audit report

Issue Date August 28, 2006	
Audit Report Number 2006 BO 1011	

TO: Donna J. Ayala, Director, Office of Public Housing, Boston, Massachusetts, Regional Office, 1APH

FROM: John A. Dvorak, Regional Inspector General for Audit, Boston, 1AGA

SUBJECT: The Portland Housing Authority, Portland, Maine, Did Not Use Reserve Funds or Properly Allocate Employee Costs, Resulting in Questioned Costs of More Than $850,000

HIGHLIGHTS

What We Audited and Why

We reviewed the Section 8 Housing Choice Voucher program (Voucher program) at the Portland Housing Authority (Authority) as part of our fiscal year 2006 annual audit plan. Our objective was to determine whether the Authority properly administered its Voucher program in accordance with its annual contributions contracts and U.S. Department of Housing and Urban Development (HUD) requirements.

What We Found

The Authority generally administered its Voucher program in accordance with its annual contributions contracts and HUD requirements. However, it did not use its Section 8 administrative fee reserves in a timely manner or properly allocate salary and employee benefits expense to the Voucher program.

In February 2003, the Authority transferred Section 8 administrative fee reserves to its local programs account, but as of March 2006, it had not used $647,814 of these reserve funds for program or other housing purposes. This occurred because the Authority (1) did not implement its Board resolution donating $550,000 to the Authority's non-profit entity, the Portland Housing Development Corporation (PHDC), (2) lacked specific plans to use available funds, and (3) was unaware that reserve funds must be expended to be considered used. The Authority also undercharged its Voucher program by $158,034 in salary and employee benefits expense because its cost allocation procedures improperly charged the program costs to its Public Housing Capital Fund (Capital Fund) program when the Voucher program had funding shortfalls. The Authority agreed to establish quantifiable and verifiable procedures, which should reduce future Capital Fund program costs by $44,336 during the next 12 months.

What We Recommend

We recommend that the director of the Office of Public Housing, Boston, Massachusetts, require the Authority to (1) repay to its Section 8 program the unused portion of $647,814 in administrative fee reserve funds transferred to its local programs account and provide supporting documents for verification of the $158,034 in transferred reserve funds to the Capital Fund program, (2) identify current and valid uses for the remaining Section 8 administrative reserves ($489,780), and (3) establish and implement formal written procedures to properly allocate costs to the benefiting programs, thereby reducing future Capital Fund program expenses by $44,336. In addition, we recommend that HUD verify the repayment of $158,034 to the Authority's Capital Fund program for ineligible administrative expenses.

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

Auditee's Response

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 Section 8 Housing Choice Voucher program (Voucher program) is the federal government's major program for helping very low-income families, the elderly, and the disabled to afford decent, safe, and sanitary housing in the private market. Participants are free to choose any housing that meets program requirements. Public housing agencies administer U.S. Department of Housing and Urban Development (HUD)-funded vouchers, which pay a housing subsidy directly to the landlord on behalf of the participating family. Public housing agencies also determine family eligibility based on income and family size and determine the amount of tenant subsidy. Annually, the agencies verify family income and composition and ensure that units meet minimum housing quality standards.

The city council of Portland, Maine, established the Portland Housing Authority (Authority) in 1943 to provide and promote safe and sanitary housing for low-income persons residing in Portland. A seven-member board of commissioners appointed by the city council governs the Authority. The Authority manages several HUD-funded housing programs including its conventional low-income public housing, Section 8, and Public Housing Capital Fund (Capital Fund) programs. The Authority's Section 8 programs include its New Construction/Substantial Rehabilitation, Moderate Rehabilitation, and Housing Choice Voucher (Voucher program) programs. The Authority must operate its Voucher program and other Section 8 programs according to the rules and regulations prescribed by HUD in accordance with its annual contributions contracts, and 24 CFR [*Code of Federal Regulations*] Part 982. The Authority's Voucher program received more than $39 million in funds from HUD to support more than 1,700 families during fiscal years 2003 through 2005.

Our overall audit objective was to determine whether the Authority managed its Voucher program according to its annual contributions contracts and HUD program requirements. We wanted to determine whether the Authority

- Properly accounted for Section 8 interfund transfers and properly used federal funds and
- Allocated and charged its Voucher program an appropriate amount of salary and employee benefits expense.

RESULTS OF AUDIT

Finding 1: The Authority Did Not Use $647,814 in Section 8 Reserve Funds in a Timely Manner

The Authority did not expend funds from its Section 8 administrative fees reserve account in a timely manner. It transferred $976,687 from its reserve funds to its local programs account in February 2003, and as of March 2006, it had only used $328,873 of the transferred reserves for Section 8 or other valid housing programs, and $647,814 in reserve funds remained. We also identified $158,034 in funding shortfalls in the Authority's Section 8 program. The Authority agreed to use part of this reserve funding to correct the condition cited (see finding 2). The failure to appropriately use the funds occurred because the Authority did not implement the Board's resolution (donation of $550,000 to PHDC), it lacked a specific plan to use available Section 8 reserve funds, and it was unaware that reserve funds must expended for program or other housing purposes in a timely manner. As a result, the Authority had $489,780 in unused transferred reserve funds that had been in its local programs account for more than three years.

