Issue Date February 11, 2008	
Audit Report Number 2008-KC-1001	

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

Henry S. Czauski, Acting Director, Departmental Enforcement Center, CV

//signed//

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

SUBJECT: The Douglas County Housing Authority of Omaha, Nebraska, Improperly Encumbered and Spent Its Public Housing Funds

HIGHLIGHTS

What We Audited and Why

We reviewed the development activities of the Douglas County Housing Authority (Authority), Omaha, Nebraska, to determine whether the Authority encumbered or spent U.S. Department of Housing and Urban Development (HUD) assets for nonfederal development activities without HUD approval. We conducted the audit because HUD had concerns that the Authority had improperly used public housing funds to assist three nonfederal developments.

What We Found

The Authority inappropriately encumbered nearly $1.67 million in federal assets when it entered into loan documents containing setoff provisions against the Authority's HUD-related bank accounts. The Authority also inappropriately entered into partnership agreements that made it responsible for all operating deficits of two nonfederal developments. Further, the Authority inappropriately spent nearly $860,000 in public housing funds on three nonfederal developments. Finally, the Authority arbitrarily allocated nearly $730,000 of its administrative and maintenance supervisor salaries to its federal programs without adequate support.

What We Recommend

We recommend that HUD require the Authority to implement adequate procedures to ensure that it does not encumber or spend HUD assets on nonfederal programs and activities without HUD approval. We recommend that HUD ensure that the release obtained by the Authority formally excludes the Authority's HUD-related bank accounts from the setoff provisions in development loan documents. Additionally, HUD should ensure that the Authority obtains formal releases from the guarantees in partnership agreements. Further, we recommend that HUD require the Authority to repay its public housing program from nonfederal sources for any federal funds used inappropriately.

We also recommend that HUD require the Authority to support salary costs allocated to HUD programs or reimburse its HUD programs from nonfederal sources for unsupported allocations. HUD should also require the Authority to implement an acceptable method for allocating future salary and benefits costs. Finally, we recommend that HUD take appropriate administrative actions against the Authority, its chief executive officer, and members of its board of commissioners for violating HUD rules.

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 draft report to the Authority on December 27, 2007, and requested a response by January 21, 2008. It provided written comments on January 16, 2008. The Authority generally agreed that it encumbered and spent public housing assets for nonfederal developments, but disagreed that its salary and benefit cost allocation plan was unsupported.

The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

TABLE OF CONTENTS

BACKGROUND AND OBJECTIVES

The Douglas County Housing Authority (Authority) of Omaha, Nebraska, was established in December 1975. The mission of the Authority is to promote personal growth and community responsibility by cultivating self-reliance, and by providing quality, affordable, and safe housing for low-to-moderate income families, the elderly, and the disabled. The Authority is governed by a seven-member board of commissioners, including a resident commissioner, who are appointed by the Douglas County Board of Commissioners.

The Authority owns and operates 78 public housing units that provide housing for the disabled, the elderly, and families whose income meets U.S. Department of Housing and Urban Development (HUD) guidelines. The Authority also administers a Section 8 Housing Choice Voucher program that enables 968 low-income families to rent from a private landlord with rental assistance administered by the Authority. The Authority received $82,125 for its public housing program and $5.2 million for its Section 8 program in 2007.

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

Due to concerns about housing authority development activities nationwide, on June 20, 2007, HUD's Office of Public and Indian Housing issued Notice: PIH-2007-15(HA), "Applicability of Public Housing Development Requirements to Transactions between Public Housing Agencies and their Related Affiliates and Instrumentalities." This notice reaffirmed the requirements of public and Indian housing programs, including the annual contributions contract, that apply to public housing development activities.

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

The Authority’s nonprofit affiliate, Community Housing and Service Corporation, became part owner and general partner of the Platte Valley Apartments development in 1997. This is a 48-unit nonfederal property in Valley, Nebraska, which was ready for occupancy when purchased. Since 2001, the Authority has contracted with a private management firm to manage the property.

Between April 2001 and May 2002, the Authority developed and constructed Woodgate Townhomes, a 20-unit nonfederal townhome subdivision for low-income families in Omaha, Nebraska. The Authority is the general partner and manages the daily operations.

Between October 2003 and October 2004, the Authority developed and constructed Orchard Gardens, a 56-unit nonfederal assisted living property in Valley, Nebraska. The Authority retained direct ownership of Orchard Gardens. The facility’s director of senior housing manages the daily operations. The Authority’s chief executive officer oversees the facility’s director.

In June 2006, HUD conducted a limited financial review of the Authority, based on declining financial scores under HUD’s Public Housing Assessment System. HUD became concerned that the Authority was using public housing funds for purposes other than routine operations of the public housing program. HUD notified the Authority of its concerns and asked us to conduct a more in-depth review of the Authority’s development activities and use of public housing funds.

Our audit objective was to determine whether the Authority improperly encumbered or spent HUD assets for nonfederal development activities without HUD approval.

