liabilities from these guarantees.
15. The IPA stated that NHE and not NRHA was responsible for cost overruns and loss of tax credits, and this is in fact the case.
16. NRHA Section 8, public housing, tax credit development and home ownership programs are operating efficiently, serving NRHA's clients effectively, and promoting HUD's objectives in providing decent, safe and sanitary housing to thousands of low income residents of western North Carolina.

OIG Response to Authority Comments

We considered the Authority's preliminary and final comments and made appropriate revisions to the finding. We added a discussion on Section 8 administrative fee reserves and additional information to show the Authority's precarious financial condition. Our conclusions and recommendations generally remained unchanged. Our responses to each of the Authority's comments are included in Appendix C.

Recommendations

We recommend that you:

1A. Declare the Authority in substantial default of its Consolidated ACC for low-income public housing and its Consolidated Section 8 ACC, and take possession and control of all Authority operations and assets.

1B. Take appropriate administrative actions against the Executive Director, Deputy Director and the Board Chairman, including issuing Limited Denials of Participation or debarment. Also, determine whether activities by other Board members warrant administrative sanctions, and if so, take appropriate actions.

1C. Instruct the Authority to immediately discontinue using funds for development activities.

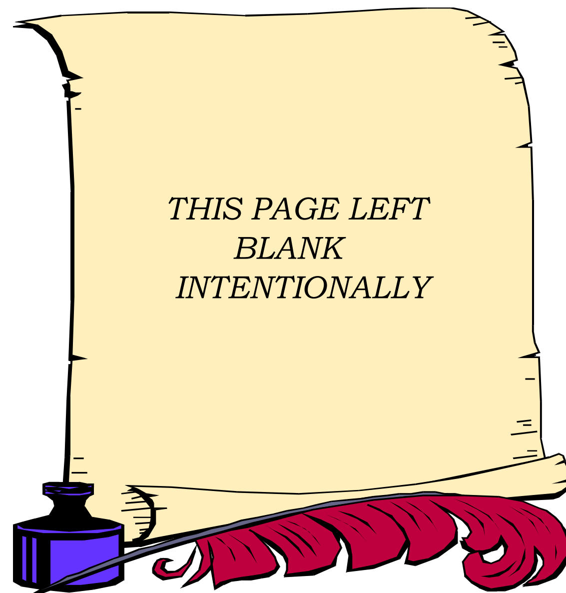
1D. Seek release of encumbered Authority assets from lenders and investors.

1E. Seek recovery of all amounts owed the Authority by NHE and its related privately owned developments. The funds should be repaid to the Authority from non-Federal funds. (Appendix H)

1F. Seek recovery of $45,324, or the current balance owed the Authority by Hospitality House of the Boone Area, Inc.

1G. Review Section 8 reserve expenditures and balances from July 1, 1998, to June 30, 2002, for accuracy and compliance with HUD guidelines.[5]

[5] This would require the Authority to provide: (1) an analysis, performed prior to any disbursements, showing how the Authority determined it possessed excess reserves qualifying for disbursement for other housing purposes, (2) a copy of Board resolutions authorizing each disbursement over $1,000, (3) documentation showing that any authorized disbursements were used for eligible housing activities, and (4) evidence that reported reserves are invested, as required.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Travel Expenses Were Unnecessary And Ineligible

The Authority incurred travel costs that were unnecessary and ineligible. It paid lavishly for meals, hotels, and tips, made frequent out-of-region trips, and paid travel expenses for family members of management and the Board. This violated the ACC's and occurred because the Authority's travel policy did not set spending limits and was not comparable with local public practice. Also, the Authority did not maintain adequate records to track amounts due and reimbursements received for expenses it paid on behalf of individuals. As a result, the Authority overspent its travel budget by $50,000 for the review period, and those funds were not available for its programs.

Criteria

Section 307 (A) of the Consolidated ACC for low rent public housing requires the Authority to adopt and comply with a statement of personnel policies comparable with pertinent local public practice. Such statement shall cover, among other things, payment of expenses of employees in travel status. Section 201 provides that the Authority should operate each project in a manner that promotes serviceability, efficiency, economy, and stability. Finally, Section 406 (B) of the ACC provides that operating expenditures must be necessary for the operation of a project. The Office of Management and Budget (OMB) Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments" establishes principles and standards for determining costs for Federal awards carried out through grants, cost reimbursement contracts, and other agreements with State and local governments and federally-recognized Indian tribal governments. OMB Circular A-87 provides "A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. The question of reasonableness is particularly important when governmental units or components are predominately federally-funded." It further provides that a cost is reasonable if it is recognized as ordinary and necessary for the performance of a Federal award and if the entity acted with prudence considering its responsibilities to its employees, the taxpayers, and the Federal Government.

The Authority's travel policy was inadequate

The Authority's travel policy was not comparable to local public practice. The City of Boone limited daily per diem to $30 in State and $36 out of State. Watauga County[6] limited daily per diem to $28 for all travel. The Authority's travel policy stated it would reimburse the actual costs of travel, meals, lodging, and other expenses directly related to accomplishing business objectives. Employees were expected to limit expenses to reasonable amounts such as standard accommodations in hotels, the cost of meals (no more lavish than would be eaten at the employee's own expense), and tips not exceeding 20 percent of the cost of a meal or taxi fare.

Following a management review, HUD issued a report dated September 30, 1988, requiring the Authority's travel policy to be comparable with local public practice. In its response to that report, the Authority stated its policy was comparable and included a daily limit for meals. As a result, HUD cleared the finding. In 1995, even though Authority management knew the requirements, it revised its policy to eliminate the daily limit and allow actual costs. The revised policy was vague and subject to wide interpretation, which allowed Authority staff to incur unnecessary travel expenses. While the Board did approve the location of the out-of-town trips and the staff members that would go, it did not approve spending amounts for the trips.

Travel expenses were unnecessary

From July 1, 1998, through June 30, 2001, the Authority spent $295,547 for travel. It charged $42,185 to its public housing program and $179,966 to its Section 8 Program. This exceeded its travel budget by over $50,000.

Fiscal Year	Budget	Actual	Amount Over/(Under) Budget	Percent
1999	$ 75,000	$ 110,112	$ 35,112	47
2000	102,000	99,431	(2,569)	-3
2001	68,000	86,004	18,004	26
Total	$245,000	$ 295,547	$ 50,547	21

6 The Authority is located in the City of Boone, Watauga County.

We reviewed documents and met with the Executive and Deputy Directors to analyze the trips. The Authority generally classified travel expenses as "out of region" or "in region." Out of region travel was any travel outside the seven counties of the Authority's jurisdiction.

Out of Region Travel

Authority staff made 79 out of region trips costing over $155,000 during the review period: 29, 30, and 20 trips in fiscal years 1999, 2000, and 2001 respectively. Twenty-two trips totaling over $23,000 were for non-Authority business and were ineligible. The Authority paid airfare, rental car, mileage, lodging, meals, parking, tips, snacks, conference registration fees, and other expenses.

We compared the cost of six of the trips to costs allowed under Federal travel regulations as a reference for reasonableness. The Authority spent from 37 to 223 percent more than the maximum costs allowed by the Federal government for those trips; over $37,000 more. While the Authority spent $160 per night <u>on average</u> for a room, the <u>maximum</u> allowable rate under Federal regulations was $125. Appendix K shows the room and meal costs for the six trips.

Many meal costs were lavish. For example, 10 employees and Board members attended a workshop in Biloxi, Mississippi, and spent $1,500 for one dinner. Also, four employees attended a conference in Raleigh, North Carolina, and spent over $1,100 on one meal. The Executive Director stated that in addition to Authority employees, the Authority often purchased meals for attorneys, bankers, and business partners such as developers, development consultants and private contributors. He considered this to be a regular cost of doing business. However, such costs were not reasonable or necessary for conducting Authority business; they were attributable to the privately owned developments. For the six trips we reviewed, the Authority spent $8,788 for meals. Under local policies, the maximum allowed was $3,672. The difference of $5,116 was unreasonable and unnecessary.

Authority policy limited payment of tips to 20 percent. However, Authority travelers paid as much as 49 percent for a meal tip, with an average tip of 23 percent, over $1,117 more than the policy allows. Authority personnel paid a tip of $100 for a meal that cost $236.

In Region Travel

The Authority appropriately paid per diem and mileage to Board members to attend monthly Board meetings and to employees for local travel costs. However, the Authority also paid for staff lunches and the Executive Director's business lunches, which were inappropriate and extravagant. Over $18,000 was spent at local restaurants during the 3-year review period, much of it listed on the Executive Director's expense reports as business or staff lunches. He stated these meals were for corporate managers, primarily the Executive Director and Deputy Director, who discussed business during lunch and for field managers to attend business activities in Boone. He also stated the charges included luncheon meetings with business partners.

Ineligible travel expenses

In violation of the ACC, the Authority paid ineligible expenses on behalf of Authority staff and Board members. For example, in January 2000, the Authority paid $395 for a plane ticket to Washington, DC, for the Deputy Director's grandson. She repaid half the cost about 6 months later, but did not repay the remainder until we questioned the cost in February 2002. The Authority often paid for plane tickets and other items for Board members' and employees' relatives when they accompanied them on trips. Some costs were reimbursed; however, according to the Deputy Director, the Authority did not maintain records to track the repayments. Thus, we were unable to determine whether all costs were reimbursed.

Board member recommended changes

In his July 25, 2000, letter to the Board Chairman, one Board member recommended changes to travel procedures. He recommended:

- Limited travel for staff members;
- All travel be reviewed and authorized by the Board Chairman;

- A complete monthly expense report for all out-of-region travel;
- A complete monthly reporting to the Board of in-region travel for staff; and,
- Reductions in the travel budget.

Although travel did decline following the recommendations, the Authority did not revise its written policy.

Authority Comments

As more specifically detailed in Appendix C, NRHA replies as follows:

1. No NRHA program, HUD or otherwise, suffered funding unavailability due to travel or other expenditures.
2. The author of the 1998 HUD report agreed that "local public practice" did not mean the policy of the Town of Boone but of comparable North Carolina Housing Authorities. According to that definition, NRHA policy conforms to "local public practice."
3. Comparable North Carolina Housing Authorities maintain a "reasonable and actual cost" policy similar if not identical to NRHA's.
4. NRHA employees are not federal employees, and the NRHA Board is not required to adopt a "GSA-style" daily limit policy. The NRHA Board prefers to monitor travel expense closely and allow managers and staff the latitude to incur reasonable and actual costs.
5. The NRHA Board approves in advance all out-of-region travel.
6. The OIG provides no evidence for its assertion that "many of the expenditures were unnecessary for the execution of HUD programs" nor that NRHA overspent its budget by $50,000. NRHA disagrees with both assertions.
7. The OIG concludes but does not prove that HUD funds paid for all travel expense or that all travel was in connection with "HUD programs".
8. The OIG provides no evidence that NRHA used funds provided under the Conventional Public Housing ACC for travel expense.
9. NRHA lawfully incurred certain of the criticized expense in connection with the lawful and authorized

development of $15 million of affordable housing units. NRHA Board and staff members incurred other criticized expense for Board-approved travel to conferences. Neither type of expense is unlawful, and the NRHA Board is the proper arbiter of what is necessary and prudent travel expense.

10. The NRHA staff member involved has repaid the single instance of inadvertent personal travel expense.
11. NRHA's since-terminated Accounting Manager did keep indeed terrible records, but no evidence of non-reimbursement exists. The current Finance Director does keep accurate records. The Board is wholly unaware of any non-reimbursed amounts that any member may owe and firmly believes that no such amounts exist.

OIG Response to Authority Comments

We considered the Authority's preliminary and final comments and made appropriate revisions to the finding. We added OMB Circular A-87 guidance for determining whether costs are reasonable and added Appendix K to show the costs of the six trips discussed in the finding. Our conclusions and recommendations generally remained unchanged. Our responses to each of the Authority's comments are included in Appendix C.

Recommendations

We recommend you require the Authority to:

2A. Revise its travel policy to prescribe reasonable maximum allowances for lodging and meals.

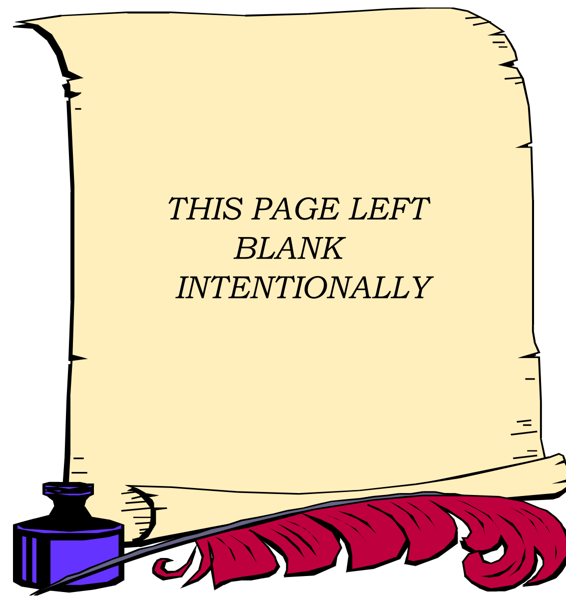
2B. Identify payments it made for family of Board members and require the Board members to reimburse the Authority or provide support that all amounts were repaid.

2C. Provide support that the $6,233 of excessive meal and tip expenses were reasonable and necessary for project operations, or repay any unsupported amounts to the Authority from non-Federal sources.

2D. Provide support that the $18,000 spent for local lunches represents reasonable and necessary expenses for project operations, or repay any unsupported amounts to the Authority from non-Federal sources.

2E. Refund $23,038 of ineligible expenses from non-Federal funds.

2F. Discontinue the practice of paying expenses for non-Authority personnel.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Other Expenses Were Unnecessary And Ineligible

The Authority incurred other unnecessary and ineligible expenses. It spent $114,302 for miscellaneous items, half of which was for entertaining and pampering its Board members and employees, their spouses and guests at Board meetings, a beach retreat, a Christmas party, and with theater tickets, jewelry, bath products, libations, and other personal gifts. The Executive Director used public money to pay for alterations of his business suit. This misuse occurred because the Authority did not establish adequate controls to ensure expenses complied with its low rent public housing and Section 8 ACC's. Consequently, the programs were deprived of needed operating funds. These actions also demonstrated the Authority's disregard of its duty to uphold the public trust.

Criteria

Section 201 of the Low Rent Public Housing ACC provides that the Authority should operate each project to promote serviceability, efficiency, economy, and stability. Section 406 (B) provides that operating expenditures must be necessary for the operation of a project.

Section 11 of the Section 8 Consolidated ACC provides that the Authority must use program receipts to provide decent, safe, and sanitary housing for eligible families. The Authority may only use program receipts to pay program expenses.

OMB Circular A-87 provides, "Costs of entertainment, including amusement, diversion, and social activities and any costs directly associated with such costs (such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities) are unallowable."

