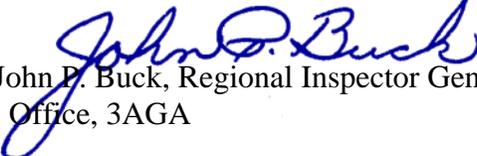


Issue Date September 27, 2007

Audit Report Number 2007-PH-1013

TO: Dennis G. Bellingtier, Director, Office of Public Housing, Pennsylvania State Office, 3APH

FROM:  John P. Buck, Regional Inspector General for Audit, Philadelphia Regional Office, 3AGA

SUBJECT: The Harrisburg Housing Authority, Harrisburg, Pennsylvania, Did Not Properly Administer Its Low-Rent Public Housing Program

HIGHLIGHTS

What We Audited and Why

We audited the Harrisburg Housing Authority's (Authority) low-rent public housing program. The audit was conducted as part of our fiscal year 2006 annual audit plan. Our objective was to determine whether the Authority administered its low-rent public housing program in accordance with U.S. Department of Housing and Urban Development (HUD) regulations.

What We Found

The Authority did not administer its low-rent public housing program in accordance with HUD regulations. It improperly disbursed \$834,969 in operating funds from its low-rent public housing program to open and support the Greater Harrisburg Community Credit Union (credit union) and allowed a related conflict-of-interest situation to exist. The Authority's noncompliance occurred because it believed that its use of operating funds and consulting contract arrangements for the credit union was proper.

What We Recommend

We recommend that HUD review the issues in this report and if appropriate, initiate action to declare the Authority in substantial default of its consolidated annual contributions contract and take appropriate administrative action as detailed in section 17 (Notices, Defaults, and Remedies) of the contract.

We recommend that HUD direct the Authority to

- Repay its low-rent public housing program \$834,969 from nonfederal funds for the ineligible disbursements related to the credit union;
- Develop and implement controls to ensure that disbursements of operating funds are eligible and supported; and
- Develop and implement controls to detect, prevent, and resolve future conflict-of-interest situations.

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 the initial draft audit report to the Authority on July 27, 2007. We discussed the draft report with the Authority at an exit conference on August 8, 2007, and provided it with a revised draft report on August 16, 2007. The Authority provided its written comments on August 22, 2007. The Authority disagreed with the report. The complete text of the Authority's response, along with our evaluation of that response, can be found in appendix B of this report.

TABLE OF CONTENTS

Background and Objectives	4
Results of Audit	
Finding: The Authority Improperly Used Public Housing Operating Funds and Allowed a Conflict-of-Interest Situation to Exist	5
Scope and Methodology	8
Internal Controls	9
Appendixes	
A. Schedule of Questioned Costs	11
B. Auditee Comments and OIG's Evaluation	12

BACKGROUND AND OBJECTIVES

The Harrisburg Housing Authority (Authority) was established in 1938 under the Housing Authority Law of the Commonwealth of Pennsylvania to serve the needs of low-income, very low-income, and extremely low-income families in the City of Harrisburg and to (1) maintain the availability of decent, safe and affordable housing in its communities; (2) ensure equal opportunity in housing; (3) promote self-sufficiency and asset development of families and individuals; and (4) improve community quality of life and economic viability. A five-member board of commissioners governs the Authority. The commissioners serve five-year terms on the board. The executive director of the Authority during the audit was Carl Payne. The Authority's main administrative office is located at 351 Chestnut Street, Harrisburg, Pennsylvania.

The Authority owns and manages 1,730 low-rent public housing units under its consolidated annual contributions contract with HUD. The consolidated annual contributions contract defines the terms and conditions under which the Authority agrees to develop and operate all projects under the contract. HUD authorized the Authority the following operating subsidies from 2004 to 2006:

Year	Amount of operating subsidy authorized
2004	\$ 7,680,083
2005	\$ 8,403,302
2006	\$ 8,870,810
Total	\$24,954,195

The Authority was integral in the creation, operation, and financing of the Greater Harrisburg Community Credit Union (credit union). The credit union was opened for business in April 2001 and was closed by the National Credit Union Administration in February 2006 because it was insolvent and had no prospects of restoring viable operations. The president and chief executive officer of the credit union was Carl Payne. The credit union was located at 223 Walnut Street, Harrisburg, Pennsylvania.

Our objective was to determine whether the Authority administered its low-rent public housing program in accordance with HUD regulations.

RESULTS OF AUDIT

Finding: The Authority Improperly Used Public Housing Operating Funds and Allowed a Conflict-of-Interest Situation to Exist

The Authority violated its consolidated annual contributions contract and federal regulations by improperly disbursing \$834,969 in low-rent public housing operating funds to open and support the Greater Harrisburg Community Credit Union (credit union) and allowing a related conflict-of-interest situation to exist. This noncompliance occurred because the Authority believed that its use of operating funds and its consulting contract with one of its employees for the benefit of the credit union were proper. The consolidated annual contributions contract¹ limits the use of funds provided under the contract to paying only costs related to the operation of the projects under the contract. Federal regulations² prohibit contributions, including cash, regardless of recipient. The consolidated annual contributions contract³ also prohibits conflict-of-interest situations involving contracts with employees. Therefore, the Authority's disbursements of operating funds for the benefit of the credit union were ineligible.

The Authority Improperly Used Operating Funds

The Authority improperly disbursed \$834,969 in low-rent public housing operating funds to open and support a credit union. It made 10 lump sum contributions to the credit union totaling \$485,000 from August 2001 to April 2005. In addition to the lump sum contributions, the Authority disbursed \$349,969 in HUD funds, from January 1998 to August 2005, to pay various expenses related to the credit union. The following paragraphs provide details.

Lump sum contributions – The Authority made 10 lump sum contributions to the credit union totaling \$485,000 from August 2001 to April 2005. It made the disbursements to cover the credit union's National Credit Union Administration net worth requirements and to meet income goals reflected in a revised business plan. The Authority's executive director was also the president and chief executive officer of the credit union during this period.

Consulting fees – From January 1998 to May 2001, the Authority paid a consultant \$132,960 to establish and manage the day-to-day operations of the credit union. In November 2000, the consultant became an employee of the Authority and as a result, caused a prohibited conflict-of-interest

¹ Part A, section 9(C).

² Office of Management and Budget Circular A-87, attachment B, section 12, paragraph a.

³ Part A, section 19(A).

situation to occur (this issue is discussed in further detail at the end of this finding).

Operating expenses – From November 2000 to June 2001, the Authority disbursed \$67,628 for the credit union’s operating expenses. These expenses included payments for office remodeling, radio grand opening promotions, rental of a stage and table cloths, and elementary school students’ artwork.

Employee salaries – The Authority intermittently disbursed \$52,246, from January 2001 to July 2004, for salaries of three nonmanagerial employees of the credit union.

Employee insurance – The Authority disbursed \$97,135 to provide insurance benefits to six credit union employees from May 2001 to June 2006.

These improper disbursements occurred because the Authority lacked policies and procedures to ensure that disbursements complied with the terms of its consolidated annual contributions contracts and applicable regulations. The Authority’s executive director, who was also the president and chief executive officer of the credit union, incorrectly believed that the use of operating funds for the credit union was eligible. However, the Authority’s consolidated annual contributions contract limits the use of funds provided under the contract to paying only costs related to the operation of the projects under the contract. Further, federal regulations prohibit contributions or donations, including cash, regardless of recipient. Since these disbursements did not result in any benefit to the low-rent public housing program, the \$834,969 disbursed was ineligible. The Authority needs to reimburse its low-rent public housing program for the ineligible disbursements and develop and implement controls to ensure that disbursements of operating funds are eligible and supported.

