



Issue Date	August 21, 2008
Audit Report Number	2008-LA-1015

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

FROM: Joan S. Hobbs, Regional Inspector General for Audit, Region IX, 9DGA

SUBJECT: The Housing Authority of the City of Los Angeles, California, Could Not Show That It Used HUD Program Funds in Accordance with HUD Requirements

HIGHLIGHTS

What We Audited and Why

We audited the Housing Authority of the City of Los Angeles' (Authority) Section 8 Housing Choice Voucher program's financial transactions. We initiated the audit prior to the close of the Authority's 2007 fiscal year as part of our fiscal year 2008 annual audit plan. Our audit objective was to determine whether the Authority properly used Section 8 Housing Choice Voucher program funds in accordance with U.S. Department of Housing and Urban Development (HUD) rules and regulations for the benefit of its program participants. During the audit, we expanded our scope to include a review of its other HUD programs to determine the extent of its inappropriate interprogram fund transfers.

What We Found

The Authority could not show that it used program funds in accordance with its consolidated annual contributions contracts, executed grant agreements, or HUD rules and regulations. Without the required HUD approval, the Authority's accounting records showed that it improperly advanced and expended more than \$27 million in restricted funds to cover its operating losses for its other programs. The Authority contended that there was no misappropriation of funds, but rather just a problem with the way the accounting system presented its financial transactions; however, we were unable to validate its contention. We attribute this deficiency to the Authority's failure to exercise

prudent oversight over the use of HUD funds to ensure that federal requirements and grant agreements and contracts were followed.

What We Recommend

We recommend that the director of HUD's Los Angeles Office of Public Housing require the Authority to: (1) reimburse \$27,801,379 in restricted funds to the proper programs; and (2) establish and implement adequate procedures and accounting controls to ensure that no interprogram advances of restricted funds are made in the future and funds are solely used for each program's intended purpose.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We provided our discussion draft report to the Authority on July 3, 2008, and held an exit conference on July 22, 2008. As a result of the discussion and comments at the exit conference, we provided the Authority with a revised draft report on July 25, 2008. The Authority provided its written response to the draft report on August 1, 2008. The Authority disagreed with our report finding and recommendation to reimburse the restricted funds, although they reimbursed the funds to the restricted account toward the end of our audit.

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

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BACKGROUND AND OBJECTIVES

The Housing Authority of the City of Los Angeles (Authority) was organized as a public housing authority in 1938 to provide low-cost housing to individuals meeting established criteria. The Authority is a state-chartered public agency that provides the largest stock of affordable housing in the Los Angeles area and it gets the majority of its funding from HUD. However, it has built numerous key partnerships with city and state agencies, nonprofit foundations, and community-based organizations, as well as private developers. As of the fiscal year end December 2007, the Authority had issued over 41,000 housing choice vouchers and paid more than \$350 million in housing assistance payments for the housing of eligible participants under its Section 8 Housing Choice Voucher program.

Even though the Authority met its dollar lease up threshold rate of 95 percent, its accounting records show more than \$83 million in HUD Section 8 housing assistance payments surplus had accrued on its books between fiscal years 2004 through 2007. Approximately \$28 million of this surplus subsidy will be used to offset the authorized subsidy paid in fiscal year 2008. The Authority's general ledger also showed more than \$58 million in accrued administrative fees earned and over \$16 million in interest and reinvested interest income and unrealized gains on housing assistance payment investments. Moreover, the Authority has built up over \$180 million in portfolio investments, more than \$132 million of which were funded primarily from its general revolving fund.

Of the \$58 million in accrued administrative fees earned, more than \$46 million represented the Authority's pre-2003 administrative fees. HUD's Assistant Secretary for Public and Indian Housing authorized the Authority to use \$40.5 million of its pre-2003 administrative reserves for the purpose of investing in rebuilding the Section 8 program, information technology, and multifamily housing development and other real estate acquisitions. As of December 31, 2007, the Authority had an available balance of over \$26 million in pre-2003 reserves, of which, over \$22 million may be used only for housing development and real estate acquisition (see chart below).

Description	Initial allocation	Disbursements	December 31, 2007 ending balance
Rebuild Section 8 program area	\$ 1,500,000	\$ -	\$ 1,500,000
Information technology	\$ 3,000,000	\$ (621,478)	\$ 2,378,522
Housing development	\$ 36,000,000	\$ (13,351,872)	\$ 22,648,128
Total	\$ 40,500,000	\$ (13,973,350)	\$ 26,526,650

Our objective was to determine whether the Authority used program funds in accordance with HUD rules and regulations. We expanded our scope to include a review of its other HUD programs to determine the extent of its inappropriate interprogram fund transfers.