Unnecessary expenses

The Authority spent over $26,000 for 6 semi-annual board meetings. This included charges for food, drinks, flowers, and hotel rooms. Attendees included Authority employees and spouses/guests, Authority Board members and spouses/guests, and members of the community including bankers and County Commissioners. The functions were held at the Hound Ears Club in Blowing Rock, North Carolina. Our review noted payments for beer, wine, bourbon, whiskey, etc., totaling $3,892 for five meetings.

There were between 32 and 83 attendees at these meetings. The Authority only employed about 22 staff.

In addition to the semi-annual board meetings, during calendar year 2000 the Authority spent a total of $18,275 for retreats and a Christmas party. It had one planning retreat in April, 3 months prior to the July semi-annual board meeting, and another in August, just 1 month after the July meeting. The total cost for the two retreats was $7,284. This included charges for food, drinks, cottage and condo rentals, and conference room rentals. Further, the Authority spent $1,269 for a Christmas party in December 2000 and $9,722 for a staff retreat in Wrightsville Beach, North Carolina, in September 2001.

Given the Authority's precarious financial condition and its poor quality housing, we question whether these expenses were reasonable and necessary.

Ineligible expenses of $11,070

In recognition of its 20-year anniversary, the Authority purchased watches for Board members, the Authority attorney, the Executive Director, Deputy Director, and other staff. In addition to a watch, the Authority also purchased an emerald ring for the Deputy Director. These jewelry purchases totaled over $3,600.

The Authority also purchased other gifts for employees, Board members, and a Board member's spouse including:

- Kitchen and food products;
- Beauty supplies and cosmetics;
- Bath and body products;
- Tickets for benefit balls, $1,300;
- Theater tickets, $770, for management, Board members, and spouses;
- Luggage for the Executive Director, $265;
- A sweater for a Board member's spouse, $160 and,
- An $85 carriage ride for the Executive Director and his Deputy.

In total, the Authority spent $11,070 for ineligible items from July 1, 1998, to June 30, 2001, (Appendix I). These purchases were not necessary for the operation of public housing and were not used for Section 8 Program

operations. Thus, they were not in compliance with the ACC's.

Authority Comments

As more specifically detailed in Appendix C, NRHA replies as follows:

1. Charging miscellaneous expense to public housing and Section 8 results from an allocation policy for common expenses that spreads them across all NRHA programs. NRHA's IPA has not objected to this practice and advises that in his extensive experience the practice is common among Housing Authorities.
2. NRHA at no time deprived its public housing and Section 8 programs of essential operating funds, its financial condition was not and is not precarious, and no tenant resided in units other than decent, safe and sanitary. See the comment to findings 1 and 4.
3. Appendix C provides additional details for all expenses questioned as ineligible.
4. The vast number of questioned expenses were for morale-building nominal gifts and mementos for NRHA staff not able to attend conferences. NRHA does not think it improper for the Board and management to let employees know their leaders are thinking of them and value their efforts.
5. NRHA agrees that a small number of questioned expenses were not properly incurred, and the beneficiaries of those expenses have since re-paid NRHA.
6. The NRHA Board decided to halt the "memento purchase" practice in early 2000; with one exception, no expense questioned by the OIG occurred after 1999.

OIG Response to Authority Comments

We considered the Authority's preliminary and final comments and made appropriate revisions to the finding. We added a discussion showing the expenditure of $3,892 for beer, wine, bourbon, whiskey, etc., for semi-annual board meetings. The Authority included a schedule in its preliminary response that we have added as Appendix I of the audit report, as it provides more detailed information about the questioned expenditures. The schedule also

showed that expenses we originally questioned as unsupported were actually ineligible. Thus, we changed the finding to show expenditure of $11,070 for ineligible items. We also made appropriate changes to recommendation 3E and deleted recommendation 3F, which requested support for $1,787. Otherwise, our conclusions and recommendations generally remained unchanged. Our responses to each of the Authority's comments are included in Appendix C.

Recommendations

We recommend you require the Authority to:

3A. Adopt controls to ensure that costs meet ACC requirements.

3B. Discontinue the practice of using Authority funds to purchase gifts for staff, Board members, and others.

3C. Provide support that the $26,000 spent for Board meetings represents reasonable and necessary expenses for project operations, or repay any unsupported amounts from non-Federal funds.

3D. Provide support that the $18,275 spent for retreats and a Christmas party represent reasonable and necessary expenses for project operations, or repay any unsupported amounts from non-Federal funds.

3E. Refund $11,070 of ineligible expenditures from non-Federal funds.

Health And Safety Concerns Existed At Public Housing Sites

Our inspection of the public housing units and grounds revealed health and safety concerns needing immediate attention. We observed trash and debris around the property and playground equipment in disrepair. Railing or fences were needed to prevent tenants from falling down hazardous embankments. Each of the 23 units we inspected also required maintenance. The Authority needed to improve its procedures to ensure deficiencies are promptly corrected in order to provide decent, safe, and sanitary housing.

Criteria

Section 209 of its low rent public housing ACC requires the Authority to provide decent, safe, and sanitary dwellings at all times. HUD requires health and safety hazards to be corrected immediately. In October 2001, after performing property inspections of Authority units, HUD's Real Estate Assessment Center (REAC) reported physical assessment scores of 82 for Woodland Apartments and 68 for Cub Creek Apartments. However, during our February 2002 property inspections, we found serious health and safety hazards, which had existed for some time. Also, we inspected 23 of the Authority's 83 units and found that none of them met HUD's requirements. Some of these deficiencies were reported by REAC in October 2001, but the Authority had not corrected them.

Health and safety concerns around the buildings

The topography behind buildings D, E, and F of Cub Creek Apartments is very steep and hazardous. Protective railings or fences are needed to reduce the likelihood of tenants falling down the embankment. There was also excessive trash and debris, including sharp and potentially dangerous items scattered throughout the property. The playground equipment was in need of repair to prevent injury. Some areas of the concrete walkways were broken and upheaved creating serious tripping hazards. An Authority representative accompanied us on the inspections and was made aware of the deficiencies. The debris and tripping hazards were also identified by REAC in its October 2001 report. These deficiencies required immediate attention.

We also found the following examples of health and safety hazards at Woodland Apartments:

- Rusted, potentially dangerous water heaters that had been discarded on the property by maintenance staff.
- The topography behind Building C was very steep and should be protected by railings or fences.
- Refuse containers were in poor condition.
- Broken window at the rear of Building F.

The following photographs were taken in February 2002.

Trash, garbage, and other debris behind buildings at Cub Creek Apartments. This was also cited by REAC.

Rusted, potentially dangerous water heaters at Woodland Apartments.

Example of steep, hazardous terrain at Woodland Apartments.

Units were not decent, safe and sanitary

The Authority performed annual unit inspections when tenants re-certified their program eligibility. It also performed inspections when tenants moved out of their units. However, it did not always prepare work orders, and deficiencies were not always corrected.

The most prevalent deficiencies in the units we inspected were electrical hazards (53) and damaged floors (18). The electrical hazards included outlets near the kitchen sinks that were not protected with Ground Fault Circuit Interrupters (GFCI). The damaged floors apparently resulted from faulty subfloors or underlayment. We also found defective kitchen cabinets and countertops in 13 units, including heavily marred tops and countertop corner joints that were not sealed resulting in unsanitary surfaces (Appendix J). We will provide HUD and the Authority with a schedule of all deficiencies identified during our inspection. Following are examples of deficiencies we found at three units.

<u>Woodland Apartments Unit C-1</u> - The unit had 11 deficiencies. These included damaged floor tiles in the living room and kitchen that appeared to have resulted from faulty subfloor or underlayment. Because of the conditions, the tenant could not keep the floors in a sanitary condition. Also, electrical outlets near the kitchen faucet, which dripped excessively, were not GFCI protected. The kitchen countertop was not sealed at the corner joint.

<u>Woodland Apartments Unit G-2</u> - The unit had nine deficiencies. Electrical outlets near the kitchen sink were not GFCI protected and the kitchen counter joint was not sealed. Globe covers were missing from ceiling fixtures in three bedrooms and from an exterior light. The hall laundry closet dryer vent was neither properly installed nor vented to the exterior as required.

<u>Cub Creek Apartments Unit E-8</u> - The unit had seven deficiencies. These included clogged heat duct vents and a water damaged ceiling in the exterior storage room. The ceiling was heavily mildewed and a portion of the ceiling had caved in, presenting a serious safety concern. Electrical wall outlets throughout the unit were not secured and electrical outlets in the kitchen were not GFCI protected.

While the Authority neglected its Cub Creek and Woodland Apartments units, it rehabilitated its newer, 8-year old, Valley View units to ready them for sale (Finding 1).

Authority Comments

As more specifically detailed in Appendix C, NRHA replies as follows:

1. NRHA emphatically denies that it neglected its conventional public housing units.
2. The OIG claims to have found allegedly health and safety threatening "deficiencies (that) require immediate attention" during a February inspection but did not advise NRHA of its finding until September.
3. The cited REAC scores are well within the acceptable range; the same REAC survey gave NRHA a perfect score for conventional public housing management.
4. Appendix C provides more detailed explanations concerning the five specific findings, the upshot being that four of them indeed have rebuttal explanations and only the discarded water heaters are an NRHA stumble, since corrected.
5. Ground Fault Circuit Interruptors were not Code-required when the units were built, and although NRHA is not required to retrofit, it has budgeted capital funds to do so.
6. Subfloor and cabinet/countertop replacement programs are both in the plan for capital fund expenditures, and HUD approved the undertaking of the latter improvements in April, 2002.
7. Regarding the individual unit findings, while NRHA agrees that no deficiency is acceptable, it notes that seven, nine, and eleven deficiencies are not an overwhelming number in a protocol with several hundred criteria.

OIG Response to Authority Comments

We considered the Authority's preliminary and final comments and made appropriate revisions to the finding. Our conclusions and recommendations generally remained unchanged. Our responses to each of the Authority's comments are included in Appendix C.

Recommendations

We recommend you:

4A. Engage a HUD engineer to inspect unit subfloors and underlayment for structural safety.

4B. Require the Authority to establish procedures to ensure deficiencies are reported and corrected.

4C. Require the Authority to immediately inspect all of its units and grounds.

4D. Ensure the Authority corrects deficiencies identified by both OIG and REAC.

The Authority Did Not Maintain Accurate Accounting Records

The Authority did not maintain accurate accounting records. Costs were not properly allocated, accounts were out of balance, complicated journal entries were not adequately explained, and other accounting deficiencies existed. Funds advanced to privately owned developments were understated. An IPA reported similar conditions in his audits of the Authority's fiscal years ended June 30, 2000, and 2001. With accounting records that were unreliable and unauditable, the Authority could not adequately administer its programs.

Severe accounting deficiencies existed

The Consolidated ACC for low rent public housing, Part 2, requires the Authority to maintain complete and accurate books of account and records including records which permit a speedy and effective audit. To the contrary, Authority management did not ensure its books and records were complete and accurately reported all accounting transactions. We found costs were not properly allocated, accounts were out of balance, complicated journal entries were not adequately explained, and other accounting deficiencies existed.

Much of the accounting information pertaining to the privately owned developments was maintained on several complicated spreadsheets. These spreadsheets were not integrated with the Authority's accounting system. Whenever the Authority advanced funds, paid expenses, or allocated costs to a development entity or NHE, inter-entity entries should have been made showing a receivable due to the Authority and a payable owed by the appropriate development entity or NHE. We found the inter-entity accounts were grossly out of balance. Also, over $500,000 of development fees the entities owed the Authority was not recorded in the accounts. During our audit, the current Finance Officer recorded the development fees.

Management stated that although the accounting for the privately owned developments was originally accomplished through the Authority's accounting system, the system was not adequate to maintain the complicated multi-entity accounting. Thus, management hired a vendor to establish an accounting system for the development entities on a

personal computer. As a result, Authority records and development entity records were maintained separately. This required transferring all of the balances for the development entities from the Authority's accounting system to the new system. However, according to the IPA, the vendor did not transfer all of the amounts the entities owed the Authority to the new system. As a result, the development costs and the amounts owed the Authority were understated. Subsequently, management obtained cost certifications for the developments based on the amounts recorded in the new system. Therefore, the costs were understated on the certifications.

The identification, magnitude, and effect of the unrecorded and/or improperly recorded transactions are unknown. The IPA and Authority management attempted to resolve some of the allocation discrepancies by reviewing invoices and making adjustments to the accounts.

IPA reported records were unauditable

An IPA reported similar conditions in his audit reports for the Authority's fiscal years ended June 30, 2000, and June 30, 2001. The IPA reported that internal control procedures failed due to a lack of trained personnel. Further, the IPA reported:

- Untimely bank reconciliations;
- Detailed records out of balance with General Ledger control accounts;
- Significant transactions that remained unrecorded for several months;
- Almost all balance sheet accounts were inaccurate as were many income and expense accounts; and,
- Records were unauditable.

The IPA concluded the Authority could not possibly administer its programs properly with such grossly inaccurate records. He recommended the Authority recruit and retain capable staff. The Authority recently hired a new Finance Officer and a bookkeeper.

The IPA did not issue his audit of the Authority's fiscal year ended June 30, 2001, until May 17, 2002. The report included a finding similar to the June 30, 2000, report. It says that internal controls were inadequate to allow for accurate and timely recording and reporting of financial

transactions. Further, journal vouchers contained little or no supporting documentation.

Improvements have been made

During our audit, the new Finance Officer made significant progress towards correcting the account balances for fiscal year ended June 30, 2001. He discovered that about $400,000 the developments owed the Authority was not recorded on the developments' books. The IPA took the position that since the cost certifications had been completed for the developments, the Authority could not record the payables on their books. The IPA also stated the funds were likely not recoverable, and it was uncertain which entities owed the funds. Thus, management wrote off the $400,000 as a loss to the Authority. We questioned the write-offs during our audit. Subsequently, management reinstated them by recording a payable due to the Authority on NHE's books with a corresponding receivable on the Authority's books. However, management also recorded an offsetting allowance because it was unlikely the receivable would be collected.

We believe with the expertise of the current Finance Officer the Authority can resolve future accounting problems. However, it is unlikely, even with the current expertise, the Authority will ever fully correct the prior accounting records. Because of the condition of the records, we have no confidence in their historical accuracy.

Authority Comments

As more specifically detailed in Appendix C, NRHA replies as follows:

1. NRHA agrees that its since-terminated Accounting Manager was less than competent and restates that he was the cause of every supportable element of this Finding. As the report shows, his poor practices and lack of professionalism caused short-term, since corrected harm to NRHA's accounting system.
2. As the report notes, the current Finance Director is an extremely capable CPA who has guided NRHA through the remedial actions required to correct the former Accounting Manager's numerous accounting depredations. The current Finance Director is successfully continuing his efforts to maintain the

books and records of NRHA and its affiliates to the highest professional standards.

3. The IPA stated that the former problems were in the accounting controls over the general ledger and in the reporting function, rather than in controls over cash collection or disbursement, both of which were subject to good controls.
4. Developments costs and amounts due NRHA were not properly identified but they were correctly stated.
5. As noted in Finding 1, the IPA rendered an unqualified opinion regarding NRHA's financial position and results of operations for fiscal years 1999, 2000 and 2001.

