



Issue Date January 7, 2008

Audit Report Number 2008-FW-1005

TO: Justin R. Ormsby
Director, Office of Public Housing, 6APH

FROM: *Gerald R. Kirkland*

Gerald R. Kirkland
Regional Inspector General for Audit, Fort Worth Region, 6AGA

SUBJECT: The Housing Authority of the City of McKinney, Texas, Inappropriately
Advanced Funds and Transferred Real Estate to Its Not-for-Profit Affiliate

HIGHLIGHTS

What We Audited and Why

Based on a hotline complaint, we audited the Housing Authority of the City of McKinney (Authority). Our objective was to determine whether the Authority's transactions with its affiliated nonprofit, the McKinney Housing Opportunity Corporation (Corporation), complied with U.S. Department of Housing and Urban Development (HUD) requirements.

What We Found

In violation of its annual contributions contract, the Authority inappropriately provided \$915,487 in funds and real estate to its not-for-profit affiliate. Further, the Authority did not follow requirements when it made \$79,059 in housing assistance payments to the Corporation between January 1, 2005, and June 15, 2007. Specifically, the Authority did not obtain independent determinations of

fair market rents or compliance with housing quality standards for properties owned by the Corporation.

What We Recommend

We recommend that HUD require the Authority to (1) repay \$915,487 to its low-income accounts, (2) support \$79,059 in housing assistance payments to the Corporation by obtaining independent determinations of fair market rents and compliance with housing quality standards, and (3) implement policies and procedures to ensure that it complies with HUD requirements.

For each recommendation without 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 draft report to the Authority on December 7, 2007, and held an exit conference on December 18, 2007. We requested a written response by December 28, 2007. The Authority agreed with our recommendations and provided a written response on December 28, 2007. We have included the Authority's response and our evaluation of it as Appendix B.

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BACKGROUND AND OBJECTIVES

The City of McKinney established the Housing Authority of the City of McKinney (Authority) to provide housing to low-income persons. A five-member board of commissioners (board), appointed by the mayor of McKinney, governs the Authority. The board appoints an executive officer to administer the operations of the Authority. The Authority's main office is located at 1200 North Tennessee Street, McKinney, Texas.

The Authority receives U.S. Department of Housing and Urban Development (HUD) funding for 201 low-rent units and 345 housing choice vouchers. The Authority was required to use its low-rent funds in accordance with its annual contributions contract. Under its Section 8 Housing Choice Voucher program, the Authority receives HUD funds to provide housing assistance so that eligible families can afford decent, safe, and sanitary housing.

The Authority created the McKinney Housing Opportunity Corporation (Corporation) on July 18, 1996, to further affordable housing and provide charitable services. The Corporation is an affiliated nonprofit entity.

The Authority received adverse opinions on its Office of Management and Budget (OMB) Circular A-133 audits for fiscal years 2004, 2005, and 2006. The adverse opinions cited the exclusion of the Corporation in the Authority's financial statements and internal control weaknesses. We did not observe any action taken by the Authority to correct the deficiencies. In September 2007, HUD entered into a memorandum of agreement with the Authority to correct deficiencies.

Our objective was to determine whether the Authority's transactions with the Corporation complied with HUD requirements.

RESULTS OF AUDIT

Finding 1: The Authority Inappropriately Provided \$915,487 in Funds and Real Estate to Its Not-for-Profit Affiliate

The Authority inappropriately used more than \$915,000 in low-rent funds without HUD approval and inappropriately advanced and transferred more than \$71,000 in real property to the Corporation. The Authority was aware of the transfers based on its adverse audit opinions.¹ In addition, the Authority did not allocate costs, including salary costs, between its HUD-funded housing and the Corporation. This condition occurred because the Authority did not follow requirements. As a result, the funds were not available to operate its public housing programs. The Authority should reimburse its low-rent programs \$915,487.