The Authority Transferred Reserves to Its Local Programs Account

The Authority transferred $976,687 in Section 8 voucher, moderate rehabilitation, and new construction administrative fee reserves (reserves) to its local programs account on February 28, 2003. The transfer was completed to distinguish between reserves earned before October 1, 2002, which could be used for other housing programs, and reserves earned after enactment of the 2003 appropriations act, which required reserves be used for Section 8 program purposes only. However, the transfer did not constitute a "use" of reserve funds because the Authority did not expend the funds in a timely manner subsequent to their removal from the Section 8 program accounts, as required. As a result, the Authority's Section 8 administrative fee reserve accounts were understated by $976,687 at the time of the transfer, and HUD lost visibility of the reserve funds.

Section 8 Reserves Were Not Used for Program Expenses

Federal regulations and the Authority's contract with HUD require that Section 8 administrative fee reserves be used to pay for Section 8 program expenses when expenses exceed program receipts. Any funds remaining after program expenses have been paid may be used for other housing purposes. However, the Authority's internal controls did not adequately ensure that program expenses were met before using the $976,687 in reserve funds for other purposes (see finding 2). For instance, from July, 1 2003, through March 11, 2006, the Authority had Voucher program shortfalls and incorrectly charged $158,034 in program expenses to the Capital Fund program. In response to our audit recommendation, the Authority agreed to repay its Capital Fund program for these expenses from the Section 8 reserve funds transferred to its local programs account.

The Authority Lacked a Specific Plan for Unused Reserves

The Authority originally intended to use the $976,687 in Section 8 reserve funds transferred to its local programs account, but its management was unaware that reserve funds must be expended before HUD considers them as used, nor did it have a specific use for the funds when they were transferred. For instance, the Authority spent $180,000 of the transferred reserve funds in October 2003 for other housing purposes,[1] approximately eight months after the transfer. In December 2003, the Authority's board of commissioners passed a resolution to donate $550,000 in Section 8 reserves to the Authority's nonprofit housing development corporation for unspecified housing purposes. However, the reserve funds were never donated to the development corporation. In October 2004 (20 months after the transfer), the Authority spent another $148,873 for the maintenance of public housing projects in preparation for an inspection of its public housing units.

During the audit, the Authority identified several possible uses for the transferred reserve funds. For example, the reserve funds could have been used to pay expenses associated with hard-to-house, lead-based paint testing, and abatement fees. The Authority also identified other needs such as a new roof for its Harbor Terrace project and street, sewer, and water main work for the Riverton Family Development. Despite the occasional identification of other housing needs that could have been satisfied, the Authority did not develop specific plans to use the transferred Section 8 reserve funds in meeting these needs. At the conclusion of our audit, $489,780 of the transferred reserve funds remained unused for more than three years.

Conclusion

The Authority understated its Section 8 administrative fee reserves to HUD when it transferred $976,687 in Section 8 reserves to its local programs account. Of the total funds transferred, the Authority used $328,873 for other valid housing

[1] The $180,000 was expended to purchase and renovate of the Authority's Washington Avenue property.

purposes. It also agreed to repay $158,034 to its Capital Fund program for its Section 8 funding shortfalls (see finding 2) in response to our audit recommendations. However, the Authority's management was unaware of the requirement that reserve funds be expended to be considered used for program or other housing purposes, and it lacked a specific plan to use the transferred reserve funds for program purposes or other housing needs. As a result, the balance of $489,780 in transferred reserve funds has remained unused for more than three years.

Recommendations

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

1A. Repay its Section 8 program account the unused portion of $647,814 in administrative fee reserve funds.

1B. Provide supporting documents on the payment of $158,034 from transferred reserve funds to the Capital Fund program to the Office of Public Housing for review and verification.

1C. Develop or strengthen internal controls to ensure administrative reserve funds are transferred only when used (expensed) for valid program purposes or as allowed; and develop a specific plan to identify current and valid uses for its Section 8 administrative fee reserves ($489,780) and use the funds for Section 8 program expenses or for other valid housing needs as required.

1D. Make a prior-year adjustment to reflect the repayment of the Section 8 administrative fee reserves when submitting its fiscal year 2006 financial statements.

RESULTS OF AUDIT

Finding 2: The Authority Improperly Charged $158,034 in Voucher Program Expenses to Its Capital Fund Program

The Authority did not charge the appropriate salary and employee benefits expense to its Section 8 program when funding shortfalls occurred. Instead, it charged $158,034 in Section 8 program expenses to its Capital Fund program from July, 1 2003, through March 11, 2006. The uncharged costs occurred because the Authority's cost allocation procedures needed improvement. The Authority agreed to repay $158,034 to the Capital Fund program after we identified these charges as ineligible costs. The Authority also agreed to establish quantifiable and verifiable cost allocation procedures, which should reduce future Capital Fund program costs by at least $44,336 during the next 12 months.