RESULTS OF AUDIT

Finding 1: The Authority’s Accounting Records Showed That It Improperly Advanced HUD Program Funds to Other Federal Programs to Cover Operating Deficits

According to the Authority’s accounting records, it improperly advanced and expensed more than \$27 million in HUD program funds among its other federal programs. The Authority contended that there was no misappropriation of funds, but rather, just a problem with the way the accounting system presented its financial transactions; however, we were unable to validate its contention. We attribute the deficiency to the Authority’s failure to exercise prudent oversight over the use of HUD funds to ensure that federal requirements and contracts were followed. As a result, fewer funds may have been available to serve its targeted participants and the Authority may not have met the specific purpose, goals, and requirements of those programs.

The Authority Inappropriately Advanced Funds to Other Federal Programs

Contrary to the Public and Indian Housing Low-Rent Technical Accounting Guide 7510.1 G, consolidated annual contributions contracts, and grant agreements, the Authority’s accounting records showed that it withdrew more than \$31 million in restricted funds and advanced it to other federal programs to cover operating shortfalls. Of the \$31 million in restricted funds, more than \$27 million represented HUD awarded funds (see the charts below). This occurred because the Authority commingled all of its monies into a general revolving fund account which lacked proper procedures or accounting controls to limit withdrawals only to funds available on deposit for each of its programs.

Lending programs	
Program	Receivable
Section 8 Housing Choice	\$ 16,707,150
Low Rent	\$ 4,076,910
HOPE VI	\$ 5,527,417
Section 8 New Construction	\$ 738,856
Section 8 Moderate Rehabilitation 1	\$ 10,026
Section 8 Moderate Rehabilitation 2	\$ 53,136
Section 8 Moderate Rehabilitation 3	\$ 453,159
Disaster Housing Assistance	\$ 137,569
Comprehensive Grant	\$ 97,156
Subtotal – HUD	\$ 27,801,379
Other federal	\$ 4,166,822
Workforce Investment Act - Dislocated Worker	\$ 6,297
Subtotal - non-HUD	\$ 4,173,119
Total	\$ 31,974,498

Borrowing programs	
Program	Payable
Rent Subsidy	\$ 15,011,446
Capital Fund	\$ 7,006,184
Shelter Plus Care	\$ 5,395,426
Housing Opportunities for Persons with Aids	\$ 2,203,082
Section 8 Rental Special Allocations	\$ 1,053,367
Other federal	\$ 519,963
Community Development Block Grant	\$ 421,146
Workforce Investment Act - Adult	\$ 173,010
Resident Opportunities and Self-Sufficiency	\$ 90,288
Multi-family Service	\$ 48,829
Development	\$ 41,225
Workforce Investment Act - Youth	\$ 10,532
Total	\$ 31,974,498

During our audit, the Authority explained that its Oracle system reconciles the advancements and repayments by recording either an interprogram receivable or payable in the general ledger. An interprogram receivable is created when a program loans its pooled cash to another program to cover its operating losses on a short term basis, while an interprogram payable is created when a program borrows cash from the general revolving fund to cover its operating losses. A year end reconciliation is conducted to identify the total receivable and payable amounts outstanding. Given that all program monies are commingled into one account and the lending and borrowing from the general revolving fund are tracked only by interprogram receivable and payable balances, it has no way of showing whether it has lent out excess housing assistance payment monies, administrative fees earned, or interest income for the Section 8 Housing Choice Voucher program or any of its other programs with excess funds.

When we met with the Authority to discuss the finding, it claimed that the monies lent out to the programs were solely from unrestricted funds; however, it could not provide adequate support to justify this statement. Moreover, this contradicted what we were told during the audit, which was that funds for programs with receivable balances were lent out to pay for programs with payable balances. In addition, we noted that the independent auditors certified in its 2004, 2005, and 2006 financial statements that advances are “due to/from other programs,” indicating that designated restricted monies were transferred between programs rather than unrestricted monies.

The Authority also disputed our understanding of its program advances, which it claims are short term loans of investments and are only reflected in the Authority’s books. The funds associated with the advances never leave the organization or the respective programs. However, Authority officials and staff also stated that HUD will not provide reimbursement for most of its programs’ expenditures until it can show funds were actually spent, requiring it to make payments first out of its general revolving fund to keep its programs in operation. Any excess funds in the general revolving fund are then invested in securities on a daily basis and any interest will be distributed to the

appropriate programs. Hence, the program advances are made before the excess funds are invested.

Authority officials attributed its need to advance general revolving fund monies to HUD and pass through agencies such as the Los Angeles Housing Department, because of a recurring problem with executing its grant agreements or contracts in a timely manner. If a contract is pending, the Authority will pay the expenses out of the general revolving fund and hold all of its reimbursement billings until the contract is executed. This delay negatively impacts the Authority's ability to draw funds to pay for its program expenditures.

