U.S. DEPARTMENT OF
HOUSING AND URBAN DEVELOPMENT
OFFICE OF INSPECTOR GENERAL

February 15, 2013

MEMORANDUM NO:
2013-LA-0802

Memorandum

TO: K.J. Brockington
Director, Los Angeles Office of Public Housing, 9DPH

FROM: Tanya E. Schulze
Regional Inspector General for Audit, Los Angeles Region, 9DGA

SUBJECT: Corrective Action Verification, City of Hawthorne, CA, Section 8 Program
Audit Report 2011-LA-1008

INTRODUCTION

We completed a corrective action verification of a recommendation made to the U.S. Department of Housing and Urban Development's (HUD) Office of Public and Indian Housing (PIH) pertaining to our review of the City of Hawthorne, CA's Section 8 program, Audit Report 2011-LA-1008, which was issued March 28, 2011. The purpose of the corrective action verification was to determine whether HUD officials appropriately closed audit recommendation 1A.

METHODOLOGY AND SCOPE

The corrective action verification focused on recommendation 1A from Audit Report 2011-LA-1008: The Hawthorne Housing Authority Failed To Maintain an Adequate Financial Management System, issued March 28, 2011. To accomplish our objective, we reviewed the audit report and associated supporting documentation as well as the HUD management decision and the supporting documentation used by HUD to close the recommendation. In addition, we interviewed officials from PIH and HUD's Office of Community Planning and Development (CPD) and reviewed information from HUD's systems. We did not obtain additional information from the City.

BACKGROUND

On March 28, 2011, we issued audit report 2011-LA-1008 on the Hawthorne Housing Authority's Section 8 Housing Choice Voucher program funds. The audit report noted that the Authority and City failed to maintain an adequate financial management system to properly

administer the Authority's Section 8 Housing Choice Voucher program according to HUD rules and regulations. Specifically, the Authority did not properly document more than $1.4 million in Section 8 investment and interfund activity, making the expended funds ineligible. Additionally, the Authority accumulated Section 8 deficits due partly to the City's failure to record portability receivables in its accounting system. Lastly, the Authority and City failed to implement adequate internal controls to safeguard and minimize the risk of operating a Section 8 program. The report included seven recommendations, and recommendation 1A specifically addressed $1.2 million of the ineligible Section 8 investment and interfund activity.

We recommended that the Director of the Los Angeles Office of Public Housing

1A. Require the City to repay the Section 8 program $1,288,455 for the ineligible expenditure of Section 8 investment funds from non-Federal funds.

The July 2011 management decision from the Los Angeles Office of Public Housing stated, "The HACH [Authority] must submit supporting documentation reflecting that funds were properly spent or repay $1,288,455."

RESULTS OF REVIEW

Our corrective action verification found that HUD officials inappropriately closed audit report 2011-LA-1008 recommendation 1A. The recommendation required the City to repay its Section 8 program from non-Federal funds; however, our review determined that at least $768,541 of the funds used by HUD to offset the questioned costs came from the HOME program, a federally funded HUD program.

The PIH staff conducted an extensive review of the City's financial records and found that the City had previously contributed more than $1.29 million in other funds to the Section 8 program, which was slightly more than the questioned costs cited in recommendation 1A. When recommendation 1A's management decision was closed, PIH was aware that $840,741 of this balance was CPD funds. PIH identified line item descriptions in the City's general ledger listing transfers of $768,541 (June 27, 2005) and $72,200 (June 30, 2006) as being Community Development Block Grant and HOME funds, respectively. Although PIH informed CPD of this matter in a written memorandum, dated September 8, 2011, PIH stated that it did not determine whether this was an eligible use of the CPD funds, believing it was not PIH's responsibility. PIH held that since the contributions netted against the questioned costs, there was no loss to the Section 8 program, and the recommendation could, therefore, be closed. PIH's response attached to HUD's Audit Resolution and Corrective Action Tracking System (ARCATS) also stated that the Office of Inspector General (OIG) "should decide on what further action should be taken" on the transfer of CPD funds.

CPD Funding Used To Offset Questioned Costs

Our review of these additional funds, the Line of Credit Control System, and the Integrated Disbursement and Information System found that the $768,541 transfer came from HOME program funding, as opposed to Community Development Block Grant funding as identified in the City's general ledger. OIG has not been able to conclusively verify that the remaining

$72,200 in funds came from the HOME program as described in the City's general ledger, although there were HOME withdrawals around the time of the transfer that may have included that amount.