The Authority Allowed a Conflict-of-Interest Situation to Exist

The Authority’s executive director violated the consolidated annual contributions contract’s conflict-of-interest restrictions by improperly receiving consulting fees for his work with the credit union (paid by the Authority as reported above) and a salary as an employee of the Authority. From November 2000 to May 2001, the executive director received \$17,500 for consulting services while receiving a salary from the Authority totaling \$33,520. The consolidated annual contributions contract prohibits the Authority from entering into any contract or arrangement in connection with any project under the contract with any Authority

employee who formulates policy or who influences decisions with respect to the project(s). Employees must disclose their interest or prospective interest to the Authority and HUD. While HUD can waive this requirement for good cause, neither the executive director nor the board disclosed this situation to HUD. Although the Authority's board of commissioners was aware of the situation, it took no action to resolve it. In addition, as noted above, the Authority's executive director was also the president and chief executive officer of the credit union. During the executive director's concurrent tenures, the Authority improperly disbursed low-rent public housing operating funds to benefit the credit union. This continued the conflict-of-interest situation although the Authority was no longer paying the executive director as a consultant to the credit union. The Authority did not inform HUD of these disbursements nor did it request HUD's approval before making them.

The Authority needs to develop and implement controls to detect, prevent, and resolve conflict-of-interest situations.

Recommendations

We recommend that the director of the Office of Public Housing, Pennsylvania State Office

- 1A. Review the issues in this report and if appropriate, initiate action to declare the Authority in substantial default of its consolidated annual contributions contract and take appropriate administrative action as detailed in section 17 (Notices, Defaults, and Remedies) of the contract.

We recommend that the director of the Office of Public Housing, Pennsylvania State Office, direct the Authority to

- 1B. Repay its low-rent public housing program \$834,969 from nonfederal funds for the ineligible disbursements related to the credit union.
- 1C. Develop and implement controls to ensure that disbursements of operating funds are eligible and supported.
- 1D. Develop and implement controls to detect, prevent, and resolve future conflict-of-interest situations.

SCOPE AND METHODOLOGY

We performed the audit at the Authority in Harrisburg, Pennsylvania, from October 2006 through August 2007. The audit was performed in accordance with generally accepted government auditing standards and included tests of internal controls that we considered necessary.

The audit covered transactions representative of operations current at the time of the audit and included the period January 2004 through September 2006. We expanded the scope of the audit as necessary. During the audit, we assessed the reliability of computer-processed data relevant to our audit by comparing the data to hard-copy information. We found the computer-processed data were sufficiently reliable to meet our audit objectives.

To accomplish our objectives, we

- Reviewed applicable HUD and federal regulations and guidance.
- Reviewed the Authority's consolidated annual contributions contract with HUD.
- Reviewed the Authority's internal control structure.
- Reviewed the Authority policies and procedures.
- Discussed operations with the Authority's management and staff and key officials from HUD's Philadelphia, Pennsylvania, field office.
- Reviewed minutes of the Authority's board of commissioners' meetings for years 2004 through 2006.
- Reviewed the Authority's audited financial statements for years 2003 through 2005; other financial records including general ledgers, bank statements, and check registers; and supporting documentation as appropriate.
- Reviewed the Authority's annual and five-year plans for its fiscal years 2002 through 2008.

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:

- Policies, procedures, and controls that management has implemented to ensure that the Authority administered its low-rent public housing program in accordance with HUD and federal regulations.

We assessed the relevant controls identified above.

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

Significant Weaknesses

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

The Authority did not

- Ensure that disbursements of operating funds were eligible and supported.
- Detect, prevent, and resolve conflict-of-interest situations.

**Separate Communication of
Minor Deficiencies**

Minor internal control and compliance issues were reported to the Authority by a separate letter dated August 16, 2007.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/
1B	\$834,969

- 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 AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

<p>Leon J. Feinerman Chairman</p> <p>Rev. Earl L. Harris Vice Chairman</p> <p>Constance Y. Buxton Treasurer</p>	<p>HARRISBURG HOUSING AUTHORITY</p> <p>351 Chestnut Street Harrisburg PA 17101-2785</p> <p>Phone: 717.232.6781 Fax: 717.233.8355 TTY: 711</p>	<p>Emily J. Leader Member</p> <p>Irwin W. Aronson General Counsel</p> <p>Jerry Shenck Acting Executive Director</p>
---	--	---

August 17, 2007

John P. Buck
Regional Inspector General for Audit
Philadelphia Regional Office, 3AGA
The Wannamaker Building
100 Penn Square East, 10th Floor
Philadelphia, PA 19107-3380

Dear Mr. Buck:

This letter contains the Harrisburg Housing Authority's ("HHA") response to the Draft Audit Report which was received by HHA on August 16, 2007 (Draft Audit Report) as prepared by our counsel, Reno & Cavanaugh and Willig, Williams and Davidson, and our accountant, Casterline Associates. The Draft Audit Report concludes that certain expenditures made by HHA to carry out services to its residents were ineligible because (1) they were not expended for an eligible purpose, (2) they were "contributions" prohibited by OMB Cir. A-87, and (3) that there were two incidences of a conflict of interest which made some of the expenditures ineligible. We address each of these issues below after we provide you with some background information on the expenditures in question.

The expenditures deemed ineligible by the Draft Audit Report were made to the Greater Harrisburg Community Credit Union (GHCCU), and according to the Draft Audit Report totaled \$834,969 over a seven and a half year period.¹ The genesis of these expenditures began in 1996 when, with the support and encouragement of Harrisburg Mayor Stephen R. Reed, a 45 member task force of business and community leaders, clergy, bank and government officials began looking into the possibility of forming a low-income credit union. An organizing committee called the Community Reinvestment Partnership undertook planning and conducted an extensive survey of the Harrisburg community, in particular the public housing communities², and found both need and interest in serving the financial services needs of Harrisburg's low-income residents, including public housing residents. Around this time, HHA's executive director

¹ It should be noted that this amount contributed over a seven and a half year period represents average annual expenditures of about \$114,000 per year which is less than 1.5% of HHA's total operating fund budget. Please see Exhibit 1 for more information on GHCCU.

² Of the 1,560 respondents to the survey conducted by the Community Reinvestment Partnership, 900 were public housing residents.

Comment 1

Comment 2

Comment 3

Dorsey Howard also received an invitation to a training sponsored by the Philadelphia HUD field office touting the benefits of public housing affiliated credit unions.

Ultimately this task force pursued the idea of a low-income credit union to serve the needs of the citizens of Harrisburg. The effort culminated with broad local and governmental support with commercial banks, businesses, churches and government agencies providing more than \$2 million in start-up capitalization. In addition, HHA, the City of Harrisburg, and the Commonwealth of Pennsylvania all provided operational support to GHCCU. GHCCU opened its doors in 2000 after receiving its charter from the Commonwealth and the National Credit Union Association (NCUA). GHCCU was also awarded a designation as a "low-income" credit union by the NCUA.³ The credit union successfully served the needs of the community and provided meaningful access to financial services to over 1,000 members of the Harrisburg community and including a significant number of public housing residents. Unfortunately, in 2006, the NCUA closed the doors of the credit union because of a number of non-performing loans and because GHCCU was unable to meet the complicated and burdensome net worth requirements.⁴

Response to Finding:

1. The Draft Audit Report concludes that the HHA improperly disbursed low-rent public housing operating funds to assist in the creation and operation of the GHCCU because HHA's "consolidated annual contributions contract limits the use of funds provided under the contract to paying only costs related to the operation of the projects under the contract".⁵ HHA's response is that the Inspector General (IG) misconstrues the definitions of "project" and "operations" and incorrectly narrows the scope of both definitions under the annual contributions contract (ACC) and under the Housing Act of 1937 (the "Act").

