



Issue Date: March 30, 2006

Audit Report Number: 2006-AT-1007

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

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

SUBJECT: The Housing Authority of the City of Winston-Salem, North Carolina,
Used More Than \$4.9 Million in Operating Subsidies for Other Programs

HIGHLIGHTS

What We Audited and Why

As part of U.S. Department of Housing and Urban Development (HUD), Office of the Inspector General's (OIG) strategic plan, we audited the Housing Authority of the City of Winston-Salem (Authority) located in Winston-Salem, North Carolina. Our objective was to determine whether the Authority used funds subject to its low-income housing annual contributions contract (contract) for the benefit of other programs or entities without HUD approval.

What We Found

In violation of its contract with HUD, the Authority used more than \$4.9 million in operating subsidies to pay expenses of other federal and nonfederal programs. Further, the Authority violated its contract by encumbering assets when it executed a guarantee of payment agreement for a \$475,000 loan for an affiliated entity. As a result, the funds were not available for operation or modernization of public housing units, and assets are at risk.

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The Authority's board of commissioners often was not aware of transactions that occurred because it did not establish control procedures that ensured it was provided necessary financial reports and ensured management fully informed it of Authority activities.

What We Recommend

Our recommendations include requiring the Authority to

- Repay ineligible costs of \$4,976,616 to its public housing fund,
- Establish a procedure that requires the executive director to provide monthly financial documents such as a source and application of funds statements to the board prior to meetings to assist the board in providing oversight, and
- Obtain release of encumbered assets, thereby putting potentially as much as \$475,000 to better use.

We also recommend that the director of the Office of Public Housing, Greensboro, North Carolina, determine whether the Authority substantially defaulted on its contract.

Auditee's Response

We discussed the findings with the Authority and HUD officials during the audit. We provided a copy of the draft report to Authority officials on March 3, 2006, for their comments and discussed the report with the officials at the exit conference on March 8, 2006. The Authority provided its written comments to our draft report on March 27, 2006. The Authority generally agreed with the finding.

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

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BACKGROUND AND OBJECTIVES

The Housing Authority of the City of Winston-Salem (Authority) was formed in 1941 pursuant to the North Carolina Housing Authorities Law. Its primary objective is to provide decent, safe, and sanitary housing to low-income residents in the Winston-Salem, North Carolina, area in compliance with its low-income housing annual contributions contract (contract) with the U.S. Department of Housing and Urban Development (HUD). The Authority administers 1,218 units funded under the public housing program and more than 4,200 housing choice vouchers.

A nine-member board of commissioners appointed by the mayor of Winston-Salem governs the Authority. The board increased its membership from five members to nine during our audit period. The Authority's executive director resigned during our audit; therefore, the board appointed an interim executive director.

HUD's Greensboro, North Carolina, Office of Public Housing is responsible for overseeing the Authority.

Our audit objective was to determine whether the Authority used funds subject to its low-income housing contract for the benefit of other programs or entities without HUD approval.

RESULTS OF AUDIT

Finding 1: The Authority Used More Than \$4.9 Million in Operating Subsidies for Other Programs

In violation of its contract with HUD, the Authority used more than \$4.9 million in operating subsidies to pay expenses of other federal and nonfederal programs. Further, the Authority violated its contract by encumbering assets when it executed a guarantee of payment agreement for a \$475,000 loan for an affiliated entity. The Authority's board of commissioners often was not aware of transactions that occurred because it did not establish control procedures that ensured it was provided necessary financial reports and ensured management fully informed it of Authority activities. As a result, the Authority did not have more than \$ 4.9 million available for operating its public housing program and potentially put \$475,000 in assets at risk.