Using HOME funds for the Section 8 program is not an allowable use of HOME funds. Office of Management and Budget Circular A-87 (2 CFR (Code of Federal Regulations) Part 225) states, "…any cost allocable to a particular Federal award or cost objective under the principles provided for in 2 CFR part 225 may not be charged to other Federal awards to overcome fund deficiencies, to avoid restrictions imposed by law or terms of the Federal awards, or for other reasons." The OIG recommendation also called for the repayment of the questioned costs from non-Federal funds.

Other Funding Used To Offset Questioned Costs

The remaining City contributions netted to $450,000 ($650,000 contributed less $200,000 in subsequent repayments),[1] made in December 2006 and March 2007. Since these were non-Federal contributions to the Section 8 program, OIG agrees that HUD's offset was acceptable. Therefore, the questioned costs under recommendation 1A can be reduced by $450,000, leaving a balance of $838,455 under recommendation 1A that the City must repay to its Section 8 program.

CONCLUSION

We believe that PIH did a commendable job in performing an extensive review of the City's records and identifying the questionable use of CPD funds. However, the corrective action verification found that PIH inappropriately closed recommendation 1A by offsetting questioned costs against apparent ineligible transfers of Federal funds[2]. This error occurred because PIH did not fully consider 2 CFR Part 225 requirements. As a result, recommendation 1A has not been resolved in accordance with the management decision. However, we agree that the questioned costs can be reduced to $838,455. A follow-up review of the City's HOME program is also warranted, given the City's potential questionable use of funds, which we will address under a separate assignment.

RECOMMENDATION

We recommend that the director of HUD's Office of Public and Indian Housing

1A. Reopen the audit report (2011-LA-1008) recommendation 1A in ARCATS. OIG will reduce the ineligible amount remaining due from non-Federal funds to the Section 8 program from $1,288,455 to $838,455.

[1] These amounts were also identified in OIG audit report 2011-LA-1008 and included under recommendations 1B and 1C.

[2] We have not yet followed up with the City to determine if it can otherwise justify the appropriateness of the transfers.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

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Office of the Public Housing Director
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JAN 29 2013

MEMORANDUM FOR: Tanya E. Schulze, Regional Inspector General for Audit, Los Angeles Region, 9DGA

FROM: K.J. Brockington, Hub Director, Office of Public Housing, 9DPH

SUBJECT: Corrective Action Verification, City of Hawthorne, CA, Section 8 Program Audit Report 2011-LA-1008

This is in response to your draft memorandum dated January 16, 2013, concerning the subject corrective action verification.

We acknowledge that the Community Development Block Grant (CDBG) and HOME funds cannot be used to reduce the amount due to close recommendation 1A, as these funds are not non-Federal funds. However, the opinion of our office differs with OIG's corrective action verification report regarding: 1) our communication to the Office of Community Planning and Development (CPD) and OIG regarding the HOME and CDBG funds transferred to the Hawthorne Housing Authority (HHA); 2) our office's review of governing regulations; and 3) the origin and use of the Local Agency Investment Funds (LAIF) referenced in Recommendation 1A.

Comment 1

We disagree with any assertion or insinuation that our Office did not sufficiently discuss the use of CDBG and HOME funds with CPD and the OIG, or adequately consider 2 CFR Part 225 requirements. On September 8, 2011, we formally notified the Office of CPD that HOME and CDBG funds appeared to have been used for Section 8 activities and had previously notified them informally. In the fall of 2011, our Office worked directly with CPD staff in an attempt to verify that the funds described as "HOME" funds in the City of Hawthorne's general ledger were in fact HOME funds.

Comment 2

Please keep in mind that the Los Angeles Office of Public Housing was the first to identify HHA's use of CPD funds for the Section 8 Housing Choice Voucher Program and brought it to the attention of HHA in June 2011. During the months of June through September 2011, our office also hosted three face-to-face meetings with the OIG to discuss our concerns regarding Hawthorne's use of CPD funds. During the meeting on September 7, 2011, [redacted] and [redacted] of the OIG stated that they would pursue this issue further, independently of PIH.