The IG's Draft Audit Report concludes that because HHA spent operating funds on an entity and services that were not part of the actual bricks and mortar or direct operation of a public housing project, the costs did not fall under the ACC's requirement that all funds must be spent on costs related to the operation of the project. However, the IG is in error. Under the ACC, HHA is restricted to spending funds only for the payment of costs for development and operation of the projects, for purchasing permitted investments, or other purposes as may be specifically approved by HUD.⁶ If that provision is read alone there may be support for the IG's finding. However, the Government Auditing Standards require the IG to possess "general knowledge of the environment in which the audited entity operates and the subject matter under

³ The letter of designation from the NCUA is attached as Attachment A. This letter was available and examined by the IG.

⁴ GHCCU had difficulty meeting the net worth requirements in large part because it was a designated low-income credit union with a majority of low-income families as members. In addition, the non-performing loans were made by an employee that failed to follow GHCCU's internal control processes for loan approvals.

⁵ See Draft Audit Report, page 5.

⁶ See Section 9(C) of the ACC.

Comment 4

Comment 5

Comment 6

Comment 7

Comment 8

review”.⁷ This general knowledge includes all provisions of the ACC itself, the Act, and the regulations, Notices and guidance implementing the Act. When these are considered, it becomes clear that “operations” is broader than just maintaining dwelling units. For instance, Section 4 of the ACC requires housing agencies to operate projects for the “economic and social well-being of the tenants”. In addition, Section 3(c)(2) of the Act defines operations as specifically including tenant programs and services. At no place in the Act, its corresponding regulations, or accompanying guidance are tenant programs and services restricted to mean only those services offered on-site on actual public housing property. Rather, tenant programs are broadly construed and the definition includes any service which is directly related to meeting tenant needs.⁸ Moreover, PHA’s are directly authorized to engage in partnerships and other business arrangements in order to provide such tenant services.⁹ Consequently, HHA’s expenditures in support of GHCCU should not be deemed ineligible simply because they were not spent on the operation of the dwelling units themselves. Rather, so long as the expenditures were appropriate as an eligible tenant service under the Act’s definition of operations, or in furtherance of a permissible arrangement under Section 13 of the Act to enter into business relationships with affiliated entities to provide tenant services, HHA acted properly and in accordance with their ACC.

2. HHA disagrees with the IG’s conclusion that “since these disbursements did not result in any benefit to the low-rent public housing program, the \$834,969 disbursed was ineligible”¹⁰, both because GHCCU did provide benefits to the low-rent public housing program residents, and second, because the Inspector General is applying a nonexistent standard that a housing agency must quantify and show actual benefit derived from a supportive services program in order for that program to constitute an eligible expense.

During the exit interview, the IG maintained that because HHA could not conclusively demonstrate that a single public housing resident was a member of GHCCU or benefited from GHCCU’s services, the expenditures in support of the credit union were ineligible. However, these statements and findings by the IG depart from governmental auditing standards and erroneously suppose that a housing agency must document and verify tangible benefits from supportive services offered to the residents. First, the IG contrary to the governmental auditing standards has disregarded or discounted solid and credible evidence that GHCCU did in fact benefit public housing residents. Available to the IG, and reviewed by it, is documentation submitted to the city of Harrisburg by GHCCU for its reporting requirements under an Enterprise Zone Program. In this documentation, a summary of which is attached as Exhibit 1, the membership of the credit union is broken down by residents in certain zip codes, and on the basis of these zip codes, it is conservatively estimated that a substantial number of public housing

⁷ Government Auditing Standards, 2007 Revision, 3.43(b), (hereafter, “Yellowbook”).

⁸ See Section 3(c)(2) of the Act. Further, even though not directly applicable in this context, in Section 34 of the Act “community credit unions” are contemplated as a valid tenant supportive service which provides further evidence of the Act’s broad conception of tenant services.

⁹ See Section 13 of the Act.

¹⁰ See Draft Audit Report, page 6.

Comment 9

families were members of the credit union. Due to confidentiality laws¹¹ surrounding bank depositors or credit union membership, this estimation method, rather than some form of actual verification, is the only type of verification available to the HHA on the membership of the credit union.¹² Moreover, supporting organizational documentation of GHCCU shows that that the credit union was formed to serve low-income families and that marketing efforts were directed at public housing residents. The IG chose to ignore this strong circumstantial evidence of the benefits provided to public housing residents in issuing this draft report and this finding. This is in direct violation of the Government Auditing Standards, which require governmental auditors to find enough evidence to persuade a knowledgeable person that the findings are reasonable.¹³ The burden of supporting an audit finding, in this case that the expenditures were ineligible, is on the auditors, and not on the housing agency to disprove an auditor assertion, especially in the face of supporting circumstantial evidence and confidentiality laws restricting the credit union membership information requested by the IG.

Beyond the available evidence that the GHCCU did in fact benefit public housing residents, the IG's conclusion that a housing agency must retroactively verify the benefit received by public housing residents in order for a supportive services program to be deemed an eligible expense. As discussed above in comment 1, operating funds may be spent on tenant services and programs under the Act. However, there is no statutory or other requirement that a housing agency demonstrate actual benefit of these services offered to the residents. The nature of tenant and supportive services is such that actual benefits can rarely be quantified in any meaningful way. If housing authorities were required to demonstrate actual benefit in order to prove eligibility of expenses the result would be to quantify how many drugs were prevented from being brought into projects as the result of drug prevention and enforcement spending, or how many residents were able to obtain employment solely because of outreach or training services offered by the housing agency. This is not the case, and the eligibility of drug enforcement or prevention expenditures or job training programs would not be questioned because such quantifiable results are unavailable. Similarly, the expenditures on a credit union that was to offer financial services to public housing residents should not be deemed ineligible merely because the number of residents served, or the actual benefit derived cannot be quantified ex post facto. As was described in the exit interview, the HHA expected the GHCCU to be a continuing institution in the community providing services and economic benefit to low-income and public housing residents of Harrisburg. HHA has further explained, and demonstrated through supporting materials, that GHCCU's purpose was to connect public housing residents with much needed banking services. The eligibility of expenditures cannot be determined by who is, or who is not a member of the credit union at any given point in time.

¹¹ See, e.g., the Fair Credit Reporting Act, 15 USC §1681 et seq. and the Gramm-Leach-Bliley Financial Services Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (November 12, 1999).

¹² While such specific information may have been available to the IG under its investigatory and audit authority from the National Credit Union Association, which took over and closed the GHCCU, the IG representatives said they made no such effort.

¹³ See, e.g., Yellowbook sections 6.21 and 7.56.

Comment 10

3. Contrary to the Draft Audit Report finding¹⁴, HHA's disbursements to the GHCCU were eligible expenses under Sections 3 and 13 of the Act, and not unallowable donations or contributions under OMB circular A-87 because HHA's arrangement with GHCCU was for the purpose of providing tenant services to its residents that were directly related to meeting tenants needs.

