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| Issue Date October 30, 2007 |
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| Audit Report Number 2008-SE-1001 |
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TO: Ken A. Bowring, ONAP Administrator, Northwest Office of Native American Programs, OAPI

Joan S. Hobbs

FROM: Joan S. Hobbs, Regional Inspector General for Audit, Region X, OAGA

SUBJECT: Accounting for Program Income from NAHASDA-Assisted 1937 Act Housing Projects at Warm Springs Housing Authority, Warm Springs, Oregon

HIGHLIGHTS

What We Audited and Why

We audited Warm Springs Housing Authority (Authority) as part of our review of the Office of Native American Programs' guidance on calculating program income for United States Housing Act of 1937 (1937 Act) housing projects assisted by the Native American Housing Assistance and Self Determination Act of 1996 (NAHASDA). The objective of the audit was to determine whether the Authority calculated program income for NAHASDA-assisted 1937 Act properties in accordance with applicable U.S. Department of Housing and Urban Development (HUD) guidance, regulations, and requirements and to observe uses of revenue from NAHASDA-assisted 1937 Act properties.

What We Found

The Authority did not have an adequate accounting process and system in place to accurately allocate income from 1937 Act properties receiving Indian Housing Block Grant program assistance because it failed to track NAHASDA's cumulative investment in individual 1937 Act single family housing units (unit) as required by PIH Notice 2000-18, section 3.4. Our review of the Authority's incomplete 2004 to 2006 records

identified at least five properties that exceed thresholds and should be transitioned from the 1937 Act into the NAHASDA program. Because it failed to track cumulative NAHASDA modernization expenses for each unit, the Authority did not transition 1937 Act assets into the NAHASDA program when appropriate, understated income attributable to the NAHASDA Indian Housing Block Grant program, and delayed the introduction of HUD oversight to the operation of these properties. In addition, it did not properly credit NAHASDA for insurance proceeds and did not have a system to track restricted nonprogram income removed from its Mutual Help homeownership program.

These conditions occurred because management in place prior to 2004 had not made it a priority to establish an accounting system to allocate income attributable to the 1937 Act and Indian Housing Block Grant programs. As a result, the Authority inappropriately removed more than \$1.4 million in low-income housing rental and monthly equity payment account receipts from HUD-monitored NAHASDA-eligible affordable housing activities during the period 1998 to 2006.

The low-income housing receipts removed from the program with HUD's consent were used to repay monitoring findings related to unsupported compensation of housing officials and unsupported travel expenses. Other uses of nonprogram income included unallowable bad debt, personal expenses on Authority credit cards, miscellaneous HUD-rejected expenses, and maintenance of tribal housing outside the NAHASDA program.

What We Recommend

We recommend that HUD require the Authority to (1) establish an accounting system that allocates income attributable to the NAHASDA program and documents the total cost of NAHASDA-funded rehabilitation and capital improvements, by 1937 Act unit, from 1998 forward or return \$1.4 million, which was previously withdrawn from 1937 Act revenue as nonprogram income, to the NAHASDA program; (2) reconcile insurance proceeds and ensure that they are credited to NAHASDA-eligible activities for any policy paid using NAHASDA funds or policies covering NAHASDA-assisted units; (3) establish a separate accounting for Mutual Help program proceeds of sale to ensure proper restriction on the use of those funds, and (4) complete repayment of \$204,456 in unsupported travel expenses questioned during a 2003 Office of Native American Programs monitoring review, which is currently charged to the Authority's NAHASDA funds.

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

We provided our discussion draft to the Authority and HUD's Northwest Office of Native American Programs on September 19, 2007, and held an exit conference on September 24, 2007. The Authority generally disagreed with our recommendations but

acknowledged many of the report findings. 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 Housing Act of 1937, as amended (the 1937 Act), included several low-income housing programs including the Low Rent and Mutual Help homeownership programs. The Low Rent program was a subsidy program in which funding was provided to meet the operating needs that could not be met by existing rental revenue. Therefore, the 1937 Act regulations and annual contributions contracts for the Low Rent program did not use program income terminology. The Mutual Help program allows Indian housing authorities to help low-income Indian families purchase a home. A family makes monthly payments based on 15 to 30 percent of its adjusted income. Payments are credited to an equity account that is used to purchase the home.

The Native American Housing Assistance and Self Determination Act of 1996 (NAHASDA) reorganized the system of housing assistance provided to Native Americans by the U.S. Department of Housing and Urban Development (HUD), eliminating several separate programs of assistance and replacing them with a block grant program.