OIG Response to Authority Comments

We considered the Authority's preliminary and final comments and made appropriate revisions to the finding. Our conclusions and recommendations generally remained unchanged. However, we did revise the finding to emphasize that management, not staff, is responsible for ensuring its records are complete and accurate. Our responses to each of the Authority's comments are included in Appendix C.

Recommendation

We recommend you:

5A. Require the Authority ensure its accounting records are maintained according to requirements.

The Authority Withdrew Excess Section 8 Funds

The Authority did not follow Section 8 fund requisition requirements. It did not perform reviews of its estimated annual needs and often withdrew excess funds. The Authority also did not maintain the excess funds in an interest-bearing account as required. Rather, it used them for other activities. As a result, it paid almost $11,000 in interest to HUD and had to borrow $240,000 to repay its excess withdrawals because it no longer had the money on deposit.

Criteria

Annually, HUD requires an Authority to submit Form HUD-52633, Requisition for Partial Payment of Annual Contributions. The annual requisition must be submitted 90 calendar days prior to the start of the Authority's fiscal year. The requisition reflects 12 monthly payments based on the HUD approved budget. No later than 90 days following the beginning of the Authority's fiscal year, it must review its estimated requirements for the year. If its initial estimate exceeds 5 percent of actual funding needed for the year, it must submit a revised Form HUD-52663. In addition, the Authority is required to invest any excess advances into HUD approved interest-bearing accounts and report the interest earned. The Authority must repay any excess funds at the end of each fiscal year; otherwise HUD deducts the amounts owed from future Section 8 allotments.

The Authority did not perform required reviews

The Authority did not perform required 90-day reviews and often exceeded the 5 percent requirement for individual projects. For example, in fiscal year 1999, the Authority withdrew $106,400 for one project when only $15,757 was due, an excess of $90,643. Again in fiscal year 2000, it withdrew $427,451 for one project when only $332,889 was due, an excess of $94,562.

While the Authority withdrew excess for most projects, it also withdrew less than needed for some. For example, in fiscal year 2000, the Authority did not withdraw $376,359 that it was due for one project.

From July 1, 1999, through June 30, 2001, the Authority withdrew excess Section 8 funds totaling $636,568. As of

December 31, 2001, the Authority had already withdrawn another $391,429 of excess Section 8 funds for its fiscal year ending June 30, 2002. The Authority had to pay HUD almost $11,000 in interest for the period.

The Authority did not maintain the funds. Rather, it deposited them into its general fund account along with other funds. It then used the funds to pay other costs, including ineligible private development costs (Finding 1). Thus, it did not always have funds available to repay the excess to HUD at the end of the fiscal year. As a result, in June 2000, the Authority had to obtain a bank loan at an interest rate of 9.37 percent to repay debt, including excessive withdrawals of $240,000.

Authority Comments

As more specifically detailed in Appendix C, NRHA replies as follows:

1. For the fiscal year ending June 30, 2001, HUD's Section 8 Management Assessment Plan (SEMAP) awarded NRHA's Section 8 Program a score of 96 out of 100, which afforded NRHA HUD's highest level of program recognition, that of Section 8 High Performer.
2. NRHA agrees that the since-terminated Accounting Manager did not undertake the required ninety-day reviews. The current Finance Director has been doing so since October, 2001, and indeed performs such reviews monthly.
3. NRHA does in fact deposit all requisitioned funds (and all other funds) in interest bearing accounts, although for purposes of reconciliation of Section 8 requisitions this practice is irrelevant, since HUD imputes an interest rate on excess requisitions regardless of where funds are deposited.
4. At no time did NRHA excess withdrawals approach $1 million, and NRHA promptly repaid in the normal course of business the excess withdrawals for two of the report years as part of the annual settlement process that all PHA's undertake. For the third year, the annual reconciliation showed that HUD owed NRHA $376,359 on the NRHA voucher program.
5. NRHA has determined that the $391,429 figure (which was as of December 31. 2001 and not within the report

period) had been over-stated. The actual figure as of March 31, 2002 was $224,000, well within the five per cent guideline.

6. The cited extreme example of 575% over-requisitioning involved a moderate rehabilitation program that is a miniscule part of NRHA's overall Section 8 program. It was caused by the failure of landlords to keep their properties fully leased. From an overall Section 8 program cash management perspective, NRHA has not come close to exceeding the five per cent guideline.
7. NRHA has never deprived eligible applicants of available housing and needed financial assistance. The 104 certificates and vouchers cited were part of a fair share allocation that HUD awarded to NRHA in October 2001(outside the report period) as part of the FY 2002 distribution. HUD's own regulations permit PHA's eighteen months to issue and lease up allocated vouchers or certificates, in this case until March 31, 2003. In fact, a mere two and one half months into the permitted eighteen month period, NRHA had issued almost half the allocated vouchers. Thus, NRHA was well ahead of HUD's permitted schedule.

OIG Response to Authority Comments

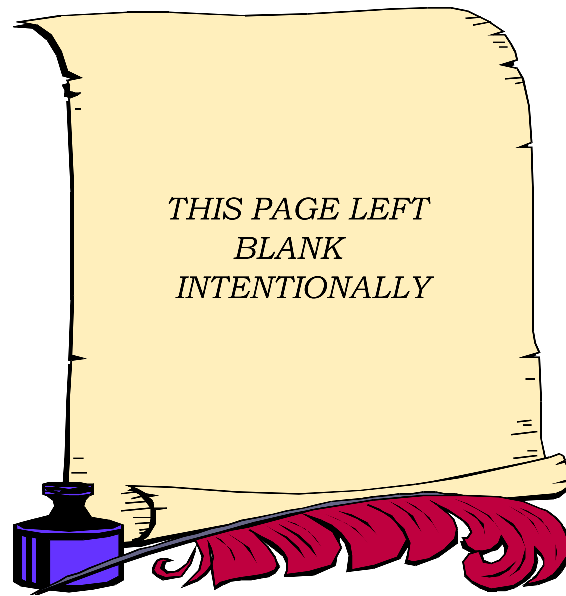
We considered the Authority's preliminary and final comments and made appropriate revisions to the finding and recommendations. Our conclusions and recommendations generally remained unchanged. However, we did remove a discussion regarding the Authority's failure to issue Section 8 certificates and vouchers. Our responses to each of the Authority's comments are included in Appendix C.

Recommendations

We recommend you require the Authority to:

6A. Review its estimates of annual Section 8 funding requirements for each program within the first 90 days of its fiscal year.

6B. Invest any excess advances into HUD approved interest-bearing accounts and report the interest earned.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Mismanagement Was Apparent in Other Areas of Operations

We noted weak procedures in other areas of Authority operations. Management did not properly segregate tenant escrow funds, adequately pursue collection of tenant rents, or follow its own nepotism policies. This occurred because management did not implement adequate controls and elected not to comply with its written policies. As a result, (1) tenant funds were not fully available for disbursement, (2) the Authority could not assure it consistently enforced rent collection efforts or assure tenants received fair and equitable treatment, and (3) the Authority hired relatives of employees in positions that violated its nepotism policy.

FSS is a program that aids low-income families renting under Section 8 and Public Housing Programs to achieve economic independence, self-sufficiency, and eventual non-reliance upon government assistance programs. The Authority is required by 24 CFR, Subtitle B, to maintain all FSS funds in a single depository account. The total on deposit must balance to the Authority's subsidiary ledger. Further, 24 CFR 880, requires the Authority to place tenant security deposits in a separate, interest-bearing account. The balance of that account must match the amount collected from tenants plus interest earned.

The Authority did not segregate and safeguard FSS funds. It commingled the deposits with other funds and used them for other purposes. As of March 31, 2002, there were 269 tenants participating in the FSS Program. They had paid $253,278 to the Authority. Only $236,791 was on deposit. However, as discussed in Finding 1, the Authority had pledged most of that ($235,448) as collateral for a loan, making it unavailable for disbursement. The Authority was unable to account for the remaining $16,487 of tenant FSS funds. According to the Authority, as of June 30, 2002, there was a shortage of $34,823.

Also, the Authority did not maintain a separate interest-bearing account for public housing security deposits. It commingled those deposits with tenant rent receipts and did not credit interest earnings to tenant accounts. As of March 31, 2002, the Authority's liability for public housing security deposits was $11,160 plus

interest. However, because the Authority did not maintain the deposits in a separate interest-bearing account, it could not assure funds, including interest due, were fully available for disbursement to tenants.

Tenant accounts receivable exceeded HUD guidelines

The Authority's tenant accounts receivable balance significantly exceeded HUD's guidelines. This occurred because management did not establish written policies and procedures governing rent collections. As a result, the Authority could not assure it consistently enforced rent collection efforts or assure tenants received fair and equitable treatment. Further, the uncollected funds were not available for other housing programs or for maintenance of its housing stock.

The standards and criteria for admission to and occupancy of public housing are set forth in 24 CFR 960. The criteria for lease procedures and requirements are set forth in 24 CFR 966, Subpart A. The Authority is authorized to terminate tenancy only for serious or repeated violations of material terms of the lease, such as failure to make payments due under the lease. Grievance procedures are provided by 24 CFR 966, Subpart B, to assure tenants are protected from arbitrary actions.

HUD rates an Authority's ability to collect rent based on the average number of days it takes to collect its tenant accounts receivable. If the average number of days is 7 or less, an Authority receives the maximum score. If the average is more than 33 days, the Authority receives no points. As of fiscal year ended June 30, 2001, the Authority averaged 110 days to collect its tenant accounts receivable.[7] This is nearly 16 times the number of days needed to obtain the maximum score and more than 3 times the level needed to receive any points. Further, during the fiscal year the Authority wrote off $12,731 as uncollectible.

According to a Co-Manager of Housing, collections were handled on a case-by-case basis. The level of collection effort was based on how well a site manager knew the tenant and the tenant's past payment experience. She said

[7] $109,128 total rent income/365 days = $299 average daily rent income. $32,883 accounts receivable balance/$299 average daily rent income = 110 days.

as long as a tenant cooperated and made an effort to pay, the Authority worked with him or her.

We found that 34 former tenants owed the Authority $16,676 at June 30, 2001. In addition, 59 current tenants owed the Authority $19,960. One current tenant had a balance due of $2,611. The tenant's monthly rent was $165. Thus, the tenant owed about 16 months rent. One former tenant owed the Authority $2,371.

Without written policies and procedures, the Authority cannot assure it consistently enforces rent collection efforts or assure tenants receive fair and equitable treatment.

Nepotism

Authority policy prohibited hiring relatives of an employee if they would be working directly for or supervising that Authority employee. The policy defined a relative as any person who is related by blood or marriage including spouse, child, parent, brother, sister, or spouse of a child, brother or sister of any board member or employee.

The Authority violated its policy by hiring relatives of employees and Board members. The Authority hired the husband, son, and daughter-in-law (the son's spouse) of a Co-Manager of Housing. The Co-Manager directly supervised her daughter-in-law, an Assistant Contract Manager, and had program responsibilities for contract work performed by her husband and son. Another Co-Manager of Housing supervised her sister, a County Human Service Representative. A County Contract Manager was the daughter-in-law of a Board member.

Nepotism weakens internal controls needed to ensure integrity of operations. HUD considers the practice to be improper and in 1995, revised the Consolidated ACC to prevent it. Although HUD intended for all public housing authorities to convert to the revised ACC, the Authority, among others, did not convert. The Authority should, at a minimum, adhere to its written policy.

Authority Comments

As more specifically detailed in Appendix C, NRHA replies as follows:

1. At all times NRHA has been able to identify or calculate funds that its holds on behalf of tenants or program participants, and NRHA has in all cases promptly paid all sums due to any tenant or program participant.
2. As noted in the comments to Finding 1, NRHA agrees that it inadvertently but no less improperly pledged two CD's containing FSS funds as collateral for a loan, but the holding Bank has since agreed to release the collateral. The report's statement about an unaccounted-for $116,948 is likely a reflection of the auditors' not noticing the second CD.
3. NRHA agrees that it should take the steps required to bring its depository handling of tenant security deposits into conformance with HUD requirements, and it is in the process of doing so. Its overall administrative and tenant pay-out treatment of security deposits is proper and accurate, and no tenant interests have been prejudiced by NRHA's depository practices.
4. NRHA agrees that its accounts receivables are higher than it would prefer, but NRHA is not ashamed of trying to work with delinquent tenants rather than casting them into the street. Note that the $12,731 cited as a write-off covers two fiscal years. NRHA will gladly entertain HUD's assistance in crafting a policy that balances sound fiscal management of tenant rent accounts with the need to treat deprived and sometimes desperate tenants humanely.
5. NRHA did not violate its nepotism policy because a violation requires circumstances that do not fall within policy guidelines or circumstances where the Board did not grant a waiver to a relationship that would otherwise fall within the policy. As shown in Appendix C, the assertions of nepotism set forth here either inaccurately portray the nature of the family relationship or the character of the employment relationship, or do not take into account Board deliberation and assent.
6. NRHA has never received a copy of the 1995 ACC revisions regarding nepotism policies.

OIG Response to Authority Comments

We considered the Authority's preliminary and final comments and made appropriate revisions to the finding and recommendations. Our conclusions and recommendations generally remained unchanged. Our responses to each of the Authority's comments are included in Appendix C.

Recommendations

We recommend you require the Authority to:

7A. Establish separate interest-bearing bank accounts for FSS funds and tenant security deposits and deposit amounts needed to fund current balances. These accounts should be free from any liens, and readily available for disbursement to tenants.

7B. Deposit all future amounts collected for the FSS Program and tenant security deposits into the designated deposit accounts.

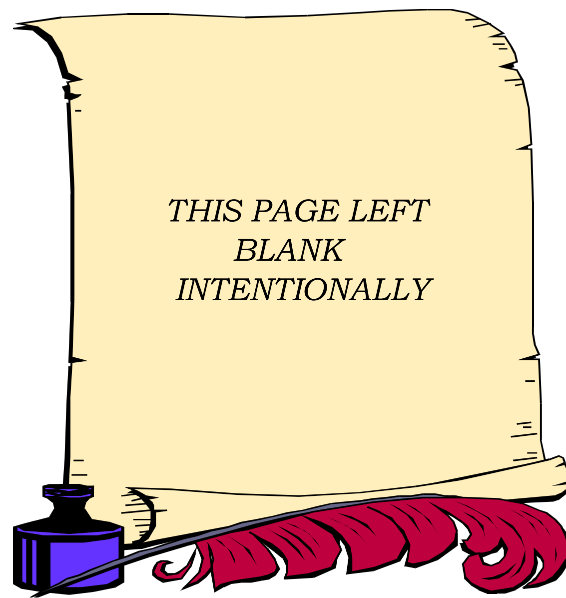
7C. Credit applicable interest earnings to each tenants' subsidiary account balance.

7D. Develop and implement written policies and procedures governing rent collections.

7E. Increase collection efforts on past due accounts and determine whether they are collectible. If deemed uncollectible, write off the balances.

7F. Reassign staff who are supervised by relatives, or whose duties or performance may be affected by a relative.

7G. Discontinue the practice of hiring staff who are supervised by relatives.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Management Controls

Management controls include the plan of organization, methods, and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Management Controls

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

- Program Operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- 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 – Polices and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

We assessed all of the relevant controls identified above.

