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TO: Larry Knightner, Director, Office of Public Housing, 4EPH

James D. McKay

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

SUBJECT: The Housing Authority of the City of Charleston
Charleston, South Carolina

HIGHLIGHTS

What We Audited and Why

We reviewed the Housing Authority of the City of Charleston's (Authority) administration of its housing development activities as part of our audit of the U.S. Department of Housing and Urban Development's (HUD) oversight of Public Housing Agency development activities with related nonprofit entities.

Our primary objective was to determine whether the Authority encumbered resources subject to an Annual Contributions Contract (Contract) or other agreement or regulation to the benefit of other entities without specific HUD approval. Our objective included determining whether the Authority's cost allocation method complied with provisions of Office of Management and Budget (OMB) Circular A-87, and whether the Authority used the Section 8 administrative fee reserves in accordance with the Contract and other regulations.

What We Found

The Authority did not support its allocations of \$8,956,361 and costs of \$6,681,053 in salaries, wages, and fringe benefits that were charged to the Federal

programs, as required in OMB Circular A-87. The Authority officials believed their allocation method complied with the requirements. However, without support to substantiate the allocations and costs of actual services performed by personnel or some type of quantifiable measures of employee effort, the Authority may not have accurately charged the Federal programs.

The Authority transferred \$400,000 of its Section 8 administrative fee reserves to its Housing Finance Agency (Agency) fund but never expended or returned the funds to the reserve account, contrary to its Contract. When the Authority transferred the funds to its Agency account, HUD lost visibility of the funds. Therefore, HUD could not monitor the funds to ensure they were properly spent for other housing purposes, as stated in the Contract.

What We Recommend

We recommend that the Director of the Office of Public Housing require the Authority to provide documentation to justify the \$8,956,361 of allocated costs and the \$6,681,053 of costs without supporting certifications and ensure the Authority makes appropriate adjustments to the various programs.

We also recommend that the Director of the Office of Public Housing require the Authority to develop a reasonable method for allocating its future costs to include daily activity reports and semi-annual certifications for services performed by its personnel.

Further, we recommend that the Director of the Office of Public Housing direct the Authority to transfer the \$400,000 of Section 8 administrative fee reserve funds back to the reserve account, along with the interest earned on the funds.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We discussed our review results with the Authority and HUD officials during the audit. We provided a copy of the draft report to Authority officials on October 12, 2004, for their comments and discussed the report with the officials at the exit conference on October 21, 2004. The Authority provided written comments on November 4, 2004.

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

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BACKGROUND AND OBJECTIVES

The Housing Authority of the City of Charleston (Authority) was organized in 1935. It is a public, corporate, and political body organized under the laws of the State of South Carolina by the City of Charleston. The purpose of the Authority is to provide adequate housing for qualified low-income individuals in compliance with its Annual Contributions Contracts (Contract) with HUD.

The Mayor and City Council of Charleston appoint the Authority's seven-member Board of Commissioners (Board) to 5-year terms. The Board elects its own chairperson and designates its own chief executive officer, who currently is Donald J. Cameron. The chief executive officer provides oversight over the Authority, and a chief operating officer is responsible for the Authority's daily operations, under the direction of the chief executive officer.

The Authority entered into Contracts with HUD to be the administrator of housing and housing-related programs. The Authority's funding is primarily from HUD and payments received from tenants of the Authority-owned housing. In 2003, the Authority managed 1,383 public housing units, administered 1,317 Section 8 vouchers, and was awarded approximately \$12.3 million in HUD funds for housing and other programs.

One of the Contracts regulates the Authority's use of its Section 8 administrative fee reserves. Section 12 of the Section 8 Contract states that funds in the administrative fee reserves must be used to pay administrative expenses in excess of program receipts or, if needed, to improve administration of the Section 8 program. Section 12 also allows remaining funds to be used for other housing purposes if permitted by State and local law.

Our overall audit objective was to determine whether the Authority encumbered resources subject to its Contract or other agreement or regulation to the benefit of other entities without specific HUD approval. Our objective included determining whether the Authority's cost allocation method complied with provisions of OMB Circular A-87, and whether the Authority used the Section 8 administrative fee reserves in accordance with the Contract and other regulations.