RESULTS OF AUDIT

Finding 1: The Authority Inappropriately Encumbered Its Federal Funds for Development Activities

The Authority inappropriately encumbered its HUD-related assets when it developed and operated two nonfederal entities. This condition occurred because the Authority's board of commissioners did not have adequate controls in place to keep it from encumbering the Authority's federal assets when pursuing nonfederal housing ventures. As a result, it inappropriately encumbered nearly $1.67 million in federal funds held in Authority bank accounts and placed these funds at risk of being seized.

Authority Encumbered Its Public Housing Funds

The Authority inappropriately encumbered its HUD-related assets when it developed and operated two nonfederal entities. The Authority entered into

- Loan agreements containing setoff provisions allowing the bank to seize the Authority's assets in the event of default on the loans and
- Partnership agreements that guaranteed recourse against the Authority's assets to ensure payment of all operating deficits of the developments.

The public housing annual contributions contract between HUD and the Authority states that the Authority shall not in any way encumber any public housing project without prior approval from HUD. The Section 8 annual contributions contract between HUD and the Authority states that the Authority must use program receipts only to pay program expenditures.

The Authority obtained bank loans, totaling more than $1.75 million, for the Platte Valley Apartments and Woodgate Townhomes developments at the same bank in which it had federal money on deposit. The bank loan documents for each development contained a setoff provision that allowed the bank to seize all funds in the Authority's bank accounts in the event of default on either of the loans. As of October 15, 2007, the Authority's HUD-funded bank accounts held nearly $1.67 million.

Three members of the board of commissioners and the chief executive officer told us that they were not aware that the loan documents contained setoff provisions.

In addition, the Authority entered into partnership agreements for the Platte Valley Apartments and Woodgate Townhomes developments, which guaranteed that the Authority would be responsible for all operating deficits of the developments. The agreements also stated that recourse might be had against the Authority's properties and assets if the Authority did not pay the obligations. The agreements further stipulated that the Authority's properties and assets were subject to fulfilling any judgments rendered by the courts that related to the developments. Finally, the Authority waived protections afforded to housing authorities by Nebraska state law.

The chief executive officer told us that she relied on her legal advisors who said that it was acceptable to sign the partnership agreements.

Authority Lacked Controls to Avoid Encumbrances

The Authority's board of commissioners did not have adequate controls in place to keep it from encumbering the Authority's federal assets when pursuing nonfederal housing ventures. In addition, the Authority's chief executive officer did not perform the necessary due diligence when signing loan documents and partnership agreements.

Authority Placed Federal Assets at Risk

The Authority placed $1.67 million in federal assets at risk of being seized if it defaulted on either of two nonfederal development loans and the bank exercised the setoff provision.

The Authority also risked its future assets by entering into partnership agreements that made it responsible for all operating deficits and potential judgments of the nonfederal developments. Without removal of the guarantees, the Authority's future assets remain at risk. We valued this risk at nearly $230,000, which is the estimate of funding that HUD will provide to the Authority in fiscal year 2008.

Recommendations

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

1A. Require the Authority to implement adequate procedures to ensure that it does not encumber HUD assets without HUD approval. These procedures should include following PIH Notice 2007-15, which addresses encumbering HUD-related assets.

1B. Ensure that the lender has formally released the Authority's HUD-related bank accounts from the right of setoff provisions in the loan documents for Platte Valley Apartments and Woodgate Townhomes. As of October 15, 2007, the Authority's HUD-related bank accounts placed at risk totaled $1,666,592.

1C. Require the Authority to pursue removing the guaranty from the partnership agreement for Platte Valley Apartments, which will ensure that the $228,339 it receives from HUD next year will be put to better use.

1D. Ensure that the Authority's partner for Woodgate Townhomes has formally released its recourse against the Authority's assets related to the partnership agreement guaranty. As stated in recommendation 1C, this will ensure that the Authority's HUD funding in the next year will be put to better use.

1E. Take appropriate administrative actions against the Authority for violating the annual contributions contract with HUD and refer to findings 2 and 3 for additional support for administrative actions.

We recommend that the Director of the Departmental Enforcement Center

1F. Impose appropriate administrative sanctions against the Authority's chief executive officer and members of its board of commissioners who violated HUD rules and refer to findings 2 and 3 for additional support for administrative sanctions.

Finding 2: The Authority Inappropriately Spent Its Public Housing Funds for Development Activities

The Authority inappropriately used public housing assets for nonfederal development activities. This condition occurred because the Authority's board of commissioners did not have adequate controls in place to ensure that financial transactions were in accordance with its annual contributions contract with HUD. As a result, nearly $860,000 of the Authority's public housing funds was not available for its intended purpose, which was to provide decent and safe housing for low-income families, the elderly, and persons with disabilities.

Authority Used Public Housing Funds to Pay Nonfederal Development Expenses

The Authority inappropriately spent nearly $860,000 in public housing assets for nonfederal development activities. According to the Authority's contract with HUD, the Authority may withdraw money from the public housing fund only for the payment of the costs and operation of the projects covered under the annual contributions contract. The nonfederal developments were not approved projects under the annual contributions contract.

The Authority spent nearly $1.8 million from its public housing account on three nonfederal developments, as detailed in the chart below.