Significant weaknesses

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

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

- <u>Program Operations</u> - Because the Authority did not maintain adequate accounting records, it could not adequately administer its programs (Finding 5). The Authority did not maintain its low-income housing units in good repair and condition (Finding 4). The Authority

did not follow Section 8 fund requisition requirements (Finding 6). Authority management did not properly segregate tenant escrow funds and did not adequately pursue collection of rents (Finding 7).

- Validity and Reliability of Data - The Authority did not maintain accurate accounting records (Finding 5).

- Compliance with Laws and Regulations - Authority management inappropriately pledged Authority assets and guaranteed repayment of development loans, obtained unauthorized loans, and misused public funds, which violated the ACC (Finding 1). The Authority did not maintain accurate accounting records (Finding 5). The Authority incurred excessive, unnecessary, and ineligible travel and other costs (Findings 2 and 3). The Authority did not provide decent, safe, and sanitary housing (Finding 4). The Authority did not perform required reviews of its estimated annual Section 8 requirement and did not deposit excess funds as required (Finding 6). The Authority violated regulations requiring it to segregate FSS funds and tenant security deposits (Finding 7).

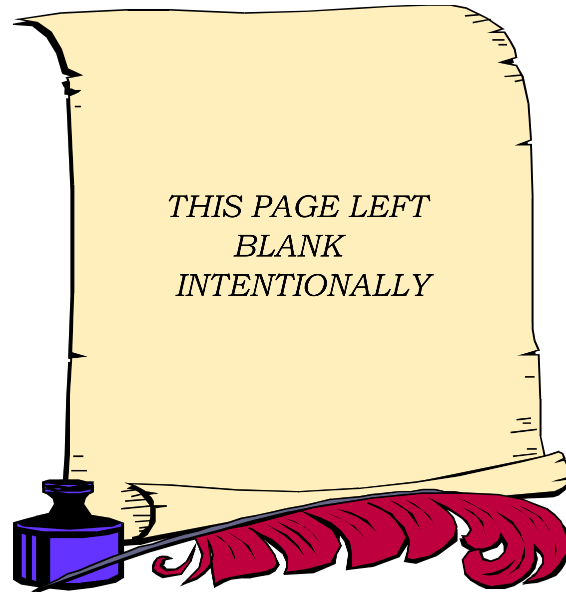
- Safeguarding Resources - Authority management inappropriately pledged Authority assets and guaranteed repayment of development loans, obtained unauthorized loans, and misused public funds (Finding 1). The Authority did not keep adequate records of funds advanced to privately owned developments (Finding 5). The Authority incurred excessive, unnecessary, and ineligible travel and other costs (Findings 2 and 3). The Authority withdrew excess Section 8 funds and used some of the funds for unauthorized development activities (Finding 6). The Authority did not segregate FSS funds and tenant security deposits (Finding 7).

Follow-Up On Prior Audits

This was the first Office of Inspector General audit of this Authority. The Authority's independent audit report for fiscal year ended June 30, 2000, included a finding that the Authority's control procedures failed due to a lack of trained personnel and due to the resignation of personnel. The Authority did not implement many control procedures over its general ledgers. As a result, the financial statements were significantly inaccurate to the point that the IPA considered the records to be unauditable.

The IPA did not issue the report for the year ended June 30, 2001, until May 17, 2002. The report contained three findings: (1) the Authority had not performed the required physical inventory, (2) the Authority drew CIAP funds of $35,697 for which it was not able to identify associated costs, and (3) the Authority's internal controls over the accumulation, recording, and reporting of transactions were inadequate to allow for the accurate and timely recording of financial transactions. In addition, journal vouchers contained little or no supporting documentation and usually no explanation. The IPA considered findings two and three to be material weaknesses.

As shown in Findings 1 and 5 of this report, we found similar conditions.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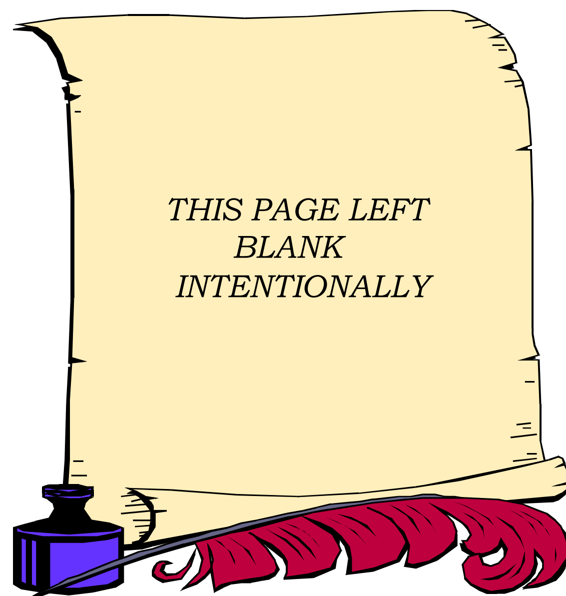
Schedule of Questioned Costs

Recommendation	Ineligible[1]	Unnecessary[2]
1E	$ 4,224,342	
1F	45,324	
2C		$ 6,233
2D		18,000
2E	23,038	
3C		26,000
3D		18,275
3E	11,070	
Total	$ 4,303,774	$ 68,508

[1] Ineligible costs are those that are questioned because of an alleged violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the expenditure of funds.

[2] Unnecessary costs are those which are not generally recognized as ordinary, prudent, relevant, and/or necessary within established practices. Unreasonable costs exceed the costs that would be incurred by the ordinarily prudent person in the conduct of a competitive business.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HUD Comments

U. S. Department of Housing and Urban Development

Greensboro Field Office
2306 West Meadowview Road
Greensboro, NC 27407-3707
www.hud.gov/local/gre

September 27, 2002

MEMORANDUM FOR: Nancy H. Cooper
Regional Inspector General for Audit, Region 4, 4AGA

FROM: Michael A. Williams, Director, Office of Public Housing, 4FPHI

SUBJECT: Draft Report
Northwestern Regional Housing Authority
Public Housing Programs
Boone, North Carolina

We are providing the following response to the draft audit report identified above.

Recommendation 1A:

Declare the Authority in substantial default of its Consolidated ACC for low-income public housing and its Consolidated Section 8 ACC, and take possession and control of all Authority operations and assets.

PIH Response:

We concur on the audit recommendation.

Recommendation 1B:

Take appropriate administrative actions against the Executive Director, Deputy Director and all Board members, including issuing Limited Denials of Participation or debarment.

PIH Response:

We concur on the audit recommendation with limitations.

Recommendation 1C:

Instruct the Authority to immediately discontinue using funds for development activities.

PIH Response:

We concur on the audit recommendation.

Action Planned:

- Official notification to NRHA requiring they discontinue using funds for development activities immediately.
- Place "zero threshold" for all Capital Fund programs. This will prohibit any "draw-downs" without prior HUD approval.
- Require prior HUD approval for utilization of any operating reserves for both Public Housing and Section 8 Programs.

Recommendation 1D:

Seek release of encumbered Authority assets from lenders and investors.

PIH Response:

We concur on the audit recommendation.

Recommendation 1E:

Seek recovery of all amounts owed the Authority by NHE and its related privately owned developments. The funds should be repaid to the Authority from non-federal funds.

PIH Response:

We concur on the audit recommendation.

Recommendation 1F:

Seek repayment of $45,324, or the current balance owed the Authority by Hospitality House of the Boone Area, Inc.

PIH Response:

We concur on the audit recommendation.

Recommendation 2A:

Revise its travel policy, making it comparable with local public practice, including maximum allowances for lodging and meals.

PIH Response:

We concur on the audit recommendation.

Recommendation 2B:

Identify payment it made for family of Board members and require the Board members to reimburse the Authority or provide support that all amounts were repaid.

PIH Response:

We concur on the audit recommendation.

Recommendation 2C:

Provide support that the $6,233 of excessive meal and tip expenses were reasonable and necessary for project operations, or repay any unsupported amounts to the Authority. Payment should be from non-Federal funds.

PIH Response:

We concur on the audit recommendation.

Recommendation 2D:

Provide support that the $18,000 spent for local lunches represents reasonable and necessary expenses for project operations, or repay any unsupported amounts to the Authority. Repayment should be from non-Federal funds.

PIH Response:

We concur on the audit recommendation.

Recommendation 2E:

Discontinue the practice of paying for non-Authority personnel.

PIH Response:

We concur on the audit recommendation.

Recommendation 3A:

Adopt controls to ensure that costs meet ACC requirements.

PIH Response:

We concur on the audit recommendation.

Recommendation 3B:

Discontinue the practice of using Authority funds to purchase gifts for staff, Board members, and others.

PIH Response:

We concur on the audit recommendation.

Recommendation 3C:

Provide support that the $26,000 spent for Board meetings represents reasonable and necessary expenses for project operations, or repay any unsupported amounts to the Authority. Repayment should be from non-Federal funds.

PIH Response:

We concur on the audit recommendation.

Recommendation 3D:

Provide support that the $18,275 spent for retreats and a Christmas party represent reasonable and necessary expenses for project operations, or repay any unsupported amounts to the Authority. Repayment should be from non-Federal funds.

PIH Response:

We concur on the audit recommendation.

Recommendation 3E:

Repay $9,283 of ineligible expenditures from non-Federal funds.

PIH Response:

We concur on the audit recommendation.

Recommendation 3F:

Provide support for $1,787 of miscellaneous expenses or repay any unsupported amounts from non-Federal funds.

PIH Response:

We concur on the audit recommendation.

Recommendation 4A:

Engage a HUD engineer to inspect the Authority's housing for structural safety.

PIH Response:

We concur on the audit recommendation.

Action Planned:

- Schedule Physical Inspection to be conducted by HUD engineer. Additional travel funds have been requested for the first quarter of the 2003 fiscal year.
- Provide written report indicating any deficiencies noted during the inspection.
- Review response for approval or denial of corrective actions completed; and proposed.

Recommendation 4B:

Require the Authority to establish written procedures for performing annual inspections of its units and grounds.

PIH Response:

We concur on the audit recommendation.

Recommendation 4C:

Require the Authority to immediately inspect all of its units and grounds.

PIH Response:

We concur on the audit recommendation.

Recommendation 4D:

Require the Authority to timely correct deficiencies identified by both our inspections and any future inspections by the Authority or HUD.

PIH Response:

We concur on the audit recommendation.

Recommendation 5A:

Require the Authority to ensure its accounting records are maintained according to requirements.

PIH Response:

We concur on the audit recommendation.

Recommendation 6A:

Review its estimates of annual Section 8 funding requirements for each program within the first 90 days of its fiscal year.

PIH Response:

We concur on the audit recommendation.

Recommendation 6B:

Invest any excess advances into HUD approved interest-bearing accounts and report the interest earned.

PIH Response:

We concur on the audit recommendation.

Recommendation 6C:

Issue any remaining Section 8 certificates/vouchers to eligible applicants.

PIH Response:

We concur on the audit recommendation.

Recommendation 7A:

Establish separate interest bearing bank accounts for FSS funds and tenant security deposits and deposit amounts needed to fund current balances. These accounts should be free from any liens, and readily available for disbursement to tenants.

PIH Response:

We concur on the audit recommendation.

Recommendation 7B:

Deposit all future amounts collected for the FSS Program and tenant security deposits into the designated deposit accounts.

PIH Response:

We concur on the audit recommendation.

Recommendation 7C:

Credit applicable interest earnings to each tenants subsidiary account balance.

PIH Response:

We concur on the audit recommendation.

Recommendation 7D:

Develop and implement written policies and procedures governing rent collections.

PIH Response:

We concur on the audit recommendation.

Recommendation 7E:

Increase collection efforts on past due accounts and determine whether they are collectible. If deemed uncollectible, write off the balances.

PIH Response:

We concur on the audit recommendation.

Recommendation 7F:

Reassign or terminate staff who are supervised by relatives, or whose duties or performance may be affective by a relative.

PIH Response:

We concur on the audit recommendation to reassign staff; however do not concur with terminating staff. Our concern is that this may pose an undue hardship on the individual being terminated.

Recommendation 7G:

Discontinue the practice of hiring staff who are supervised by relatives.

PIH Response:

We concur on the audit recommendation.

Recommendation 7H:

Execute the 1995 revised ACC.

PIH Response:

We do not concur on the audit recommendation due to regulatory constraints. The language pertaining to the 1995-revised ACC specifically states its implementation is optional. Therefore, the field office may not require them to convert as such.

Authority Comments

October 10, 2002

Ms. Nancy Cooper
Regional Inspector General for Audit
US Department of Housing and Urban Development
75 Spring Street, SW, Room 330
Atlanta, GA 30303-3388

Subject: Draft Audit Report
NRHA Final Comments

Dear Ms. Cooper,

As promised, NRHA is pleased to provide its Final Comments to the subject audit report. Consistent with your statements at the meeting on September 18, NRHA has made every effort to provide comments that succinctly summarize the detailed response previously provided to you as the preliminary comments. NRHA further has taken great pains to frame its comments in a wholly professional, non-inflammatory manner. We realize the number of bullet point comments that accompany some findings are sizeable, but this is simply a function of the number of specific items that merit this auditee's comments. NRHA has rendered no comment unnecessarily and has where possible consolidated various elements of a finding under the umbrella of a single comment. Accordingly, NRHA fully expects that the "auditee's comments" sections of the Final Report will reproduce these comments without change or OIG summary. NRHA also expects that the Final Report will also reproduce this cover letter in connection with the Report's Executive Summary.

NRHA is confident that your staff will carefully consider the Final Comments, and more pertinently, the Preliminary Comments previously submitted that will be attached to the Final Report as Appendix C. The Board and I have every expectation that a fair and comprehensive reading of the Comments will lead to an accurate Final Report that will allow the cognizant Office of Public Housing to render an informed and impartial decision.

For twenty years, NRHA has provided a variety of housing services and opportunities to thousands of low-income families in seven economically-distressed, rural counties in the mountains of North Carolina. NRHA has been recognized by HUD and Affordable Housing professionals as a national leader in the development of Affordable Housing and in the development and operation of housing programs, not just for rural areas but against any measurement. The Board was therefore mystified, shocked and dismayed by many of the findings in the draft report. The Board and I are convinced that NRHA's Comments have completely rebutted every one of the significant findings in the draft report, and we are prepared to continue to offer that rebuttal wherever and whenever required. Please be assured that the Board and I remain fully supportive of NRHA management and staff, and fully committed to the successful operation and growth of the many Affordable Housing programs to which NRHA devotes its full energy and attention.

As a public body, NRHA welcomes public oversight and scrutiny, and it was our privilege to host the OIG during the conduct of the audit. NRHA has always found the audit process to be illuminating and instructive, and this audit was no different. The Board and I always appreciate

any advice, encouragement or suggestions that will allow the Board, management and staff of NRHA better to discharge our important mission of providing real housing opportunities to our many thousands of clients.

NRHA also welcomes the opportunity to help the Greensboro Office of Public Housing better understand the extent of our many Affordable Housing initiatives, and our many successes in this area. We will be pleased to respond to the Final Report in whatever fashion the Office of Public Housing requests.