Section 8 Costs Charged to the Capital Fund Program

Federal cost principles require that activities benefiting from a governmental unit's indirect costs receive an appropriate allocation of costs. The Authority could not support the amount of expenses allocated for employees who worked on multiple programs. It improperly charged the salary and employee benefits costs of one housing inspector to the Capital Fund program from July, 1 2003, through March 11, 2006. The charges were ineligible because the inspector spent 90 percent of his time conducting inspections for the Section 8 programs and only 10 percent of his time conducting inspections for the Capital Fund program. The Authority charged the inspector's salary costs to its Capital Fund program because procedures allowed these costs to be allocated to programs with available funding when its Section 8 programs did not have sufficient funds to pay the salary costs. If the appropriate allocations had been made, $158,034 would have been charged to the Section 8 program, and $17,559 would have been charged to the Capital Fund program.

Inadequate Allocation Procedures

The salary and employee benefits were not properly charged because the policies and procedures followed did not provide a reasonable basis for identifying and allocating these costs. For instance, the Authority did not maintain certifications for employees showing the programs for which they worked, and the managers developing the cost allocation plan were unaware that some program employees worked on multiple programs. This budget planning information would help identify anticipated expenses and whether the Authority's various programs were adequately funded. In addition, the Authority did not maintain time records to show how many hours employees spent working for each program. Instead, procedures allowed allocation of salary costs to programs based on unsupported estimates and available funding. As a result, the amount of salaries and employee benefits the Authority charged for employees working on multiple programs was not quantifiable, verifiable, or supported in accordance with federal requirements.

Authority to Repay $158,034 and Establish New Procedures

In response to our audit finding, the Authority agreed that 90 percent of the inspector's costs were not properly allocable to the Capital Fund program. The Authority agreed to repay $158,034 to the Capital Fund program with unused Section 8 program reserve funds. It also agreed to establish quantifiable and verifiable cost allocation procedures for salary and employee benefits. Implementing new procedures should ensure that the appropriate housing programs are charged their share of salary expenses and reduce future Capital Fund salary costs by at least $44,336 during the next 12 months. The savings for the Capital Fund program will be realized when the cost of the inspector is appropriately charged under the Section 8 program.

Conclusion

The Authority undercharged its Section 8 program $158,034 when program costs exceeded program income and incorrectly charged them to the Capital Fund program. It improperly charged the $158,034 in Section 8 program costs to its Capital Fund program because its cost allocation procedures did not provide for the proper allocation of salary costs. However, it agreed to repay the Capital Fund program for the ineligible costs and to establish adequate cost allocation procedures, which would reduce future Capital Fund program costs by $44,336 during the next 12 months.

Recommendations

We recommend that the director of the Office of Public Housing

2A. Verify that the Authority repaid the $158,034 to the Capital Fund program from its Section 8 reserve funds.

2B. Require the Authority to establish and implement formal written procedures that properly allocate costs to the benefiting programs, which would reduce Capital Fund program expenses, resulting in $44,336 in funds to be put to better use (reduced outlays).

SCOPE AND METHODOLOGY

We performed our review in accordance with generally accepted government auditing standards. We conducted the audit between January and April of 2006. Our fieldwork was completed at the Authority's office located at 14 Baxter Boulevard, Portland, Maine. Our audit covered the period July 1, 2003, through June 30, 2005. To accomplish our audit objectives, we

- Reviewed program requirements, including federal laws and regulations, Office of Management and Budget circulars, and the consolidated annual contributions contracts between the Authority and HUD.

- Reviewed the Authority's financial statements and independent public accountant's reports.

- Interviewed Authority and HUD personnel and officials and reviewed meeting minutes from the Authority's board.

- Selected and tested a representative nonstatistical sample of Voucher program tenant files, which we reviewed for compliance with program requirements to ensure that program participants were eligible, housing assistance payments were properly supported and calculated, housing deficiencies were corrected in a timely manner, and rents paid were reasonable (10 tenant files from a universe of 1,704 Voucher program tenants as of December 1, 2005).

- Reviewed allocation procedures to determine whether the Authority charged its Voucher program an appropriate amount of salary and employee benefits expense.

- Reviewed interfund transfer procedures to verify that transfers were properly accounted for and that federal funds were used for their intended program.

Regarding funds to be put to better use (Appendix A), the funds indicated will be put to better use (i.e., used for program purposes) once the Authority implements our recommendations because it will cease charging the Capital Fund program for Section 8 inspectors' salary expenses. When the Authority successfully improves its procedures and implements its controls, this will be a recurring benefit. Our estimate reflects only the initial year of these recurring benefits.

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:

- Controls over tenant eligibility and calculating housing assistance payments, tenant payments, and utility allowances;
- Controls over rent reasonableness;
- Controls over housing quality standards inspections;
- Controls over allocating salary and employee benefits costs;
- Controls over accounting for interfund transfers

We assessed the relevant controls identified above.

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

Significant Weaknesses

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

- Accounting procedures did not ensure that Section 8 administrative fees were properly classified and reported to HUD (see finding 1).

- Allocation procedures did not adequately ensure that expenses were charged to the appropriate programs (see finding 2).

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Funds to be put to better use 2/
1A	$647,814	
2A	$158,034	
2B		$44,336
Subtotal	$805,848	$44,336
Total		$850,184

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local polices or regulations.

