



Issue Date August 30, 2006

Audit Report Number 2006-KC-1013

TO: Debra L. Lingwall, Coordinator, Omaha Public Housing
Program Center, 7DPHO

//signed//

FROM: Ronald J. Hosking, Regional Inspector General for Audit, 7AGA

SUBJECT: The Columbus Housing Authority of Columbus, Nebraska, Improperly
Expended and Encumbered Its Public Housing Funds

HIGHLIGHTS

What We Audited and Why

We reviewed the development activities of the Columbus Housing Authority, Columbus, Nebraska (Authority), to determine whether the Authority expended or encumbered U.S. Department of Housing and Urban Development (HUD) assets for development activities without HUD approval. We conducted the audit because HUD told us the Authority had improperly used public housing funds to subsidize a multifamily housing facility.

What We Found

The Authority inappropriately spent more than \$204,000 of public housing funds to develop Crown Villa, a non-HUD multifamily housing development. The Authority also improperly encumbered its public housing assets when it signed Crown Villa loan documents containing set-off provisions that allowed the bank to take Authority bank account funds in the event of default on the loans. The Authority defaulted on the loans, and the bank seized more than \$88,000 in public housing funds.

What We Recommend

We recommend that HUD require the Authority to repay its public housing program from nonfederal sources, continue to pursue recovery of the funds seized in the bank set-off, and ensure that no additional HUD funds are used for nonfederal purposes without HUD approval.

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

The Authority agreed with our findings and recommendations. We provided the audit report to the Authority on July 27, 2006, and requested a response by August 24, 2006. The Authority provided written comments on August 22, 2006.

The complete text of the auditee's response can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

The Columbus Housing Authority (Authority) is a small public housing authority located in Columbus, Nebraska. It is a municipal corporation created by state law and is funded almost exclusively by the U.S. Department of Housing and Urban Development (HUD). It owns and operates 84 units of public housing in Columbus and administers approximately 100 Section 8 housing vouchers for HUD's Housing Choice Voucher program.

To participate in HUD's public housing programs, the Authority executed an annual contributions contract with HUD on January 31, 1996. The annual contributions contract defines the terms and conditions under which the Authority agreed to develop and operate all projects under the agreement. The contract defines a project as any public housing developed, acquired, or assisted by HUD under the United States Housing Act of 1937, as amended. The contract says the Authority may withdraw public housing funds only for the payment of the costs of development and operation of the projects under the contract or other purposes approved by HUD. It also provides that the Authority shall not in any way encumber any project, or portion thereof, without the prior approval of HUD.

In accordance with its agency plan, a public housing agency may form and operate wholly owned or controlled subsidiaries or other affiliates. Such wholly owned or controlled subsidiaries or other affiliates may be directed, managed, or controlled by the same persons who constitute the board of directors or similar governing body of the public housing agency, or who serve as employees or staff of the public housing agency, but remain subject to other provision of law and conflict of interest requirements. Further, a public housing agency, in accordance with its agency plan, may enter into joint ventures, partnerships, or other business arrangements with or contract with any person, organization, entity or governmental unit with respect to the administration of the programs of the public housing agency such as developing housing or providing supportive/social services subject to either Title I of the United States Housing Act of 1937, as amended, or state law.

Between 2000 and 2003, the Authority developed Crown Villa, a multifamily housing facility for senior residents. In May 2000, the Authority requested HUD approval to borrow \$50,000 from its public housing funds to assist in purchasing the land for Crown Villa. HUD approved the request, conditioned on repayment, but did not approve any additional use of HUD funds for the development. The Authority obtained bank financing, constructed the property, retained direct ownership, and began managing its daily operations in September 2003.

Our audit objective was to identify development costs for Crown Villa and determine whether the Authority expended or encumbered HUD assets for Crown Villa development activities without HUD approval.

RESULTS OF AUDIT

Finding: The Authority Improperly Expended and Encumbered Public Housing Funds for Development Activities

The Authority violated its annual contributions contract with HUD when it expended and encumbered public housing funds for Crown Villa, its nonfederal multifamily development. This occurred because its former executive director and board of commissioners disregarded HUD regulations. The Authority also lacked adequate controls to keep it from expending or encumbering public housing assets for nonfederal ventures. As a result, it inappropriately expended or encumbered more than \$204,000 in public housing funds.

The Authority Used Public Housing Funds to Pay Development Expenses

The Authority improperly expended nearly \$151,000 in public housing funds for start-up costs before and during construction of the development. According to HUD regulations, the Authority may withdraw funds from the public housing general fund only for the payment of the costs of development and operation of the projects under an annual contributions contract with HUD. Crown Villa was not an approved project under the Authority's annual contributions contract.

The public housing money was expended primarily for architect fees, legal fees, marketing studies, property surveys, and the land purchase for Crown Villa. The Authority had not obtained start-up financing from outside sources when it began planning the development. As a result, it spent public housing funds on the nonfederal development and never repaid the money.