With best regards,

L. J. McEntyre, Jr., Chairman

cc HUD and OIG recipients of the OIG draft report
NRHA counsel
NHE counsel
E. G. "Ned" Fowler, Executive Director

EDITORIAL NOTE: In the interest of brevity, only the Finding title and the Authority Comments heading have been reproduced from the draft report. For each Finding, beginning with the heading Authority Comments: the bullet points for that Finding are designed to be lifted out of this document and inserted into the appropriate Authority Comment section in the Final Report. The OIG is free to adjust margins or tabs as required provided that the text and the numbering format remain intact.

FINDING 1 – MANAGEMENT INAPPROPRIATELY PLEDGED AUTHORITY ASSETS

Authority Comments: As more specifically detailed in Appendix C, NRHA replies as follows:

1. NRHA is a North Carolina public corporation whose overall activities are governed by its charter, its by-laws, and the North Carolina General Statutes. Its existence as a Housing Authority in no way means that HUD has oversight and control over every contract or other arrangement to which NRHA chooses to become a party.

   OIG response
   The finding does not mention North Carolina law or the Authority's charter or by-laws. By guaranteeing loans, the Authority encumbered assets in violation of the ACC. Any discussion of North Carolina law, charters, or by-laws is irrelevant.

   By entering into the ACC's and receiving HUD subsidies, the Authority agreed to abide by regulations and HUD rules. These regulations and rules prohibit activities such as those undertaken by the Authority. HUD and the OIG are mandated to ensure housing authorities abide by regulations and rules and to report violations.

2. The only improper pledge of NRHA assets was the inadvertent pledge of two CD's containing FSS funds, and the holding Bank has since agreed to release the collateral.

   OIG response
   The finding contains several examples of violations of ACC Section 313. For example, management pledged tenant FSS funds, real estate, and expected proceeds from the sale of real estate to obtain unauthorized loans. Further, in violation of Section 313 the Authority pledged its assets to guarantee the obligations of a private non-profit corporation. The Authority must realize that the definition of "project" is broad (ACC Section 312). It includes not only the physical real estate, but also personal property such as cash on hand, deposits, reserves, equipment, intangible personal property, etc. The pledge or encumbrance of any of these assets constitutes a violation of Section 313.

   We revised the finding to show the Authority pledged two CDs representing tenant FSS funds.

3. Absent a showing of improper use of HUD program funds, decisions lawfully and properly made by the NRHA Board about business risk, encumbrance of assets not subject to HUD's control, and the amount and type of loans and loan guarantees are not within OIG's purview.

   OIG response
   See our responses to comments 1, 2, and 6.
4. NRHA is solvent, well-managed and at no time has it been in a precarious financial position. The IPA has rendered an unqualified opinion regarding NRHA's financial position and results of operations.

OIG response
We believe our assessment is fair and accurate. As detailed in the report, the small Authority had $2.6 million in bank debt. Debt service alone was approximately $18,000 per month and the Authority had no funds with which to repay the principal. The Authority's financial condition led it to request HUD approval to sell 18 public housing units. The Authority had virtually no cash reserves and very little cash with which to operate. The Authority pledged tenant FSS funds for unauthorized operating loans. Also, by its own admission, it owed that program another $35,000 it had used for other purposes. Further, it had not funded a separate tenant security deposit account, as required by HUD. During 2000 it obtained a bank loan to repay HUD overdrawn Section 8 funds. It was also carrying as an asset $4.2 million in receivables due from private entities for which collection is uncertain.

The IPA rendered an unqualified opinion. However, we noted a few days before the end of the fiscal year, June 30, HUD wire transferred funds into the Authority's Section 8 bank account. Thus, the financial statements show a large cash balance at the end of the fiscal year. This is deceptive because most of the cash represented short-term liabilities payable to landlords for Section 8 rents, which were paid shortly after the end of the fiscal year. In reality, the Authority had very little cash.

5. NRHA is not in Substantial Default of its Section 8 ACC in that the ACC authorizes use of excess administrative fee reserve funds for any housing activities otherwise lawful under state and local law, which was in fact the use of the $310,610.

OIG response
We removed the statements declaring the Authority in substantial default of its ACC. Rather, we recommended the HUD Action Official make that determination.

We added a discussion to the finding pertaining to the requirements for using Section 8 administrative fee reserves. We also questioned the Authority's claims that it both expended reserves and yet reported to HUD that it had significant reserves on deposit. We also added a recommendation that the Action Official review Section 8 reserve expenditures and balances for accuracy and compliance with requirements.

6. NRHA is not in Substantial Default of its Conventional Public Housing ACC because changes to the US Housing of 1937 enacted by QHWRA permit the use of CPH funds in mixed finance developments such as NHE's tax credit projects. The amount in question, $37,531.40 and not $274,248, was used to pay a small portion of the construction costs of two tax credit projects and not salaries or other development costs.

OIG response
As stated in our response to the preceding comment, we removed the statements declaring the Authority in substantial default of its ACC and recommended the action official make that determination.

We disagree that the amount of misused public housing funds was $37,531.40. The questioned amount was $274,248. The Authority's admission that it used over $37,000 of public housing funds for private development expenses is in itself, a serious matter.

The Authority claimed that the Quality Housing and Work Responsibility Act of 1998 (QHWRA) changed the National Housing Act of 1937 giving housing authorities the right to finance privately owned Section 8 properties using public housing funds. Not only is that interpretation incorrect, it is a poor argument since the Authority's early development activities actually predated QHWRA by

several years. QHWRA does provide for limited use of certain public housing funds for development of public housing using a mixed finance model. The Authority misrepresented what QHWHA permits by quoting only one sentence of Section 3(b)(1) of the United States Housing Act of 1937 as Amended by QHWRA. The preceding sentence of that section reads: "The term 'public housing' means low-income housing, and all necessary appurtenances thereto, assisted under this Act other than under Section 8." To meet QHWRA requirements, mixed financed developments must include "public housing". Authorities desiring to develop mixed finance public housing are required to follow HUD regulations at 24 CFR 941 Subpart F. The regulations require approvals by HUD Headquarters throughout the development process and require an amended ACC. The Authority did not develop public housing, obtain HUD approval, or obtain an amended ACC. The Authority developed privately owned Section 8 properties, which is specifically prohibited by QHWRA.

7. HUD at all times was aware of the various developments and related activities, provided extensive support and encouragement, and consistently and timely rendered any HUD approvals that NRHA required in order to complete and operate the projects.

OIG response
The Authority asserted that HUD approved the development activities and related bank loans. While HUD was aware the Authority developed privately owned Section 8 properties, we did not find any evidence that HUD was aware the Authority used Federal funds, pledged assets, or guaranteed loan repayments. Further, we found no evidence HUD granted any waivers allowing such activities.

8. No loan agreement to which NRHA is a party was unauthorized, as all were approved by NRHA's Board and by HUD, where HUD approval was required. In particular, HUD fully reviewed and approved the release of Valley View units for sale to first time low-income home buyers before the property was encumbered. The Valley View loan is current, as are all NRHA loans, and the sales of four Valley View units have closed.

OIG response
See our response to comment 7 pertaining to HUD's knowledge of Authority activities. We have concerns about the application for the sale of the Valley View units. For example, the application states the Authority would sell the units to develop new affordable housing. The units were sold primarily to pay off debts for the units that had already been improperly developed. No new units were developed. We will address our concerns with the application in a separate memorandum to the Special Applications Center.

At completion of our fieldwork, the Authority had not sold any of the Valley View units. Further, it did not provide any evidence that it had since sold units.

9. Of the $4.2 million that NHE owes NRHA, only the $347,000 in Section 8 and conventional housing funds are of concern to OIG, and as noted above their expenditure was proper. NHE owes the remaining $3.638 million to NRHA's development and general funds, which are not within OIG's ambit. The loaned funds will ultimately be recouped through payment of deferred developer fees to NRHA and through NHE's acquistion at the end of the tax credit period of real estate assets likely to be valued at far more than $3.5 million dollars.

OIG response
The Authority commingled funds into its general fund. These commingled funds included tenant rents, public housing operating funds and Section 8 funds. While the Authority may have deposited loan proceeds and other funds into the general fund, commingling the funds cannot obscure the character of the Federal funds. Further, because of the poor condition of the accounting records, the

funds cannot be distinguished. Regardless, when the Authority pledged assets as collateral for bank loans and commingled the loan proceeds with Federal funds, those funds became subject to HUD rules. Thus, OIG has a duty and responsibility to ensure proper use of the funds.

NHE has the option of acquiring the developments when the tax credits expire after 15 years of operation. However, it is not clear how that would benefit the Authority. First, there is no guarantee NHE would acquire the developments. NHE is not the Authority. It is an independent non-profit corporation structured in such a way that the Authority has no guarantee of continued control. Further, there is no guarantee NHE would repay the Authority. Even if the agenda plays out as the Authority hopes, it doesn't change the fact that all the development activities were improper. Also, for the Authority to loan such significant funds with no guarantee of repayment, and with little or no interest, shows its neglect for its fiduciary responsibilities. If NHE does not repay the Authority, what recourse will the Authority have?

10. The tax credit projects are solvent, cash-flow positive, well-managed and successful, operating precisely as intended. The tax credit projects regularly pay NRHA management fees, and the more mature projects are making payments on deferred developer fees balances.

    OIG response
    Since there are only 156 units, the Authority earns only limited management fees. Much of what the Authority classifies as management fee income is actually direct expense reimbursement. After payment of management expenses, including salaries of Authority staff, there could be little if any positive cash flow from management fees.

    Technically, the Authority earned development fees. However, it was not authorized to undertake the development activities. The ACC does not permit any Authority resources, including staff, to be used to develop privately owned housing. Even though it did develop the projects, it deferred the revenue. While this may have been an acceptable accounting classification, the Authority, in effect, loaned the earned fees to the private developments.

    While the Authority contends that the more mature projects are making payments on deferred development fees, this is misleading. According to an exhibit the Authority provided with its preliminary comments, most of the developer's fees that were paid, were paid at closing. Based on the Exhibit, the total developer's fees earned were $792,817. Of that, $229,519, or 29 percent, was paid at the loan closings while $563,298, or 71 percent was deferred. Following closings, some of which occurred several years ago, the Authority has only been paid $90,021, 16 percent, of the deferred fees. Interestingly, $80,021 of that was paid by Woodland Hills, which closed in 1996. White Laurel paid the other $10,000. The remaining $473,277 remains outstanding. If the developments have cash available as the Authority claims, the Authority should demand payment immediately.

11. The cost overrun assertions are based on the preliminary cost estimates generated several years before project completion. If one uses the standard industry practice of comparing actual cost against final budgets, the overruns are $1.327 million and not the $5.2 million asserted in the report.

    OIG response
    We stand by our numbers. While original construction budgets are estimates, they are not completely meaningless as the Authority implies. The Authority planned the developments and obtained tax credits and other financing based on the original budgets. We believe the original budgets are therefore most relevant for a comparison of planned versus actual development costs. The use of budgets prepared late in the construction process would

necessarily incorporate at least some of the cost overruns and be misleading. As the finding makes clear, consistent inability to complete developments without huge cost overruns is cause for concern.

12. The IPA did not state that collection of $1.03 million from NHE was questionable, only that the collection of the accrued interest was questionable.

    OIG response
    We added the IPA's report notes verbatim regarding the collection of the loans/interest into the finding. The IPA told us, during discussions regarding write-off of the $400,000 in receivables, that additional NHE receivables should probably be written off because they would likely never be collected. Also, the IPA advised the Authority it could not reinstate the $400,000 of receivables without an allowance account because he did not think it was likely they would ever be collected.

13. NRHA has a formal repayment agreement with the Rock Haven owner, who has repaid NRHA the $45,324 advance.

    OIG response
    The Authority was not authorized to develop the Rock Haven project. Advancing Authority funds to this project violated the ACC. Thus, whether or not there is now a repayment agreement is immaterial. As such, we removed the statement regarding the repayment agreement from the finding. We also noted that the Authority's Executive Director is also on the Board of Rock Haven, which at a minimum gives the appearance of a conflict of interest.

    The Authority did not provide any support that the owner of Rock Haven repaid the $45,324. It should provide any support of the repayment to the Action Official.

14. NRHA lawfully and with proper Board approval entered into limited and not unbounded guaranty agreements, most of which have been extinguished. At no time was NRHA unconditionally exposed to millions of dollars of liabilities from these guarantees.

    OIG response
    Since we could not be more exact in quantifying the potential liabilities to which management exposed the authority, we changed "millions of dollars" to "unknown magnitude" in the finding. However, millions of dollars were certainly involved. In fact, the actual liabilities arising out of cost overruns alone total over $5 million. The existence of these guarantees not only violates the ACC, but also shows management's disregard for its fiduciary responsibilities. Management agreed, if necessary, in multiple cases and various ways to use public funds to protect the interests of private investors. That some of these guarantees may have now expired without occurrence of circumstances causing the private investors to exercise a claim on Authority assets is of little consequence.

    Our draft report discussed two loan guarantees. We later found there were three guarantees and revised the finding accordingly.

15. The IPA stated that NHE and not NRHA was responsible for cost overruns and loss of tax credits, and this is in fact the case.

    OIG response
    Upon further review, we agree that we misinterpreted the IPA's note. We therefore deleted the comment from the report. However, although the Authority is technically correct in stating the

(primary) responsibility for loss of tax credits rests with NHE, the remarks fall short of full disclosure. NHE, as general partner/managing member of the LP/LLCs, was responsible to the private investors for loss of tax credits. However, Authority management caused the Authority to take on that obligation, for at least two of the projects, by signing agreements with the investors for those projects. Through these agreements the Authority acquired responsibility for the loss of tax credits by guaranteeing NHE would perform its obligations.

16. NRHA Section 8, public housing, tax credit development and home ownership programs are operating efficiently, serving NRHA's clients effectively, and promoting HUD's objectives in providing decent, safe and sanitary housing to thousands of low income residents of western North Carolina.

    OIG response
    As shown in the finding, the facts remain that the Authority repeatedly violated the ACC's with HUD. Management inappropriately pledged Authority assets as collateral for unauthorized bank loans. Management also misused $584,858 of HUD Section 8 and public housing funds for development activities. As a result of payments and advances by the Authority, NHE and the developments owed the Authority at least $4,224,342. Management advanced another $45,324 for development of a property owned by another non-profit company. Management and the Board put the Authority at further risk by guaranteeing repayment of private development loans and exposing the Authority to potential liabilities. These actions not only violated the ACC's, but also reduced funds available for public housing operations. Management and the Board's disregard for HUD requirements left the Authority in a precarious financial condition and led to the selling of 18 public housing units.

FINDING 2 – TRAVEL EXPENSES WERE UNECESSARY AND INELIGIBLE

Authority Comments: As more specifically detailed in Appendix C, NRHA replies as follows:

1. No NRHA program, HUD or otherwise, suffered funding unavailability due to travel or other expenditures.

    OIG response
    If the funds were spent, they are not available. The funds could have been used to improve the condition of its public housing units. As shown in Finding 4, improvements were needed. The Authority's personal travel, no matter how small, was ineligible. The Authority did not provide any evidence the funds were repaid.