2/ "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. In this instance, if the Authority implements our recommendations, it will cease to charge the Capital Fund program for Section 8 inspectors' salary expenses. Between July, 1 2003, and March 11, 2006, the Authority charged $158,034 in Section 8 program expenses to its Capital Fund program, which is on average $1,246 a week or $58,356 in annual salary cost. For our estimate of funds put to better use, we used the average chargeable Section 8 salary of $852.62 a week reflected by the payroll register for the inspector during the period of July 2005 through March 2006 to arrive at the fund put to better use of $44,336 during the next 12 months. Once the Agency successfully improves its procedures and implements its controls, this will be a recurring benefit. Our estimate of $44,336 reflects only the initial year of these recurring benefits.

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AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation | **Auditee Comments**

Comment 1

PORTLAND HOUSING AUTHORITY
14 BAXTER BOULEVARD, PORTLAND, MAINE 04101-1822
www.porthouse.org
Administrative Office (207) 773-4753 • TDD (207) 774-2570
Fax (207) 774-6471
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BRUCE R. LORING
Executive Director and Secretary

MARK B. ADELSON
Deputy Executive Director

August 14, 2006

RECEI
2006 AUG 15 PM 3:27
HUD-OIG
OFFICE OF AUDIT
BOSTON, MASSACHUSETTS

Kevin Smullen, Assistant Regional Inspector General for Audit
U.S. Dept. of HUD - Office of Inspector General for Audit
10 Causeway Street - Rm. 370
Boston, MA 02222-1092

Dear Mr. Smullen:

Please find enclosed our written response to the draft findings. If this response must be summarized to fit into the OIG template, please add it as an attachment, unedited and in its entirety.

If you have any questions, please do not hesitate to contact me.

Sincerely,

BRUCE R. LORING
Executive Director

BRL:mah

Enc.

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AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

Response to Draft Results of Audit
Portland Housing Authority
August 7, 2006

Finding 1: The Authority Did Not Use $647,814 in Section 8 Reserve funds in a Timely Manner.

The Portland Housing Authority (the "PHA") has a superlative record of administering both Conventional Public Housing and Section 8 programs spanning over half a century. It has consistently achieved Recognized High Performer status in both programs since these criteria were developed by HUD with its most recent scores being the highest in its history. Its Section 8 program, the subject of this OIG review, has never achieved less than a perfect ranking of 100%. As both primary field auditors noted to both staff and the board chairperson on a number of occasions, our administration of the Section 8 program is the best that they have reviewed.

As a result of the high caliber of its program administration, by February of 2003 the PHA had managed to accumulate $976,687 of surplus reserves from its Section 8 voucher, moderate rehab and new construction programs. In order to further the mission of the PHA as stated in its HUD-approved agency plan, at that time it transferred these funds to the Local Program Account of the Authority so that 1) supportive activities could be undertaken for both the Section 8 and Conventional Public Housing programs and 2) other housing activities such as low income homeownership or affordable rental housing development could be pursued through the Portland Housing Development Corporation (the "PHDC", a component unit of the PHA). At the time of transfer, all of the PHA's Section 8 programs were fiscally sound and program revenues exceeded operating costs. The transfer met all relevant criteria applicable to such use of surplus funds.

After the transfer, activities in support of the PHA's mission were begun as intended:

- **$175,000** was donated to the PHDC and expended shortly thereafter for the purchase of a building adjacent to the PHA's Washington Gardens development for use as administrative office space. The building was acquired and retrofit shortly thereafter and the space was utilized as planned (freeing up for occupancy a public housing dwelling unit previously used for this purpose). The OIG auditors agree that this was an appropriate use of the funds.

- **$148,873** was expended on upgrades to other PHA public housing developments including paving, fencing, roofs, windows, etc. Partly as a result of this investment, the PHA subsequently received a score of 94% on its REAC physical plant inspection - its highest score on this criteria ever. The OIG auditors agree that this was an appropriate use of the funds.

Comment 1

- **$158,000** has been expended through transfer to the PHA Capital Fund as reimbursement for the housing inspector position which has been determined to be only a partially eligible expense in proposed finding #2.

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Comment 2

- **$550,000** was obligated by Board resolution for the purpose of providing affordable homeownership opportunities. Specifically, in support of the Administration's and HUD's emphasis on affordable homeownership, on December 2, 2003, $550,000 was committed by PHA Board resolution to develop these opportunities for eligible clients. Based on this commitment, immediately thereafter the PHDC began negotiating with four individual families for the purchase, with its own funds, of their units in a failing 8 unit condominium project adjacent to a PHA public housing development. This program was seen as a winning situation for all parties concerned: a failing condominium project would be renewed, four eligible families would be given an opportunity for affordable homeownership, a public housing unit (ME3-17) already in the condominium development would be safeguarded and a neighborhood eyesore would be prevented.

Comment 3

PHDC funds were used instead of the excess Section 8 reserves for two reasons: first, any development or homeownership program carries with it some inherent risk. Targeted units may not be able to be acquired, eligible purchasers may not be found, rehab work may ultimately cost in excess of estimates. By merely obligating the excess reserves and using other funds to complete the program the PHA was exposed to none of these risks. If the program were unable to be completed as planned, the PHA would simply not transfer the funds and the PHDC would take any losses. With regard to the inherent risks of development programs, this arrangement was extremely favorable to the PHA.