Development		Examples of expenditures
Orchard Gardens	$1,605,111	Architect fees, infrastructure, surveys, environmental studies, and insurance
Platte Valley Apartments	$83,069	Roof repair, insurance, and cash for operations
Woodgate Townhomes	$92,871	Land purchase, architect fees, legal fees, and neighborhood association dues

Not all of the funds used to support the developments were from HUD's public housing subsidies (operating and capital funds). The Authority had commingled about $922,000 in sales proceeds from the HUD-related 5(h) homeownership program home sales with the public housing subsidies. HUD allowed the Authority to use its 5(h) sales proceeds for the nonfederal developments but did not allow it to use public housing subsidies for the developments. Therefore, the Authority inappropriately spent public housing funds on the remaining development costs.

Of the nearly $860,000 in federal funds inappropriately spent, the public housing program has recouped about $663,000. One nonfederal development owed the public housing program about $200,000 as of October 15, 2007.

Orchard Gardens	
Nonfederal expenses paid from public housing account	$1,605,111
Repayment from Orchard Gardens	($487,016)
Sale proceeds from HUD's 5(h) program	($921,936)
To be repaid	$196,159

Platte Valley Apartments	
Nonfederal expenses paid from public housing account	$83,069
Repayment from Platte Valley Apartments	($83,069)
To be repaid	$0

Woodgate Townhomes	
Nonfederal expenses paid from public housing account	$92,871
Repayment from state grant	($92,871)
To be repaid	$0

Authority Management Did Not Have Controls in Place

Housing authorities' boards of commissioners are responsible for their operations. However, the Authority's board of commissioners did not have adequate controls in place to ensure that financial transactions were in accordance with its annual contributions contract with HUD. The Authority did not have written policies and procedures to address developing, constructing, financing, and operating nonfederal properties. Further, the Authority's board of commissioners did not employ a monitoring process to ensure that the Authority did not use federal funds in its nonfederal development efforts.

The Authority's chief executive officer told us she needed startup funds for the developments while awaiting private financing. She also told us she knew that HUD did not allow housing authorities to use HUD funds for these purposes but she believed that the Authority had sufficient 5(h) funds to use on the nonfederal developments. However, because the Authority did not separately account for the 5(h) funds from the public housing funds, either in its financial records or bank accounts, the chief executive officer was not aware when the Authority had fully depleted the 5(h) funds and began using public housing funds for the nonfederal developments.

Public Housing Funds Were Not Available for Intended Purposes

Nearly $860,000 of the Authority's public housing funds was not available for its intended purpose, which was to provide decent and safe housing for low-income families, the elderly, and persons with disabilities. The $860,000 is equivalent to four years of public housing funding for the Authority, which receives an average of about $200,000 per year.

Recommendations

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

2A. Require the Authority to repay its public housing program from nonfederal sources for any federal funds inappropriately used, including $196,159 owed by Orchard Gardens as of October 15, 2007.

2B. Require the Authority to implement adequate procedures to ensure that it does not spend HUD funds on nonfederal programs and activities without HUD approval. These procedures should include following PIH Notice 2007-15, which addresses spending HUD-related assets in relation to development activities.

Finding 3: The Authority Arbitrarily Allocated Its Administrative and Maintenance Supervisor Salaries and Benefits

The Authority arbitrarily allocated its administrative and maintenance supervisor salaries and benefits to federal and nonfederal programs. This condition occurred because the Authority's chief executive officer believed that the Authority's budget estimates for time spent on federal and nonfederal activities was sufficient support for salary and benefits allocations. As a result, HUD has no assurance that the Authority used nearly $730,000 in salary costs or additional costs for related benefits charged to its federal programs for HUD-funded activities.

Authority Did Not Support Its Personnel Cost Allocations

The Authority arbitrarily allocated its administrative and maintenance supervisor salaries and benefits to federal and nonfederal programs. In contrast to HUD requirements, Authority management used yearly budget estimates as a basis for allocating these personnel costs.

The annual contributions contract between the Authority and HUD states that the Authority must maintain records that identify the source of funds and application of funds in a way that allows HUD to determine that all funds are and have been spent in accordance with each specific program requirement. Further, Office of Management and Budget Circular A-87 states that when employees work on multiple activities, the employer must support salary distributions with personnel activity reports or equivalent documentation. It also states that budget estimates or other distribution percentages determined before the services are performed do not qualify as support for charges to federally funded programs.

As part of its yearly budgeting process, the chief operating officer estimated percentages for administrative and maintenance personnel time spent on federal and nonfederal activities. From April 2004 through September 2007, the Authority paid more than $1.2 million in salaries, excluding benefits, for employees who divided their time between federal and nonfederal activities. The $1.2 million did not include costs for personnel that did not work on HUD programs or were paid from non-HUD sources. The Authority allocated nearly $730,000 of the $1.2 million to its public housing and Section 8 programs. However, it did not have support for the cost allocations applied to its HUD-related programs.

Authority Management Believed Budget Estimates Were Sufficient Support

The Authority's chief executive officer believed that the Authority's budget estimates for time spent on federal and nonfederal activities provided sufficient support for salary and benefits allocations and that it was not necessary to maintain additional support for cost allocations.