2. The author of the 1998 HUD report agreed that "local public practice" did not mean the policy of the Town of Boone but of comparable North Carolina Housing Authorities. According to that definition, NRHA policy conforms to "local public practice."

    OIG response
    The Authority knew, based on the results of the 1988 HUD review, that its travel policy should have spending limits in order to be comparable with "local public practice." It provided no evidence to support that a HUD official advised them that local practice meant comparable housing authorities. Even if that is the case, the Authority did not provide evidence that it had performed a comparability study and had adopted policies similar to comparable authorities. Should the Authority have support, it should provide it to the Action Official.

3. Comparable North Carolina Housing Authorities maintain a "reasonable and actual cost" policy similar if not identical to NRHA's.

OIG response
The Authority did not provide evidence that it had performed a comparability study and had adopted policies similar to comparable authorities. Should the Authority have support, it should provide it to the Action Official.

4. NRHA employees are not federal employees , and the NRHA Board is not required to adopt a "GSA-style" daily limit policy. The NRHA Board prefers to monitor travel expense closely and allow managers and staff the latitude to incur reasonable and actual costs.

OIG response
Our comparison to Federal guidelines was a comparison for demonstration purposes, which brings into question whether the costs were reasonable and necessary in accordance with A-87. We believe they were not. OMB Circular A-87 provides, "A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. The question of reasonableness is particularly important when governmental units or components are predominately federally-funded." In addition, the Circular provides that a cost is reasonable if it is recognized as ordinary and necessary for the performance of a Federal award and if the entity acted with prudence considering its responsibilities to its employees, the taxpayers, and the Federal Government.

We added Appendix K showing the costs of the six trips discussed in the finding. Again, while the Authority is not required to follow Federal per diem limits, the table shows the unreasonableness of the Authority's travel costs, particularly the amounts spent on meals. The finding provides additional examples of unreasonable costs, such as $1,100 for a meal for four persons. The Authority did not present any evidence to OIG that the costs were in accordance with A-87.

Based on the high level of spending, the Board either was not effectively monitoring travel expenses or had turned its head to the excessive spending, since the Board participated in the abuse. Regardless of the "local policy" used, the Authority had not demonstrated restraint. Limits should be adopted.

5. The NRHA Board approves in advance all out-of-region travel.

OIG response
Evidence showed the Board approved the location of the out-of-town trips and the staff members that would go, but it did not approve a spending budget for the trips.

6. THE OIG provides no evidence for its assertion that "many of the expenditures were unnecessary for the execution of HUD programs" nor that NRHA overspent its budget by $50,000. NRHA disagrees with both assertions.

OIG response
The finding clearly shows the expenditures were not reasonable and necessary in accordance with OMB Circular A-87. We added a schedule to the finding showing the Authority overspent its travel budget by $50,000.

7. The OIG concludes but does not prove that HUD funds paid for all travel expense or that all travel was in connection with "HUD programs".

OIG response
The draft finding said in part, "The Authority spent $295,547 for travel during our review period. These travel costs included unnecessary and ineligible costs, such as paying travel expenses for family members of management and Board members…From July 1, 1998, through June 30, 2001, the Authority spent $295,547 for travel. Many of the expenditures were unnecessary for the execution of HUD programs." Our reference to the $295,547 was for informational purposes to give readers of the report a perspective of the amount spent. However, we revised the finding to show that $221,151 was charged to its public housing ($42,185) and Section 8 programs ($179,966). It is not necessary for the OIG to show that all travel was in connection with HUD programs. It is our responsibility to show the use of the Federal funds was not reasonable and necessary, and that Federal funds were used for ineligible travel expenses.

We also revised the finding to show that twenty-two trips totaling over $23,000 were for improper authority business, such as activities solely associated with the unauthorized developments, and were ineligible. We made other changes to clarify the finding.

8. The OIG provides no evidence that NRHA used funds provided under the Conventional Public Housing ACC for travel expense.

   OIG response
   We revised the finding to show the Authority charged $42,185 of the travel expenses to its public housing program.

9. NRHA lawfully incurred certain of the criticized expense in connection with the lawful and authorized development of $15 million of affordable housing units. NRHA Board and staff members incurred other criticized expense for Board-approved travel to conferences. Neither type of expense is unlawful, and the NRHA Board is the proper arbiter of what is necessary and prudent travel expense.

   OIG response
   As stated in previous responses, the Authority was not authorized to develop the housing units. We also previously addressed the Board approval of the travel. The Authority apparently does not realize that while the Board does have authority to approve travel, it also has a responsibility to ensure costs are reasonable, necessary, and eligible. It is not the Board that determines what is reasonable and necessary. The OMB establishes the requirements, and HUD determines whether the requirements were met.

10. The NRHA staff member involved has repaid the single instance of inadvertent personal travel expense.

    OIG response
    The Authority refers to a single instance. As shown in the finding, travel included costs for other personal travel, such as for spouses of Board members. While the staff member, Deputy Director, did repay this expense, she only did so after OIG brought it to her attention.

11. NRHA's since-terminated Accounting Manager did keep indeed terrible records, but no evidence of non-reimbursement exists. The current Finance Director does keep accurate records. The Board is wholly unaware of any non-reimbursed amounts that any member may owe and firmly believes that no such amounts exist.

OIG response
Due to the Authority's failure to maintain records, we could not determine whether all personal travel expenses were reimbursed. In fact, the Deputy Director told an OIG auditor that no records were kept for Board members personal expenditures.

FINDING 3 – OTHER EXPENSES WERE UNNECESSARY, INELIGIBLE, AND UNSUPPORTED

Authority Comments: As more specifically detailed in Appendix C, NRHA replies as follows:

1. Charging miscellaneous expense to public housing and Section 8 results from an allocation policy for common expenses that spreads them across all NRHA programs. NRHA's IPA has not objected to this practice and advises that in his extensive experience the practice is common among Housing Authorities.

   OIG response
   We did not question the allocation process in the report. The statement in the finding regarding charges to the public housing and Section 8 programs was provided to give the readers a perspective of the costs. The questioned costs included those charged to Federal programs.

2. NRHA at no time deprived its public housing and Section 8 programs of essential operating funds, its financial condition was not and is not precarious, and no tenant resided in units other than decent, safe and sanitary. See the comment to findings 1 and 4.

   OIG response
   The property conditions described in Finding 4 show the units were not decent, safe, and sanitary. We addressed the comment regarding the Authority's financial condition in our responses to Finding 1 comments.

3. Appendix C provides additional details for all expenses questioned as ineligible.

   OIG response
   The Authority referred to Appendix C, which would have included its preliminary comments; however, because they were voluminous, we did not include them in the report. The details, to which the Authority refers, discuss the value of having staff and Board retreats, annual meetings, seasonal social events and the purchase of gifts for staff and others. The comments lend credence to our statements in the finding that it pampered staff and Board members. We fail to see any benefit to the tenants from these expenditures.

   The Authority included a schedule in its preliminary response that we have added as Appendix I of the audit report, as it provides more detailed information about the questioned expenditures. The schedule also showed that expenses we originally questioned as unsupported were actually ineligible. Thus, we changed the finding to show expenditure of $11,070 for ineligible items. We also made appropriate changes to recommendation 3E and deleted recommendation 3F, which requested support for $1,787.

4. The vast number of questioned expenses were for morale-building nominal gifts and mementos for NRHA staff not able to attend conferences. NRHA does not think it improper for the Board and management to let employees know their leaders are thinking of them and value their efforts.

OIG response
Professional awards would be considered reasonable, but as shown in Appendix I of the report, the Authority repeatedly purchased gifts and other improper personal items for staff, Board members, spouses, and others. The Authority did not provide any support the questioned expenditures were necessary for the execution of HUD programs.

5. NRHA agrees that a small number of questioned expenses were not properly incurred, and the beneficiaries of those expenses have since re-paid NRHA.

OIG response
The Authority did not provide any evidence that any of the questioned expenditures were repaid.

6. The NRHA Board decided to halt the "memento purchase" practice in early 2000; with one exception, no expense questioned by the OIG occurred after 1999.

OIG response
The Authority claimed it halted the memento practice early in 2000, with one exception. As shown in Appendix I, the Authority purchased luggage for the Executive Director in April 2000, gifts for board members spouses and others in June 2000, and candy and other items for staff in March 2001.

FINDING 4 – HEALTH AND SAFETY CONCERNS EXISTED AT PUBLIC HOUSING SITES

Authority Comments: As more specifically detailed in Appendix C, NRHA replies as follows:

1. NRHA emphatically denies that it neglected its conventional public housing units.

OIG response
The conditions cited in the finding show the Authority did neglect its public housing units.

2. The OIG claims to have found allegedly health and safety threatening "deficiencies (that) require immediate attention" during a February inspection but did not advise NRHA of its finding until September.

OIG response
Indeed, OIG would be remiss in not promptly reporting inspection results had it not been that a member of the Authority's staff accompanied us on our February inspection.

3. The cited REAC scores are well within the acceptable range; the same REAC survey gave NRHA a perfect score for conventional public housing management.

OIG response
A conventional public housing management score addresses overall management of public housing, is based on information provided by the Authority, and does not pertain to unit conditions.

4. Appendix C provides more detailed explanations concerning the five specific findings, the upshot being that four of them indeed have rebuttal explanations and only the discarded water heaters are an NRHA stumble, since corrected.

OIG response
The five findings, to which the Authority refers, are:

- *Trash, garbage, and other debris behind buildings at Cub Creek Apartments.*
- *Rusted, potentially dangerous water heaters that had been discarded on the property.*
- *The topography behind Building C of Woodland Apartments was very steep and should be protected by railings or fences.*
- *Refuse containers were in poor condition.*
- *Broken window at the rear of Building F had not been repaired even though REAC identified the deficiency in its October 2001 report.*

In its preliminary comments, the Authority said its maintenance staff cleaned up trash and removed debris every 2 months. However, that the trash and debris we observed were also identified by REAC 4 months earlier, and that Authority staff admittedly discarded the water heaters indicated maintenance staff needed closer supervision.

The Authority is responsible for ensuring the safety of its residents. As such, it should install protective railings or fences at Cub Creek to reduce the likelihood of tenants falling down the embankment.

The Authority should ensure the refuse containers are repaired or replaced.

We removed the reference to the broken window being previously identified by REAC because we could not ensure it was the same break REAC identified.

5. Ground Fault Circuit Interruptors were not Code-required when the units were built, and although NRHA is not required to retrofit, it has budgeted capital funds to do so.

OIG response
The Authority's installation of GFCI outlets will address the condition.

6. Subfloor and cabinet/countertop replacement programs are both in the plan for capital fund expenditures, and HUD approved the undertaking of the latter improvements in April, 2002.

OIG response
The Authority's replacement of faulty subfloors, cabinets, and countertops will address several conditions.

7. Regarding the individual unit findings, while NRHA agrees that no deficiency is acceptable, it notes that seven, nine and eleven deficiencies are not an overwhelming number in a protocol with several hundred criteria.

OIG response
While the number of deficiencies may not be overwhelming, we consider them to be significant since they reflect on the living conditions of residents.

FINDING 5 – THE AUTHORITY DID NOT MAINTAIN ACCURATE ACCOUNTING RECORDS

Authority Comments: As more specifically detailed in Appendix C, NRHA replies as follows:

1. NRHA agrees that its since-terminated Accounting Manager was less than competent and estates that he was the cause of every supportable element of this Finding. As the report shows, his poor practices and lack of professionalism caused short-term, since corrected harm to NRHA's accounting system.

   OIG response
   Our draft report did not attribute the accounting deficiencies to any single person or factor. Rather, we attributed the deficiencies to several factors, including:

   - *Numerous, complicated, and improper inter-entity transactions;*
   - *Complicated journal entries;*
   - *Complicated spreadsheets that were not integrated with the Authority's accounting system;*
   - *An inadequate automated system; and,*
   - *Failure of a vendor to transfer all balances for the development entities from the Authority's accounting system to a personal computer that was to account for development entity activities.*

   The final report continues to reflect these causes. However, we revised the finding to emphasize that management, not its staff or contractors, is ultimately responsible for ensuring its records are complete and accurate.

2. As the report notes, the current Finance Director is an extremely capable CPA who has guided NRHA through the remedial actions required to correct the former Accounting Manager's numerous accounting depredations. The current Finance Director is successfully continuing his efforts to maintain the books and records of NRHA and its affiliates to the highest professional standards.

   OIG response
   As stated in the finding, the current Finance Officer made significant progress towards correcting the deficiencies.

3. The IPA stated that the former problems were in the accounting controls over the general ledger and in the reporting function, rather than in controls over cash collection or disbursement, both of which were subject to good controls.

   OIG response
   We did not question the controls over cash receipts and disbursements. We questioned the recording of transactions. The IPA agreed transactions were not properly recorded or reported, and there were weak controls.

4. Developments costs and amounts due NRHA were not properly identified but they were correctly stated.

   OIG response
   If amounts were not properly identified, we do not understand the Authority's claim they were correctly stated. Further, as stated in the finding, about $400,000 the developments owed the

Authority was not recorded on the development's books, thus management wrote the $400,000 off as a loss to the Authority.

5. As noted in Finding 1, the IPA rendered an unqualified opinion regarding NRHA's financial position and results of operations for fiscal years 1999, 2000 and 2001.

   OIG response
   Although the IPA gave unqualified opinions, the records were not maintained in accordance with HUD requirements.

FINDING 6 – THE SECTION 8 PROGRAM WAS NOT PROPERLY ADMINISTERED

Authority Comments: As more specifically detailed in Appendix C, NRHA replies as follows:

1. For the fiscal year ending June 30, 2001, HUD's Section 8 Management Assessment Plan (SEMAP) awarded NRHA's Section 8 program a score of 96 out of 100, which afforded NRHA HUD's highest level of program recognition, that of Section 8 High Performer.

   OIG response
   A Section 8 Management Assessment Plan score addresses the overall management of the Section 8 Program, but does not address the adequacy of requisitioning Section 8 funds. The Authority's score is, therefore, irrelevant to the finding.

2. NRHA agrees that the since-terminated Accounting Manager did not undertake the required ninety-day reviews. The current Finance Director has been doing so since October, 2001, and indeed performs such reviews monthly.

   OIG response
   Performing monthly reviews should help resolve the deficiency.

3. NRHA does in fact deposit all requisitioned funds (and all other funds) in interest bearing accounts, although for purposes of reconciliation of Section 8 requisitions this practice is irrelevant, since HUD imputes an interest rate on excess requisitions regardless of where funds are deposited.

   OIG response
   Our review of the general ledgers showed the Authority typically drew down the funds, and then soon thereafter transferred them to the general fund where they were commingled with other funds. While the general fund did earn interest, the funds were quickly disbursed, thus interest earnings were minimal. We revised the finding to emphasize that rather than "maintaining" the funds, the Authority spent them. The Authority should maintain the funds in an interest-bearing account, use them to pay program expenses, or reimburse them to HUD to the extent required. Because the Authority did not maintain the funds, it had to obtain a bank loan at 9.37 percent interest to repay debt, including excessive withdrawals of $240,000.