Comment 4

Second, leaving the excess Section 8 reserves in the Local Programs Account during development activities allows any interest income to accrue to the PHA for use to support both the Section 8 and Conventional Public Housing programs. Again, this arrangement was extremely favorable to the PHA

Comment 5

Comment 6

These properties were purchased on July 14, 2004 and substantial rehab of units and common areas was subsequently begun and completed. Potential homeowners were screened for eligibility, negotiations with each purchaser were finalized and all four condominiums were sold between 6/05 and 1/06. This time frame is well within the norms for completion of an acquisition and rehab project of this type. As the closing statements previously provided to the OIG auditors show, the closing for the last condominium occurred one week before this OIG review process began. Although we believe that we had the right to transfer these funds at any time (the PHA resolution did not specify a time frame for the transfer), we held off on doing so while the auditors were performing their review. During this audit process, we were subsequently directed by the OIG field auditors to not transfer any funds pending completion of their review. This audit process has now taken in excess of seven months as of this writing and the transfer of funds directed by the Board resolution has not yet occurred. The failure to transfer these funds as intended within this period is the essence of proposed Finding #1.

The Draft Results of Audit also contains a number of statements which the PHA disagrees with and which are individually addressed herein:

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HIGHLIGHTS

What We Found

"The Authority transferred Section 8 administrative fee reserves to its local account ... "

Comment 7

This statement is potentially misleading. In fact, these funds were transferred to the PHA's Local Programs Account, a specific account (Business Activity Account) identified on HUD's Financial Data Schedule (submitted to HUD annually).

"The Authority lacked a formal plan to use the available funds ... "

Comment 8

The PHA disagrees with this statement. These funds were transferred to support the mission statement, goals and objectives of the PHA, developed with substantial effort on the part of the Board and staff and clearly outlined in the published, HUD-approved Agency Plan.

What We Recommend

"Repay to its Section 8 program the unused portion of $647,814 in administrative fee reserve funds ... "

Comment 9

The PHA disagrees with this figure for two reasons. First, it does not reflect the fact that the $158,034 discussed in the second proposed finding has already been transferred and, second, it does reflect an inaccurate value for the building purchased for office space discussed above. The actual cost of the building was $175,000, not $180,000 as indicated in the proposed finding. This error was brought to the attention of the OIG during the audit process but remains uncorrected.

Finding 1: The Authority Did Not Use $647,814 in Section 8 Reserves Funds in a Timely Manner

"The Authority did not expend funds from its Section 8 administrative fee reserve account in a timely manner"

Comment 10

The PHA disagrees with this statement. Its contention that all activities related to the use of these funds were completed in a timely manner is discussed at length below.

"It had not determined a use for the remaining $647,814."

Comment 11

The PHA disagrees with this statement. The Authority clearly intended to use the bulk of these funds for the development of the affordable homeownership program; this intention is confirmed by the Board resolution passed on December 4, 2003 and OIG discussions with staff and the PHA board chair.

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The Authority Transferred Reserves to Its Local Program Account

"... and HUD lost visibility of the reserve funds."

Comment 12

The PHA disagrees with this statement. All of the subject funds were reported in the HUD FDS (Business Activity column), the year-end settlement statements (HUD 52681), the Management Discussion and Analysis (MDA) of the annual Independent Public Accountant report and within the body of the annual IPA audit report (submitted to HUD as required). It would have been difficult for the PHA to have made these funds more visible to HUD and the public.

Section 8 Reserves Were Not Used for Program Expenses

"... the Authority's internal controls did not adequately ensure that program expenses were met before transferring ... the reserve funds..."

Comment 13

The PHA disagrees with this statement. All of the PHA's Section 8 programs were fiscally sound and strong when the subject funds were transferred. This was clearly evident in the records provided by the PHA during the course of the audit.

Footnote #1: "The $180,000 was expended to purchase and renovate the Authority's Washington Avenue property"

Comment 14

The PHA disagrees with this statement. The actual cost as reported to the OIG audit staff was $175,000.

Finding 2: The Authority Improperly Charged $158,034 in Voucher Program Expenses to Its Capital Fund Program

"The Authority agreed to repay ..."

Comment 15

These funds have already been transferred back to the Reserve account.

Schedule of Questioned Costs ...

Comment 16

Comment 17

The PHA disagrees with this statement. The amount stated of $805,848 reflects a double-counting of the $158,034 transferred. Also, as discussed below, it is our opinion that the $550,000 obligated for the affordable homeownership program is a legitimate use of these funds which should not be included.

Comment 18

In reviewing the proposed Finding #1, it appears that the salient points made by the OIG field auditors are that the PHA did not develop a formal plan for the use of these funds prior to transfer, the PHA did not expend the surplus funds when they were transferred from the Section 8 program, these funds must be expended before HUD considers them as used and that the expenditure must be timely. In order to verify these assertions we requested of the OIG auditors a list of corresponding citations of Notices, Handbooks, regulations, etc. that would substantiate these allegations. In response, we were provided with the following (Attachment 1):

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- Housing Choice Voucher Program - Consolidated Annual Contributions Contract (HUD form 52520, par 12 Administrative Fee Reserve): The Housing Authority must use funds in the administrative fee reserves to pay administration expenses in excess of program receipts.

Comment 18

In our opinion, this does not apply; at the time of transfer there were no program expenses in excess of receipts.