RESULTS OF AUDIT

Finding 1: The Authority Did Not Support Its Allocation of Costs to the Federal Programs

The Authority did not support its allocations of \$8,956,361 in salaries, wages, and fringe benefits charged to the Federal programs, as required in OMB Circular A-87. In addition, the Authority did not perform certifications for employees who worked solely on a single Federal award or cost objective, as required in OMB Circular A-87. As a result, charges of \$6,681,053 to the Federal Program for employees' salaries, wages, and fringe benefits were not supported by required certifications. The Authority did not have records of the actual time spent by employees between Federal programs and non-Federal programs. The Authority officials believed their allocation method complied with the requirements. However, without support to substantiate the allocations of actual services performed by personnel or some type of quantifiable measures of employee effort, the Authority may have inaccurately charged the Federal programs. Therefore, the allocations and costs of \$15,637,414 for salaries, wages and fringe benefits charged to the Federal programs over the past 5-year period were unsupported.

Allocation of Costs Was Not Documented

The Authority did not have supporting documentation to support its allocations of salaries, wages, and related fringe benefits charged to the Federal programs. According to the Authority's allocation plan, wages and related benefits of senior staff and general administrative positions were charged based on a time analysis, but the Authority could not provide the supporting documentation used to perform the time analysis. The Authority charged maintenance labor wages and related benefits on a per-unit-per-program basis as opposed to actual work orders or work performed.

We inquired whether the Authority kept activity reports or equivalent documentation for services performed by its administrative personnel. The Authority stated, "we believe our methodology complies with the spirit of A87 and further believe that should actual activity reports were kept, the amounts applicable to the federal programs would be significantly more than its methodology charges and has a detrimental impact on the viability of the federal programs."

We determined that the allocation method used by the Authority does not comply with the provisions of OMB Circular A-87 nor does it have HUD's approval. The Authority did not base its cost allocation of salaries and related fringe benefits on actual services performed or use statistical sampling standards per OMB Circular

A-87. The provisions of OMB Circular A-87, Attachment B, Section h.(4), comprise, in part, “Where employees work on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation ... The activity reports must reflect an after the fact distribution of the activity of each individual employee... Budget estimates or other distribution percentages determined before the services are performed do not qualify as support for charges to Federal awards...”

Since the Authority was unable to provide supporting documentation of actual services performed by personnel or some type of quantifiable measures of employee effort, we are questioning all allocations of administrative and maintenance salaries, wages, and fringe benefits that were charged to the Federal programs over the past 5 fiscal years, from October 1, 1998, through September 30, 2003. During the 5-year period, the Authority charged \$8,956,361 of administrative, maintenance, and tenant service costs to the Federal programs without support for its allocations.

Costs Were Not Supported by Certifications

The Authority did not have the required certifications to support costs of \$6,681,053 charged the Federal program for salaries, wages, and fringe benefits of employees who worked solely on a single Federal award or cost objective. The Authority did not perform certifications as required in OMB Circular A-87. According to OMB Circular A-87, Attachment B, Section h. (3), salary and wage charges for employees who are expected to worked solely on a single Federal award or cost objective will be supported by periodic certifications, and the certifications will be prepared at least semi-annually and will be signed by the employee or supervisory official.

Because the Authority did not have certifications for employees who worked solely on a single Federal award or cost objective, we are questioning all costs that were charged to the Federal program for salaries, wages, and fringe benefits for these employees. Over the past 5 fiscal years, from October 1, 1998, through September 30, 2003, the Authority charged \$6,681,053 of administrative, maintenance, and tenant service costs to the Federal programs without supporting certifications.

Recommendations

We recommend that the Director of the Office of Public Housing:

- 1A. Require the Authority to provide documentation to justify the \$8,956,361 of allocated costs and ensure the Authority makes appropriate adjustments to the various programs.
- 1B. Require the Authority to obtain assistance in developing a justifiable method of supporting the allocated costs.
- 1C. Require the Authority to develop a reasonable method for allocating its future costs to include daily activity reports for services performed by its personnel.
- 1D. Require the Authority to provide documentation to justify the \$6,681,053 of costs without supporting certifications.
- 1E. Require the Authority to perform semi-annually certifications for employees who work solely on a single Federal award or cost objective.

Finding 2: The Authority's Section 8 Administrative Fee Reserves Were Not Used in Accordance With Its Contract

The Authority withdrew \$400,000 of its Section 8 administrative fee reserves and transferred the funds to its Agency fund. However, the funds were not spent, which is contrary to the Contract. Also, when the Authority transferred the funds to its Agency account, HUD lost visibility of the funds. Therefore, HUD could not monitor use of the funds to ensure they were properly spent for other housing purposes, as stated in the Contract.