4. At no time did NRHA excess withdrawals approach $1 million, and NRHA promptly repaid in the normal course of business the excess withdrawals for two of the report years as part of the annual settlement process that all PHA's undertake. For the third year, the annual reconciliation showed that HUD owed NRHA $376,359 on the NRHA voucher program.

OIG response
Although the Authority did in fact withdraw "in total" over $1 million ($636,568 + $391,429) of excess funds, we deleted the $1 million figure from the finding. The finding did not say the Authority had over $1 million at a given time. In fact, as the revised finding shows, the Authority quickly spent the funds.

We added a discussion to the finding regarding the Authority's withdrawal of $376,359 less than it was due.

5. NRHA has determined that the $391,429 figure (which was as of December 31. 2001 and not within the report period) had been over-stated. The actual figure as of March 31, 2002 was $224,000, well within the five per cent guideline.

   OIG response
   At the time of our review, the amount was $391,429. Although the Finance Director told us the Authority would have to borrow to repay any excess, we removed the statement from the finding.

6. The cited extreme example of 575% over-requisitioning involved a moderate rehabilitation program that is a miniscule part of NRHA's overall Section 8 program. It was caused by the failure of landlords to keep their properties fully leased. From an overall Section 8 program cash management perspective, NRHA has not come close to exceeding the five per cent guideline.

   OIG response
   HUD requires housing authorities to requisition Section 8 funds and perform year-end reconciliations by individual project. As a result, HUD's 5 percent guideline applies to individual projects, not a housing authority's entire Section 8 Program. Our review showed that in 12 of 21 instances, the Authority exceeded the 5 percent threshold.

   We removed the cited example from the finding and added a discussion to show the Authority other examples of excessive withdrawals and an example of the Authority withdrawing $376,359 less than it was due for one project. The examples show the Authority did not following requisitioning requirements.

7. NRHA has never deprived eligible applicants of available housing and needed financial assistance. The 104 certificates and vouchers cited were part of a fair share allocation that HUD awarded to NRHA in October 2001(outside the report period) as part of the FY 2002 distribution. HUD's own regulations permit PHA's eighteen months to issue and lease up allocated vouchers or certificates, in this case until March 31, 2003. In fact, a mere two and one half months into the permitted eighteen month period, NRHA had issued almost half the allocated vouchers. Thus, NRHA was well ahead of HUD's permitted schedule.

   OIG response
   Based on the Authority's explanation, we removed the discussion from the finding.

FINDING 7 – MISMANAGEMENT WAS APPARENT IN OTHER AREAS OF OPERATIONS

Authority Comments: As more specifically detailed in Appendix C, NRHA replies as follows:

1. At all times NRHA has been able to identify or calculate funds that its holds on behalf of tenants or program participants, and NRHA has in all cases promptly paid all sums due to any tenant or program participant.

   OIG response
   The Authority admitted it did not have almost $35,000 of the tenant FSS fund on deposit but argued that enough funds were available and, if not, it would make up any difference from the general fund. The Authority missed the point. HUD clearly requires the funds to be segregated and deposited in an interest-bearing account. At all times the full balance must be available. If, as the Authority stated, the CDs representing tenant FSS funds were pledged as collateral for loans, they could not be used to repay tenants.

2. As noted in the comments to Finding 1, NRHA agrees that it inadvertently but no less improperly pledged two CD's containing FSS funds as collateral for a loan, but the holding Bank has since agreed to release the collateral. The report's statement about an unaccounted- for $116,948 is likely a reflection of the auditors' not noticing the second CD.

   OIG response
   The Authority's explanation of the pledging of the second CD helped account for a significant portion of the FSS funds. It also provided another example of the Authority's unauthorized pledging of assets and disregard for HUD requirements. As such, we made appropriate changes to this finding as well as Finding 1.

   The Deputy Director failed to advise us of the second CD when we asked for a full accounting.

3. NRHA agrees that it should take the steps required to bring its depository handling of tenant security deposits into conformance with HUD requirements, and it is in the process of doing so. Its overall administrative and tenant pay-out treatment of security deposits is proper and accurate, and no tenant interests have been prejudiced by NRHA's depository practices.

   OIG response
   The tenant security deposits were commingled with rent receipts and expended along with other funds. Without a separate account where the funds are maintained on deposit, the Authority cannot clearly show funds are on hand and available for disbursement.

4. NRHA agrees that its accounts receivables are higher than it would prefer, but NRHA is not ashamed of trying to work with delinquent tenants rather than casting them into the street. Note that the $12,731 cited as a write-off covers two fiscal years. NRHA will gladly entertain HUD's assistance in crafting a policy that balances sound fiscal management of tenant rent accounts with the need to treat deprived and sometimes desperate tenants humanely.

   OIG response
   We added a section to the finding explaining the standards and criteria for admission to and occupancy of public housing. At times it may be necessary for the Authority to terminate leases of tenants who fail to make their rent payments. Regulations provide grievance procedures to assure tenants are protected from arbitrary actions.

   Regarding the write-off of $12,731 of receivables, it is immaterial the write-off covered 2 years. The points were that since they were written off, they were not collected and are unavailable. The Authority should ensure it pursues collection remedies, and then, if receivables are deemed uncollectible, write off the balances.

5. NRHA did not violate its nepotism policy because a violation requires circumstances that do not fall within policy guidelines or circumstances where the Board did not grant a waiver to a relationship that would otherwise fall within the policy. As shown in Appendix C, the assertions of nepotism set forth here either inaccurately portray the nature of the family relationship or the character of the employment relationship, or do not take into account Board deliberation and assent.

   OIG response
   While it may be permissible for the Board to grant an occasional waiver, to frequently do so weakens internal controls needed to ensure integrity of operations.

6. NRHA has never received a copy of the 1995 ACC revisions regarding nepotism policies.

   OIG response
   HUD considers the practice of nepotism to be improper and, in 1995, revised the Consolidated ACC to prevent it. Although HUD intended for all public housing authorities to convert to the revised ACC, this authority, among others, did not convert. The Authority should, at a minimum, adhere to its written policy and closely scrutinize relationships that could affect internal controls.

Limited Partnership and Limited Liability Companies

Following is summary information regarding the tax credit entities.

Woodland Hills Limited Partnership

NHE partnered with tax syndicator National Equity Fund 1994 Limited Partnership to form a North Carolina LP, National Woodland Hills Limited Partnership. NHE formed the LP to develop Woodland Hills, a 32-unit apartment complex for low-income elderly and disabled persons. The Authority managed the property.

Blue Ridge Housing of Sparta, LLC

Blue Ridge Housing of Sparta, LLC is a North Carolina Limited Liability Company formed to develop Highland Village, a 30-unit low-income housing development. NHE partnered with tax syndicator Carolina Equity Fund V Limited Partnership to form the LLC. The Authority developed the project and was the property manager.

Blue Ridge Housing of Bakersville, LLC

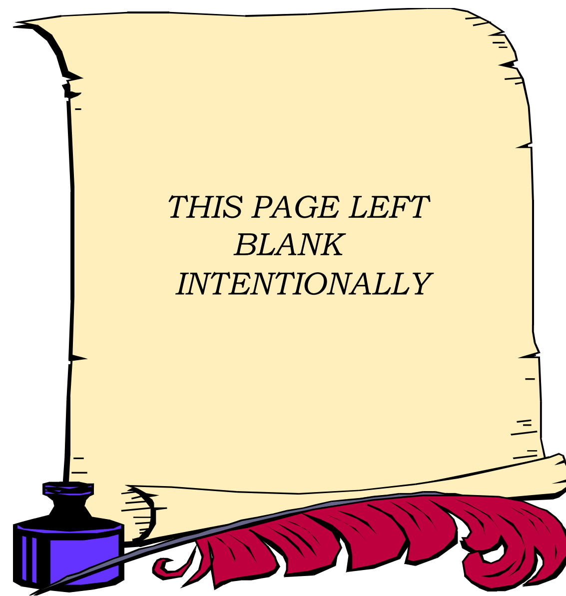
Blue Ridge Housing of Bakersville, LLC is a North Carolina Limited Liability Company formed to develop Cane Creek Village, a 25-unit low-income housing development. NHE partnered with tax syndicator North Carolina Equity Fund III Limited Partnership to form the LLC. The Authority developed the project and was the property manager.

Blue Ridge Housing of Jefferson, LLC

Blue Ridge Housing of Jefferson, LLC is a North Carolina Limited Liability Company formed to develop Oak Grove Village, a 30-unit apartment complex for low-income families. NHE partnered with tax syndicator North Carolina Equity Fund III Limited Partnership to form the LLC. The Authority developed the project and was the property manager.

Boone-White Laurel, LLC

Boone-White Laurel, LLC is a North Carolina Limited Liability Company formed to develop White Laurel, a 42-unit apartment complex for low-income families. NHE partnered with tax syndicators National Equity Fund 1997, and 1997 Series II, Limited Partnerships to form the LLC. The Authority developed the project and was the property manager.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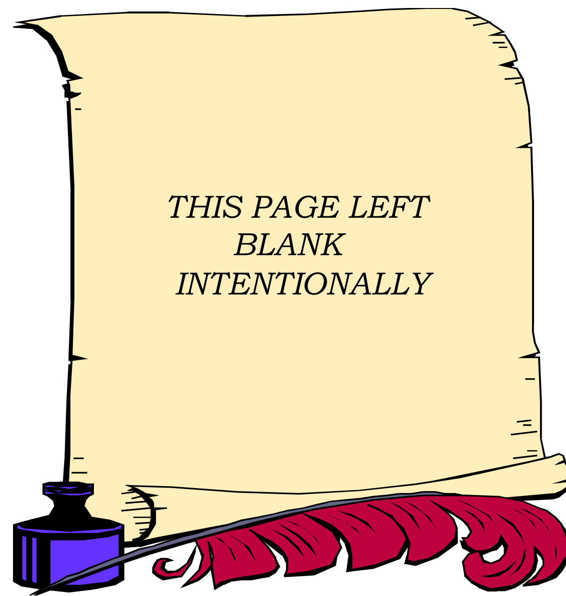
Comparison of Budgeted and Actual Development Costs

Funding Source	Woodland Hills	Highland Village	Cane Creek Village	Oak Grove Village	White Laurel
Sale of Tax Credits	$ 892,457	$1,314,531	$1,232,986	$1,408,616	$1,755,252
Bank Loans	290,000			435,000	1,181,358
NCHFA Loans[3]	500,000	945,078	815,000	515,000	
Federal Home Loan Bank		240,000	131,419	174,144	
Deferred Developer Fees	168,600	50,000			
Owner Investment	28,000[4]		17,706	20,228	
Total Budget	$ 1,879,057	$2,549,609	$2,197,111	$2,552,988	$2,936,610
Actual Cost per Cost Certification	1,947,782	3,154,801	3,260,846	3,394,136	5,544,647
Cost Overrun	$ 68,725	$ 605,192	$1,063,735	$ 841,148	$2,608,037

Total cost overruns were $5,186,837.

3 Includes HOME funds.
4 The application indicates the $28,000 was land provided by the Authority.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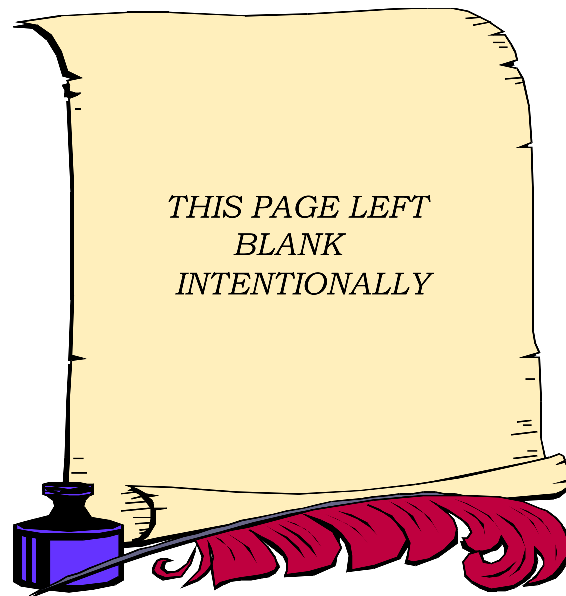
White Laurel II Homeownership Project

White Laurel II is a NHE homeownership project located adjacent to the White Laurel townhouse development. Unlike other NHE projects, it was financed entirely by the Authority through NHE, and it did not involve tax credits. On October 27, 1997, The Authority obtained a $2.48 million bank construction loan secured by a deed of trust on the property. The Authority then loaned the funds to NHE for project development. Original budgets indicated the project could provide homeownership opportunities to low and moderate-income families at a profit. That scenario proved overly optimistic.

White Laurel II came about as part of the Town of Boone's flood mitigation project. It was an ambitious undertaking involving the relocation and renovation of 21 single-family homes located in a flood plain. The Authority paid the town $10 each for the homes. Heavy equipment relocated the homes to a mountainside site. The site required extensive and expensive site preparation. The Authority planned to use proceeds from selling the homes to retire the construction loan. Sales prices were limited to $104,500, the maximum sales price under the U.S. Department of Agriculture low interest rate loan program for low-income buyers.

Unfortunately, various unexpected costs caused the project to be much more expensive than originally planned, resulting in a loss. The actual loss can only be estimated because of the poor condition of the accounting records (Finding 5), and uncertainty regarding how much more it will cost to complete the project. As of March 31, 2002, five units remained unsold. The Authority estimated that, once the remaining units were sold, the project would lose $1,053,083. However, that estimate did not consider renovations that were needed on three of the remaining units. The Authority's Construction Manager estimated these renovations would cost between $150,000 and $200,000 in total.

The bank that provided the construction loan realized that sales proceeds from the remaining five units would be insufficient to retire its loan. In a September 12, 2001, letter to the Authority it stipulated the Authority pay $350,000 toward the loan balance and sell remaining units at market value - instead of discounted to low income buyers. On November 30, 2001, the Authority obtained another loan for $1.35 million and paid the $350,000 from those proceeds. The Authority had plans to sell a public housing development to repay the $1.35 million loan (See Finding 1).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Bank Loans

Bank	Original Note Amount	Date Obtained	Monthly Payment	March 31, 2002 Balance
Wachovia Bank (1)	$ 2,482,000	10/27/1997	$ 1,407.72	$ 626,124
Bank of America (2)	1,350,000	11/30/2001	2,991.69	755,000
Bank of America (3)	606,000	06/29/2000	7,798.42	545,031
Centura Bank (4)	500,000	06/24/1999	1,859.74	195,363
Branch Bank & Trust (5)	400,000	03/29/2000	3,833.33	400,000
Total	$ 5,338,000		$ 17,890.90	$ 2,521,518

(1) The Authority obtained this loan to finance construction of White Laurel II (Appendix F). The Executive Director and Deputy Director signed various loan documents. Management borrowed the funds in the name of the Authority, and then executed another note for the same amount between the Authority and NHE. The NHE note and deed of trust to the property secured the loan. In addition, management guaranteed the bank that it would, if needed, repay the NHE note with Authority funds. The 2-year loan has been refinanced several times for varying amounts as NHE failed to complete the development on schedule. The loan has been paid down to the current level as the houses were sold. Further, in December 2001, the Authority used $350,000 of a $755,000 consolidation loan draw (Note 2) to reduce the loan balance.

