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Memorandum No.
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November 5, 2004

MEMORANDUM FOR: Cecilia J. Ross, Director,
Los Angeles Office of Public and Indian Housing, 9DPH
Joan S. Hobbs

FROM: Joan S. Hobbs, Regional Inspector General for Audit, 9DGA

SUBJECT: Housing Authority of the City of Los Angeles
Nonprofit Organizations
Los Angeles, CA

INTRODUCTION

We have completed an external audit survey of the Housing Authority of the City of Los Angeles' (Authority) activities with its 13 related nonprofit organizations. The survey focused on the use of assets provided by the Department of Housing and Urban Development (HUD). We performed the survey as part of the audit of the HUD oversight of Public Housing Agency (PHA) development activities with related nonprofit entities. Our objective was to determine whether the Authority complied with laws and regulations and properly safeguarded resources when it conducted business with its 13 related nonprofit entities.

Our survey disclosed that the Authority inappropriately transferred \$30,196,274 in Section 8 administrative fee reserves to the nonprofit entity Los Angeles LOMOD West, Inc. However, at HUD's direction, Los Angeles LOMOD West, Inc. transferred all of the reserves back to the Authority. We also found that the Authority had difficulty using their accounting system to produce supporting documentation for general ledger transactions. To correct this problem, the Authority is implementing an Oracle based accounting system which is expected to be operational in December of 2004.

Since the Authority has taken appropriate actions to correct the problems identified, we do not believe additional audit work relative to the survey objectives is warranted.

METHODOLOGY AND SCOPE

To accomplish our objective, we reviewed applicable HUD regulations, the Authority's Annual Contributions Contract (ACC), and other requirements. We interviewed appropriate Authority and HUD Office of Public and Indian Housing management staff and reviewed various Authority documents including audited financial statements, general ledgers, bank statements, invoices, minutes from Board meetings, and HUD correspondence. We also reviewed audited financial statements for 9 of the 13 Authority controlled nonprofit entities.

We performed our on-site survey work from June 01, 2004, through September 10, 2004, and covered the period January 01, 2002, to May 31, 2004.

BACKGROUND

The Housing Authority of the City of Los Angeles was organized as a Public Housing Authority in 1938 under California law to provide safe and sanitary housing for persons of low and moderate income. The Authority is one of the largest Public Housing Authorities in the nation and has more than 60 developments with over 8,000 units and 20,000 residents in its conventional public housing program. The Authority also manages a Section 8 Program with over 44,000 units and 95,000 residents. As of October 26, 2004, the Authority had 25,000 applicants on the public housing program waiting list and as of October 22, 2004, there were 94,151 applicants for the Section 8 Program. The Authority is the parent company of thirteen active wholly owned nonprofit subsidiaries:

- Los Angeles LOMOD Corporation is a housing development corporation created in 1973 to develop low-income properties. In March of 2003, the Los Angeles LOMOD Corporation was selected as the contract administrator for the Authority's Project-based Section 8 program.
- La Cienega LOMOD, Inc., Los Angeles LOMOD South, Inc., and Los Angeles LOMOD West, Inc. were created in 1975 to provide housing for persons of low and moderate income;
- Los Angeles LOMOD Owensmouth, Inc. was created in 1975 to provide sanitary and low income housing to elderly/disabled persons;
- Los Angeles Section 8 Apperson LOMOD Corporation, Los Angeles Section 8 Jefferson LOMOD Corporation, Los Angeles Section 8 Manhattan LOMOD Corporation, Los Angeles Section 8 Simpson LOMOD Corporation, Los Angeles Section 8 Browning LOMOD Corporation, Los Angeles Section 8 Coronado LOMOD Corporation, and Los Angeles Section 8 Juanita LOMOD Corporation are all housing development corporations created in 1982 for the development, construction, financing and rehabilitation of housing projects for persons of low and moderate income;
- New Vision Assets, Inc. was created in 2003 to provide assistance to the Authority by owning and operating multifamily residential rental properties, land and equipment for the exclusive use and benefit of the Authority. The assets for Los Angeles LOMOD Owensmouth were transferred to New Vision Assets in 2003 as part of a bond issue to fund the creation of New Vision Assets.

- Kids Progress, Inc. is a children and youth foundation created in 2002 to increase educational, artistic, cultural and technical opportunities for Authority residents.