The primary objectives of NAHASDA are

- (1) To assist and promote affordable housing activities to develop, maintain, and operate affordable housing in safe and healthy environments on Indian reservations and in other Indian areas for occupancy by low-income Indian families;
- (2) To ensure better access to private mortgage markets for Indian tribes and their members and to promote self-sufficiency of Indian tribes and their members;
- (3) To coordinate activities to provide housing for Indian tribes and their members with federal, state, and local activities to further economic and community development for Indian tribes and their members;
- (4) To plan for and integrate infrastructure resources for Indian tribes with housing development for tribes; and
- (5) To promote the development of private capital markets in Indian country and to allow such markets to operate and grow, thereby benefiting Indian communities.

The two programs authorized for Indian tribes under NAHASDA are the Indian Housing Block Grant, which is a formula-based grant program, and Title VI Loan Guarantee, which provides financing guarantees to Indian tribes for private market loans to develop affordable housing. Regulations are published at 24 CFR [*Code of Federal Regulations*] Part 1000. The Indian Housing Block Grant formula currently uses the fiscal year 1996 national average operating subsidy, adjusted for inflation and local area costs, as the basis for per unit funding to an Indian tribe to operate 1937 Act housing.

During the transition into NAHASDA, 1937 Act grants were cancelled, and HUD's Office of Native American Programs (ONAP) interpreted that 24 CFR 85.25(h) allowed HUD to determine the future use of income from 1937 Act properties as a matter of policy. ONAP took the position that, while NAHASDA specified that 1937 Act assets, reserves, and cash accounts were to transition into the new program, HUD could release the government's interest in the future revenue

stream of those assets and allow the tribes to use much of that revenue for other purposes without restriction.

The regulations at 24 CFR 1000.62(a) state that program income does not include any amounts generated from the operation of 1937 Act units unless the units are assisted with grant amounts and the income is attributable to such assistance. Public and Indian Housing (PIH) Notice 2000-18 provides guidance on accounting for program income generated by the use or disbursement of Indian Housing Block Grant funds.

HUD allows tribes to remove much of the revenue generated by NAHASDA-assisted 1937 Act rental properties from the restrictions and oversight of the NAHASDA program based on their interpretation of PIH Notice 2000-18. The tribes may remove an amount equal to the 1996 national average rent collections from 1937 Act properties before attributing any remaining income to NAHASDA. The Office of Native American Programs interpreted that these funds may be removed before offsetting the expense to operate 1937 Act properties funded by NAHASDA. The use of these unrestricted funds drawn from NAHASDA-assisted 1937 Act rental properties is not restricted or monitored by ONAP.

The Warm Springs Tribal Council designated the Warm Springs Housing Authority (Authority) to act on its behalf for NAHASDA grants. The Authority provides housing services for low-income families on the Warm Springs reservation and is responsible for the management of housing programs funded by both the tribe and HUD. There are a total of 184 housing units under the 1937 Act, including 100 Low Rent program units and 84 Mutual Help program units.

HUD's Northwest Office of Native American Programs completed an on-site monitoring review of the NAHASDA Indian Housing Block Grant programs administered by the Authority and published the results of the review on June 13, 2003, identifying nine findings and six concerns. The Authority proposed recalculating program income to create nonprogram income to repay the questioned funds on July 31, 2003. It performed a retroactive calculation to reclassify rent revenue from 1937 Act properties from restricted program income to unrestricted nonprogram income. The change was retroactive back to 1998, and the Authority used these 1937 Act rents to repay the questioned funds.

On February 8, 2005, the Warm Springs Tribal Council placed the Authority's board of commissioners in abeyance for an indefinite period. An interim oversight committee was appointed to restore sound management standards and practices, complete an assessment of the Warm Springs Tribal Code, and review the organization for modification to better meet the Warm Springs reservation's housing needs.

Our objective was to determine whether the Authority calculated program income for NAHASDA-assisted 1937 Act properties in accordance with applicable HUD guidance, regulations, and requirements and to observe uses of revenue from NAHASDA-assisted 1937 Act properties.