The Authority Used Operating Subsidies to Pay Nonprogram Expenses

The Authority used operating subsidies to pay nonprogram expenses. It deposited funds from all its programs into its general fund and used the funds to pay all expenses of various federal and nonfederal programs, including those of its affiliated entities. As of June 30, 2005, 13 programs or entities owed the general fund more than \$4.9 million. For example, an affiliated nonprofit entity, Forsyth Economic Ventures, Inc., owed almost \$1.1 million but only had \$89,309 on deposit as of June 30, 2005. In addition, the Authority's "corporate account" owed more than \$1.5 million.

Part C, section 9, of the Authority's contract with HUD allows the Authority to use general fund cash only for (1) the payment of the costs of development and operation of projects under contract with HUD, (2) the purchase of investment securities approved by HUD, and (3) such other purposes as may be specifically approved by HUD.

Further, because the Authority did not have adequate controls over its source and use of funds, some of the programs/entities do not have adequate funds to repay the general fund. The Authority's records show that without the use of the Authority's funds, Forsyth Economic Ventures, Inc., does not have sufficient funds to continue operations. Further, both Oak Hill Apartments and Lansing Ridge experienced net losses in 2004 and 2005. The "corporate account" consists primarily of payroll and other expenses for both public housing operations and management of nonfederal apartments. As shown below, several other programs/entities did not have sufficient funds to repay the general fund.

Programs/entities that owed general fund

Program/entity	Amount due to general fund	Funds on deposit
Lansing Ridge	\$ 10,443	\$ 0
Oak Hill Apartments	13,910	5,061
Oak Creek	68,065	2,968
Plaza Apartments	68,355	3,441
Pinnacle Place	106,442	1,559
Johnson Square	121,628	2,577
Administrative fund	145,266	0
Public Housing Capital Fund	204,104	0
HOPE VI	285,835	264,935
Rolling Hills	471,684	53,590
Section 8 Housing Choice Voucher program	837,125	1,949,843
Forsyth Economic Ventures, Inc.	1,087,130	89,309
Corporate account	<u>1,556,629</u>	<u>0</u>
Totals	<u>\$ 4,976,616</u>	<u>\$ 2,373,284¹</u>

The Board Did Not Establish Adequate Controls

The Authority’s board of commissioners often was not aware of transactions that occurred because it did not establish control procedures that ensured it was provided necessary financial reports and ensured management fully informed it of Authority activities. The only financial reports that were provided to the board were budgets. The interim executive director acknowledged that operating subsidies were used for other programs.

The Authority Inappropriately Encumbered Assets

Part A, section 7, of the Authority’s contract with HUD states that the Authority shall not encumber any such project, or portion thereof, without prior written approval from HUD. Part A, section 17, of the contract provides that upon occurrence of a substantial default by the housing authority, as determined by HUD in accordance with the contract, HUD shall be entitled to any or all of the remedies set forth in paragraphs (E), (F), and (H) of section 17 of the contract. Paragraph (F) states that nothing contained in the contract shall prohibit or limit

¹ Differences in individual amounts and total amounts are due to rounding.

HUD from the exercise of any other right or remedy existing under applicable law or available at equity.

The Authority violated its contract by encumbering assets when it executed a guarantee of payment agreement for a \$475,000 loan for an affiliated entity, Forsyth Economic Ventures, Inc. The repayment agreement (agreement) provides that in the event that the guarantor fails to pay his obligation, any of the guarantor's assets of any kind, nature, or description in possession, control, or custody of the bank may, without notice to the guarantor, be reduced to cash or the like and applied by the bank in reduction of payment of the guarantor's obligation. By potentially putting \$475,000 at risk, the Authority may not have the funds available for eligible program activities if Forsyth Economic Ventures, Inc., defaults on the loan. As previously discussed, the Authority's records show that without the use of the Authority funds, Forsyth Economic Ventures, Inc., does not have sufficient funds to continue operations.