As defined in the Act "operations" include services which are directly related to meeting tenant needs¹⁵. It is well documented that lack of access to financial services is a pressing problem for low-income individuals, including those that reside in public housing. Without adequate access to credit or conventional financial institutions, low-income individuals are forced to turn to expensive alternative financial services which constitute a drain to otherwise sparse financial resources. Providing access to financial services including small loans, check cashing, and savings accounts have direct ties to increased financial awareness, savings, and ownership of homes, cars and other property.¹⁶ Credit unions, as a vehicle to providing access to these financial services, have been widely lauded as a tool to benefit low-income families, including in at least one speech by HUD Secretary Jackson.¹⁷ Given the fact that lack of access to financial services is a barrier for public housing families to achieving self-sufficiency and that a credit union can provide services which help overcome this barrier, HHA was reasonable in determining that disbursements of operating funds in support of a community credit union were eligible tenant services expenses under the Act's definition of operations. Further, forming a business arrangement with GHCCU to provide financial services to residents was a valid method of providing tenant services under the Act. The Act specifically authorizes PHAs to enter into partnerships or other business arrangements with other organizations for the provision of supportive or social services.¹⁸ The intent of the section of OMB Cir. A-87 cited by the IG is to preclude State and Local grantees of federal funds from using those funds for charitable type donations. Because the intention of all the parties was for HHA to provide operational support to GHCCU and in exchange for GHCCU to provide services to HHA and its residents, the expenditures were not unallowable contributions or donations as asserted by the OIG.

Comment 11

4. Because HHA chose to fund its support for the services provided by GHCCU from budget line item 1406-capital funds applied to operations-no specific disclosure was required under the PHA Annual Plan and no specific HUD approval was required for the expenditures so long as the funds were expended for "operations" as defined by the Act.

Under Section 5A of the Act and the corresponding regulations at 24 CFR Part 903, housing agencies are required to submit an annual plan to HUD for approval. The annual plan is intended to be the document which governs PHA operations throughout the fiscal year. The

¹⁴ Draft Audit Report, page 6.

¹⁵ See Section 3 of the Act.

¹⁶ See, e.g., Michael S. Barr, The Brookings Institution, Banking the Poor: Policies to Bring Low-Income Americans Into the Financial Mainstream (2004); and James H. Carr & Jenny Schuetz, Fannie Mae Foundation, Financial Services in Distressed Communities: Framing the Issue, Finding Solutions (2001).

¹⁷ See speech by Secretary Jackson to the NCUA on October 14, 2004. Available at <http://www.hud.gov/news/speeches/2004-10-14.cfm>.

¹⁸ See Section 13 of the Act.

Comment 11

regulations at Part 903 enumerate the subjects which must be disclosed in the annual plan, and which consequently require a specific HUD approval.¹⁹ However, housing agencies are not required to submit line item detail on every expenditure under operations, nor are they required to receive specific HUD approval of such line item detail. Rather, housing agencies may provide general statements of operations funding. Similarly, PHAs are not required to disclose or seek HUD approval of every partnership or business arrangement entered into under Section 13 of the Act. Had HHA decided to use a different budget line item, such as BLI 1408 Management Improvements, to fund the services provided by GHCCU, then HHA would have been required to show the line item detail for the 1408 funds, and that detail would have been approved, or not as the case may be, by HUD. But, because HHA chose to fund the services provided by GHCCU out of operations, there was no requirement, and in fact no mechanism within the Annual Plan template, to disclose the disbursements to or on behalf of GHCCU within their Annual Plan and to thereby seek specific HUD approval for the expenditures.²⁰

Rather, HHA provided the required detail in the Annual Plan template including disclosing that it would “continue to establish partnership agreements and, cooperative agreements with various governmental, federal, state, private, profit, and non-profit entities for the production of affordable housing and the provision of supportive services” and general descriptions of the supportive services it was providing to the residents, which included the disbursements to and on behalf of GHCCU for the services it provided.²¹ HUD reviewed these plans, often asked for additional information and ultimately approved HHA’s Annual Plans. At no time did HUD ask for more detail or clarification of the partnerships pursued by HHA or for more detail of the supportive service programs. While it may be established that HHA could have sought explicit HUD approval of these expenditures, the fact remains that it was not required to do so under the funding source utilized, and the OIG has failed to cite any statutory, regulatory or other requirement to the contrary. As discussed in comments 1 through 3 above, the expenditures to and on behalf of the credit union are properly construed as an eligible use of operating funds for the provision of tenant services. Moreover, the fact that other housing authorities can operate similar programs indicates that supporting the operations of a credit union is indeed an eligible use of funds under Section 9 of the Act, and subsequently under the ACC. Spending operating funds for the benefit of the residents was the only obligation HHA was under in regard to the expenditures in question. The fact that HHA did not seek explicit HUD approval when it was not required to do so does not by itself make the expenditures ineligible.

Comment 12

5. HHA disagrees with the finding that HHA’s Executive Director, Carl Payne, violated the ACC or that HHA or its Board of Commissioners permitted an impermissible conflict-of-interest situation related to the operation of GHCCU because the IG has misinterpreted Section 19 of the ACC as clarified by recent HUD guidance.

¹⁹ See 24 CFR 903.7.

²⁰ It is also arguable that even though other housing authorities have chosen to fund credit unions with capital funds under BLI 1408, HHA acted more properly in using BLI 1406, since capital funds are restricted to capital expenditures for economic development, whereas operating funds (or capital funds treated as operating funds in BLI 1406) have a broader application under Sections 3 and 9 of the Act.

²¹ See HHA’s approved annual plans 2001-2006.

Comment 12

A. The fact that Mr. Payne was an independent contractor to HHA and then was hired by HHA as an employee does not create a conflict-of-interest under the ACC.

The Draft Audit Report states that the ACC prohibits conflict-of-interest situations involving contracts with employees who formulate policy or who influence decisions with respect to the project(s).²² While Section 19 of the ACC²³ restricts self-dealing the facts and circumstances here do not trigger the application of Section 19 because Mr. Payne was initially an independent contractor to the HHA and not an employee, officer or director of the HHA, or in a position to formulate policy or influence decisions within the HHA. Beginning in January of 1998, Mr. Payne performed duties with regard to the GHCCU as an independent contractor to the HHA. Subsequently, in December of 2000, he was hired as a part time employee of HHA. As an independent contractor, Mr. Payne was not in a position to influence the decision making of the HHA and therefore from January 1998 to December 2000 there was clearly no conflict-of-interest. Section 19 of the ACC prohibits a housing agency from entering into a contract with an employee. It does not prohibit a housing agency from employing a person with whom it has a personal services contract.

The fact that Mr. Payne continued to perform certain duties as an independent contractor as well as a part-time acting deputy executive director for the HHA did not create a conflict-of-interest situation. Part of Mr. Payne's duties consisted of assisting the Executive Director with the operations of the HHA and part consisted of providing technical assistance for the creation of GHCCU. During the 7-month period from December 2000 until June 2001 when Mr. Payne received compensation for his dual roles as part-time acting deputy executive director and independent contractor of the HHA related to the GHCCU, he received pro-rata pay for both positions. He made the equivalent of \$87,000/year,²⁴ a reasonable pay level for an acting deputy executive director when examined against comparable salaries.²⁵ Therefore, Mr. Payne received no "personal financial benefit" as a result of these dual roles.²⁶ Further, HUD PIH Notice 2007-15 notes that "[w]here the PHA permits its staff to provide services to an Affiliate or Instrumentality the allocation of the salary expenses between these entities do not create a

²² See Draft Audit Report, page 6-7.

²³ "(1) In addition to any other applicable conflict-of-interest requirements, neither the HA nor any of its contractors or their subcontractors may enter into any contract, subcontract, or arrangement, in connection with a project under this ACC in which any of the following classes of people has an interest, direct or indirect, during his or her tenure or for one year thereafter... any present or former member or officer of the governing body of the HA, or any member of the officer's immediate family ... [or] any employee of the HA who formulates policy or who influences decisions with respect to the project(s), or any member of the employee's immediate family, or the employee's partner."

²⁴ $(\$17,500 + \$33,250) * (12/7) = \$87,000$.

²⁵ PHADA Executive Compensation Handbook (2005).