(2) The Authority obtained this loan to consolidate its existing debt and pay development costs overruns of two LLC developments. The note requires monthly interest payments over the 2-year term. The loan can be extended an additional 12 months at the bank's discretion. The Valley View public housing development serves as collateral for the loan. The loan balance is to be reduced as the Valley View units are sold. On December 7, 2001, the Authority received its first draw of $755,000. The Authority used $350,000 of the funds to reduce the White Laurel II Wachovia loan by $350,000 (Note 1), pay about $374,000 toward interest and construction costs for an LLC, and pay various attorney and recording fees ($44,600) resulting from the loan. A Board resolution signed by the Board Chairman, the Executive Director, and Deputy Director authorized the loan. It also authorized granting the bank a security interest in any real or personal property belonging to the Authority.

(3) This is an unsecured operating loan requiring 60 monthly payments of $7,798.42. The Executive Director and Deputy Director signed the promissory note. This loan was obtained to repay $240,000 to HUD for excessive Section 8 fund withdrawals, and to pay for White Laurel cost overruns. The loan was not secured with Authority assets. However, the Executive Director requested HUD allow him to use Authority assets as collateral. HUD denied the request.

(4) This is a line of credit loan that supported development costs overruns for White Laurel. Interest is payable monthly. Management partially secured the loan with Authority certificates of deposits, including one held in trust for the FSS Program. In the April 7, 1999, loan request, the Executive Director assured the bank that, if necessary, he would use the Authority's operating revenues to repay the loan. The Executive Director and Deputy Director signed the loan documents. The Board members signed a resolution authorizing the loan.

(5) This is a loan supporting development costs overruns for White Laurel. The Executive Director and Deputy Director signed the promissory note and subsequent modifications. The loan matured on May 26, 2002. Management planned to draw funds from the consolidation loan (Note 2) to repay this loan.

Sources and Uses of Funds Provided to the LP, LLC, and NHE

Sources of Funds[5]

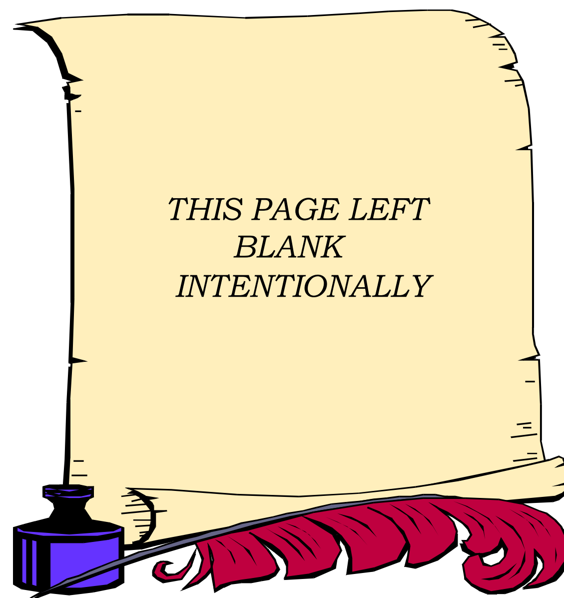
Development/Property Management	$ 2,693,087
Deferred Development Fees	503,277
Unknown – Reinstated Receivable	399,563
Section 8 Vouchers	310,610
Conventional Public Housing	274,248
General Fund	42,959
Capital Fund Program	598
Total	$ 4,224,342

Amounts Owed to the Authority by the Various Entities[6]

NHE, Inc.	$ 3,034,466
Blue Ridge Housing of Bakersville, LLC	554,514
Blue Ridge Housing of Sparta, LLC	244,746
Boone White Laurel, LLC	155,267
Woodland Hills, LP	136,847
Blue Ridge Housing of Jefferson, LLC	98,502
Total	$ 4,224,342

[5] Amounts derived from Authority's General Ledger trial balance at April 30, 2002, adjusting entries (1) reinstating receivables previously written off, and (2) recording deferred development fees not previously recorded in General Ledger.

[6] These amounts are General Ledger receivables from the various entities. Amounts shown for the LLCs/LP project ownership entities represent funds the Authority directly advanced them or expenses the Authority paid on their behalf. The project ownership entities further benefited from amounts NHE paid on their behalf, or advanced to them, from the $3,034,466 it received from the Authority.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Other Ineligible Expenses

PAYEE	COST	DATE	ITEM(S) PURCHASED	DESCRIPTION (as prepared by the Auditee)
Alterations Express	31.25	06/29/99	Alterations	ED personally purchased a new business suit while on NRHA business travel in Greensboro, North Carolina for purpose of dressing to accept SERC NAHRO Creativity Award 1999 for NRHA's sponsorship of the WHITE LAUREL affordable housing development combining assisted rental, FSS and first time homeownership. Suit vendor failed to timely complete alterations requiring purchase of this express service.
Crabtree & Evelyn	75.00	08/14/99	Beauty supplies	Nominal soap and cream gifts for staff promoting employee morale received by 10-12 staff
Hospitality House	700.00	12/05/99	Holiday Benefit Ball	Annual fundraiser for regional homeless shelter – NRHA purchases once per year tickets for one eight-top table for key staff and professional affiliates to support emergency shelter and to promote employee morale. NRHA ED has served as a volunteer board member of Hospitality House for the past 14 years. Shelter serves 14,400 bed nights and 25,200 meals to its clients annually.
Hospitality House	600.00	12/02/98	Same as above	Same as above
Carolina Polo Carriage Co	85.00	10/15/99	Carriage ride in Charleston, SC	ED and Deputy were on NRHA business travel in Charleston, South Carolina attending a series of professional meetings with assisted housing personnel, attorneys and private investors. Meeting locations were 12 to 15 blocks from lodging. Carriage ride was from lodging to meetings. ED acknowledges they could have taken a taxi at more reasonable expense and has reimbursed the $85.00 cost of the carriage ride to NRHA. It should be noted that ED and Deputy donated personal weekend time to attend these important meetings on behalf of NRHA.
Saks Fifth Avenue	110.24	08/14/98	Cosmetics	Nominal creams and lotion gifts for staff promoting employee morale received by 10 staff
Belk	265.00	04/22/00	Luggage	ED utilized document and clothing carriers for NRHA business locally and on travel and wears them out approximately every five years – this was a replacement carrier.
Greensboro Wine Whse	228.73	06/29/99	Wine	Personal purchase of a case of wine by ED was mistakenly charged on NRHA,

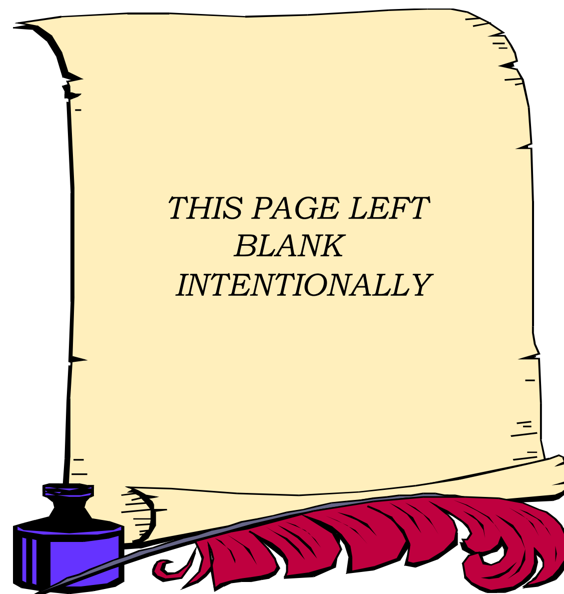
				rather than personal credit card, in his absence – vendor executed the charge ticket – ED was not informed by accounting staff of the error – ED reimbursed NRHA by personal check.
Wal-Mart	11.85	05/27/98	Socks	Personal purchase of socks by Deputy Director for grandchildren which by oversight had remained umreimbursed – Deputy reimbursed NRHA by personal check.
The Style Company	425.05	06/26/00	Gift	Gift baskets at Annual meeting for board members spouses, attorney spouse and key staff comprised of nominal soaps, lotions, candles and potpourri. 25-30 baskets were made up and delivered for corporate team building and employee morale.
Williams & Sonoma	688.45	12/17/99	Gifts	Gift baskets same purpose and volume as above comprised of nominal hand towels, oils, teas, spices, peppercorns, crackers, wooden spoons and assorted kitchen utensils for staff promoting employee morale.
Capital Image DC	195.43	03/10/99	Staff Gifts	Nominal t-shirts and capital city mementos for staff promoting employee morale received by 12-14 staff.
Filenes Basement DC	63.44	03/10/99	Staff Gifts	Same as above
Hall of Cards	71.10	09/16/98	Staff Gifts	Frames for certificates of professional achievement rewarding outstanding performance
Market Sq T-Shirt – Texas	65.88	10/25/98	Staff Gifts	Nominal tin ware, refrigerator magnets, t-shirts and mementos for staff gifts promoting employee morals received by 12-14 staff.
Official City Store – Texas	226.28	10/27/98	Staff Gifts	Same as above
Williams & Sonoma	796.01	06/17/99	Gifts	Same as previous entry for this vendor except that additional (in addition of NRHA staff) of nominal gifts included selected professional partners – 25 to 30 recipients.
Wal-Mart	205.82	12/14/98	Gifts	Gift packages for spouses and staff comprised of nominal wooden cutting boards, platters, ribbons and wrapping (10-12 recipients) along with a filter for an office air purification device.

South's	163.24	12/15/99	Sweater	Gift sweater to board member spouse who had been unable to attend Christmas meeting and dinner due to major surgery. All other board members or member's spouse gifts were foregone at this Christmas meeting.
Peabody's Beer & Wine	637.04	08/11/98	Refreshments and sundries	Refreshments and sundries for after house celebration of staff and professional partners of successful completion of financing a two-year effort providing public-private financed new affordable housing community.
Saslow's Jewelers	2,091.17	06/02/99	Watches	Gift watches and ring for board and staff in celebration of twentieth anniversary of NRHA.
Saslow's Jewelers	1,546.54	06/28/99	Watches and ring	Same as above and all distributed at Annual corporate meeting with 25 recipients.
The Mole Hole	221.01	10/16/99	Gifts – no receipt	Nominal gifts for staff comprised of mementos, refrigerator magnets and snacks promoting employee morale 12-14 recipients. Charge ticket was attached to ED travel sheets which were held by federal audit team for 6 months during the on site review.
Beau Rivage	770.40	09/21/99	Theater tickets – no receipt	Theater tickets while on professional business travel during personal weekend time for six board members, key staff and attorney provided in lieu of Christmas gifts promoting corporate team building. This item was booked through corporate travel agent with receipt attached to ED's travel sheets. 16 tickets were purchased as a cost of $48.15 each.
Grandover Golf Course	106.81	08/05/99	Unknown – no receipt	Business lunch with professional development and finance partners while attending training by Federal Home Loan Bank of Atlanta (FHLB). FHLB has provided low or no cost financing for new affordable rental and homeownership to NRHA and affiliated entities in excess of 2 million private dollars in the past five years, reducing the burden of government.
Hecht's	179.91	03/18/01	Unknown – no receipt	Nominal candies, jelly beans, miniature stuffed animals, baskets for Easter gifts to staff promoting employee morale 10-12 recipients. Charge ticket attached to ED travel sheet – vendor receipt has apparently been lost.

Lillian Vernon	53.42	06/03/98	Unknown – no receipt	Nominal door prizes for professional business meeting of the Southeastern Section 8 Housing Association. Charge ticket attached to ED travel sheet.
Pier 1 Imports	49.82	06/23/98	Unknown – no receipt	Nominal gifts for staff at Annual meeting. Charge ticket attached to ED travel sheet.
Williams & Sonoma	153.70	07/27/98	Unknown – no receipt	Same as above.
Williams & Sonoma	252.28	06/22/98	Unknown – no receipt	Same as above.
Total	**11,069.87**			

Inspection Deficiencies by Category

DEFICIENCY	CUB CREEK	WOODLAND	TOTAL
Security	3	3	6
Defective Windows	3	3	6
Defective Ceilings	3	0	3
Defective Walls	3	2	5
Defective Floors	9	9	18
Defective Interior Doors	5	6	11
Defective Bathtubs	2	0	2
Defective Smoke Detectors	1	1	2
Electrical Hazards	21	32	53
Defective Kitchen and Bath Sinks	0	4	4
Defective Kitchen Cabinets and Countertops	6	7	13
Kitchen Appliances	3	0	3
Building Exteriors	0	3	3
Safety of Heating–Equipment & Quality of Interior Air	8	0	8
General Health and Safety	12	3	15
Other Hazards	0	1	1
Total	**79**	**74**	**153**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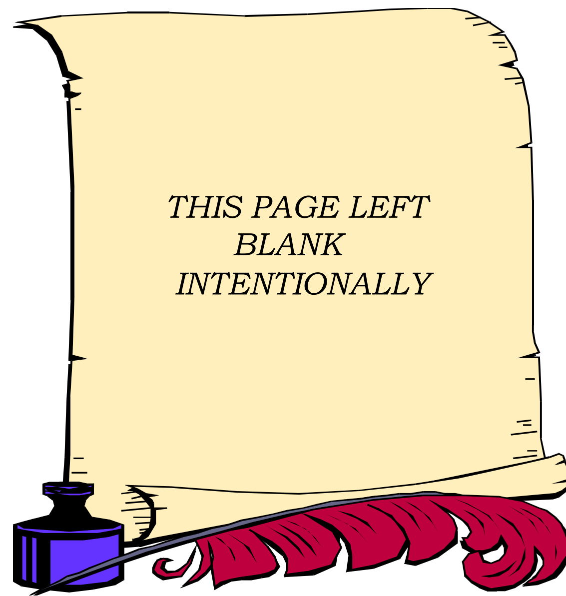
Room and Meal Cost for Six Trips

		Amount Spent		Federal Allowance		Difference		Difference	
Dates of Travel	**Destination**	**Lodging**	**Meals**	**Lodging**	**Meals**	**Lodging**	**Meals**	**Lodging**	**Meals**
11/16/98-11/18/98	Raleigh, NC	$ 1,112	$ 1,583	$ 768	$ 380	$ 344	$ 1,203	45%	317%
10/14/99-10/17/99	Charleston, SC	1,194	1,557	570	294	624	1,263	109%	429%
11/12/99-11/16/99	Biloxi, MS	3,168	2,636	2,304	1,710	864	926	38%	54%
01/06/00-01/09/00	Washington, DC	1,374	636	708	322	666	314	94%	98%
10/28/00-11/01/00	Scottsdale, AZ	3,184	957	1,264	945	1,920	12	152%	1%
03/17/01-03/21/01	Washington, DC	5,264	1,418	1,904	828	3,360	590	176%	71%
Totals		**$ 15,296**	**$ 8,787**	**$ 7,518**	**$ 4,479**	**$ 7,778**	**$ 4,308**	**103%**	**96%**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