A seven member Board of Commissioners governs the Authority. Three of the Authority's Board of Commissioners serve concurrently as the Board of Directors for each of the 13 nonprofit subsidiaries. The Authority's Executive Director and Chief Financial Officer normally serve as the President and Treasurer, respectively, for each of the 13 nonprofit subsidiaries. The Authority's financial records were maintained primarily at its central office located at 2600 Wilshire Boulevard, Los Angeles, California.

SURVEY RESULTS

Based upon the limited external audit survey work, the majority of the Authority's activities with its 13 nonprofit subsidiaries appear to be in accordance with statutory and regulatory requirements. Our survey did identify a deviation from program requirements and an area of apparent risk: (1) transfer of \$30,196,274 in Section 8 Administrative Fee Reserves to the nonprofit entity Los Angeles LOMOD West, Inc., and (2) inability to provide sufficient general ledger data. However, both of these problems have been adequately addressed by corrective actions taken by HUD and the Authority. Los Angeles LOMOD West, Inc. has transferred the \$30,196,274 back to the Authority's reserve account, and the Authority's outdated accounting system is being replaced with a new Oracle based accounting system.

The Authority inappropriately transferred \$30,196,274 in Section 8 Administrative Fee Reserves

On December 31, 2003, Authority management violated its Section 8 Annual Contributions Contract (ACC) with HUD by inappropriately advancing \$30,196,274 in Section 8 Administrative Fee Reserves to Los Angeles LOMOD West, Inc., an Authority controlled nonprofit entity. This occurred because the Authority inappropriately prioritized spending administrative reserves on various Authority activities rather than covering over-leasing costs in 2003 and 2004. However, on March 30, 2004, Los Angeles LOMOD West transferred the \$30,196,274 back into the Authority's Section 8 reserve account.

Part A, Section 12 of the Section 8 ACC, Administrative Fee Reserve, states that the Authority may only use administrative fee reserve funds for other housing purposes if the funds are not needed to pay administrative expenses. Title 24 of the Code of Federal Regulations, Part 982.155 (b)(1), subpart D, provides requirements for administrative fee reserves. Under Title 24 C.F.R § 982.155(b)(1), the Authority must use funds in the administrative fee reserve to pay program administrative expenses in excess of administrative fees paid by HUD for a fiscal year.

The Authority transferred \$30,196,274 to Los Angeles LOMOD West, Inc. as part of \$74,743,213 transferred from Section 8 administrative fee reserves to various other accounts and activities in order to protect the reserves from being used to cover Authority over-leasing costs in 2003 and projected over-leasing costs in 2004. Apparently, the former Executive Director wanted to use administrative fee reserves on Authority activities before Congress passed legislation that would limit how public housing authorities could spend their reserves. The hope

was that over-leasing costs for 2003 and 2004 would be covered through additional financial assistance, which was requested from HUD. On March 30, 2004, at HUD's direction, \$63,132,880 was transferred from various Authority accounts and activities back into the Section 8 administrative reserve account to be applied to the actual and expected over-leasing costs. The \$63,132,880 represented the unspent portion of the \$74,743,213 originally removed from the reserve account and included all of the \$30,196,274 which had been transferred to the Authority's nonprofit affiliate, Los Angeles LOMOD West, Inc. The \$11,610,333 in spent funds was used for public housing security consulting contracts, Section 8 new construction operating deficits, public housing operating expenses, resident relations program deficits, and compensation for the conversion from cash to an accrual accounting method.

Authority accounting staff had difficulty providing supporting documentation for general ledger transactions

In order to isolate the nonprofits' cash and accounts payable entries on the Authority's general ledgers and select a sample of transactions to test, we first had to extract (download) raw data from the Authority's accounting system. After sorting, filtering and analyzing the Authority's data using external Audit Command Language software, we made a sample selection and requested the related supporting documentation. It then took the Authority accounting staff over a month to research and retrieve all of the documents necessary to support the transactions.

The accounting staff had difficulty because the Authority was using an outdated accounting information system purchased in the 1980's, and they did not know how to extract data and support in a timely fashion. To correct the problems with the accounting system, the Authority has installed an Oracle based accounting information system, which will run parallel to the existing system until it is fully operational which is expected in December 2004. During our survey fieldwork, Authority staff had been receiving training on the new Oracle system.

RECOMMENDATIONS

Since the Authority has taken appropriate corrective action for the problems identified by our survey, no recommendations are considered necessary.

If you have any questions, please contact me at (213) 894-8016, or Charles Johnson, Assistant Regional Inspector General for Audit, at (602) 379-7243.