²⁶ HUD PIH Notice 2007-15 emphasizes that "as a practical matter, the Department is most concerned with conflicts of interest resulting in an actual or perceived financial benefit to agents of the PHA, Instrumentality or Affiliate involving public housing funds." [Emphasis in original]

Comment 13

conflict of interest for the individual employees”.²⁷ HHA could have elected to terminate the personal services contract and pay Mr. Payne the salary of \$87,000 to perform both functions without raising a question as to a conflict of interest. Just because HHA chose an alternative method to handle employment contracting should not, and does not, create a conflict of interest.

After Mr. Payne became the full-time deputy executive director and later the executive director of the Authority in June 2001, he was only compensated for his deputy executive director and executive director positions. He served in a continuing volunteer capacity with the GHCCU, clearly receiving no “personal financial benefit”. Therefore, at no time was there a conflict-of-interest situation with regard to Mr. Payne’s dual roles with the HHA and GHCCU.

B. There is additional statutory and regulatory authority and administrative guidance related to the creation and operation of related entities, such as the GHCCU, and such guidance further clarifies that there was no conflict-of-interest because Mr. Payne was both executive director of HHA and chief executive officer of GHCCU.

The Draft Audit Report concludes that because HHA’s Executive Director was also the chief executive officer of GHCCU during the period when funds were disbursed to GHCCU, the conflict-of-interest was continued even though the Executive Director was no longer being compensated by, or on behalf of, GHCCU.²⁸ This conclusion is incorrect and based on an antiquated interpretation of the conflict-of-interest provisions in Section 19 of the ACC. More recently enacted HUD statutes, regulations and guidance clarify that the appropriate application of the ACC conflict provision to the facts at issue here should result in a determination that there was no conflict-of-interest.

Section 13 of the Act and 24 CFR 943.142 provide statutory and regulatory authority for the creation of the GHCCU. These provisions make clear that a housing agency can create and operate affiliated entities and may enter into joint ventures, partnerships and other business arrangements. Further, both the statute and regulations state explicitly that such an affiliated entity “may be an organization controlled by the same persons who serve on the governing board of the PHA or who are employees of the PHA.”²⁹ Thus, not only is it clear that these identify of interest positions are contemplated by the Congress and HUD, but they are also encouraged and do not create impermissible conflicts-of-interest under the ACC. Moreover, contrary to the assertion in the Draft Audit Report that had HUD been aware of the situation it could have waived the conflict³⁰, neither the applicable statute nor regulations require HUD approval or waiver for such situations so in essence there was no waiver for HHA to seek.

²⁷ Even though PIH Notice 2007-15 applies directly in the development context, its clarification of general conflict of interest provisions as contained in the ACC should be persuasive in non-development contexts, since the ACC applies equally to development and non-development contexts.

²⁸ Draft Audit Report, page 7.

²⁹ Section 13 of the Act and 24 CFR Part 943 are directly applicable to entities such as the GHCCU that relate to management or tenant services.

³⁰ Draft Audit Report, page 7.

Most recently, in June of this year, HUD issued PIH Notice 2007-15, the stated purpose of which was to reaffirm requirements of the Act, the ACC and HUD regulations. The notice stated that with regard to conflicts-of-interest, HUD is focused on conflicts resulting in personal financial benefit. As discussed above, that was not the case here. At no time did Mr. Payne receive a personal financial benefit for his dual roles. If anything, there was a personal financial detriment as he continued to volunteer time with the GHCCU while fulfilling full-time employment responsibilities as executive director of the HHA. While PIH Notice 2007-15 is only applicable to housing agency development activities, with regard to its guidance regarding a reaffirmation of requirements pertaining to conflicts of interest, it is persuasive as to non-development activities as well.

Thus, because the Act allows for PHA employees to fulfill dual roles with respect to affiliated entities that provide supportive services, and because Carl Payne did not receive any personal financial benefit for his service in both roles, no conflict-of-interest was created in this situation.

Comment 14

- C. Since no conflict-of-interest existed, neither did any obligation to disclose the situation to HUD or to seek approval or waiver from HUD. Consequently, HHA's expenditures to support GHCCU can not be deemed improper by reason of a conflict-of-interest or failure to disclose or seek waiver of such a conflict.

The Draft Audit Report finds that HHA's Board of Commissioners and the Executive Director allowed the conflict of interest to exist without taking action to resolve it and that HHA did not inform HUD of the disbursements to GHCCU or request HUD's approval before making them.³¹ However, as discussed above, no conflict of interest existed in this situation. Consequently, HHA and its Board of Commissioners can not be found liable for failing to disclose the situation or seek HUD approval because there was nothing to disclose or for HUD to approve.

Moreover, there can be no finding that otherwise eligible expenditures became ineligible by reason of the conflict of interest. As detailed in comments 1-4, the HHA's disbursement of funds to the GHCCU was a permissible use of funds and HHA was under no obligation to seek HUD approval for the disbursements. Since no conflict-of-interest existed in this situation, the otherwise eligible use of funds cannot be deemed ineligible by reason of a conflict of interest or a failure to obtain a HUD approval or waiver of such conflict.

Comment 15

Response to Scope and Methodology:

The Draft Audit Report included a statement of the OIG's scope and methodology in conducting the audit of the HHA. However, we again raise our concerns that this audit did not conform with the Government Auditing Standards. This point is of utmost concern to us, since when followed, the result is that the audited entity has the information and points relied upon by the OIG which can reveal and clear up any misunderstandings and prevent harmful or misleading findings. During the exit interview with the IG and HUD representatives, our attorneys

³¹ Draft Audit Report, page 7.

attempted to obtain information on the experience of, and methodology used by, the IG auditor in initiating and conducting the audit. The IG representative objected to this line of questioning and refused to answer questions during the exit interview relating to the Government Auditing Standards. Given the uncooperativeness of the IG on the topic of standards, our attorneys have been left to conclude that because the Draft Audit Report reached conclusions without credible support and a lack of understanding of the "criteria" against which the conditions found are to be measured, that the audit was possibly conducted in a manner inconsistent with the Yellowbook.³² We continue to have serious concerns about the motivation of the IG in conducting the audit and the conclusions it reached in the Draft Audit Report based upon the conditions it found.

Comment 16

The initial draft of the Audit Report, received by the HHA on July 27, 2007, included a second finding which stated that HHA had used low-rent public housing funds to pay the expenses of its other HUD and non-HUD programs and did not balance the interfund accounts in a timely manner. In the most recent revision of the Draft Audit Report, received by HHA on August 16, 2007, the OIG has dropped this finding. While we recognize and appreciate the IG's effort to correct its mistake in the initial draft report, the fact that this finding was ever included in a draft report raises additional concerns as to a lack of diligence during the audit and whether Government Auditing Standards were followed during the course of the IG's investigation.

Comment 17

Since the original second finding concerns HHA's accounting practices, and implicates HHA's reputation as a trustworthy and responsible business entity, we have included below our response to the original Finding 2. Further, to the extent this finding still exists as a "minor finding" as communicated to the HHA in a communication separate from the Draft Audit Report, we object and disagree, and offer the below as our response to that separate and additional communication.

Response to Original Finding Number 2:

The Draft Audit Report concludes that contrary to its ACC, HHA used low-rent public housing funds to pay the expenses of its other HUD and non-HUD programs and did not settle the balance due to the low-rent public housing fund in a timely manner. This funding was based on a flawed analysis by the IG and should not be included in the Audit Report. We disagree with this finding and believe it improper for the following reasons.

Comment 18

The Authority utilizes a due-to/due-from method of distributing expenses among its programs. This methodology is very common among housing authorities and is generally accepted by HUD as long as reimbursements are made on a timely basis. HUD's inclusion of lines to report this activity on REACs year end reporting format, the Financial Data Schedule, is evidence that this accounting method is acceptable.