The Authority Transferred \$844,168 to the Corporation

According to the Corporation's financial statements and records, the Authority had advanced \$729,496 in low-rent funds to the Corporation as of June 30, 2006.² Further, the Authority paid \$114,672 to the Corporation on April 25, 2006.³

The Authority's annual contributions contract allows it to use general fund cash only for (1) the payment of the costs of development and operation of projects under contract with HUD, (2) the purchase of investment securities approved by HUD, and (3) such other purposes as may be specifically approved by HUD. The Authority did not obtain HUD approval for the transactions and did not provide evidence that the Corporation had reimbursed it for the advances. The Authority should repay \$844,168 to its low-rent programs.

The Authority Transferred Real Property to the Corporation

The Authority purchased property with low-rent funds or seized properties through eminent domain and transferred the properties to the Corporation. According to the Collin County, Texas, tax assessor's office, the fair market value

¹ Independent audits for fiscal years 2004, 2005, and 2006.

² The latest audited financial statements.

³ The Corporation transferred a certificate of deposit to the Authority's housing choice voucher account to pay a contractor that worked on the Authority's maintenance building. The Authority reimbursed the Corporation from its low-rent account.

of the properties at the time of transfer was \$71,319. The Authority's annual contributions contract required it to obtain HUD approval to transfer the properties.

The Authority Did Not Allocate Costs

The Authority did not allocate direct and indirect costs to the Corporation as required by OMB Circular A-87. OMB Circular A-87 establishes principles for determining allowable costs. In general, the Authority was required to allocate indirect cost between its programs and affiliates. Specifically, while the Corporation used Authority staff and office space, the Authority did not require the Corporation to reimburse it for its share of these costs. Further, the Authority did not collect information to calculate the proper allocation. The Authority should ensure that future costs are properly allocated.

Recommendations

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

- 1A. Reimburse its low-rent housing programs \$915,487.
- 1B. Implement internal control policies to ensure that program funds are used only for eligible program activities.

Finding 2: The Authority Did Not Comply with Requirements When It Made Housing Assistance Payments on the Corporation's Rental Units

The Authority did not comply with requirements when it made \$79,059 in housing assistance payments to the Corporation⁴ between January 1, 2005, and June 15, 2007. HUD regulations allowed the Authority, with HUD approval, to make the payments if an independent entity determined the fair market rent and inspected the units for compliance with housing quality standards. The Authority was unaware of the requirements. The Authority should support the housing assistance payments to the Corporation and comply with HUD requirements.

Housing Assistance Payments Were Not in Accordance with Requirements

Violating requirements, the Authority made \$79,059 in housing assistance payments to the Corporation between January 1, 2005, and June 15, 2007. HUD prohibited the Authority from using its personnel to determine the reasonableness of the rents charged by the Corporation and to inspect the Corporation's units for compliance with housing quality standards.⁵ The requirements prevent a potential conflict of interest between the Authority's administration duties and its interest as a landlord.

The Authority should have hired an independent entity⁶ to make the determination of fair market rent and to inspect the units. The Authority was not aware of the requirements. The Authority should obtain support for the \$79,059 and independently confirm that the units meet housing quality standards. Further, the Authority should implement procedures to ensure future compliance with requirements when its units are used in its Housing Choice Voucher program.

Recommendations

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

⁴ The property that the Corporation built using the inappropriately transferred funds would be considered Authority-owned property according to 24 CFR [*Code of Federal Regulations*] 983 due to the Corporation's being an affiliate.

⁵ 24 CFR 983.59.

⁶ HUD must approve of the entity.

- 2A. Support or repay the \$79,059 to its programs for housing assistance payments made to the Corporation.
- 2B. Implement internal control policies to ensure future compliance with HUD requirements when using Corporation-owned units in its Housing Choice Voucher program.