RESULTS OF AUDIT

Finding 1: The Authority Could Not Properly Account for NAHASDA Program Income

The Authority did not have an adequate accounting process and system in place to accurately allocate income from 1937 Act properties receiving Indian Housing Block Grant program assistance between the 1937 Act and Indian Housing Block Grant programs. It failed to track cumulative NAHASDA modernization expenses for each property as required by PIH Notice 2000-18, section 3.4 and did not allocate the property's share of income attributable to the NAHASDA Indian Housing Block Grant program. Further, it did not properly credit insurance proceeds and did not have a system to track restricted nonprogram income removed from its Mutual Help program. This condition occurred because the Authority had not made it a priority to establish an accounting system to allocate income attributable to the 1937 Act and Indian Housing Block Grant programs. As a result, it inappropriately removed more than \$1.4 million in low-income housing receipts from HUD monitored NAHASDA affordable housing activities during the period 1998 to 2006.

HUD Requirements

The regulations at 24 CFR 1000.62(a) state that program income does not include any amounts generated from the operation of 1937 Act units unless the units are assisted with grant amounts and the income is attributable to such assistance. Tribes may remove revenue produced by NAHASDA-assisted 1937 Act low-income housing from HUD restrictions and oversight as nonprogram income according to PIH Notice 2000-18's implementation of 24 CFR 1000.62(a).

On July 9, 2002, HUD issued guidance to remind grant recipients of the program income requirements pertaining to 1937 Act units supported with NAHASDA funds. That guidance noted that, in the absence of an accounting system to allocate income attributable to the 1937 Act and Indian Housing Block Grant programs, all income would be program income and would be required to be used for Indian Housing Block Grant program purposes.

The Authority did not have an accounting process and system in place to properly allocate income from 1937 Act properties receiving Indian Housing Block Grant program assistance between the 1937 Act and Indian Housing Block Grant programs because it failed to track NAHASDA's cumulative investment in individual 1937 Act single family housing units. Specifically, the Authority's accounting process and system (1) failed to reclassify 1937 Act units as NAHASDA units when these units received NAHASDA-funded rehabilitation or capital improvements and (2) did not properly treat insurance proceeds used for rehabilitation or capital improvements as NAHASDA funds.

The Authority did not attribute any significant income to NAHASDA even though NAHASDA provided substantially all funding for 1937 Act operations. Using the Authority's program income calculation, substantially all of the rent money collected from these low-income tenants was classified as unrestricted nonprogram funds.

In addition, the Authority had no system to track nonprogram income of \$412,954 removed from the Mutual Help program, which had some restrictions to its use based on revisions to NAHASDA's Notice of Revised Transition Requirements, published on page 15778 of the *Federal Register* on April 1, 1999. Based on a HUD policy decision, these funds can only be used for any housing activity, community facility, or economic development activity. The funds were classified as nonprogram income and commingled with unrestricted assets.

Reclassifying 1937 Act Units as NAHASDA Units

PIH Notice 2000-18 Section 3.4 states that all income from a 1937 Act unit is NAHASDA program income once cumulative NAHASDA funding for rehabilitation and capital expenditure meets or exceeds 40 percent of the maximum allowable dwelling construction and equipment cost, effective with the October 1, 1997, enactment of NAHASDA. According to the notice, the 40 percent threshold is only a concept for accounting for program income and has no affect in determining what is eligible formula current assisted stock under the Indian Housing Block Grant formula.

Because the Authority failed to track cumulative NAHASDA rehabilitation and capital expenditures for each property, they are unable to accurately and timely transition revenues from an unrestricted state to NAHASDA rules. The information used by the Authority to calculate the cumulative allowable dwelling construction and equipment cost for the Authority's 1937 Act units was incomplete. The Authority could not provide records for rehabilitation and capital expenditure costs to individual housing units. The accounting system could not provide information for materials and contracts before 2004, and it did not track labor costs at the unit level throughout the audit period. Consequently, the Authority cannot ensure that it accurately identified all units exceeding the 40 percent threshold.

Further, the maximum allowable dwelling construction and equipment costs are listed, by tribe, in a table as an appendix to Notice 2000-18. According to this appendix, 40 percent of the maximum allowable dwelling construction and equipment cost for the Authority is between \$22,136 and \$35,726 per unit, depending on the number of bedrooms in the unit. The Authority mistakenly used a 40 percent threshold of \$45,000 per unit. Using this higher figure delays the transition of the Authority's 1937 Act units to NAHASDA for program

income calculation purposes. As of December 31, 2006, none of the Authority's 1937 Act units had transitioned to NAHASDA units for program income purposes. After correcting the thresholds, the Authority's director of finance identified one property with rehabilitation costs exceeding the 40 percent threshold.