Further, the former executive director of the Authority and his assistant spent time managing the development during the planning and construction phases. The Authority paid their full salaries and related benefits from public housing funds, but Crown Villa did not reimburse the public housing account for time spent on development activities. In 2004, the Authority conducted a time study showing that the executive director spent 23 percent of his time and his assistant spent 8 percent of her time on the development. Based on the time study, Crown Villa failed to reimburse the public housing account at least \$53,000 for their salaries.

The Authority Encumbered Its Public Housing Funds

The Authority encumbered its public housing assets when its former executive director and former board chairman signed development loan documents containing set-off provisions, which allowed the bank to take the Authority's depository funds in the event of default on the loans. The annual contributions contract with HUD says that the Authority shall not in any way encumber any project without the prior approval of HUD. The Authority did not have approval from HUD to sign the loan documents containing set-off provisions. It defaulted on the development loans, and the bank exercised its right of set-off when it seized more than \$88,000¹ in public housing funds from the Authority's depository accounts for payment of Crown Villa's development debt.

Authority Management Ignored HUD Regulations

The former executive director and board of commissioners had a general disregard for HUD regulations, and the Authority lacked adequate controls to ensure that it did not expend or encumber public housing assets for nonfederal activities. The board chairman told us that the board knew it did not have approval to spend the public housing funds for the development. However, the Authority had development debts that needed to be paid so it used public housing funds with the intention of paying back the funds when the development had a positive cash flow. Crown Villa never reached a positive cash flow, and no funds were repaid to the public housing account.

Recommendations

We recommend that the coordinator of the Omaha Public Housing Program Center

- 1A. Require the Authority to repay its public housing program \$204,162 from nonfederal sources (\$150,696 in start-up costs and \$53,466 in salaries).
- 1B. Require the Authority to pursue recovery of the \$88,063 seized from the Authority's bank accounts.
- 1C. Require the Authority to implement adequate procedures to ensure that it does not expend or encumber HUD assets without HUD approval.

¹ The bank seized \$88,063 from the Authority's bank accounts as a result of the set-off provisions. HUD determined that it had a direct interest in \$80,200 of the seized funds. HUD is pursuing recovery of the funds directly tied to HUD.

SCOPE AND METHODOLOGY

Our review generally covered the period from January 2000 through September 2003. To achieve our audit objective, we conducted interviews with the Authority's current and former staff; members of its board of commissioners; and its fee accountant, attorney, bank representative, consultant, and property appraisers. Additionally, we conducted interviews with HUD staff at the Omaha, Nebraska, Office of Public Housing.

We reviewed the Authority's policies and procedures, Crown Villa development files, general and subcontractor construction files, time studies of Authority staff, general ledgers, and audited financial statements. We also reviewed the Authority's five year administrative plan, board of commissioners meeting minutes, correspondence with HUD, annual contributions contracts, bank statements, and bank loan documents. In addition, we reviewed federal regulations and HUD's monitoring reports.

We reviewed reports generated from the Authority's computerized accounting system for evidence of expending or encumbering public housing assets without prior HUD approval. We used the computerized data for background information purposes only. We did not conduct tests of the data or controls governing the data. We did not use the data to support audit conclusions but used only original source documents to reach our conclusions.

We performed on-site work from March through June 2006 at the Authority's office located at 2554 40th Avenue in Columbus, Nebraska. 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 – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding of resources – Policies and procedures that management has implemented to reasonably ensure that 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 Weaknesses

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

- The Authority did not have adequate controls in place to safeguard its federal resources and ensure compliance with the annual contributions contract (see finding).

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/
1A	\$204,162
1B	88,063

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.

Appendix B

AUDITEE COMMENTS



Columbus Housing Authority

Phone: 402-564-1131
Fax: 402-564-1648
TDD: 402-564-1131
2554 40th Avenue
Columbus, NE 68601-8519

August 21, 2006

Mr. Ronald J. Hosking
Regional Inspector General for Audit
U.S. Department of Housing & Urban Development
Gateway Tower II – 5th Floor
400 State Avenue
Kansas City, Kansas 66101-2406

Dear Mr. Hosking:

Below are the written comments of the Columbus Housing Authority concerning the audit of the Columbus Housing Authority's planning and construction of Crown Villa.

The Columbus Housing Authority will work with the U.S. Department of Housing and Urban Development to repay its public housing program, \$204,162, using nonfederal sources.

Regarding the \$88,063 seized in the bank set off, I have spoke with [redacted] Kansas City HUD. [redacted]

The Columbus Housing Authority ensures that it will not expend or encumber HUD assets for nonfederal purposes without HUD approval. To ensure control, the Executive Director and Board of Commissioners will acknowledge and follow all policies, as approved by HUD, of the Columbus Housing Authority. Auditors completing the Columbus Housing Authority's annual audit will be requested to verify that such policies are followed.

If you have any questions, please contact me.

Sincerely,

A handwritten signature in cursive script that reads "Constance J. Foust".

Constance J. Foust
Executive Director



Note:
We redacted sensitive legal information.