Comment 3

The Los Angeles Office of Public Housing did review the CPD regulations at 24 CFR §92.205 and discussed the eligibility of the HOME funds transferred to the Section 8 program with CPD staff. At no time did CPD nor OIG ever convey to our office that we inadequately informed them of the funds in question, or that we inadequately reviewed the governing regulations. Although the Los Angeles Office of Public Housing repeatedly highlighted the use of CPD funds by

* Names redacted for privacy reasons

Comment 3

the Section 8 program, the monitoring and review of CPD funds remains outside of PIH's authority and scope. Nonetheless, these issues, originally identified through the significant efforts of the Los Angeles Office of Public Housing, are currently being investigated by both CPD and OIG.

Comment 4

The HHA uses fund-based accounting with pooled cash in checking and savings accounts. At no time did OIG provide evidence in the form of journal entries supporting their claim that these funds were in fact Section 8 and were used for non-Section 8 activity. PIH reviewed the origin of the LAIF funds beyond the scope of OIG's audit to determine whether the funds were in fact Section 8. However, the LAIF funds date back to before 1998, beyond the scope of the documentation held by both the housing authority and Wells Fargo, and far past the required retention period for such documentation. At this time there has been no agreed determination as to which entity holds the burden of proof supporting whether or not the LAIF funds are in fact Section 8 program receipts.

Please know that we will continue to work closely with the HHA and the City of Hawthorne during our monthly on-site monitoring visits in order to re-close recommendation 1A. Should you have any questions or concerns regarding this matter, please do not hesitate to contact me.

OIG Evaluation of Auditee Comments

Comment 1 The body of the report included a discussion acknowledging that the Los Angeles Office of Public Housing notified CPD on September 8, 2011. The OIG is not questioning the adequacy of the notification. To help clarify this, we have removed discussion of the HOME criteria and a portion of the conclusion concerning PIH following up with CPD. We have determined those points are not material since 2 CFR part 225 would not allow for federal funds to be used for this purpose in any event, and PIH therefore did not need CPD's assistance to make that determination.

Comment 2 The OIG acknowledges that PIH was the first to identify the City of Hawthorne's use of CPD funds for the Section 8 Housing Choice Voucher Program. The OIG also acknowledges that PIH met with OIG staff; however, the OIG has a different recollection of the meeting. PIH indicated to the OIG staff that it was possible that CPD funds made up a portion of the initial funds in the Local Agency Investment Fund (LAIF) account, noting a 1998 transfer of $600,000 from the City's community redevelopment agency account to the authority. PIH stated it would set up a meeting with CPD to discuss the funds, and it would attempt to determine whether CPD had records indicating CPD funds were ever transferred or used for Hawthorne's Section 8 program. If so, PIH was going to discuss the eligibility of such a transfer. The OIG staff asked if PIH wanted them present at that meeting and were told it would not be necessary at the time but the OIG was welcome to attend. The OIG requested to be informed of how the meeting went and notified of the results. PIH also provided a flowchart it had prepared from its analysis of the City's records that also included notation of the 2005 and 2006 general ledger transfers to Section 8 accounts. However, the OIG has no recollection of this being a significant topic during the meeting or that the OIG stated it would independently follow up on the matter. Subsequent discussions with PIH and revised management decisions submitted by PIH (rejected by the OIG) dated November 29, 2011, December 19, 2011, and February 22, 2012, focused on the source of the LAIF funds.

Comment 3 The OIG is not questioning the manner in which PIH informed either CPD or the OIG of the transfers. The OIG takes issue with PIH closing recommendation 1A by using the $840,541 in CPD funds as an offset to the original $1,288,455 in questioned costs that were to be repaid to the Section 8 investment funds with non-Federal funds. As a result of the recommendation being closed in this manner, it was necessary for the OIG to conduct a corrective action verification review. Although we agree the monitoring and review of CPD funds is outside of PIH's authority and scope, this is not relevant to the appropriateness of PIH using Federal funds from another program as an offset to close the recommendation.

The OIG office of audit has initiated a separate external review of the City's actions.

Comment 4 PIH previously submitted this position as part of proposed revised management decisions on December 19, 2011 and February 22, 2012, both of which were discussed and ultimately rejected by the OIG due to disagreement concerning which entity holds the burden of proof. As part of HUD's audit resolution process, when a revised management decision is rejected the previously agreed upon management decision (July 2011) remains in effect. In addition, the source of the LAIF funds is not the reasoning PIH used to close recommendation 1A so it is irrelevant to the conclusions reached in the corrective action verification review. After reopening the recommendation, PIH may revisit or propose alternative revised management decisions.