Recognition of Insurance Proceeds as a Credit to NAHASDA

The regulations at 24 CFR 1000.136 require the recipient to obtain insurance proceeds or provide indemnification from nonprogram income for casualty losses. Specifically, 24 CFR 1000.136 states in part: "... (a) The recipient shall provide adequate insurance either by purchasing insurance or by indemnification against casualty loss by providing insurance in adequate amounts to indemnify the recipient against loss from fire, weather, and liability claims for all housing units owned or operated by the recipient."

NAHASDA Guidance No. 2001-03T, question and answer number 15, explains that insurance proceeds are not considered program income. Instead, the insurance proceeds from an Indian Housing Block Grant-assisted unit are considered credits to the program and must be treated like Indian Housing Block Grant funds and used in accordance with NAHASDA requirements. Insurance proceeds from an Indian Housing Block Grant-assisted unit are considered applicable credits regardless of which funds were used to purchase the insurance. Any expenditures resulting from indemnification, in place of receiving insurance proceeds, would also constitute NAHASDA assistance.

The Authority's accounting system for program income did not recognize insurance proceeds as NAHASDA assistance for the purpose of tracking modernization of 1937 Act units. Our review of seven units with significant expenditures identified five units that received insurance proceeds that were not considered NAHASDA assistance for purposes of the 40 percent of dwelling construction and equipment cost threshold.

Units Exceeding 40 Percent of the Dwelling Construction and Equipment Cost Threshold Not Transitioned to NAHASDA

Our review of the Authority's incomplete 2004 to 2006 records identified at least five properties that exceed the modernization and capital expenditure thresholds of PIH Notice 2000-18, section 3.4 and should be transitioned from the 1937 Act into the NAHASDA program. We were unable to review records from 1998 to 2003 which may contain additional modernization and capital expenditures that would directly impact current program income calculations.

We analyzed modernization costs for seven Authority 1937 Act units that were not transitioned as NAHASDA units for program income calculation. The Authority often used a combination of insurance and nonprogram income or NAHASDA funds to complete the planned scope of work on these units. Five units had modernization costs totaling more than 40 percent of the applicable dwelling construction and equipment costs, making all income for these units NAHASDA program income. One of these units, 2557 Mt. Jefferson, was identified by the Authority after we informed it of the correct 40 percent threshold range.

We could not determine whether the remaining two units exceeded the 40 percent threshold because the Authority could not provide records for materials and contracts at the unit level before 2004, and its accounting system did not track labor costs at the unit level. The table below contains our analysis of all seven units

| Address | Unit size | 40 percent of dwelling construction & equipment cost | Project type | NAHASDA expenditures observed | Unit's revenue becomes program income? | Notes |
|--------------------|-----------|--|--------------|-------------------------------|--|--------|
| 2751 West Spur | 4 | \$ 31,702 | Mutual Help | \$ 56,900 | Yes | Note 1 |
| 2633 Juniper | 5 | 35,726 | Mutual Help | 50,445 | Yes | Note 1 |
| 1815 Kalish | 4 | 31,702 | Low Rent | 35,880 | Yes | Note 1 |
| 2332 High Lookee | 2 | 24,137 | Low Rent | 37,335 | Yes | Note 1 |
| 2557 Mt. Jefferson | 3 | 26,448 | Mutual Help | 33,385 | Yes | Note 2 |
| 1870A Poosh | 2 | 24,137 | Low Rent | 11,669 | Indeterminable | Note 3 |
| 1819 AutJi | 3 | 26,448 | Low Rent | 0 | Indeterminable | Note 3 |

- Note 1 Costs were reimbursable by insurance and exceeded 40 percent of the dwelling construction and equipment cost threshold. This work was completed during 2007 and the Authority has until the end of the year to transition these properties as NAHASDA.
- Note 2 NAHASDA 2006 expenditures observed exceeded 40 percent of the dwelling construction and equipment cost threshold. The unit should have been transitioned to NAHASDA.
- Note 3 NAHASDA 2006 expenditures observed did not exceed 40 percent of the dwelling construction and equipment cost threshold. However, actual expenditures are not known since the housing authority did not have a system to track all NAHASDA assistance for rehabilitation or capital improvements.

Tracking Program Income on 1937 Act Units Not a Priority

Authority officials told us that they had not made it a priority to establish an accounting system to allocate income attributable to the 1937 Act and Indian Housing Block Grant programs prior to 2004. Additionally, the Authority's financial audit report for the year

ending December 31, 2005, noted that the amount of Indian Housing Block Grant program funds used to rehabilitate 1937 Act properties was not tracked and that management believed that the amount of rehabilitation expenditures, if any, would not exceed the limits established by HUD for purposes of determining nonprogram income.