If any funds remain in the administrative fee reserve, the Housing Authority may use the administrative reserve funds for other housing purposes.

This supports the PHA actions with regard to the subject transfer

If the Housing Authority is not adequately administering any Section 8 program funds in accordance with HUD requirements, HUD may (1) direct the Authority to use funds to improve administration of the Section 8 program, or for reimbursement of ineligible expenses, or (2) prohibit the Authority from using administrative fee reserve funds.

Comment 19

In our opinion, this does not apply; as stated in the proposed finding draft, our PHA was found to have administered its program in accordance with its Annual Contributions Contract and program requirements.

HUD-PIH Notice 2004-07, HUD Handbook 7420.7 - The transfer of amounts from the operating 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 ... Reserve funds must be expended to be considered used for other housing purposes.

Comment 20

In our opinion, these missives do not provide any clear guidance as to timely use of excess reserves and contain no clear requirement for either a formal plan prior to transfer or the expenditure of funds upon transfer. Further, PIH notice 2004-07 was issued over one year after the transfer and HUD Handbook 7420.7 was rescinded two years prior to the transfer of the subject excess reserves.

HUD-PIH Notice 2005-01 and Housing Choice Voucher Program - Consolidated Annual Contributions Contract (HUD form 5250, par. 2.5 A) PIH Notice 2005-01 reiterates the procedures identified in previously issued HUD Handbook 7420.7 requirements re: unauthorized transfers). Paragraph 2.5.A of the ACC requires PHA's to maintain complete and accurate books of account for the Section 8 program in accordance with HUD requirements.

Comment 21

Again, in our opinion, this Notice does not provide any clear guidance as to timely use of excess reserves and contains no clear requirement for either a formal plan prior to transfer or the expenditure of funds upon transfer. Further, the PHA has always kept complete and accurate books of account for the Section 8 program in accordance with HUD requirements.

HUD Handbook 7420.6 (HAP Accounting Handbook) identifies account #2826 for the operating

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reserve. The ACC, par 2.4.C provides that this account must be maintained and used for the administrative expenses in excess of program receipts.

In our opinion, this does not relate to the substance of this proposed finding; account #2826 is used for reporting operating reserves and, again, there were no administrative expenses in excess of program receipts at the time of transfer.

Comment 22

On balance, while the formal citations offered by the OIG and outlined above do verify the contention that funds must be expended to be considered as used, they do not clearly support the assertions that a formal plan is required prior to transfer and that funds must be expended at the time of transfer. Most importantly, this formal guidance does not clearly support the finding addressed herein that the subject funds were not expended in a timely manner. It is also noted that no examples of informal guidance concerning the timeliness of expenditures such as letters, memorandums or e mails, were provided.

PHA Response to OIG Recommendation Regarding Finding #1: The Authority Did Not Use $647,814 in Section 8 Reserve Funds in a Timely Manner

Comment 23

Nothing in this proposed finding disputes the merits or appropriateness of the proposed and actual expenditures made with the excess Section 8 reserves. The purchase of office space, investment in the physical properties of the PHA and the provision of affordable homeownership opportunities are clearly eligible uses of these resources. Provision of homeownership opportunities has been the focus of HUD and the current administration for some time and, in fact, the particular homeownership project discussed herein was recognized and lauded by an Undersecretary of HUD in a personal visit conducted for that purpose. Rather, the assertions contained in the proposed finding are technical in nature and confine themselves to process issues. The process of administering HUD programs is ordinarily clearly defined for housing authorities through Handbooks, Notices, Memorandums, regulations, guidebooks and statutes. In this instance, this was not the case. Nowhere in the citations given by the OIG audit staff was the requirement for or definition of what constitutes a timely use of these funds (the essence of this proposed finding) clearly delineated. Rather, in the exit conference it was clear that the issue of timeliness is subjectively determined by the informal policies of the particular regional office and the opinions of the OIG audit staff assigned to the auditee.

Comment 24

This situation put this Authority in an untenable position. The PHA is expected to have remained in compliance with a Handbook that had been rescinded years prior, Notices that had not yet been issued and informal and subjective HUD policies which were not clearly disseminated into the field. In the PHA's experience, development programs such as the one discussed herein are challenging and require a long time to complete. The duration of the subject homeownership project was, in fact, very comparable to similar projects undertaken by other PHA's in New England (some of which are still in progress). If HUD expectations for the PHA to formally seek time extensions for this expenditure of funds had been made clear, it would certainly have complied. Based on HUD's emphasis on affordable homeownership and the success of this particular homeownership project, additional time would almost certainly have been granted, and the project would have been completed exactly as it was without any compliance issues being raised.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation	Auditee Comments
Comment 25	This PHA has compiled a long history of excellence in administering all of its programs. Based on this record, on the fact that the homeownership program was a success, on the fact that it was executed in a fashion that preserved and enhanced the financial integrity of the PHA, on the fact that it was completed in a manner almost identical to programs of its peers (which have been reviewed and approved by HUD and the OIG) and the fact that responsibility for the alleged non-compliance is shared by both the PHA and HUD, we must disagree with this proposed finding and recommendation and we respectfully request that we be allowed to make the transfer of funds to the PHDC as previously directed by the Board resolution discussed herein.
	PHA Response to OIG Recommendation Regarding Finding #2: The Authority did not charge its Section 8 programs an appropriate amount of salary and employee benefit expense.
Comment 26	We want to note for the record that this proposed finding has already been addressed and resolved. The funds in question have been reimbursed and proper salary allocation plans have been developed and implemented. Both the reimbursement documentation and allocation plans are available for the Office of Public Housing to review at their convenience.