Recommendations

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

- 1A. Repay ineligible costs of \$3,649,552 representing funds owed by other entities, or the current balance owed to the general fund. Repayment should be from nonfederal funds and should be repaid to the low-income public housing reserve account. If any of the amounts owed by the corporate account represents expenses for the low-income public housing program, the director should require the Authority to provide a complete accounting, showing the source and use of the funds for eligible program activities.
- 1B. Repay \$837,125 to the low-income public housing reserve account, or the current balance owed to the general fund, from its Section 8 program.
- 1C. Repay \$285,835 to the low-income public housing reserve account, or the current balance owed to the general fund, from its HOPE VI program.
- 1D. Repay \$204,104 to the low-income public housing reserve account, or the current balance owed to the general fund, from its Public Housing Capital Fund program. Funds owed from any grants which are closed must be provided from nonfederal funds.
- 1E. Establish a procedure that requires the executive director to provide monthly financial documents such as a source and application of funds statement to the board prior to meetings to assist the board in providing oversight.

- 1F. Obtain release of encumbered assets, thereby putting potentially as much as \$475,000 to better use.
- 1G. Submit monthly accounting reports, showing the source and use of its low-income public housing operating funds, along with adequate supporting documentation, for your review until such time as you are assured funds are only used for program activities.

We recommend that the director of the Office of Public Housing

- 1H. Determine whether the Authority substantially defaulted on its contract with HUD and what sanctions and remedies are available to HUD as prescribed by part A, section 17, of the contract.

SCOPE AND METHODOLOGY

Our audit objective was to determine whether the Authority used funds subject to its low-income housing contract for the benefit of other programs or entities without HUD approval. To accomplish our objective, we did the following:

- Reviewed applicable laws, regulations, and other HUD program requirements.
- Interviewed HUD and Authority management and staff.
- Reviewed various documents, including financial statements, general ledgers, bank statements, minutes from board meetings, loan documents, and other records as needed.

We conducted our audit from July through December 2005 at the Authority's offices in Winston-Salem, North Carolina. Our audit period was from January 1, 2002, through June 30, 2005. We expanded our audit period as needed to accomplish our objectives.

We conducted the audit in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

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

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

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

Relevant Internal Controls

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

- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure resource use is consistent with laws and regulations.
- Safeguarding of resources – Policies and procedures that management has implemented to reasonably ensure resources are safeguarded against waste, loss, and misuse.

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 Weakness

Based on our review, we believe the following item is a significant weakness:

- The Authority did not have an adequate system to ensure that federal funds were properly used and the funds were not put at risk (see finding 1).

FOLLOWUP ON PRIOR AUDITS

Office of Inspector General (OIG) audit report 2006-AT-1005, issued January 18, 2006, reported that Authority management failed to implement an effective internal control plan that ensured its Section 8 units met minimum housing quality standards. As a result, tenants lived in units that were not decent, safe, and sanitary, and HUD made housing assistance payments for units that did not meet standards. The report found that 51 of 67 units inspected (76 percent) did not meet minimum housing quality standards. Of the 51 units, 26 were in material noncompliance with housing quality standards. Projecting the results of the statistical sample to the population indicates at least 2,813 of the Authority's 4,255 units did not meet minimum housing quality standards and 1,230 units were in material noncompliance with housing quality standards. Based on the sample, the report estimated that over the next year, HUD would pay housing assistance payments of more than \$6.4 million for units in material noncompliance with housing quality standards. The report contained two significant recommendations that remain open, pending obtaining management decisions and completing corrective actions.

Darnell & Thompson, P.C., Certified Public Accountants, completed the most recent independent auditor's audit report for the 12-month period ending September 30, 2004. The report contained three findings, one of which pertains to the Authority's interprogram balances. The report included the following deficiency:

- Interprogram balances are not being reimbursed on a timely basis.

The report recommended that the Authority repay balances on a regular and timely basis to eliminate large interprogram payables and receivables. As discussed in the finding of this report, the Authority continued to accumulate large interprogram payables and receivables.