Calculation of Program Income

For the period between 1998 and 2006, the Authority used HUD's guidance on the calculation of program income to unrestrict and remove \$995,661 from the Low Rent program and an additional \$412,954 of proceeds from the Mutual Help program for a total of more than \$1.4 million in nonprogram income. In the first eight years, the process only retained \$15,456 in rent money to be attributed to NAHASDA's support of these assets in the form of program income, restricted to affordable housing uses under NAHASDA. According to its 1998 through 2005 annual performance reports, the Authority used more than \$3.7 million in NAHASDA funds to support these same 1937 Act units.

The revenue removed by the Authority was produced by NAHASDA-assisted 1937 Act low-income housing under the Low Rent subsidized housing program and Mutual Help homeownership program. It was classified as nonprogram income according to PIH Notice 2000-18's implementation of 24 CFR 1000.62(a). Using the Authority's program income calculation, substantially all of the rent money collected from these low-income tenants was classified as unrestricted nonprogram funds.

The calculation for Low Rent properties according to PIH Notice 2000-18 produces nonprogram income by determining the lesser of actual rent collections or a surrogate for historical rent collections before enactment of NAHASDA. This surrogate is 46 percent of the Allowable Expense Level (AEL) for the recipient. This number reflects the national average for rents received for 1937 Housing Act units in the last year of the 1937 Housing Act programs for Indians.

The Authority's calculation for Low Rent properties generally complied with HUD policies, except for their failure to track and transition assets from a 1937 Act identity to a NAHASDA identity. The surrogate is calculated by multiplying the Authority's 100 Low Rent units, times 12 months, times \$101 (which is 46 percent of the allowable expense level for Warm Springs per the Appendix to PIH Notice 2000-18).

For Mutual Help properties, the amount of nonprogram income generated is equal to the proceeds from the sale of homeownership units developed under the 1937 Act. We did not take exception with current amounts represented as nonprogram income, except that the failure to transition properties to NAHASDA will understate future program income. Also, the Authority did not place restrictions on these proceeds as required by NAHASDA's Notice of Revised Transition Requirements, published on page 15778 of the *Federal Register* on April 1, 1999.

Uses of Nonprogram Income

Previously identified ineligible costs were charged to nonprogram income. The Authority's previous Executive Director agreed to use \$204,456 of the \$1.4 million in nonprogram income to repay funds questioned during a 2003 Northwest Office of Native American Programs monitoring review. Finding No. 4 of the review noted that travel expenses charged to the tribe's NAHASDA funds were based on estimates and there was no submission of a claim or adjustment to actuals. There was no assurance the expenses are allowable, or assignable to the grants.

However, our review of nonprogram income expenses determined that the adjustment was not recorded in the Authority's accounting system. As a result, restricted funds were used to pay for \$204,456 in unsupported travel expenses. The Authority could not find sufficient records or housing board authorization to correct the adjustment at the time of our fieldwork. The adjustment is required by 24 CFR §1000.26, 24 CFR §85.20, and OMB Circular A-87.

Finding No. 5 from the 2003 monitoring report found \$119,861 in unsupported compensation of housing officials. The Authority reimbursed NAHASDA from nonprogram income to resolve the finding. The unsupported compensation included \$1000 payments to staff and commissioners described as a cost of living adjustment, but were not based on wages or inflation. In HUD's opinion, the payment more closely resembled a bonus, but was not supportable, according to requirements of OMB Circular A-87 designed to document goals and achievements necessary to earn the bonus.

The Authority also charged \$11,176 to nonprogram income for unreimbursed personal expenses of former Authority board members and key employees on Authority credit cards. These expenses included travel, entertainment, fuel, local meals, late fees, finance charges, and other miscellaneous expenses. Some of these housing officials are still associated with the Authority.

Additional uses of the nonprogram income included \$121,390 in unallowable tenant bad debt written off primarily in the 2003 Financial Audit, \$18,495 in other HUD-rejected expenses, and \$6,964 in additional questioned travel from a Warm Springs internal audit.

The source of these nonprogram funds is revenue collected from NAHASDA-assisted low-income Native Americans. The funds were removed from the program and became unrestricted based on the advice and consent of HUD's Office of Native American Programs. We consider the unrestricted use of these rent revenues a potential abuse of the NAHASDA Act's intent which is to "assist and promote affordable housing activities to develop, maintain, and operate affordable housing in safe and healthy environments on Indian reservations and in other Indian areas for occupancy by low-income Indian families."