SCOPE AND METHODOLOGY

Our objective was to determine whether the Authority's transactions with the Corporation complied with HUD requirements. To accomplish our objective, we

- Reviewed background information on the Authority and the Corporation, applicable regulations, and legal documents;
- Reviewed and analyzed reports, databases, and documents to determine existing conditions at the Authority, including fiscal years 2004, 2005, and 2006 independent audit reports and HUD monitoring reports;
- Analyzed available data in the Authority's accounting and operations systems;
- Reviewed and analyzed the Authority's relationships with its nonprofit Corporation to determine whether the Authority inappropriately supported the nonprofit operations with federal funds; and
- Interviewed Authority staff, the Authority's independent public accountant, and HUD personnel.

We conducted our audit from April through October 2007 at the Authority and our office in Fort Worth, Texas. Our audit period was from January 1, 2005, through March 31, 2007. We expanded the scope as necessary to accomplish our objective. We performed our audit in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

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

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

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

Relevant Internal Controls

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

- Compliance with laws and regulations—policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and 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 Weakness

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

- The Authority did not have effective policies, procedures, or controls to reasonably ensure that it complied with laws and regulations.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible <u>1/</u>	Unsupported <u>2/</u>
1A	\$915,487	
2A		\$79,059

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local policies or regulations.

2/ 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.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

**HOUSING AUTHORITY
OF THE CITY OF MCKINNEY**
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972-542-5641 • Metro 972-562-9996 • FAX 972-562-8387

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December 28, 2007

Mr. Gerald R. Kirkland
Regional Inspector General for Audit, Fort Worth Region, 6AGA
819 Taylor Street, Suite 13A09
Fort Worth, TX 76102

Dear Mr. Kirkland:

I have had an opportunity to review the audit report from your office regarding the subject matter: The Housing Authority of the City of McKinney, Texas, Inappropriately Advanced Funds and Transferred Real Estate to Its Not-for-Profit Affiliate.

Please note that on November 27, 2007, the McKinney Housing Authority and the McKinney Housing Opportunities Corporation completely separated under resolution effective December 31, 2007.

As a result of the findings, please accept the following responses per the audit recommendations:

OIG Recommendation 1A. Reimburse its low-rent housing programs \$915,487.

MHA Response to Recommendation 1A:

The McKinney Housing Authority recommends that appropriate assets of the not-for-profit affiliate be transferred to the McKinney Housing Authority.

An independent appraisal of the not-for-profit properties was commissioned and completed on December 21, 2007.

OIG Recommendation 1B. Implement internal control policies to ensure that program funds are used only for eligible program activities.

MHA Response to Recommendation 1B:

On December 18, 2007, the Board of Commissioners of the McKinney Housing Authority established a committee of community partners, inclusive of a legal representative, to participate in the review and establishment of internal control policies.

EQUAL HOUSING
OPPORTUNITY

Comment 1

Comment 2

OIG Recommendation 2A: Support or repay the \$79,059 to its programs for housing assistance payments made to the Corporation.

MHA Response to Recommendation 2A:

The McKinney Housing Authority will complete independent inspections of the properties owned by the not-for-profit affiliate. It is the presumption of the McKinney Housing Authority that the inspection findings will support the housing assistance payments that were made.

OIG Recommendation 2B: Implement internal control policies to ensure future compliance with HUD requirements when using Corporation-owned units in its Housing Choice Voucher program.

MHA Response to Recommendation 2B:

On December 18, 2007, the Board of Commissioners of the McKinney Housing Authority established a committee of community partners, inclusive of a legal representative, to participate in the review and establishment of internal control policies.

The aforementioned is aimed towards the elimination of findings during the OIG site visits and ultimate audit report.

The McKinney Housing Authority desires to be in full compliance with the statutes and regulations of the U. S. Department of Housing and Urban Development.

Should you have questions or require additional information, please contact me or Beth Bentley at 972-542-5641.

Respectfully submitted,


Leonard McGowan
Executive Director

EQUAL HOUSING
OPPORTUNITY

OIG Evaluation of Auditee Comments

Comment 1

We commend the Authority for trying to address the finding. The improvements in internal controls should prevent future deficiencies. However, HUD will need to determine the appropriateness of transferring assets to the Authority to resolve the finding.

Comment 2

We agree with the Authority's willingness to correct the deficiencies.