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OIG Evaluation of Auditee Comments

Comment 1 Funds were expended as corrective action in response to the condition identified during the audit (see Finding 2).

Comment 2 As noted in this report, $550,000 of the transferred administrative fee reserve funds were committed or planned for use in December 2003. However, these funds had not been expended by the Authority as of the start of our audit, in January 2006, nor did the Authority have a specific or intended use.

Comment 3 In transferring the administrative fee reserve funds from the Section 8 program to its local program account, the Authority implicitly assured HUD that these funds would be used, in a timely manner, for other housing purposes. In its response to our report, the Authority acknowledged that it was able to avoid risks associated with the homeownership development project by using PHDC funds instead of the transferred funds. Admittedly, this arrangement was "extremely favorable" to the Authority, but it violated the basis of the agreement between the Authority and HUD in regards to the use of administrative fee reserve funds transferred from the Section 8 program. The overall purpose of the transfer was not to enrich the Authority by avoiding risks associated with development projects; the purpose in this instance was to use the funds for other housing purposes, and to do so in a timely manner.

Comment 4 As noted in **Comment 3**, the purpose of the transfer was not to enrich the Authority by accruing interest income on the funds that were unspent. Rather the purpose was to use the funds for other housing purposes, and to do so in a timely manner.

Comment 5 OIG Audit did not direct the Authority to any particular course of action. We did however recommend, verbally and in writing, that the Authority delay transferring or otherwise using the funds until it had received our draft report. We noted that our report would address the funds in question, and that it would be advisable for the Authority to consider our comments before any of the funds were used.

Comment 6 The Board resolution referred to in the Authority's response occurred in December 2003. As of the beginning of our audit, in January 2006, the Authority still had not expended the $550,000. The period of our audit (January – May 2006), and the failure to transfer the funds in question during this period, is not the essence of Finding 1. The failure to use, or expend the funds between December 2003 and January 2006 is the essence of Finding 1. Any delay in the transfer or expenditure of the funds was unrelated to the timing or the duration of our review.

Comment 7 The wording in the Report has been changed to "local programs account."

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OIG Evaluation of Auditee Comments

Comment 8 The Authority did intend to use $550,000 of the total funds that were available by transferring them to the PHDC. Although the plan could be considered "formal" in that it was identified in a resolution by the Board of Commissioners, the funds were never expended, or used, by transferring them to PHDC. The Board resolution was to transfer the funds "for the purpose of creating and maintaining decent, safe, and sanitary housing for families of low to moderate income." The wording in the Report was changed from "formal plan" to "specific plan."

Comment 9 As we recommended, once the Authority submits the supporting documentation to HUD showing that the $158,034 has been transferred back to the Section 8 program account, we will consider this recommendation partially closed. For the remaining $489,780 ($647,814 less $158,034), the Authority needs to transfer these funds back to the Section 8 program account, and provide the supporting documentation of the transfer to HUD. Also, the cost for the building as shown in the Authority's accounting records for this purchase transaction was $180,000, which included a $5,000 down-payment plus the $175,000 the Authority indicated as the actual cost of the building. The Authority was advised that the difference was a $5,000 down-payment, but failed to provide documentation for the $175,000 or explain why their accounting records were incorrect.

Comment 10 As of the start of our audit, the $647,814 in funds were not "expended" as defined by HUD regulations. These funds were initially transferred from the Section 8 program to the Authority's local programs account in February 2003 in accordance with a Board resolution to develop affordable homeownership opportunities for eligible clients. However, these funds were not spent or used for the purpose indicated in the Board resolution because PHDC used it own funds. As of January 2006, approximately three years later, these funds remained unspent in the Authority's local program account, and the Authority did not have a specific plan for its use after they failed to use the funds for the purpose indicated. We do not consider three years to be timely.

Comment 11 The Authority had planned to use $550,000 of the funds by transferring them to the PHDC from the local program account and using (expending) the funds for developing homeownership opportunities. This did not occur because the PHDC used (expended) its own fund for developing the homeownership opportunities. Therefore, once the PHDC used its own funds, the Authority did not have a use for the $550,000. Also, the Authority had not identified any use, formal or otherwise, for the remaining $97,814 ($647,814 less $550,000).

Comment 12 The funds reported to HUD were identified and labeled as funds in the Authority's local programs account, not as Section 8 reserve funds. HUD was not aware that the funds reported by the Authority represented funds that had been transferred in 2003, and had not yet been expended.

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OIG Evaluation of Auditee Comments

Comment 13 The condition cited within Finding 2 supports the comment in Finding 1 that internal controls were not sufficient to ensure program expenses were met before transferring the reserve funds. If the controls had been operating properly, then the Authority's Capital Fund program would not have been charged for Section 8 (inspector's) expenses.