More recently, the Authority charged \$471,444 of its nonprogram income to maintain other non-HUD tribal housing, which was not originally documented as a NAHASDA-eligible activity, but may qualify. The remaining nonprogram income after the Authority repays the unsupported travel expenses will consist of a cash balance of \$454,829.

Conclusion

Since the Authority did not have a system in place to track dwelling construction and equipment costs for its 1937 Act units at the unit level as required by PIH Notice 2000-18, section 3.4, it could not ensure the accuracy of its program income calculation for its 1937 Act units assisted with NAHASDA funds. Further, this deficiency errs in favor of attributing income to the 1937 Act, resulting in more funds becoming unrestricted. Since the 40 percent threshold is cumulative, any failure to identify costs delays transition of 1937 Act units assisted with NAHASDA rehabilitation funds. Unless the records can be accurately reconstructed for all units, the effect of the failure is permanent.

Due to this lack of a system, the Authority did not qualify to remove nonprogram income in 2003 by recalculating operations back to 1998 and restating related financial records. According to HUD Program Guidance 2002-12, the \$1.4 million in nonprogram income generated by Low Rent and Mutual Housing revenue from 1998 through 2006 must be repaid unless the program income accounting system is shown to be accurate and complete. Any expenditure from these funds must be restricted to NAHASDA-eligible activities.

Recommendations

We recommend that HUD require the Authority to

- 1A Establish an accounting system that allocates income attributable to the NAHASDA program and documents the total cost of NAHASDA-funded rehabilitation and capital improvements, by 1937 Act unit, from 1998 forward or return \$1.4 million, which was previously withdrawn from 1937 Act revenue as nonprogram income, to the NAHASDA program.
- 1B Reconcile insurance proceeds and ensure that they are credited to NAHASDA-eligible activities for any policy paid using NAHASDA funds or policies covering NAHASDA-assisted units.
- 1C Establish a separate accounting for Mutual Help program proceeds of sale to ensure proper restriction on the use of those funds.
- 1D Complete repayment of \$204,456 in unsupported travel expenses questioned during a 2003 Office of Native American Programs monitoring review, which is currently charged to the Authority's NAHASDA funds.

SCOPE AND METHODOLOGY

Our objective was to determine whether the tribe complied with criteria for program income from NAHASDA-assisted 1937 Act housing projects and to observe uses of revenue from NAHASDA-assisted 1937 Act properties. The criteria are contained in NAHASDA, implementing regulations found in 24 CFR 1000.62, HUD's Office of Native American Programs' guidance, and external requirements such as those from the General Accounting Office and the Office of Management and Budget. The audit steps were designed to gain an understanding of the 1937 Act income and related use restrictions, the accounting for associated program income, and support relied upon to calculate program and nonprogram income.

To accomplish our objectives, we reviewed the Authority's calculation of program income from NAHASDA-assisted 1937 Act housing projects and related supporting data at its offices in Warm Springs, Oregon. We reviewed sufficient cost accounting system information to confirm whether the accounting system was capable of tracking modernization and capital expenditures at the housing unit level if the tribe chose to remove nonprogram income. We also reviewed the system to track the transition of units from a 1937 Act identity to a NAHASDA identity. Finally, we observed the use of nonprogram income generated from NAHASDA-assisted 1937 Act units.

Our review of the Authority's cost accounting system included a review of calendar year 2004 expenses forward due to the limitations in records preceding that date. Out of the 184 NAHASDA assisted 1937 Act housing units, we selected the seven units with the largest materials and subcontract expenditures from 2004 through 2006. Those units were selected to identify whether the system missed identifying units that should be transitioned from a 1937 Act identity to a NAHASDA identity for the purpose of calculating program income. We did not test properties rehabilitated before 2004 due to the limited records.

The audit was conducted between April 6 and August 13, 2007. Our review covered the period from January 1, 1998, to December 31, 2006, which corresponds to the financial reporting period restated by the Authority in 2003 to remove nonprogram income from the NAHASDA program, through the latest calendar year of operations.

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:

- The system of calculating and tracking the use of program income and nonprogram income.
- The cost accounting system dedicated to identifying and collecting the cost of individual tasks and assigning those costs to an end unit of production.
- The financial accounting system used to collect and report accounting information for use in financial statements and other performance reports.

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 accounting system was not capable of tracking cumulative NAHASDA modernization expenses for each property and did not allocate the property's share of income attributable to the NAHASDA Indian Housing Block Grant program.