Corrective Action

When we brought this issue to the Authority officials' attention, it promptly took action and asked their independent public accountant to revise the presentation of the 2007 financial statement report to reflect that advanced funds were repaid with accrued pre-2003 administrative fee reserves (\$20,019,740) and Los Angeles LOMOD Incorporated (\$15,946,630) monies. We were able to validate that these funds were used to repay the programs based on the documentation provided after our fieldwork was concluded. Nevertheless, had we not questioned the Authority's usage of its funds, it is likely that the Authority would not have taken any remedial action to correct this deficiency, despite the fact that program funds were restricted to specific programs and there is a sufficient amount of alternative unrestricted funds to cover the operating costs of its programs from its authorized pre-2003 administrative fees. This violation occurred because the Authority did not exercise prudent oversight over the use of program funds to ensure that federal requirements and basic accounting principles were followed.

Conclusion

The Authority's accounting records showed that it improperly advanced and expensed more than \$27 million in restricted program funds to cover the operating shortfalls of its other programs. The Authority disagreed that there was any misappropriation of funds and contended that it was just a problem with the way that the accounting system presented its financial transactions. We were unable to validate its contention. We believe this violation occurred because the Authority did not exercise prudent oversight over the use of program funds to ensure that federal requirements and basic accounting principles were followed. Consequently, the Authority failed to ensure that HUD funds were spent in accordance with requirements and may not have served its programs' targeted participants.

Recommendations

We recommend that the director of the Los Angeles Office of Public Housing require the Authority to

- 1A. Identify the amounts that were borrowed from or lent out to a specific program and immediately reimburse \$27,801,379 in restricted funds to the proper programs or require the Authority to repay the balance from nonfederal funds.
- 1B. Establish and implement procedures and controls to ensure that no interprogram advances of restricted funds are made in the future and funds are solely used for each program's intended purpose.

SCOPE AND METHODOLOGY

We performed our on-site audit work at the Authority, located in Los Angeles, California between January and April 2008. Our audit generally covered the period January 1, 2005 through December 31, 2007. Our objective was to determine whether the Authority used Section 8 Housing Choice Voucher program funds in accordance with HUD requirements. We expanded our scope as necessary to include a review of all the Authority's HUD administered program funds as it relates to any internal advances.

To accomplish our audit objectives, we

- Reviewed applicable HUD regulations, including HUD Public and Indian Housing Notices, 24 CFR [*Code of Federal Regulations*] Part 982.152, Office of Management and Budget Circular A-87, and HUD Low-Rent Technical Guide 7510.1 G.
- Reviewed the Authority's Section 8 Housing Choice Voucher, Low Rent, HOPE VI, Section 8 New Construction, Section 8 Moderate Rehabilitation, Disaster Housing Assistance, and Comprehensive Grant programs' consolidated annual contributions contracts or grant agreements.
- Reviewed the Authority's policies and procedures related to its administration of its HUD program funds.
- Interviewed HUD and Authority personnel to acquire background information about the Authority.
- Interviewed the Authority's finance department personnel to obtain an understanding of its financial operations, practices, and controls.
- Reviewed Authority accounting records including its 2004, 2005, 2006, and 2007 audited financial statements, general ledgers, bank statements, reimbursement forms, and other supporting documentation.
- Reviewed the cumulative interfund account activity through the end of December 31, 2007, which was updated by the Authority and provided to us on April 14, 2008.

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:

- Policies, procedures, and accounting controls in place to reasonably ensure that its HUD program funds were being used in accordance with applicable laws and regulations.
- Safeguarding HUD program funds by reasonably ensuring that resources are protected 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 item is a significant weakness:

- The Authority lacked sufficient procedures and controls in place over the use of its HUD program funds to ensure compliance with rules and regulations (finding 1).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation Number	Ineligible <u>1/</u>
1A	\$27,801,379

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. In this situation, the Authority advanced and expended \$27,801,379 in restricted HUD program funds to its other federal programs to cover operating deficits.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments



HOUSING AUTHORITY OF THE CITY OF LOS ANGELES
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August 1, 2008

Joan S. Hobbs
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
611 West Sixth Street, Suite 1160
Los Angeles, CA 90017

Dear Ms. Hobbs:

On behalf of the Housing Authority of the City of Los Angeles (HACLA), I would like to thank the U.S. Department of Housing and Urban Development, Office of Inspector General for Audit, for undertaking an audit of the Section 8 Housing Choice Voucher program's financial transactions.

As you know, since 2005 HACLA has partnered closely with OIG to transform the Section 8 program, one of the largest in the nation from a very troubled program to one that in 2008 is "**high-performing**". As of today the HACLA Section 8 program is fully leased up and in compliance with all material requirements of the program. At our invitation, the OIG was asked to perform several audits in furtherance of the transformation of the section 8 program. Moreover, all recommendations from previous audits have been implemented and completed.

Although during this administration HACLA has cooperated extensively with OIG, in the case of this audit we find that the OIG's findings and recommendations are seriously flawed and unsubstantiated.