Although there were periods of time in recent years where reimbursements were not made on a monthly basis, we feel that it should be noted that in some cases the funds owed were spent on costs for the development and operation of the projects (such as amounts owed from the Capital Fund Program), and in other cases interest was accrued on amounts owed (such as

³² See, e.g., sections 6.41-6.45 of the Yellowbook.

Comment 19

amounts owed from the Housing Choice Voucher program). In nearly every case, amounts owed were between federal programs. Furthermore, there are inaccurate statements made in the audit finding.

A. Finding 2 of the Draft Audit Report contains erroneous statements that should be corrected in order to prevent misleading its readers.

The OIG audit finding states that “the authority reconciles its interfund accounts at year end” and that “it could not provide interim interfund account balances³³”. Neither of these statements is true. The interfunds are always in balance and are reconciled monthly. They have always been in balance and have always been reconciled monthly, they just have not been reimbursed monthly.

Furthermore, interim interfund balances are available and can be provided at any time for any period for which we have records. In fact, we provided a trial balance for each month of the 2007 fiscal year showing the interim interfund balances. During the exit conference the IG representatives acknowledged receiving interim balances and that the interfunds were in balance (that due-to’s match due-from’s). Thus the Draft Audit Report is misleading to readers.

B. A significant portion of amounts owed were from the Capital Fund Program, and were for payment of costs of development and operation of the low-rent projects

The ACC states that “the Authority may withdraw funds from the general fund only for the payment of costs of development and operation of the projects under the consolidated annual contributions contract with HUD...³⁴”. Of the balances shown in the audit finding, a significant portion was owed by the Capital Fund Program back to the low-rent program:

Date	Amount due to the low-rent public housing program:	Portion of the amount due to the low-rent public housing program that was owed from the Capital Fund Program:
12/31/04	\$719,239 ³⁵	\$39,449
12/31/05	\$488,052	\$433,597
12/31/06	\$44,961	\$30,090

The Capital Fund Program is another federal program to benefit the projects, and the Capital Fund expenses that were paid were all related to the projects. Therefore, consistent with the language in the ACC, these amounts were used for payment of costs of development and operation of the low-rent projects. In addition, the Capital Fund Program is an extension of, and was created for the benefit of, the low-rent public housing program. HUD obviously feels this

Comment 20

³³ Draft Audit Report, page 9

³⁴ Section 9(C) of the ACC.

³⁵ Note that in January 2005, the Housing Choice Program transferred \$500,000 to the Low Rent Public Housing program, which was the majority of what was owed at December 31, 2004.

way, as they will require Capital Fund activity to be reported on the financial statements of each project under Asset Management.

- C. Of the amounts identified by the Draft Audit Report, nearly all of the amounts owed were due from federal programs.

It should be further noted that, except for \$4,178 owed from business activities at the end of 2006, all of the amounts shown are due between federal programs, such as low-rent public housing, the Capital Fund Program, and the Housing Choice Voucher Program. Funds were not advanced or due from non-federal programs or non-profits.

- D. In order to compensate the low-rent Public Housing program for its due to balances interest was paid to low-rent on amounts due from the Voucher Program

It is also important to note that interest was calculated on balances owed from Section 8 to low-rent public housing during periods where large amounts were owed, and this interest was transferred from the Housing Choice Voucher Program to the low-rent public housing program. Therefore, the low-rent public housing program received interest income to compensate it for amounts owed by the Housing Choice Voucher program.

In addition, HHA, along with all other housing authorities, experienced delays in earlier years in receiving HUD funding for Housing Assistance Payments (HAP). In some cases, HAP payments from HUD were received several days after those amounts were due to be paid to landlords. The Authority had little choice but to leave this cash in the program as a reserve to allow for these delays in receiving HAP funding from HUD -- so that landlords could be paid timely. The program did not have enough of its own cash to advance the HAP payments due to reductions in administrative fees.

- E. The interfund balances have been reduced and reimbursements are now made on a timely basis. In addition, given that the amounts were largely due between federal programs, HHA is unsure how these funds could be put to better use, as recommended by the Draft Audit Report.

The due-to/due-from balances have been reduced each year. At the end of 2006, as shown in the Draft Audit Report, the balance was just \$44,961, which is immaterial in relation to the dollar volume of the Authority's programs. This \$44,961 had already been reimbursed through the normal course of business even before the OIG published its draft finding. In fact, the Authority has reimbursed all amounts shown as due in the audit finding, mostly reimbursed in prior years, and has now implemented a process for monthly reimbursement of all due-to/due-froms.

There is no guidance from HUD, OMB nor Congress indicating how frequently due-to/due-from's are to be reimbursed. Because there is no guidance on the frequency of reimbursements there is no criteria on which the IG can base a finding. During the exit conference, the IG representatives indicated that they feel it is "good business practice" to

Comment 21

Comment 22

reimburse these amounts monthly. We agree and have implemented a monthly reimbursement process, as indicated above.

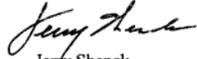
Comment 23

The OIG indicates that \$417,417 could be “put to better use”. We also question what is meant by that statement and what exactly is the “better use”. The funds would have been invested in the Low Rent Public Housing federal bank account instead of the Housing Choice Voucher program federal bank account. Given that the Low Rent Public Housing received interest from the Housing Choice Voucher program, we are unsure what better use would have been available.

Comment 24

In sum, for the reasons laid out above, we request that the IG modify the Draft Audit Report, and the corresponding “minor finding” to remove the incorrect or unsupported portions of the findings. We also request that the entirety of our comments, including exhibits, be published with the Final Audit Report, including any online publication.

Respectfully submitted,



Jerry Shenck
Acting Executive Director

Comment 8

Exhibit 1

In addition to support from the HHA, the GHCCU was also supported by the City of Harrisburg with funds received under an Enterprise Community Grant. As part of the reporting requirements under this grant, the City had to provide the number of clients served by GHCCU and the number of clients that resided in the Enterprise Community, which was defined in part by the Harrisburg zip codes of 17102, 17103, and 17104. Based on the number of public housing buildings and residents located in those zip codes, and the fact that at least 50.1% of the membership of GHCCU was required to be low-income (and therefore public housing eligible), it has been estimated that at least 20% of the Enterprise Community residents were also public housing residents. The number of credit union members and Enterprise Community Members for 2001-2003 is summarized in the table below.

We should also note that the IG had access to this information, and indicated during the exit interview that this information had been examined.

Membership Information

Year	Number of Clients Served	Number of Enterprise Community Residents	Estimated Number of Public Housing Residents
2001	516	272	56
2002	837	442	88
2003	1115	532	106



NATIONAL CREDIT UNION ADMINISTRATION

REGION II

June 14, 1999

Comment 8

Harold E. Dunbar, Esquire
Proposed Greater Harrisburg
Community Credit Union
Morrison Tower
c/o Harrisburg Housing Authority
12th Floor, 351 Chestnut Street
Harrisburg, PA 17105-3461

Dear Mr. Dunbar:

This responds to your May 10, 1999 letter and updated application information, including the field of membership (FOM), as approved by the Pennsylvania Department of Banking. We note approval of the FOM is contingent upon the area receiving a low-income designation.

We reviewed the median household income for each census tract comprising the FOM (201-217, inclusive), as reported by the Bureau of Census for 1990. We have determined, with the exception of 10, 11 and 17, all census tracts qualify as low-income areas based on NCUA's 1990 National Median Household Income Standard of \$24,044. A majority of the residents, or 79.8 percent, qualify for low-income designation. Therefore, I am pleased to inform you the low-income designation is approved for the proposed Greater Harrisburg Community Credit Union.