APPENDIXES

Appendix A

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

| Recommendation number | Unsupported <u>1/</u> |
|-----------------------|-----------------------|
| 1A | \$1,613,071 |

1/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures. The finding questions the entire \$1,408,615 calculation of nonprogram income by the Authority. Until the Authority sets up an accounting system to track rehabilitation costs for its 1937 Act units, at the unit level, back to 1998, all income associated with the NAHASDA-assisted 1937 Act units must be considered program income. The questioned amount represents the total revenue generated by NAHASDA-assisted 1937 Act housing units that was removed from NAHASDA low-income housing programs as part of this calculation. In addition, the tribe is required to repay NAHASDA for \$204,456 in unsupported travel expenses currently charged to grants.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Warm Springs Housing Authority provided the following comments to our office by email on October 11, 2007:

Ref to OIG Evaluation

Auditee Comments

| <u>Ref to OIG Evaluation</u> | <u>Auditee Comments</u> |
|------------------------------|--|
| Comment 1 | <p>Auditee Response to OIG Draft report dated September 19, 2007</p> <p>Introduction:</p> <p>A one week audit was performed by 2 representatives of the Office of Inspector General with the stated purpose of testing the calculations for determining "program income under the 1937 Act as applicable to the NAHASDA Act of 1996."</p> |
| Comment 2 | <p>We feel the overall conclusion of "\$1.4 million in non-program income must be repaid unless the program income accounting system is shown to be accurate and complete" is overreaching, mean-spirited and punitive, almost to the degree of being arbitrary and capricious, in conflict of the trust, Treaty and fiduciary responsibilities the federal government has to the Confederated Tribes of Warm Springs under the treaty of 1855.</p> |
| Comment 3 | <p>We are diligently addressing past concerns with the focus of our energy going toward improving our programs and systems for the future.</p> |
| Comment 4 | <p>The accounting system in place from 1998 – 2004 was a manual system and audited by a CPA. To demand to create records and systems for the past 8 years which did not exist is unconscionable and in bad faith.</p> <p>All calculations were made using ONAP guidance to the best of our ability. All numbers were derived from audited financial statements upon which an unqualified opinion was rendered.</p> <p>Finding 1: The Authority could not properly account for NAHASDA Program Income</p> <p>The current accounting system was set up in 2004. Present staff started at the Warm Springs Housing Authority (WSHA) in October of 2004. At that time WSHA was dealing with several issues, not least of all the accounting and tracking systems.</p> |

Ref to OIG Evaluation

Auditee Comments

Comment 3

The Warm Springs Housing Authority has and is working closely with the HUD Office of Native American Programs to straighten out problems and correct deficiencies in its Housing program. At the time of audit, WSHA had taken great strides in correcting problems and deficiencies materials and subcontracts were being tracked. Since the audit, the labor costs for rehab units are being tracked.

Comment 5

Reclass 1937 Act Units as NAHASDA Units

All costs are being collected for rehabilitation and maintenance of units. Labor, materials and subcontracts are being tracked by unit. Units meeting the 40% requirement are documented as NAHASDA units in the year that percentage is reached.

Comment 6

Recognition of Insurance Proceeds as a Credit to NAHASDA

Insurance proceeds are currently being tracked. Warm Springs Housing Authority experienced a total loss of three units, two were Mutual Help with the remaining being Low Rent. As of audit time only one unit was back on line and occupied which is a Mutual Help unit. The Mutual Help units do not generate income of any kind until conveyance. Both units will be conveyed as NAHASDA units and the funds will become program funds. Until conveyance there are no accounting entries needed to recognize their status as NAHASDA units.

Units exceeding 40% of construction cost not transitioned to NAHASDA

2751 W. Spur – Not complete – unit is Mutual Help – no entries required until conveyance
2633 Juniper – Complete/occupied – unit is Mutual Help – no entries required until conveyance
1815 Kalish – Not complete – unit is Low Rent – entries will be made at completion of unit
2557 Mt. Jefferson – Occupied – unit is Mutual Help – no entries required until conveyance
1870A Poosh – Occupied – unit is Low Rent – NAHASDA costs are \$11,669
1819 Aut-Ji – Occupied – unit is Low Rent – NAHASDA costs are being tracked

Comment 7

All 1937 Act units will be transitioned when appropriate.

Ref to OIG Evaluation

Auditee Comments

Comment 8

Tracking Program Income on 1937 Act units not a priority

Outside of stated scope and review – no response necessary.