APPENDIXES

Appendix A

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

<u>Recommendation</u>	<u>Ineligible 1/</u>	<u>Funds to be put to better use 2/</u>
1A	\$3,649,552	
1B	837,125	
1C	285,835	
1D	204,104	
1F		<u>\$475,000</u>
Total	<u>\$ 4,976,616</u>	<u>\$475,000</u>

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local policies or regulations.
- 2/ “Funds to be put to better use” are quantifiable savings that are anticipated to occur if an 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, reduction 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



March 24, 2006

Mr. James D. McKay
U.S. Department of Housing and Urban Development
Office of the Inspector General for Audit, Region 4
Richard B. Russell Federal Building
75 Spring Street, SW, Room 330
Atlanta, GA 30303-3388

Dear Mr. McKay:

This is the Housing Authority of the City of Winston-Salem responses to the Audit Report of the Office of the Inspector General pertaining to the use of low-income annual contributions contract for the benefit of other programs or entities without HUD approval.

Finding 1(a):

The Authority used more than \$4.9 million in operating subsidies for other programs.

Authority's Response:

The Authority has taken the following corrective action:

1. The Authority has changed its method of disbursement of funds.

Previously, the Low Rent Public Housing general fund was the primary disbursement account for the housing authority. Presently, the Authority has established a new disbursement system whereby each program is responsible for its direct bills and a "revolving" central account is used to disburse funds for payroll and allocated costs.

- Each project collects and deposits its receipts into its checking account.
- Each project disburses funds for its direct bills, based on funds available in the account.
- The "revolving" central fund disburses funds for payroll costs and allocated costs.
- Each program reimburses the "revolving" fund for its share of the disbursements.

	Board of Commissioners	
A. Fulton Meachem, Jr. <i>Interim Executive Director</i>	James Rousseau, <i>Chairman</i> DeWayne H. Anderson Naomi W. Jones Yvonne Jefferson Walter Pitt	Lida Hayes-Calvert, <i>Vice Chairman</i> Doris Kimbrough Simpson Brown, Jr. Bruce Levin

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2. In December, 2005, the Authority implemented expense reduction measures.

The Board of Commissioners authorized a comprehensive work out plan to reduce the inter-program balance in all of the Authority's programs in the following manner:

3. The Authority is aggressively seeking the sale of Lansing Ridge.

The Authority owns 24 lots originally purchased for future construction use. The land is now for sale at its appraised value.

Result: It is anticipated that the Lansing Ridge lots will sell for approximately \$500,000. These funds will be used to pay existing debt of \$383,000 and reimburse Low Rent Public Housing with the remainder.

4. The Authority is closing the sale of Pinnacle Place Apartments.

Pinnacle Place Apartments is a 32-unit complex that has not had sufficient income to cover its expenses and cash flow. The Authority plans on closing sale by the end of March, 2006.

Result: The anticipated sale price is \$318,074 which will be used to pay down existing outside debt. There will be no further cash drain on the Authority.

5. The Authority is seeking approval from HUD to convert Johnson Square Apartments and Oak Creek Apartments to Public Housing.

Johnson Square Apartments is a 32 unit apartment complex and Oak Creek Apartments is a 60 unit apartment complex leased by the Authority. Based on estimates presented to HUD, the conversion of these apartment buildings to public housing units would ensure the financial viability of these low income properties.

Results: It is estimated that the conversion to public housing would result in positive cash flow, stabilize the property and replace the public housing stock loss with the implementation of our HOPE VI Programs.

6. The Board of Commissioners has established a Finance Committee and a Development Committee.

The Finance Committee and the Development Committee consisting of Board of Commissioners members and staff members that meets monthly to review current activities and financial status of the Authority.

Results: The Board of Commissioners receives detailed balance sheets and statements of revenues and expenses monthly. The Board of Commissioners is also updated on current development activities and how it impacts the finances of the Authority.