The Authority Did Not Use the Funds in Accordance With Its Contract

In March 2003, the Authority transferred \$400,000 of its Section 8 administrative fee reserves to its Agency fund. The Authority's Board approved the transfer on February 25, 2003, from funds in the reserve as of September 30, 2002. The Board's minutes documented that the Authority's chief executive officer indicated that most of the reserves were at risk of HUD recapturing the money or not allowing the Authority to do whatever it wanted with the money.

The chief executive officer told us that the reserves were transferred to supplement a proposed \$1 million revolving loan for renovation of affordable housing for first-time homebuyers. The loan was to be made through the Agency to the City of Charleston (City). The Board's minutes also indicated that the Board discussed using the \$400,000 transfer to reduce the amount the Authority would need to borrow for the loan to the City. The Board also discussed how the City's proposed affordable housing project would provide a project for which the funds were used productively, should HUD question the transaction. The chief executive officer stated that he could make a good case that the money was continuously benefiting the people the Authority served and that the money could remain active and be reused. He anticipated that HUD might attempt to recapture the administrative fee reserves in 2003.

The chief executive officer informed us that the City's plan failed so the funds were not used. In April 2003, the City requested that its proposal be deferred. The Authority's chief operating officer stated that Authority officials interpreted the deferral to mean that the City's plan failed because the proposal was never resumed. The chief executive officer added that the funds remained in the Agency account for future affordable housing renovations.

The \$400,000 has been unused in the Agency account for more than a year. The Contract allows use of the reserve funds for other housing purposes. However, transferring the funds to the Agency and not expending them does not constitute funds being used for other housing purposes. Therefore, the funds did not benefit

the people the Authority serves. The funds should be transferred back to the reserve account, along with the interest earned on the funds, so that HUD can monitor how the funds are used.

HUD Could Not Monitor Use of The Funds

A HUD Headquarters Public Housing official stated that it was never HUD's intent for the excess funds to be transferred out of the Section 8 administrative fee reserves, and the Authority needs to return the \$400,000 to the reserve account. The official added that HUD's intent was for funds to be spent directly from the reserves. Otherwise, HUD could not monitor the expenditures and ensure that the Authority properly used the funds for other housing purposes. When the Authority transferred the funds to its Agency account, the funds became vulnerable to being used for purposes other than those allowed by the Contract because HUD lost visibility of the funds.

Recommendations

We recommend that the Director of the Office of Public Housing:

- 2A. Require the Authority to transfer the \$400,000 of Section 8 administrative fee reserve funds back to the reserve account, along with the interest earned on the funds, so that HUD can monitor the funds and ensure that they are used for their intended purpose.
- 2B. Require the Authority's Board to establish controls to monitor future transfers of Section 8 administrative fee reserves and ensure that transactions comply with the Contract and other HUD requirements.

SCOPE AND METHODOLOGY

To achieve our audit objectives we reviewed the following:

- Applicable laws, regulations, and other HUD program requirements;
- The Authority's consolidated Contracts;
- HUD's and the Authority's program files; and
- The Authority's accounting books and records.

We reviewed all outstanding loans and documents supporting the loans and all outstanding notes receivable from October 1, 2001, through September 30, 2003. We reviewed related guarantee agreements, management agreements, partnership agreements, and the related nonprofit entity's bylaws. We also reviewed the Section 8 administrative fee reserves, the financial statements, and HUD's Real Estate Assessment Center financial data.

Additionally, we used audit software to retrieve and analyze the accounting data from the general ledger in an electronic form provided by Authority staff. We also interviewed HUD staff, Authority officials, and Authority accounting staff.

We performed our onsite work between March and May of 2004. Our audit covered the period from October 1999 through September 2003, but we extended the period as necessary.

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

INTERNAL CONTROLS

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

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

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

Relevant Internal Controls

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

- Compliance with Laws and Regulations and
- Safeguarding of Resources.

We assessed the relevant controls identified above.

Significant Weaknesses

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

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

- The Authority violated the requirements of OMB Circular A-87 by not supporting its allocations of \$8,956,361 and not performing certifications for \$6,681,053 in salary costs charged to Federal programs (see finding 1).
- The Authority violated its Contract by transferring \$400,000 of its Section 8 administrative fee reserves to another account but not using the funds (see finding 2).

FOLLOW-UP ON PRIOR AUDITS

Citizen Complaints – Housing Authority of the City of Charleston - Audit Report No: 99-AT-204-1807

The audit was initiated based on citizen complaints concerning the sites selected for the development of new public housing projects by the Authority. All recommendations in the report have been implemented.