Authority May Have Allocated Improper Share of Personnel Costs to HUD Programs

HUD has no assurance that the Authority used nearly $730,000 in salary costs or additional costs for related benefits charged to its federal programs for HUD-related activities. Further, without an acceptable method of allocating salaries and benefits, the Authority will charge HUD-related programs at least $221,000 for unsupported salary costs, excluding benefits, within the next year.

Recommendations

We recommend that the Coordinator of the Omaha Public Housing Program Center require the Authority to

3A. Provide documentation to support salary and benefits costs allocated to HUD programs or reimburse its HUD programs from nonfederal sources for costs that it cannot adequately support. These costs should include $729,361 allocated from April 1, 2004, to September 30, 2007.

3B. Implement an acceptable method for allocating future salary and benefits costs, such as daily activity reports or equivalent documentation, for services performed. This will ensure that an estimated $221,228 in salary costs, excluding benefits, that will be allocated in the next year will be put to better use.

SCOPE AND METHODOLOGY

Our review generally covered the period from June 2000 through April 2007 and was expanded as necessary. To achieve our audit objective, we conducted interviews with the Authority's staff and with HUD staff at the Omaha, Nebraska, and Kansas City, Kansas, Offices of Public Housing.

We reviewed the Authority's policies and procedures; development files for Platte Valley Apartments, Woodgate Townhomes, and Orchard Gardens; general ledgers; trial balances; payable files; payroll files; and audited financial statements. We also reviewed the Authority's annual plan, board of commissioners meeting minutes, correspondence with HUD, annual contributions contracts, bank statements, and bank loan documents. In addition, we reviewed federal regulations and HUD monitoring reports.

We relied in part on computer-processed data from the Authority's computerized accounting system for evidence of spending public housing assets without prior HUD approval. We assessed the data's reliability and found it adequate to identify expenses paid with public housing funds on behalf of the nonfederal developments. In reaching our audit conclusions, we used the Authority's original source documents as corroborating evidence for the information obtained from the Authority's computer-processed data.

We assigned a value to the potential savings to the Authority if HUD implements our recommendations. If HUD implements recommendation 1B to eliminate setoff provisions in certain loan documents, as of October 15, 2007, $1,666,592 in HUD-related bank funds will no longer be at risk. If HUD implements recommendation 1C to eliminate the guarantees placing HUD funds at risk, it will protect an estimated $228,339 that it will provide to the Authority in fiscal year 2008. The estimate is based on the average HUD operating and capital funding provided to the Authority in fiscal years 2000 through 2007. The estimate will be a recurring benefit; however, our estimates reflect only the initial year of this benefit. Similarly, if HUD implements recommendation 3B requiring the Authority to implement an acceptable cost allocation plan, it will protect an estimated $221,228 in salary allocations that the Authority has budgeted for its fiscal year 2008. The estimate will be a recurring benefit; however, our estimates reflect only the initial year of this benefit.

We performed on-site work from May through August 2007 at the Authority's office located at 5404 North 107th Plaza, Omaha, Nebraska. We performed our review in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

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

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

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

Relevant Internal Controls

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

- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

- Safeguarding of resources – Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse

We assessed the relevant controls identified above.

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

Significant Weaknesses

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

- The Authority did not have adequate controls to ensure that it did not put HUD funds at risk or inappropriately spend the funds (findings 1 and 2).
- The Authority did not have an acceptable cost allocation plan in place to ensure that it adequately supported salary and benefits costs charged to its HUD-related programs (finding 3).

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Unsupported 2/	Funds to be put to better use 3/
1B			$1,666,592
1C			$228,339
2A	$196,159		
3A		$729,361	
3B			$221,228

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.

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.

3/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings which are specifically identified.

If HUD requires the Authority to implement the OIG recommendations, it will remove encumbrances on the Authority's HUD-related assets. Additionally, once the Authority successfully improves its controls over encumbering and spending annual contributions contract assets and implements an adequate salary and benefits allocation plan, there will be a recurring monetary benefit. Our estimates reflect only the initial year of this benefit.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation | **Auditee Comments**

Douglas County Housing Authority

5404 North 107 Plaza • Omaha, NE 68134-1100
Phone: (402) 444-6203 • Fax: (402) 444-6600
www.douglascountyhousing.com

Serving the Housing Needs of Douglas County since 1976

IG AUDIT GENERAL STATEMENT

January 15, 2008

First, I want to say that Christy Thomas was courteous and respectful during her work on the audit. She was a pleasure to work with, and my comments are in not way a criticism of her work.

Regarding the audit I want to first make it very clear that no one at any time intentionally or knowingly violated HUD rules. I understand that Christy does not have the history regarding actions and decision made by the DCHA and therefore, I am providing that in this statement.

Comment 1

The current board of commissioners had nothing to do with the decision to pursue the three developments included in the audit. All original decisions and executed documents took place between 1996 and the early part of 2000 before any of the current commissioners were appointed to the board.

Comment 2

When I started at the DCHA in February of 1995 I wanted to make sure that whatever was in place was according to regulations since I had never worked in this environment before. The former executive director was fired and HUD was performing a management review in light of the situation. There were loans in place for Valley View, Benn View and the Central Office when I began my employment in 1995. No one at HUD prior to my employment or shortly thereafter presented any issues about these loans. The HUD staff who included [redacted] reviewed many aspects of the operation at the DCHA. This group was also aware of the method being used to distribute administrative salaries to the different projects (by using the number of units serviced) and had no problems with this method.