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Current Measurable Results:

The following represents the amounts due Low Rent Public Housing:

- Balance at June 30, 2005 (audit date):
\$ 4,976,616
- Balance at September 30, 2005 (fiscal year end):
\$ 3,386,856
- Balance at February 28, 2006 (See attachment 1)
\$ 2,067,979

Finding 1(b):

The Authority violated its contract by encumbering its assets when it executed a guarantee of payment agreement for a loan of \$475,000 for an affiliated entity.

Authority's Response:

The Authority has requested a release of the guarantee of payment from the financial institution. Presently funds on deposit at the financial institution are nonfederal funds. The Authority will not deposit any federal dollars in this financial institution until the guarantee has been released.

We would like to thank you for your cooperation in addressing these issues. If you have any questions, please contact me at (336) 727-8500 ext. 104.

Sincerely,



A. Fulton Meachem, Jr.
Interim Executive Director

Enclosure

cc: HAWS Board of Commissioners

Attachment I

JIA OF WINSTON-SALEM
INTERPROGRAM COMPARISON
SEPTEMBER 30, 2005 VS FEBRUARY 28, 2006

	LRPH 9/30/2005 BALANCE	2/28/2006 BALANCE	CORPORATE ALLOCATE	LRPH 3/13/2006 PAYMENTS	REVOLVING CASH	FINAL BALANCE	INCREASE (DECREASE)
VOUCHERS	1,112,760.59	245,273.55	164,734.53	(465,449.15)		(55,441.07)	(1,168,201.66)
CAPITAL FUND	162,432.50	96,006.49				96,006.49	(66,426.01)
HOPE 6	(1,159.83)	16,810.97				16,810.97	17,970.80
SERVICE COORDINATOR	6,503.40	(8,538.03)				(8,538.03)	(15,041.43)
SPECIAL GRANTS	40,468.05	(28,179.67)				(28,179.67)	(68,647.72)
CORPORATE MGMT	(240,522.92)	(39,729.08)	(259,016.56)			(298,745.64)	(58,222.72)
SCATTERED SITED ADMIN	0.00	3,807.92				3,807.92	3,807.92
PLAZA APTS	115,694.63	111,921.28	3,859.35	(8,791.04)		106,989.59	(8,705.04)
PINNACLE PLACE	120,770.56	120,770.56	751.15	(1,197.21)		120,324.50	(446.06)
JOHNSON SQUARE	151,346.27	151,613.27	1,580.01	(4,361.66)		148,831.62	(2,514.65)
OAK CREEK	82,057.62	73,001.29	2,952.79	(6,506.83)		69,447.25	(12,610.37)
DRAYTON PINES	(18,039.41)	691.93	2,175.74	(6,664.36)		(3,796.69)	14,242.72
ROLLING HILLS	546,791.60	533,111.75	5,439.35	(3,061.52)		535,489.58	(11,302.02)
OAK HILL	34,103.77	25,027.18	1,191.48	(1,291.29)		24,927.37	(9,176.40)
PROPERTY MANAGEMENT	54,160.87	37,069.88	5,620.66			42,690.54	(11,470.33)
LANSING RIDGE	10,626.83	10,821.21				10,821.21	194.38
LOEWY BLDG	(14,606.50)	(80.11)	1,295.08			1,214.97	15,821.47
FEV	1,223,467.86	1,214,306.03		(9,225.23)		1,205,080.80	(18,387.06)
FEV-PROGRAM INCOME	0.00	(223,231.00)				(223,231.00)	(223,231.00)
REVOLVING	0.00	661,266.65		(357,798.65)		303,468.00	303,468.00
	3,386,855.89	3,001,742.07	(69,416.42)	(506,548.29)	(357,798.65)	2,067,978.71	(1,318,877.18)

OIG Evaluation of Auditee Comments

Comment 1

The Authority should ensure it does not include HOPE VI funds in its revolving fund.

Comment 2

The Authority should submit documentation supporting changes in the balances to the director of the Office of Public Housing, Greensboro, North Carolina for review.