Comment 14 The data obtained from the Authority during the audit substantiates the $180,000 as the cost of the renovation for the Washington Avenue property. Also see **Comment 9.**

Comment 15 See **Comment 9**.

Comment 16 The total amount shown in Appendix A (Schedule of Questioned Costs) does not reflect double-counting. It reflects the total monetary effect of the conditions identified as existing at the start of our audit. The conditions cited in Finding 1 and Finding 2 is separate and distinct from each other, and their combined effect on the Authority's Section 8 program is $850,184.

Comment 17 The expenditure of $550,000 would have been a legitimate use for an affordable homeownership program, had they been used (expended) for that purpose. They were not.

Comment 18 The Authority's Attachment 1 was not included. It was a copy of Appendix C (Selected Criteria-Administrative Fee Reserve) on page 27 of this report.

Regardless of excess receipts, according to Finding 2, this does apply (use of the reserves to pay the inspectors salary that had been incorrectly charged to the Capital Fund program). The criteria cited emphasizes the point that the primary use of Section 8 administrative fee reserves is for the payment of Section 8 administrative expenses. The use of these reserves for other housing purposes is secondary to their primary purpose.

Comment 19 The Authority generally administered its Section 8 program in accordance with HUD regulations and procedures, with the exception of the conditions cited in Finding 1 and Finding 2 that describe how the Authority did not adequately administer the Section 8 program in accordance with HUD requirements.

Comment 20 The criteria cited emphasizes the point that reserve funds must be expended to be considered used. Merely transferring funds from the federal account to the Authority's local programs account does not constitute "use" (expenditure) of the funds.

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Comment 21 The criteria cited emphasizes the point that the Authority's books of account for the Section 8 program must be complete and accurate. The Section 8 administrative fee reserves that the Authority transferred in 2003 were reported to HUD in such a way that it was unclear to HUD what these funds represented; namely transferred reserve funds that had not yet been used (expended). As a result, the data reported was not accurate.

Comment 22 Our report asserts that a plan to use (expend) the transferred funds, formal or otherwise, must exist in some form before a substantial expenditure of funds ($647,814) is made. Our report does not state that the funds in question had to have been expended at the time of transfer. The requirement was for the funds to have been expended in a timely manner. We do not consider three years to be timely.

Comment 23 The essence of the Finding 1 is the fact that the funds were not used or expended for Section 8 administrative expenses or other housing purposes, and they should have been. Underlying this is the fact that the funds were not expended in a timely manner because they were not used as intended after they where transferred. Also any definition of "timeliness" may be considered subjective, but the funds in question were clearly not expended in a timely manner. It is likely that a time limit for expenditures of 90 days or six months after the transfer may have been readily considered as occurring in a timely manner. The funds in question were not spent and remained unused for approximately three years, which we do not consider to be timely.

Comment 24 The HUD Office of Public Housing has maintained its position that it is generally well understood, within HUD and by PHAs, that funds must be expended to considered used. It was never HUD's intention that Section 8 administrative fee reserve funds, transferred from the program, were to be held indefinitely by PHAs. The transferred funds were to be used (expended) for Section 8 administrative expenses or other housing purposes in a timely manner.

Comment 25 OIG does not approve or endorse the completion of HUD housing related programs by PHAs. OIG does review the operation of HUD programs at PHAs, and other recipient entities, and when conditions warrant, OIG prepares finding and draft reports that address noted deficiencies. Our review at the Portland Housing Authority identified the conditions described in Finding 1 and Finding 2. Regarding the transfer of funds, the Authority should address the transfer of funds with HUD program staff after it repays the reserves to the Section 8 program account.

Comment 26 See **Comment 9**.

Appendix C

SELECTED CRITERIA
Administrative Fee Reserve

Housing Choice Voucher Program - Consolidated Annual Contributions Contract (HUD Form 52520, par. 12 Administrative Fee Reserve). *The Housing Authority must use funds in the administrative fee reserve to pay administrative expenses in excess of program receipts. If any funds remain in the administrative fee reserve, the Housing Authority may use the administrative reserve funds for other housing purposes. If the Housing Authority is not adequately administering any Section 8 program funds in accordance with HUD requirements, HUD may (1) direct the Authority to use the funds to improve administration of the Section 8 program, or for reimbursement of ineligible expenses, or (2) prohibit the Authority from using administrative fee reserve funds.*

HUD-PIH Notice 2004-07, and HUD Handbook 7420.7. (Re: reserve funds must be expended to be considered used). *The transfer of amounts from the operating 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...Reserve funds must be expended to be considered used for other housing purposes.*

HUD-PIH Notice 2005-01, and Housing Choice Voucher Program - Consolidated Annual Contributions Contract (HUD Form 52520, par. 2.5.A*). PIH Notice 2005-01 reiterates the procedures identified in previously issued HUD Handbook 7420.7 requirements re: unauthorized transfers). Paragraph 2.5.A of the AAC requires PHAs to maintain complete and accurate books of account for the Section 8 program in accordance with HUD requirements.*

HUD Handbook 7420.6 (HAP Accounting Handbook) identifies account #2826 for the Operating reserve. The ACC, par. 2.4.C provides that this account must be maintained and used for the administrative expenses in excess of program receipts.