The Housing Authority is in receipt of the audit findings and recommendations issued by your office relating to our Section 8 Housing Choice Voucher program's financial transactions. This letter is to provide a response to your report dated August 3, 2008. The following summary will address and answer the points that are raised:

Joan S. Hobbs
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
August 1, 2008

RESULT OF AUDIT

Finding 1: The Authority's Accounting Records Showed That It Improperly Advanced HUD Program Funds To Other Federal Programs to Cover Operating Deficits

Comment 1

The Housing Authority does not agree with the findings contained in the report provided by the Office of Inspector General (OIG). The Housing Authority does not agree that \$27,801,379 in restricted funds were borrowed from or lent out to other federal programs and that such borrowing reflected a significant weakness in internal controls over the use of its HUD program funds, or that there is a balance to be repaid from nonfederal funds.

Comment 2

The HACLA has used all program revenues in compliance with HUD program rules. This statement is further supported by the independent certified public accountants responsible for financial reporting. During the audit, Housing Authority accounting staff worked closely with OIG auditors to explain the mechanics of the accounting system and demonstrated that restricted federal programs did not lend resources to other activities, suffer any loss in ability to provide program services, or in their participation in investments. The assets of all restricted funds, including the Section 8 Housing Choice Voucher program are fully accounted for **and have been and are being used in complete compliance with applicable federal regulations**. Any deficiencies in financial resources for a given program are supported solely by unrestricted funds as demonstrated by our audited financial statements prepared by independent certified public accountants.

Comment 3

During the exit conference, members of the OIG audit team acknowledged agreement that sufficient evidence to support the proper distribution of interest income to all restricted programs was provided. The Housing Authority demonstrated to the OIG auditors that no amount of interest income of restricted program funds was lost.

Comment 4

The OIG indicated that based upon its observation of the Housing Authority's preliminary presentation of interfund balances, it could not determine the source of cash used to support federal programs. As a result of this observation, the Housing Authority took immediate action to change the presentation of interfund balances to accurately reflect the use of unrestricted funds to cover operating losses of other programs as provided by the following:

Joan S. Hobbs
 Regional Inspector General for Audit
 U.S. Department of Housing and Urban Development
 August 1, 2008

<u>Program</u>	
Due from other programs (receivable):	
Section 8 Housing Choice Voucher Program (Pre 2003 Earned Admin Fees)	\$ 20,354,569
Section 8 Rental Special Allocations	<u>15,273,240</u>
	<u>\$ 35,627,809</u>
Due to other programs (payable):	
Multifamily Service Coordinator Grant Program	\$ 48,827
Community Development Block Grant Program	421,146
Shelter Plus Care	5,395,426
Resident Opportunity and Supportive Services Development	90,287
	41,226
Housing Opportunities for People with AIDS	2,203,082
Capital Fund	7,006,184
HOPE VI	329,133
Workforce Investment Act	177,246
Rent Subsidy	15,011,442
Other	<u>4,903,810</u>
	<u>\$ 35,627,809</u>

INTERNAL CONTROLS

Significant Weaknesses

- **The Authority lacked sufficient procedures and controls in place over the use of its HUD program funds to ensure compliance with rules and regulations (finding 1)**

This finding from the OIG is unsupported, erroneous and not based on solid auditing standards. The Housing Authority demonstrated to the OIG auditors and demonstrates annually to its independent certified public accountants that sufficient procedures and controls over the use of its HUD program funds are in place to ensure compliance with rules and regulations. The independent auditor's opinion of our compliance with government accounting standards as well as our internal controls and our compliance with laws, regulations, contracts and grant agreements is provided as follows:

Comment 5
Comment 6



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The Honorable Board of Commissioners
Housing Authority of the City of Los Angeles, California

INDEPENDENT AUDITORS' REPORT

We have audited the accompanying basic financial statements of the Housing Authority of the City of Los Angeles, California (Housing Authority) as of and for the years ended December 31, 2007 and 2006. These financial statements are the responsibility of the management of the Housing Authority. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Housing Authority of the City of Los Angeles, California, as of December 31, 2007 and 2006, and the changes in financial position and cash flows of the Housing Authority of the City of Los Angeles, California for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The information identified in the accompanying table of contents as *management's discussion and analysis* is not a required part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming opinions on the basic financial statements of the Housing Authority as a whole. The supplemental financial information for 2007, as identified in the table of contents, which includes the Financial Data Schedule as combining regulatory statements, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Joan S. Hobbs
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
August 1, 2008

The Honorable Board of Commissioners
Housing Authority of the City of Los Angeles, California
Page Two

In accordance with *Government Auditing Standards*, we have also issued a report dated May 20, 2008 on our consideration of the Housing Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Mayor H. Harman, 1126 Green St.

Irvine, California
May 20, 2008

Joan S. Hobbs
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
August 1, 2008

Comment 7

It is because of these significant improvements in Internal Control and Section 8 program execution that HACLA's SEMAP scores (as determined by HUD) have progressed from Troubled in 2004 to High Performer in 2008.

Comment 3

Furthermore, the Housing Authority demonstrated to the OIG auditors and demonstrates annually to its independent certified public accountants that interest is distributed to federal programs each month based upon each program's share in the investment portfolio and that no interest was distributed to unrestricted funds being used to support HUD and other federal programs.