Comment 3

The former chair of the board of commissioners was referred by the local HUD office Program Coordinator as a good candidate to be appointed to the board because of her extensive experience with affordable housing and her knowledge of HUD regulations. In fact her business was regularly recommended to PHA's by the local HUD office. It was her expertise and guidance that moved the board through its strategic planning process that ultimately resulted in pursuing new development initiatives. The board and myself believed we were well within our rights to use the (5) h Homeownership sale proceeds, developer fees, management fees income and Section 8 administrative reserves (through 12/31/04) to do the develop activities necessary to expand affordable housing in our community for low income families, elderly and disabled. A copy of correspondence between me and [redacted] Public Housing Coordinator, from the local HUD field office is included with this statement as an attachment.

As soon as HUD staff made the DCHA aware of the problems regarding regulation I immediately began working to resolve the issues. I worked diligently to get them

EQUAL HOUSING OPPORTUNITY

** We provided HUD officials with the attachments that the Authority included with its written response. Due to the sensitive nature and volume of the attachments, we have not included them in the report but can provide them upon request.

resolved, but some things simply took a long time to complete. When I was notified of the IG audit, the letter stated that the audit period would cover 2000 through FYE 2007. However, due to my cooperation, I dug into our archived records and provided Christy with detail documents as far back as 1996. At no time did anyone try to cover up transactions or activities. Everything done was properly documented. While we were using appropriate funds for development activities, I now understand that the income used for development activities, and deposited into the public housing bank account, should have been deposited in a separate development account. Christy's work resulted in a difference of approximately $80,000 from my records, and I believe much of this was due to trying to reconcile old records, since the general ledger had not detail before 2002. We are ready to pay the difference back to the Public Housing bank account as soon as I get the OK from the IG.

Comment 4

Comment 5

Regarding the two guaranties between DCHA and Woodgate Townhomes, this was cleared up in March 2007. Christy has a copy of the Amended and Restated Guaranty executed on March 20, 2007. Just today, January 15, 2008, I received an agreement letter from the Midwest Housing Equity Group (MHEG) that releases DCHA from any and all obligations under the Platte Valley Apartments, LP Guaranty with DCHA, and acknowledges that the Community Housing and Service Corporation is now the sole guarantor under the Guaranty. These actions cure the Guaranty issues on Woodgate Townhomes, LP and the Platte Valley Apartments, LP.

The 1999 QHWRA Legislation dramatically changed the public housing business. In fact, the Department of Housing and Redevelopment's own strategic plans issued since QHWRA encouraged public housing authorities to become more entrepreneurial and be innovative in partnerships to develop affordable housing options for low-income families, and special needs populations (elderly; disabled). This is what a lot of authorities did and perhaps in the transition made some mistakes. The results of what was done at the Douglas County Housing resulted in providing 136 more low-income families and special needs population with affordable housing opportunities.

Another important thing to add to this statement is the FYE 2007 Public Housing Assessment System Score received by DCHA. The score of ***97*** gives DHCA a designated status of ***HIGH PERFORMER!*** The scores for each indicator are:

- Physical Condition = 28 out of a possible 30 points
- Financial Condition = 30 out of a possible 30 points (unaudited)
- Management Performance = 30 out of a possible 30 points
- Resident Satisfaction = 9 out of 10

Comment 6

Finally, I just want to say that the statements in the draft audit report regarding "sanctions and administrative actions" seem excessive and harsh, when nothing was done intentionally and all the issues were resolved.

Respectfully Submitted

Joan Bertolini

Joan Bertolini, CEO

Douglas County Housing Authority

5404 North 107 Plaza • Omaha, NE 68134-1100
Phone: (402) 444-6203 • Fax: (402) 444-6600
www.douglascountyhousing.com

Serving the Housing Needs
of Douglas County since 1976

COMMENTS TO IG AUDIT REPORT
Douglas County Housing Authority
Prepared by: Joan Bertolini, CEO
January 15, 2008

Page 1 Highlights (What We Found)

First, I want to say that no one intentionally or knowingly violated regulations in helping to provide much needed affordable housing for low income families, elderly and disabled persons with the two nonfederal developments. ***The action taken to provide additional affordable housing was at the direction and counsel of the chairperson of board during that time period (1996 – 1999), and with opinion from legal counsel.***

Comment 7

I agree that the Authority did spend $860,000 of the 5(h) Homeownership fund proceeds to further develop affordable housing options for low income families, elderly and disabled persons. ***However, it was not public housing funds!***

Comment 2

Finally, the use of the word "arbitrarily" is inaccurate when referring to the allocation of salaries among the various programs being administered by the DCHA. There was an acceptable rationale used. In fact, the HUD Project-Based Multi-Family program uses this method in conducting its management review ***(HUD Management Review Questionnaire is attached for your review).***

Page 2 What We Recommend

Comment 8

The DCHA has already provided Christy Thomas with a formal release excluding DCHA's HUD-related bank accounts from the setoff provisions in all current loan documents. It is our understanding that this matter has been cured. However, now that DHCA is aware of the issue, the board of commissioners will work on a policy to ensure any ***future*** development documents include a statement to remove any Right to Offset against the Public Housing funds to satisfy payments on non-public housing loans or mortgages, including bond issues.