This designation gives a credit union the opportunity to accept non-member deposits, participate in the Community Development Revolving Loan Program, apply for technical assistance, and take advantage of other benefits provided to low-income designated credit unions.

We note your package does not contain an original Insurance Application (NCUA Form 9600). On receipt of a formal request for insurance, we will complete our review of your application.

If you have any questions, please contact Insurance Analyst Claudia Yale in this office.

Sincerely,

Tawana Y. James
Tawana Y. James
Regional Director

DO/CBY:cby
SSIC 8340

cc: John Woodward
Administrator for Credit Unions
Pennsylvania Department of Banking

OIG Evaluation of Auditee Comments

- Comment 1** The Authority stated that it is responding to the draft audit report which we provided it on August 16, 2007. However, in the latter part of its reply the Authority also included several pages of comments addressing a minor finding reported in a separate letter to the Authority. We reported this minor finding in a separate letter and did not request a written response due to the relatively small dollar amount involved and because the Authority had begun to take action to correct this matter during the audit. Nevertheless, at the Authority's request we have included all of its comments, including those related to the minor finding, in their entirety.
- Comment 2** The Authority incorrectly paraphrases the report by stating that we concluded expenditures made by the Authority to "carry out services to its residents" were ineligible. The audit report actually states that the Authority violated its consolidated annual contributions contract and federal regulations by improperly disbursing \$834,969 in low-rent public housing operating funds to open and support the credit union and allowing a related conflict-of-interest situation to exist. This is an important correction to note because the audit actually found insufficient evidence to show that any of the questioned expenditures were used to carry out any services to its residents. This is why we also cited Office of Management and Budget Circular A-87 which prohibits contributions, including cash, regardless of recipient. As stated in the report, the consolidated annual contributions contract prohibits conflict-of-interest situations involving contracts with employees also making the disbursements for the benefit of the credit union ineligible.
- Comment 3** The Authority's assertions that we incorrectly narrowed the scope of these definitions is incorrect. The Authority incorrectly asserts that we concluded expenditures were ineligible simply because they were not spent on the actual bricks and mortar or direct operation of the dwellings themselves. This is not stated in the report and this was not our conclusion. On the contrary, we agree that Section 2 of the consolidated annual contributions contract does in fact state that the term "project" includes all real and personal property, tangible and intangible, which is acquired or held by the Authority in connection with a project under the consolidated annual contributions contract. Further, Section 3(c)(2) of the Act states that the term "operation" also means the financing of tenant programs and services for families residing in low-income housing projects. However, the audit showed that Authority officials disbursed \$834,969 in low-rent public housing operating funds to operate and support a credit union which was not connected in any way to the operations of the projects under its consolidated annual contributions contract.
- Comment 4** The audit was performed in accordance with generally accepted government auditing standards and the conclusions in the report are supported by relevant and substantial evidence documented in the audit workpapers. As such, the audit team

collectively possessed adequate professional proficiency for the tasks required and was properly supervised. The audit team properly took into account the annual contributions contract, the Act, and the regulations, notices, and guidance implementing the Act.

- Comment 5** The full text of Section 4 of the consolidated annual contributions contract states that the Authority shall at all times develop and operate each project solely for the purpose of providing decent, safe, and sanitary housing for eligible families in a manner that promotes serviceability, economy, efficiency, and stability of the projects, and the economic and social well-being of the tenants. In this regard, the audit found insufficient evidence to show that the Authority used \$834,969 to develop and operate its projects for the purpose of providing decent, safe, and sanitary housing for eligible families or in a manner that promoted serviceability, economy, efficiency, and stability of its projects, and the economic and social well-being of its tenants.
- Comment 6** As discussed previously, the audit showed that Authority officials disbursed low-rent public housing operating funds to operate and support a credit union which was not connected to the projects under its consolidated annual contributions contract. Notwithstanding this fact, Section 3(c)(2) of the Act also states that to the maximum extent available and appropriate, existing public and private agencies in the community shall be used for the provision of such services.
- Comment 7** Section 13 of the Act allows a public housing agency, in accordance with the public agency plan, to form and operate wholly-owned or controlled subsidiaries and other affiliates. However, Section 13 does not authorize the use of public housing funds for such purposes. The Act also specifically states that the Inspector General of the Department of Housing and Urban Development may conduct an audit of any of these activities at any time. Accordingly, our audit showed the Authority's public agency plan which was approved by HUD did not disclose that it intended to use HUD funds for the activities of the credit union. Further the audit also found insufficient evidence to show that any of the questioned expenditures were used to carry out services to its public housing residents.
- Comment 8** The Authority provided no solid or credible evidence that the credit union benefited public housing residents. The Authority estimated credit union membership solely on census data which was not sufficient to justify the disbursements. Further, as stated previously, the Authority's public agency plan which was approved by HUD did not disclose that it intended to use HUD funds for the activities of the credit union. We did not ignore the circumstantial evidence the Authority provided. On the contrary, we evaluated the circumstantial evidence the Authority provided and concluded it was not sufficient to demonstrate the eligibility of expenditures under the terms of the Authority's consolidated annual contributions contract.

In the Authority's attachment to its reply (Exhibit 1) it estimated that the credit union serviced only 106 public housing residents. Even if we were to accept the Authority's circumstantial evidence based solely on census data, this would mean it supported about 6 percent⁴ of the Authority's 1,730 public housing units at a cost of almost \$8,000 in public housing funds⁵ for each resident who purportedly belonged to the credit union. The Authority's estimate would also indicate that less than 10 percent⁶ of the credit union's clients resided in public housing even though all of the credit union members were supported with significant amounts of public housing funds. The credit union was not located near the majority of its public housing residents and membership in the credit union was open to anyone who lived, worked, worshipped, or volunteered within the city. Membership was also open to businesses, associations, and other organizations that maintained facilities in the city. Lastly, our review of minutes from the Authority's board of commissioner's meetings showed that at least two of the Authority's board members expressed concerns regarding the propriety of using public housing funds to operate and support this credit union.

Comment 9 We did not conclude, as the Authority asserts, that a housing agency must retroactively verify the benefit received by public housing residents. Rather, we requested the Authority provide documentation supporting specific disbursements of public housing funds it made and our review of that documentation showed the purpose of the expenditure was not eligible under the terms of the consolidated annual contributions contract. While the audit found the Authority's usage of low-rent public housing funds was not in accordance with its annual contributions contract it is important to note that HUD does in fact require actual benefits for supportive services. HUD requires performance measures and goals for supportive services. As an example, HUD's Supportive Housing Program is designed to develop supportive housing and services that will allow homeless persons to live as independently as possible. Specific performance measures are established based on the needs and characteristics of the homeless population to be served. Grant recipients are required to monitor their clients' progress in meeting their performance measures on an ongoing basis. In addition to recordkeeping and evaluation that grantees may conduct for their own purposes, HUD in fact requires recordkeeping and annual progress reports for supportive services.

Comment 10 The audit showed that Authority officials disbursed \$834,969 in low-rent public housing operating funds to operate and support a credit union which was not connected in any way to the operations of the projects under its consolidated annual contributions contract. Since these expenses were ineligible we also cited Office of Management and Budget Circular A-87 which prohibits contributions,

⁴ Highest estimated membership of 106 public housing members/1,730 public housing units = 6.1 percent.

⁵ \$834,969 in public housing funds expended on the credit union/ highest estimated membership of 106 public housing members = \$7,877 per member.

⁶ Highest estimated membership of 106 public housing members/ highest total credit union membership of 1,115 members = 9.5 percent of public housing residents.

including cash, regardless of recipient. Section 13 of the Act does allow a public housing agency, in accordance with the public agency plan, to form and operate wholly-owned or controlled subsidiaries and other affiliates. However, it does not authorize the use of public housing funds for such purposes. Section 3 of the Act states that the term “operation” also means the financing of tenant programs and services for families residing in low-income housing projects. However, as stated previously, the audit found that no tenant programs or services could be reasonably attributed to the questioned costs.