Comment 8

OIG auditors validated that certified financial reports for 2004, 2005, and 2006 reflected less than \$24 million, \$38 million, and \$40 million in interprogram payable balances respectively. Also during 2004, 2005, and 2006 the Housing Authority had over \$40 million in unrestricted funds and no interest income was allocated to these unrestricted funds during these years, thereby proving beyond a reasonable doubt all restricted accounts were "whole" and received their respective interest income. We also provide our external auditor's "financial highlights" "submitted with our audited financial statements which demonstrates this agency's net increase in assets and operating revenues. Which is presented as follows:

Comment 9

Joan S. Hobbs
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
August 1, 2008

HOUSING AUTHORITY OF THE CITY OF LOS ANGELES, CALIFORNIA
Management's Discussion and Analysis
December 31, 2007 and 2006

This section of the annual financial report of the Housing Authority of the City of Los Angeles (Housing Authority) presents management's discussion and analysis of the Housing Authority's financial performance during the fiscal years that ended December 31, 2007 and 2006. The discussion should be read in conjunction with the Housing Authority's basic financial statements, accompanying notes to the basic financial statements, and the financial and compliance data following this section.

Financial Highlights

- The assets of the Housing Authority exceeded its liabilities at December 31, 2007 and 2006 by \$446,477,470 and \$445,314,487, respectively.
- The Housing Authority's net assets increased by \$1,162,983 (.3%) at December 31, 2007, and increased at December 31, 2006, by \$65,659,604 (16.3%), as immediately preceding compared to the prior year. Such change is primarily attributable to revenue in excess of housing assistance payments to landlords offset by recognition of an allowance for un-collectable developer advances in 2007 and revenue in excess of housing assistance payments to landlords in 2006.
- Operating revenues for 2007 increased by 2.6% to \$807,069,393 and 6.6% to \$786,641,963 for 2006, while 2007 operating expenses increased 11.8% to \$827,367,409 and for 2006 decreased less than one percent to \$740,022,511 as compared to the immediately preceding prior year.
- Net capital assets increased by \$10,098,995 (3.1%) at December 31, 2007 and increased at December 31, 2006 by \$7,470,812 (2.3%) as immediately preceding compared to the prior year, primarily resulting from capital improvements to the Housing Authority's public housing stock augmented by multifamily family property acquisitions for 2007 and 2006.
- Total liabilities increased at December 31, 2007 by \$30,881,767 (25.4%) and decreased at December 31, 2006 by \$5,435,077 (4.3%) over the immediate preceding prior year, primarily as a result of increases to notes and bonds payable in 2007 and reductions to deferred revenues in 2006.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Housing Authority's basic financial statements. The Housing Authority's annual financial report is comprised of three components - management's discussion and analysis (this section), the basic financial statements, and an optional section of supplemental financial information that presents combining financial statements, regulatory combining financial statements, and schedules of modernization costs for complete and incomplete projects. This annual report also contains other information supplemental to the Housing Authority's basic financial statements.

The Housing Authority of the City of Los Angeles is accounted for as a Business Type Activity and utilizes the accrual basis of accounting. This method of accounting recognizes revenues when they are earned and become measurable, and expenses when they are incurred, regardless of when funds are received or expended.

Activities of the Housing Authority are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with operations are included on the Statement of Net Assets. Authority equity (i.e., total net assets) is segregated into net assets invested in capital assets, restricted net assets, and unrestricted net assets components. Business Type Activity Statement of Revenues, Expenses and Changes in Net Assets present increases (i.e., revenues) and decreases (i.e., expenses) in net assets.

Joan S. Hobbs
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
August 1, 2008

The OIG auditors found room to improve how the Housing Authority presents its interprogram balances in its public annual financial report. Housing Authority Executives and its independent certified public accountants embraced this point. As a result, changes were immediately implemented and reflected in its 2007 annual financial report.

SCHEDULE OF QUESTIONED COSTS

Recommendation Number IA

The Authority advanced and expended \$27,801,379 in restricted HUD program funds to its other federal programs to cover operating deficits.

Comment 10

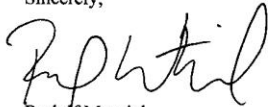
It is true that the Housing Authority desires to provide uninterrupted service to clients of all federal programs administered by the Housing Authority. HUD and other federal program grantors delay renewals of contracts to provide needed services for months. The Housing Authority has made the decision to continue services by using unrestricted resources until federal resources become available. The alternative would leave many needy individuals without valuable federally supported services.

Comment 11

OIG auditors indicated under the heading "Corrective Action" on page seven of the report that they were able to validate that unrestricted funds were used and that there were sufficient unrestricted funds available for this purpose. Our audited financial statements also demonstrate that program shortfalls were supported by unrestricted funds. Therefore, the Housing Authority will not provide any reimbursement since **no** monies are due to any program. Moreover, there is no legal or accounting reason to pay \$27,801,379 to restricted HUD programs, as there is **no** money due to these programs.