Comment 5

The Woodgate Townhomes, LP and the Platte Valley Apartments, LP guaranties have been amended to remove DCHA from its obligations to these developments. ***It is my understanding that this issue has been cured and accepted by the IG office as appropriate correction to the problem. (documents attached for your review)***

It is my understanding after working with Christy on the use of the 5(h) Homeownership fund proceeds that she found additional expenses that need to be reimbursed to the public housing program. It is my understanding from conversations with Christy and the

EQUAL HOUSING OPPORTUNITY

Comment 4

spreadsheet document that there is still approximately $80,271.66 in excess expenses to be reimbursed. Our plan is to deposit $19,222.90 from the 5(h) Homeownership Reserve Account to the public housing checking account, leaving $61,048.76 to be paid to DCHA from Orchards Gardens. ***This will be done as soon as I get confirmation from IG that this is the final repayment due to public housing.***

Comment 2

Regarding the "support of salary costs allocated to HUD programs", the Douglas County Housing Authority believes its using a method of administrative salary distribution that is reasonable and acceptable in business. ***This method has been used since I began employment in 1995 and accepted by the Omaha HUD Field Office at that time ([redacted]).***

Comment 6

Finally, I believe that the recommendation to take appropriate "administrative actions against" the authority, its chief executive officer, and members of its board of commissioners is very harsh! ***Since there was no intent to violate HUD rules or to fraud or cover up its actions (everything was recorded and documented) this type of recommendation is excessive!!!!!!!!!***

Page 4 Background and Objectives

Comment 9

For clarification, the mission statement is not the current Mission Statement. The web site does have our current statement.

Page 5

Comment 10

I spoke with Christy Thomas, IG Auditor, about changing the first line of this page. ***The Authority did not purchase Platte Valley Apartments in 1997.*** The Community Housing and Service Corporation serves as the General Partner and 1% owner of this development during the entire tax credit period.

Comment 11

I also let Christy know that the last sentence in the third paragraph needs to be corrected. ***The Director of Senior Housing and staff at the facility manage daily operations at Orchard Gardens. The CEO is not involved in the daily operations of the facility.***

Page 6 Finding 1: The Authority Inappropriately Encumbered Its Federal Funds for Development Activities

Comments 5 & 8

While the DCHA concurs that it is now aware of the interpretations in regulations regarding "encumbering HUD-related assets", DCHA believed it was well within its rights when performing new affordable housing development activities. ***This issue has been cured as presented above (page 2 What We Recommend).***

Page 7 Authority Lacked Controls to Avoid Encumbrances

The DCHA Board of Commissioners and the CEO believed that due diligence was taken when "pursuing nonfederal housing ventures", and was not knowingly violating regulations.

Comment 5

Again, the guaranty issue with Woodgate Townhomes, LP and Platte Valley Apartments, LP issue has been cured. ***(See the March 15, 2007 letter from MHEG and the signed Amendment and Restated Guaranty document dated March 30, 2007, and the January 2008 Letter to Amend Guaranty Agreement for Platte Valley Apartments, LP).***

Page 8 Recommendations for Finding 1

Regarding the recommendation that the Coordinator of the Omaha Public Housing Program Center implement the recommendation, I request that it not be the Coordinator of the Omaha Public Housing Program Center.

Comment 8

1B. ***This issue was cured and resolved with the August 27, 2007 letter from*** [redacted]***, Senior Vice President of the Nebraska State Bank, now know as Mutual of Omaha Bank.***

Comment 5

1C. **This *issue is resolved as stated above (page 7 Authority Lacked Controls to Avoid Encumbrances)***

Comment 5

1D. ***Again, this issue has been cured as presented above in 1C.***

Comment 12

1E. ***I believe this is excessive and harsh since there was no intent to violate HUD rules or to fraud or cover up its action and that the local HUD Field Office was aware of all the development activity taking place at the DCHA. Also, everything was recorded and documented, and reflected on each and every FYE Audit since 1997.***

Comment 12

1F. ***Again, under the circumstances as presented in my comments, administrative sanctions is harsh and excessive. I would request that this recommendation be removed.***

Page 9 Finding 2: The Authority Inappropriately Spent Its Public Housing Funds for Development Activities

Authority Used Public Housing Funds to Pay Nonfederal Development Expenses
Most of the funds used for development activities were from the 5(h) Homeownership proceeds and from Section 8 reserves, which were allowed according to regulations, through 12/21/04.

Page 10 Table

Comment 4

The table indicates $196,159 to be repaid from Orchard Gardens. This is not what Christy Thomas and I determined following the audit work. The spreadsheet compiled by Christy and myself resulted in net expenses of $80,271.66, after applying the final Section 8 reserve contribution. Once we apply another 5(h) Homeownership Reserve payment of $19,222.90 the balance will be $61,048.76 to be paid to the public housing

checking account from Orchard Gardens. As I stated earlier, this will be done as soon as I get confirmation from IG.