Comment 11 The Authority’s position that it funded the credit union under account number 1406 (Operations) in its annual plan, and therefore, it did not need to disclose it specifically in its annual plan, is misleading because under the 1406 account the Authority was required to comply with the provisions of its annual contributions contract. Since the Authority did not comply with its annual contributions contract the expenditures were ineligible. If the Authority had reported the expenditures under account number 1408 (Management Improvements), it would have been required to specifically list the credit union and HUD would have questioned the eligibility of these proposed expenditures. HUD capital fund regulations at 24 CFR [*Code of Federal Regulations*] 968.112(g) do not include financing a credit union as an eligible activity. Therefore, regardless of the source of funds used, either operating funds or capital funds, the Authority did not have the right to finance the credit union. Additionally, regulations at 24 CFR [*Code of Federal Regulations*] 903.7 require the Authority to provide a statement in its annual plan describing any programs it coordinated, promoted or provided for the enhancement of the economic and social self-sufficiency of assisted families, including programs provided or offered as a result of its partnership with other entities. The Authority included no such statement or disclosure to HUD in its annual plan regarding the credit union.

Comment 12 As stated in the report, the Authority’s executive director violated the consolidated annual contributions contract’s conflict-of-interest restrictions by improperly receiving consulting fees for his work with the credit union (paid from public housing funds) and a salary as an employee of the Authority. From November 2000 to May 2001, the executive director, besides being an employee of the Authority, was also receiving payments pursuant to a consulting contract which constituted a conflict-of-interest situation. The initial underlying contract under which the executive director’s services as a consultant were procured states as part of its justification that the Authority does not have anyone available among its professional staff with the requisite expertise necessary to appropriately pursue its interests in the creation of a banking and banking-related service facility. This justification for the consulting contract was no longer valid after the consultant was hired by the Authority.

Comment 13 The report actually states that during the executive director’s concurrent tenures, the Authority *improperly* disbursed low-rent public housing operating funds to benefit the credit union. We believe this improper use of HUD funds continued

the conflict-of-interest situation. While the Act does allow individuals to hold positions in both organizations, we believe this arrangement should have been disclosed to HUD and a waiver requested in light of the fact that during the executive director's concurrent tenures as executive director and president and chief executive officer of the credit union, the Authority continued to make significant questionable disbursements for the benefit of the credit union.

Comment 14 As stated in the report, the consolidated annual contributions contract prohibits conflict-of-interest situations involving contracts with employees also making the disbursements for the benefit of the credit union ineligible.

Comment 15 The Authority's concerns are unwarranted as the audit was performed in accordance with generally accepted government auditing standards and the conclusions in the report are supported by relevant and substantial evidence documented in the audit workpapers. As such, the audit team collectively possessed adequate professional proficiency for the tasks required and was properly supervised. Additionally, at the exit conference we answered all of the questions posed by the Authority's attorneys regarding our audit process and our audit scope and methodology. We also answered several detailed questions the attorneys posed regarding the qualifications and experience of the audit staff. Lastly, we informed the attorneys that we would provide any additional information they may require. We did not receive any further inquiries from the attorneys in this regard.

Comment 16 The issue was addressed as a minor finding due to the relatively small dollar amount involved and the Authority's agreement to take action to address the issue. The purpose of the draft report is to encourage feedback and provide latitude to adjust wording, tone or findings, and if necessary, issue a revised draft audit report. This change was noted on page 10 of the revised report provided to the Authority on August 16, 2007.

Comment 17 Although the Authority states that it objects to and disagrees with the minor finding, we noted that the Authority also stated on pages 12 and 13 of its response that it agreed that monthly reimbursement of all due-to/due-from accounts was a good business practice and that it has implemented a monthly process for doing so. The intent of the finding and recommendations was for the Authority to strengthen internal controls for the use HUD funds. By taking action to settle the interfund accounts monthly, the Authority will satisfy the intent of the minor finding and recommendations.

Comment 18 The Authority acknowledges that it was not making interfund reimbursements on a monthly basis and it also states that HUD generally accepts a due-to/due-from method of distributing expenses as long as reimbursements are made on a timely basis. The audit showed that controls needed to be strengthened to ensure that interfund accounts were settled monthly and the Authority agreed that monthly

reimbursement of all due-to/due-from accounts was a good business practice and it has implemented a monthly process for doing so.

Comment 19 The Authority reconciled its interfund accounts during the year and at year end, although not always monthly. For example, during the audit, the Authority's fee accountant informed us interfund balances were not reconciled for January and February 2007 until March 2007 due to the year-end close-out process. Also, we requested current interfund balances and activity detail but it could not be provided. The fee accountant informed us that there wasn't a way to provide a current interfund balance. The balances could only be provided for months for which the general ledger had been posted. As the Authority stated in its response, the interfund reimbursements were not being made monthly which was our main concern with this issue. Our intention was for the Authority to strengthen its internal controls to ensure that it reimbursed the interfund accounts monthly. As noted in our comments above, after the exit conference we removed this finding from the draft audit report and addressed the issue as a minor finding.

Comment 20 The Authority's low-rent public housing consolidated annual contributions contract states that the Authority may withdraw funds from the general fund only for the payment of the costs of development and operation of the projects under the contract with HUD, the purchase of investment securities as approved by HUD, and such purposes as may be specifically approved by HUD. It further states that program funds are not fungible and that withdrawals shall not be made for a specific program in excess of the funds available for the program. The capital fund program is another federal program, but the purpose of the funds is not the same as public housing operating funds. Public housing operating funds are primarily for operating and management expenses of public housing projects. Capital funds are primarily for developing, financing, and modernizing public housing projects.

Comment 21 Although the Authority has implemented a process, it needs to develop and implement controls to ensure that interfund accounts are settled monthly. The following events illustrate the need for the controls. The Authority's fee accountant informed us that in May 2007 it notified an Authority manager that she needed to make a reimbursement to settle the interfund balance for the Section 8 program, but the reimbursement did not occur. The manager said she never received the e-mail message to initiate the reimbursement. As a result, a reimbursement for the months of May and June 2007 occurred in June 2007. As noted in our comments above, we considered the information the Authority provided at the exit conference and decided to address this issue as a minor finding, as appropriate, and issued a revised draft audit report.

Comment 22 The Authority's consolidated annual contributions contract states that the Authority may withdraw funds from the general fund only for the payment of the costs of development and operation of the projects under the contract with HUD, the purchase of investment securities as approved by HUD, and such purposes as

may be specifically approved by HUD. It further states that program funds are not fungible and that withdrawals shall not be made for a specific program in excess of the funds available for the program. Further, in its response, the Authority stated that HUD expects interfund reimbursements to be made on a timely basis and it also agreed that monthly reimbursement of all due-to/due-from accounts was a good business practice. Moreover, the Authority stated that it has implemented a monthly reimbursement process to address this issue.

Comment 23 The term “funds to be put to better use” relates to amounts that would be used properly, effectively, or efficiently by implementing our recommended corrective action. In this instance, we estimated the amount of funds to be put to better use by taking the average amount of funds owed to the low-rent public housing program over a three-year period. However, as noted in our comments above, we considered the information the Authority provided at the exit conference and decided to address this issue as a minor finding, as appropriate, and issued a revised draft audit report.

Comment 24 As noted in our comments above, we considered the information the Authority provided at the exit conference and issued a revised draft audit report. Additionally, at the Authority’s request we have included all of its comments in this report, including those related to the minor finding, in their entirety.