We look forward to a favorable response and continued partnership with HUD. If you have any questions or wish to discuss the matter, please call me at (213) 252-1810.

Sincerely,



Rudolf Montiel
President and CEO

OIG Evaluation of Auditee Comments

- Comment 1** We disagree with the Authority's contention. During our audit, we met several times with the Authority's finance officer to gain an understanding of its interfund accounts. Each time we met, we were told that funds were borrowed between programs to cover the operating shortfalls of programs that do not have sufficient funds. This fact is reflected in the Authority's interprogram fund balances as shown in its general ledger and draft balances to be reported in the 2007 audited financial statements. The Authority explained that HUD and other federal grantors require that contracts be executed and expenditures be paid up front before reimbursements are made by HUD. Consequently, monies were borrowed from other programs with surplus funds that are restricted to a specific program. This is a violation of the consolidated annual contributions contracts. Therefore, such borrowings reflect a weakness in the Authority's internal controls over the use of its HUD program funds as the Authority could not ensure that funds were used for each of its program's specific purpose. We agree that there is no longer a balance to be repaid from nonfederal funds as the Authority had "repaid/reclassified" unrestricted funds to cover the inappropriate advancements of restricted funds. This repayment/reclassification of funds occurred **after** we had notified them of the issue, in which they had over two months to correct its records and its 2007 audited financial statements due on June 30, 2008. Once we issue the report, we intend to close out the recommendation since the Authority has already taken the recommended actions.
- Comment 2** We disagree. The executed contracts signed by the Authority and HUD strictly forbid the use of restricted monies for any other purpose. For example, section c of the public housing contract states that "the HA may withdraw funds from the General Fund only for: (1) the payment of costs of development and operations of the project under annual contributions 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. **Program funds are not fungible; withdrawals shall not be made for a specific program in excess of funds available on deposit for that program.**" The \$27,081,379 in advancements that were made between programs is strictly forbidden by the clause shown above; therefore, the Authority could not have used all program revenues in compliance with HUD program rules. An independent certified public accountant is responsible for expressing an opinion on the financial statements based on its audit as the **financial statements are the responsibility of the management of the Housing Authority**. We agree that the independent certified public accountants did not misrepresent the program advancements between programs for the audited financial statements prepared for fiscal year 2007 as the report was revised after our audit and prior to its final issuance. We notified the Authority of our contention more than two months before it was issued, which gave the Authority time to revise its "presentation" of its audited financial statements. However, a review of the fiscal years 2004, 2005, and 2006 **audited** financial statements,

which were prepared by the Authority's independent certified public accountants, show what we have concluded all along - that program funds were being borrowed and lent out between programs ("amounts advanced from and due to the Housing Authority's programs are as follows") and are used to "offset against one another" (see below). We also agree that there is no longer a balance to be repaid from nonfederal funds as the Authority had "repaid/reclassified" unrestricted funds to cover the inappropriate advancements of restricted funds. This repayment/reclassification of funds occurred **after** we had notified them of the issue, in which they had over two months to put its records in the correct order. Had we not brought this to the Authority's attention, it would not have used its unrestricted funds to repay its restricted funds, as it has been occurring for the past three years as shown below.

At December 31, 2004, amounts advanced from and due to the Housing Authority's programs are as follows:

<u>Program</u>	
Due from other programs (receivable):	
Development	\$ 187,739
Low Rents	9,131,156
Section 8 Housing Choice Voucher Program	14,191,122
Section 8 Moderate Rehabilitation	141,538
Other	176,119
	<u>\$ 23,827,674</u>
Due to other programs (payable):	
Multifamily Service Coordinator Grant Program	\$ 77,689
Community Development Block Grant Program	372,469
Shelter Plus Care	3,691,723
Resident Opportunities and Support Services Program	441,895
Housing Opportunities for People with AIDS	3,770,089
Section 8 Rental Special Allocations	46,783
Section 8 Moderate Rehabilitation	753,340
Comprehensive Grant Program	542,957
Capital Fund	5,215,006
HOPE VI	678,175
Section 8 New Construction	90,148
Adult Education	5,140
Workforce Investment Act	606,471
Rent Subsidy	4,786,840
Other	2,748,949
	<u>\$ 23,827,674</u>

For financial reporting purposes, these inter-program receivables and payables are offset against one another.

At December 31, 2005, amounts advanced from and due to the Housing Authority's programs are as follows:

<u>Program</u>	
Due from other programs (receivable):	
Low Rents	\$ 9,559,197
Section 8 Housing Choice Voucher Program	26,021,739
Section 8 Moderate Rehabilitation	38,139
HOPE VI	2,201,551
Section 8 New Construction	85,433
Adult Education	42,119
Other	47,847
	<u>\$ 37,996,025</u>
Due to other programs (payable):	
Multifamily Service Coordinator Grant Program	\$ 107,422
Community Development Block Grant Program	794,911
Shelter Plus Care	8,719,201
Resident Opportunities and Support Services Program	230,438
Development	19,204
Housing Opportunities for People with AIDS	4,702,858
Section 8 Moderate Rehabilitation	399,131
Comprehensive Grant Program	592,418
Capital Fund	8,385,578
Workforce Investment Act	502,930
Section 8 Rental Special Allocations	377,941
Rent Subsidy	6,827,409
Other	6,336,584
	<u>\$ 37,996,025</u>

For financial reporting purposes, these inter-program receivables and payables are offset against one another.