Authority Management Did Not Have Controls in Place
Policies and procedures can always be improved and as I stated earlier ***the board of commissioners will look at developing polices to address this issue.***

Comment 13

During my conversation with Christy on Monday, January 7, 2008 I asked that the inaccurate statement in the last paragraph be removed, since I never stated that I knew I violated any HUD rules.

Page 11 **Public Housing Funds Were Not Available for Intended Purposes**

Comment 14

Since most of the funds used for development activities were from the 5(h) Homeownership sale proceeds and from Section 8 reserves, I think the statement in this paragraph regarding public housing funds ***"not available for its intended purpose"*** is inaccurate. Of the $860,000 stated in the statement, at least 95% of it was from 5(h) Homeownership sale proceeds. ***I believe the statement needs to be revised to represent a more accurate picture of the situation, which is that 5(h) sale proceeds were in the general fund along with the public housing funds.***

Recommendations:
Regarding the recommendation that the Coordinator of the Omaha Public Housing Program Center implement the recommendation, I request that it not be the Coordinator of the Omaha Public Housing Program Center.

Comment 4

2A. ***As stated earlier, it is my understanding that there is only $61,048.76 remaining to be repaid to the public housing program.***

2B ***The DCHA welcomes any suggestions or recommendations to enhance or improve the policies that govern its operations***

Page 12 Finding 3: The Authority Arbitrarily Allocated Its Administrative & Maintenance Supervisor Salaries and Benefits

Comment 2

Authority Did Not Support Its Personnel Cost Allocations
The Douglas County Housing Authority has used its current method of administrative time charged to all projects since before my employment at DCHA in 1995. It was being used when I came to the DCHA and revised as needed when restructure of the staffing duties changed. It is an acceptable method and appropriate. In fact, the HUD Project-Based Multi-Family program compliance agent uses this in their Management Review Questionnaire. (A copy of the HUD Multi-family Management Review Questionnaire is attached for your review)

This method of distribution of salary cost by the number of units being served is an acceptable method and quite reasonable for the type of business we operate.

The Circular A-87 quoted in the Draft Audit Report even states "or equivalent documentation", and leaves some discretion for justifying the method used. The equivalent documentation is the distribution based on the number of units served. ***To state that the method used does not support the cost applied to its HUD related programs is subjective.***

Page 13 **<u>Authority Management Believed Budget Estimates Were Sufficient Support</u>**

Comment 2

The reason I stated that the budget estimates for time spent was sufficient support is because it was based on the number of clients served. When payroll is calculated that % of time is distributed to the appropriate projects.

<u>Recommendations</u>

Regarding the recommendation that the Coordinator of the Omaha Public Housing Program Center implement the recommendation, I request that it not be the Coordinator of the Omaha Public Housing Program Center.

3A. ***Again, the DCHA believes it does support the salary and benefits cost distributed to HUD programs. It is unreasonable to retroactively charge other programs for past salary and benefit costs (USDA – HUD Multi-Family – LIHTC – Orchard Gardens)***

3B. ***Again, the DCHA believes it current method is reasonable and appropriate.***

Respectfully Submitted,

Joan Bertolini, CEO

OIG Evaluation of Auditee Comments

Comment 1 Three of the current board of commissioners members were on the board when the Authority entered into Platte Valley and Woodgate loan agreements in 2002. One of the three board members was also on the board in 2000 when the Authority entered into the Woodgate partnership agreement. Therefore, we maintain that some of the current board members were responsible for the Authority's actions when it inappropriately encumbered HUD assets.

Comment 2 The Authority used estimates to allocate salaries and benefits to federal and nonfederal activities. The Authority did not base the estimates on a time study or other supportable method. The Authority asserted that it had based its estimates on the number of units serviced. However, the yearly budgets and general ledger payroll entries showed that the Authority did not consistently base its allocations on the number of units serviced. In addition, it did not provide any other documentation demonstrating that using the number of units serviced was a reasonable and supportable method for allocating payroll expenses.

Further, the Authority was notified of its unsupported payroll expense allocations in the independent auditor's report on the Authority's 1999 financial statements. The audit report stated that for those employees working on multiple programs, the Authority allocated their payroll expenses based on management's estimates. The audit report explained that federal regulations required that allocations of payroll expenses be based on a reasonable methodology, and the methodology should be documented and used consistently. The audit report also noted that payroll allocations must be based on after-the-fact documentation, such as timesheets. The independent auditor recommended that management formally document its payroll allocation methodology and work with the applicable federal agencies to determine the necessary support that the Authority must maintain. However, the Authority could not demonstrate that it had heeded the auditor's recommendation that was intended to bring the Authority into compliance with federal regulations. We have recommended that HUD ensure that the Authority implements an acceptable method for allocating future salary and benefits costs and therefore, HUD can determine what constitutes an acceptable and supportable method of allocating salaries and benefits.

Comment 3 As stated in the report, HUD had allowed the Authority to use 5(h) proceeds and Section 8 administrative fees earned before December 2004 for the nonfederal developments. The Authority also used earned nonfederal development fees and management fees for the nonfederal developments. However, the Authority violated its annual contributions contract when it spent public housing funds for nonfederal development.