Fiscal Year 2003 Audited Financial Statements of the Authority

Rector & Moffitt, P.C., completed the most recent audit of the Authority's financial statements for the 12-month period ending September 30, 2003. The financial statement report contains an unqualified opinion. The report did not contain any findings that required reporting under section 510(a) of Office of Management and Budget Circular A-133.

There were no findings or recommendations in any of the reports that affected our audit objectives.

APPENDIX

Appendix A

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

| Recommendation Number | Unsupported <u>1/</u> | Funds To Be Put To Better Use <u>2/</u> |
|--------------------------|-----------------------|--|
| 1A | \$8,956,361 | |
| 1D | \$6,681,053 | |
| 2A | | <u>\$400,000</u> |
| TOTAL | <u>\$15,637,414</u> | <u>\$400,000</u> |

1/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity where we cannot determine eligibility at the time of audit. Unsupported costs require a future decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of Departmental policies and procedures.

2/ Funds to be put to better use are quantifiable savings that are anticipated to occur if an Office of Inspector General (OIG) recommendation is implemented, resulting in reduced expenditures at a later time for the activities in question. This includes costs not incurred, deobligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

Comment 1



HOUSING AUTHORITY OF THE CITY OF CHARLESTON
 550 MEETING STREET, CHARLESTON, SOUTH CAROLINA 29403
 TELEPHONE (843) 720-4970 FAX # (843) 720-3977 TDD (843) 720-3685
 Donald J. Cameron, SPHM - Chief Executive Officer
 James Heyward, Jr. - Chief Operating Officer

The following is the Authority's response to the audit findings from the Office of Inspector General audit report dated October 27, 2004.

Finding 1: The Authority Did Not Support Its Allocation Of Costs To The Federal Programs

The Authority does have a methodology to determine what percentage of employee's salaries, which provide services to both federal and non-federal programs, should be charged to each program served. Each year, at budget preparation, the Authority determines the appropriate allocation based on interviews with staff, upcoming projects, and any anticipated changes in the employees' duties. During the year, revisions are made as necessitated by changed circumstances. The Authority uses spreadsheets to track the allocations for each year. The salary allocations are reviewed by the Board annually in the budget process and approved with the budget. The methodology is fair, equitable and consistently applied.

The Authority does not require employees who provide services only to federal programs to do semi annual certifications stating that their time is solely spent on federal programs. However, to ensure that we are in compliance with A-87, we will require these certifications semi annually.

Finding 2: The Authority's Section 8 Administrative Fee Reserves Were Not Used In Accordance With Its Contract

The Authority transferred the monies in question to the Authority's Housing Finance Agency, which was created as a vehicle to develop or provide funds to non profits or other government agencies for development of affordable housing. The transfer of funds for "other housing purposes" is clearly in accordance with section 12(b) of the Consolidated Annual Contributions Contract. It was not until HUD notice 2004-7 that language was added that defined what constitutes use of the administrative reserve. HUD notice 2004-7 states that "The transfer of amounts from the Operating (Administrative Fee) Reserve to another non Section 8 program account does not constitute use of the Operating Reserve for other housing purposes, even if the account to which funds would be transferred is designated for housing purposes. Operating Reserve funds must be expended to be considered used for other housing purposes." Up until that time, the regulations were silent as to what constituted a use for other housing purposes except that it had to be permitted by State or local law.

The Housing Finance Agency, a component fund of the Authority, is clearly reported on all financial reports of the Authority, all submissions to oversight agencies, and is audited by an independent auditor.

The Authority has transferred the monies back to the Operating Reserve in Section 8, along with interest.

 Donald J. Cameron, CEO


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OIG Evaluation of Auditee Comments

Comment 1

The Authority's methodology to determine what percentage of employees' salaries should be charged to Federal programs is not in accordance with the provisions of OMB Circular A-87. In essence, the Authority's comments indicate that allocations are determined, reviewed, and approved each year during the budget process. OMB Circular A-87 explicitly states that budget estimates or other distribution percentages determined before the services are performed do not qualify as support for charges to Federal awards. The Authority officials also comment that their allocations are based on interviews with staff, upcoming projects, and anticipated changes in employees' duties determined at budget preparation. OMB Circular A-87 provides that, where employees work on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation. The activity reports must reflect an after the fact distribution of each employee's activity. Further, the Authority indicates that its staff uses spreadsheets to track the allocations each year. We reviewed the spreadsheets and found that they are not equivalent to personnel activity reports because they only show percentages of time, by position title, allocated to various programs.