At December 31, 2006, amounts advanced from and due to the Housing Authority's programs are as follows:

<u>Program</u>	
Due from other programs (receivable):	
Resident Opportunity and Supportive Services	\$ 13,750
Low Rents	8,023,301
Section 8 Housing Choice Voucher Program	22,911,542
HOPE VI	5,072,698
Adult Education	6,059
Welfare to Work	1,496
Other	3,014,205
	<u>\$ 39,043,051</u>
Due to other programs (payable):	
Multifamily Service Coordinator Grant Program	\$ 30,319
Community Development Block Grant Program	281,920
Shelter Plus Care	5,278,659
Development	83,415
Housing Opportunities for People with AIDS	437,030
Section 8 Moderate Rehabilitation	850,351
Comprehensive Grant Program	541,271
Capital Fund	12,576,285
Section 8 New Construction	1,311,066
Workforce Investment Act	208,524
Section 8 Rental Special Allocations	793,805
Rent Subsidy	10,051,450
Other	6,598,956
	<u>\$ 39,043,051</u>

Comment 3 We agree. We removed the section regarding unrealized interest income as the Authority's explanation of the interest allocation was supported and verified.

Comment 4 In addition to a change in **presentation** of its interfund balances, the Authority failed to mention that it also had to repay/reclassify/move its pre-2003 administrative fees and LOMOD unrestricted funds to make its restricted funds whole.

- Comment 5** We vehemently disagree with the Authority's contention that our finding is unsupported, erroneous and not based on solid auditing standards. As explained in Comment 1, we met several times with the Authority's finance office to gain an understanding of its interfund accounts. Each time we met, we were told that funds were borrowed between programs to cover the operating shortfalls of programs that do not have sufficient funds. The accounting records also reflected our understanding of the process.
- Comment 6** The independent auditor's opinion of the Authority's compliance is to the "accounting principles generally accepted in the United States of America." On page 51 of the 2007 audited financial statements, it states that "in planning and performing our audit, we considered the Housing Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but for the purpose of expressing an opinion on the effectiveness of the Housing Authority's internal control over financial reporting. Accordingly, **we do not express an opinion on the effectiveness of the Housing Authority's internal control over financial reporting.**" Furthermore, the audited financial statements state that "we performed tests of its compliance with certain provisions of law, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, **we do not express such an opinion.**" The Authority did not demonstrate that it had sufficient procedures and controls over the use of its HUD program funds as \$27,081,379 in program funds were advanced between its programs.
- Comment 7** We cannot attest to the Authority's assertion that significant improvements in Internal Control and Section 8 program execution allowed HACLA's SEMAP scores to progress from Troubled to High Performer since that was outside the scope of our audit.
- Comment 8** We agree that the Authority had over \$40 million in unrestricted funds in its account during 2004, 2005, and 2006. However, those monies were not designated as monies used to cover the operating losses of other programs during our audit. Rather, we were informed that those monies were unrestricted and the Authority had discretion over its use. During our fieldwork, the Authority's accounting records reflected only five entries that affected the unrestricted fund balance. Those entries are related to the acquisition of four housing development properties with the aggregate amount of \$13,351,872 and information technology related expenses of \$621,478. The remaining balance of the unrestricted funds was unencumbered and was to be used to purchase other properties. It was not until after we had informed the Authority of our finding that it used its unrestricted monies to repay the restricted funds that were used to cover the operating deficits of its other programs.

Comment 9 We agree that no interest income was allocated to the unrestricted funds during 2004, 2005, and 2006. However, this does not prove that restricted funds were “whole”. As discussed in Comment 2, the accounting records showed that program funds were being borrowed and lent out between programs. We agree that the restricted funds were made whole after the fact when the Authority had “repaid/reclassified” unrestricted funds to cover the inappropriate advancements of restricted funds during 2007.

Comment 10 We commend the Authority for its desire to provide uninterrupted service to clients of federal programs administered by the Authority. However, we maintain that the Authority should not use restricted funds in violation of the annual contributions contracts.

Comment 11 We agree that there is no longer a balance to be repaid from nonfederal funds as the Authority had "repaid/reclassified" unrestricted funds to cover the inappropriate advancements. The Authority "repaid/reclassified" restricted with unrestricted funds **after** we had notified them of the issue during our audit. Once we issue the report, we will record that the corrective action has already taken place and close out the recommendation.