Comment 4

Calculation of Program Income

The methodology used was provided by the ONAP office. The method and numbers have been reviewed by ONAP and audited by an independent auditor. It is the belief of the Warm Springs Housing Authority that the calculations are accurate.

Comment 1

Uses of Non-program Income

Outside of stated scope, extraneous and superfluous commentary outside the stated objectives and purpose of the engagement.

Comment 9

Relevant Internal Controls

Outside of stated scope. The internal controls are reviewed annually by independent auditors in compliance with our OMB Circular A-133 Single Audit.

Comment 9

Significant Weaknesses

Outside of stated scope, extraneous and superfluous commentary outside the stated objectives and purpose of the engagement.

Comment 10

Schedule of Questioned Costs

The Warm Springs Housing Authority has an accounting system in place to track all costs. Labor for rehabilitation projects is currently being recognized to each unit as the work is done. Maintenance costs are also tracked, however, are not included in the calculation of the 40% of construction costs. The auditors from the Office of Inspector General didn't remove any costs tracked by unit when completing their assessment. Costs tracked include all maintenance, electricity, pest control, which are not taken into account when figuring the 40% of construction.

OIG Evaluation of Auditee Comments

- Comment 1** Our audit notification letter sent to the Authority stated the audit work would include (1) reviewing the calculation and related support for program income as included in recent Indian Housing Plans and Annual Performance Reports, (2) tying the calculation to supporting documents, (3) reviewing documentation for modernization and operating expenses, rental receipts for 1937 Act Projects, and the use of associated revenue, and (4) observing the system for tracking total IHBG funds spent for rehabilitation/capital expenditures for 1937 Act units.
- Comment 2** The audit conclusion is based on the comparison of HUD's requirements to the Authority's supporting records for their calculation of program and nonprogram income. According to HUD's guidance, modernization costs must be accumulated over the entire term of NAHASDA assistance. Our recommendations give the Authority the opportunity to remedy their deficiencies.
- Comment 3** We acknowledge that the tribe took steps to make improvements to the Authority since 2004 and worked closely with the Office of Native American Programs to correct the deficiencies noted in the 2003 monitoring report. While improvements are still being made, the rules for claiming nonprogram income are cumulative in nature and require reconstruction of records from prior management. Otherwise, the funds must be used for low income housing under the NAHASDA program as stated in our recommendation.
- Comment 4** The Authority did not try to claim nonprogram income under the prior accounting system until July 2003. The CPA's audit reports from 2003 forward cited the tribe for not having a system of tracking rehabilitation costs for their nonprogram income calculation.
- Comment 5** The Authority was not tracking rehabilitation and maintenance costs by unit prior to 2004 and the labor costs were not tracked on a unit basis until after this audit's fieldwork in 2007; however we have not reviewed their implementation.
- Comment 6** The Authority is correct that the Mutual Help units do not produce income until conveyance. However, as noted by the Authority, two Mutual Help units and one Low Rent unit were total losses. The units were replaced with units constructed with the insurance proceeds which were NAHASDA funds. Accordingly, the units became NAHASDA units and all income is program income. The Authority must maintain an official record of each unit's status.
- Comment 7** As noted in comment 6, the three units replaced with NAHASDA funds are now NAHASDA units and it was appropriate to transition them to NAHASDA when replaced. The remaining units are appropriate to transition to NAHASDA program income status based on the amount of modernization funded with NAHASDA funds.

Comment 8 The priority assigned to tracking program income provides an understanding of why the Authority had not yet put an accounting system in place that provides all the information required to meet HUD requirements for determining program and non-program income.

Comment 9 Generally accepted government auditing standards require an assessment of internal control as it relates to the specific objectives and scope of the audit. The report discusses those internal controls we determined relevant to our audit objectives.

Comment 10 As discussed in the report, the Authority did not have a system to track modernization costs on a unit basis. Currently, there is no basis to establish each unit's progress toward transitioning to the NAHASDA program, which must be cumulative since 1998.

In response to our request for the best information showing modernization costs, Authority officials provided accounting records, by unit, that were incomplete, yet commingled repair, maintenance and rehabilitation costs. The Authority used these records to determine compliance with the 40 percent of the dwelling construction and equipment threshold. Our audit results for the seven units discussed in the report are based on only those rehabilitation costs we observed and did not include maintenance expenditures.

Our report clarifies the limitations on information for modernization costs and the Authority's lack of needed management decisions on what will be considered repair, maintenance and modernization costs. The Authority's comments reiterate our report's findings.