The correspondence between HUD and the Authority's chief executive officer showed that in April 2001 HUD began questioning the Authority's use of nearly $200,000 in public housing funds for nonfederal development startup costs. The

Authority's audited financial statements for the period ended March 31, 2000, had disclosed the Authority's use of the public housing funds for this purpose. The chief executive officer replied to HUD that the source of the funds was from proceeds of home sales from the 5(h) homeownership program. The chief executive officer also told HUD that the Authority was obtaining other sources of funding and expected to repay the public housing funds used within the next year.

Comment 4 As shown in the report, as of October 15, 2007, one nonfederal development owed the public housing program $196,159. During the audit, the Authority had identified funding sources that it intended to use to repay the public housing program. One funding source was the Authority's reserve funds, which when applied would leave a balance of about $80,000 owed to the public housing program. The Authority had not used the reserve funds to repay the public housing program as of the date of this report. We explained to the chief executive officer that HUD is responsible for ensuring that the Authority repays the funds and that the repayments are from acceptable sources.

Comment 5 We provided HUD officials with the March 2007 Woodgate Townhomes amended and restated guaranty and the January 2008 Platte Valley Apartments letter agreement releasing the guaranty. HUD will determine whether the documents release the Authority from improper encumbrances.

Comment 6 The Authority's board of commissioners and its chief executive officer are responsible for the Authority's operations. These responsibilities include ensuring that the Authority does not violate federal regulations or enter into financial agreements that place the Authority at risk. As explained in the report, the board of commissioners and the chief executive officer violated federal regulations and failed to perform proper due diligence when they improperly spent public housing funds, encumbered the Authority's assets, and allocated salaries and benefits to federal programs without adequate support. Therefore, we maintain that administrative actions and sanctions are warranted.

Comment 7 As stated in the report, the Authority spent nearly $1.8 million from its public housing account on the nonfederal developments. However, only about $922,000 of the $1.8 million was from 5(h) funds, which were commingled with the public housing funds. The remaining $858,000 spent for nonfederal development was from the public housing funds.

Comment 8 We provided HUD officials with the August 2007 letter from the lender that states that the lender will not invoke the setoff provisions in the nonfederal development loan documents against the Authority's public housing accounts. HUD will determine whether the document formally releases the Authority from the improper setoff provisions.

Comment 9 We revised the report and corrected the Authority's mission statement.

Comment 10 We revised the report to correctly state the ownership of Platte Valley Apartments.

Comment 11 We revised the report to correctly describe the management structure of Orchard Gardens.

Comment 12 As explained in comments 3 and 6, HUD began questioning the Authority's use of public housing funds for nonfederal development startup costs in 2001. The chief executive officer told HUD that the funds used were from the Authority's 5(h) program. She also told HUD that the Authority expected to repay the funds within the next year. However, the Authority continued paying for nonfederal development costs from the public housing account. Further, the Authority did not separately account for the 5(h) funds from the public housing funds and subsequently exceeded the available 5(h) funds and inappropriately spent public housing funds on the nonfederal developments. The Authority's board of commissioners and chief executive officer had a responsibility to ensure that the Authority's nonfederal activities did not negatively affect the Authority's public housing program. However, under their oversight, the Authority inappropriately spent nearly $860,000 in public housing funds. Therefore, we believe that administrative actions and sanctions are warranted.

Comment 13 We revised the report to clarify what the chief executive officer told us.

Comment 14 We agree that the Authority placed the 5(h) funds in the public housing account, which the Authority used as its general fund. However, as explained in the report and comment 7, the Authority spent $1.78 million of its public housing funds on the nonfederal developments and only about $922,000 of the $1.78 million was from 5(h) funds. The remaining $858,000, nearly half of the public housing account funds spent on the nonfederal developments, was public housing funds. Therefore, the Authority was without use of the $858,000 to support its public housing programs for various periods of time until the developments repaid the public housing program and the Authority applied state grant funds to the public housing program. The Authority is currently without use of the remaining $196,159 for its intended purposes until the Authority repays these funds.

Appendix C

CRITERIA

Consolidated annual contributions contract, part A (Public Housing – form HUD-53012A), section 7, states that the Authority shall not in any way encumber any project or portion thereof without prior HUD approval.

Section 9(C) states in part that the Authority shall maintain records that identify the source and application of funds in such a manner as to allow HUD to determine that all funds are and have been expended in accordance with each specific program regulation and requirement. Funds may only be withdrawn from the general fund for (1) the payment of the costs of development and operation of the projects under contract with HUD, (2) the purchase of investment securities as approved by HUD, and (3) such other purposes as may be specifically approved by HUD.

Consolidated annual contributions contract (Section 8 – form HUD-52520), section 11(a), states that the Authority must use program receipts to provide decent, safe, and sanitary housing for eligible families in compliance with the United States Housing Act of 1937 and all HUD requirements. Program receipts may only be used to pay program expenditures.

Office of Management Budget Circular A-87, attachment B, paragraph 11h(4), states in part that when employees work on multiple activities or costs objectives, a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation. Paragraph 11h(5)(e) states that budget estimates or other distribution percentages determined before the services are performed do not qualify as support for charges to federal awards.

Nebraska Housing Agency Act, section 71-1595, states that the powers of each local housing agency shall be vested in its commissioners in office.