Appendix C

CRITERIA

A. Section 8 Housing Choice Voucher Program's Consolidated Annual Contributions Contract:

- **Paragraphs 11(a), (b), and (c)**, states, “the HA 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. The HA may not make any program expenditures, except in accordance with the HUD-approved budget estimate and supporting data for a program. Interest on the investment of program receipts constitutes program receipts.”
- **Paragraphs 12(a) and (b)**, states, “the HA must maintain an administrative fee reserve for a program and must use funds in the administrative fee reserve to pay administrative expenses in excess of program receipts. If any funds remain in the administrative fee reserve, the HA may use the administrative reserve funds for other housing purposes if permitted by state and local law.”
- **Paragraph 13(c)**, states, “the HA must only withdraw deposited program receipts for use in connection with the program in accordance with HUD requirements.”

B. Low Rent and Comprehensive Grant Programs' Consolidated Annual Contributions Contract:

- **Section 9 (C)**, states, “the HA 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. The HA may withdraw funds from the general fund only for: (1) the payment of costs of development and operations of the project under the Annual Contributions 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. Program funds are not fungible; withdrawals shall not be made for a specific program in excess of funds available on deposit for that program.”
- **Section 10 (C)**, states, “the HA shall not withdraw from any of the funds or accounts authorized amounts for the projects under the Annual Contributions Contract, or for the other projects or enterprises in excess of the amount then on deposit in respect thereto.”

C. HOPE VI Program:

- **OMB Circular A-87 C(3)(c)**, states, “any cost allocable to a Federal award may not be charged to other Federal awards to overcome fund deficiencies, to avoid restrictions imposed by law or terms of the Federal awards, or for other reasons.”

D. Section 8 New Construction Program’s Consolidated Annual Contributions Contract:

- **Section 4 (d)(2)**, states, “housing assistance payments shall only be paid to the owner for contract units occupied by eligible families leasing decent, safe and sanitary units from the owner in accordance with statutory requirements, and with all HUD regulations and other requirements.”

E. Section 8 Moderate Rehabilitation Program’s Consolidated Annual Contributions Contract:

- **Section 1.13 (c)**, states, “the HA may only withdraw deposited program receipts for use in connection with the program in accordance with HUD requirements.”

F. Disaster Housing Assistance Program’s Grant Agreement:

- a. **Section 10 (a)**, states, “program receipts may only be used to pay eligible program expenditures.”
- b. **Section 11 (c)**, states, “PHA may only withdraw deposited program receipts for use in connection with the program in accordance with HUD requirements.”
- c. **Public and Indian Housing Notice 2007-26 (4)(r)**, states, “DHAP funding may not be used for other activities or costs. DHAP funding remains separate and distinct from the PHA’s regular voucher program and the DVP (Disaster Voucher Program) in terms of the source and use of the funding.”

G. 24 CFR [Code of Federal Regulations] 982.152(a)(3), last amended on May 14, 1999, states, “the HA administrative fees may only be used to cover costs incurred to perform HA administrative responsibilities for the program in accordance with HUD regulation and requirements.”

H. PIH [Public and Indian Housing] Notice 2004-7, section 8, states, “transfer of amounts from the operating (administrative fee) reserve to another non-Section 8 program account does not constitute use of the operating reserve for other housing purposes, even if the account to which funds would be transferred is designated for housing purposes. Operating reserve funds must be expended to be considered used for other housing purposes.”

- I. **PIH [Public and Indian Housing] Notice 2006-03, section 9**, states, a “pha must be able to differentiate housing assistance payments equity (budget authority in excess of housing assistance payments expenses) from administrative fee equity (administrative fees earned in excess of administrative costs).”
- J. **PIH [Public and Indian Housing] Notice 2007-14, section 8 (i)**, states, “any administrative fees from 2007 funding (as well as 2004, 2005 and 2006 funding) that are subsequently moved into the administrative fee equity account in accordance with generally accepted accounting principles at year-end must only be used for the same purpose.”
- K. **PIH [Public and Indian Housing] Low-Rent Technical Accounting Guide 7510.1G:**
- **Part 2-13**, states, “the HA receives funds from a variety of HUD program funding sources including management operations, development, modernization, and community involvement grants. The HA also receives locally generated income such as tenant rents and charges. The use of these funds is restricted to the specific purposes authorized in the program budgets. It is the responsibility of the HA to assure that the accounting system used by the HA accurately identifies the source, use, and remaining balances of individual program cash resources.”
 - **Part 2-15**, states, “the HA may use pooled funds for any expenditure chargeable to the HA programs which have funds on deposit; however, funds shall not be withdrawn for a program in excess of the amount of funds on deposit for that particular program. The HA should take care to maintain supporting documentation for pooled fund transactions in enough detail to provide an adequate audit trail.”
 - **Part 2-16**, states, “funds provided by HUD are to be used by the HA only for the purposes for which the funds are authorized. Program funds are not fungible and withdrawals should not be made for a specific program in excess of the funds available on deposit for that program. As generally used, the term ‘commingling of funds’ refers to the use of one program's funds to pay expenditures for, and in excess of the funds available for, another program.”