



U.S. Department of Housing and Urban Development

Office of Inspector General

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2009-LA-0802

MEMORANDUM FOR: Milan Ozdinec, Deputy Assistant Secretary for Public Housing and Voucher Programs, PE

Joan S. Hobbs

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

SUBJECT: HUD Lacks Adequate Oversight to Require Public Housing Agencies to Separately Account for Unrestricted and Restricted Section 8 Program Administrative Fees
Los Angeles, California

INTRODUCTION

We performed a review of the U.S. Department of Housing and Urban Development's (HUD) oversight of public housing agencies' unrestricted and restricted Section 8 administrative fee reserves. We initiated this review because in our audits of two housing authorities, neither agency was able to clearly account for its administrative fee reserve funds and demonstrate that they were used appropriately. Our objective was to determine whether HUD had policies, procedures, and controls in place to ensure that public housing agencies properly accounted for their administrative fees and used them for their 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 review.

SCOPE & METHODOLOGY

The scope of our review was limited to determining whether HUD had policies, procedures, and controls to ensure that public housing agencies met statutory requirements with respect to the use of administrative fee reserves. Our conclusions were largely based on prior audit work

conducted at the Housing Authority of the City of Los Angeles¹ (City Authority) and the Housing Authority of the County of Los Angeles² (County Authority).

To accomplish our review objective, we contacted and interviewed appropriate staff in headquarters and the local Office of Public Housing, the Real Estate Assessment Center, and the Financial Management Center to determine current policies, procedures, and controls. In addition, we reviewed applicable HUD handbooks, guidebook, Public and Indian Housing notices, and the *Code of Federal Regulations* to gain an understanding of the Office of Public Housing's monitoring responsibilities and administrative fee reserves program guidelines.

BACKGROUND

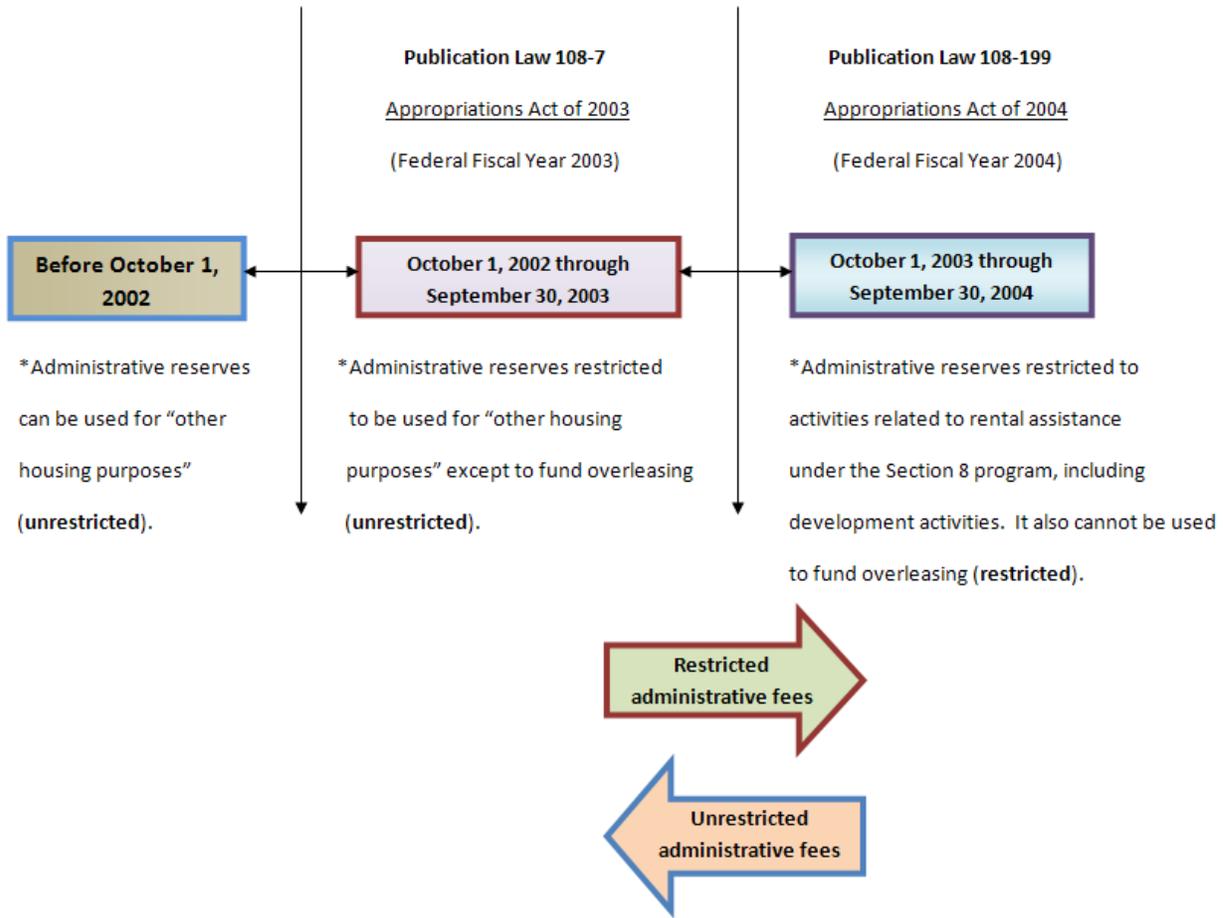
Public housing agencies receive millions of dollars in administrative fees each year from HUD for the ongoing costs of administering the Section 8 Housing Choice Voucher program. For fiscal years 2005, 2006, and 2007, the City Authority received more than \$106 million in administrative fees. For fiscal years 2006, 2007, and 2008, the County Authority received more than \$50 million in administrative fees. Unused administrative fees are accumulated in the unrestricted net assets account and reserved for future eligible expenditure needs. Depending on the federal fiscal year in which the funds were awarded, administrative fees may be classified as either "unrestricted" or "restricted."

Before the enactment of the 2003 Appropriations Act, administrative fee reserves could be used for "other housing purposes"; however, HUD has taken a lenient interpretation of what constitutes eligible expenses under this category. Moreover, HUD Handbook 7420.3 states that public housing agencies are responsible for determining what expenditures are necessary and reasonable, and the use of the reserves for other housing purposes is a matter left to their discretion (see appendix B). In 2003, Congress prohibited the use of the reserves for overleasing costs, but public housing agencies retained the right to use them for other housing purposes. Accordingly, any administrative fees awarded before federal fiscal year 2004 are generally referred to as "unrestricted" since public housing agencies have considerable flexibility in how such funds are spent. In 2004, Congress further limited the use of the reserves for activities related to the provision of rental assistance under the Section 8 Housing Choice Voucher program, including related development activities. Because of this provision, administrative fee reserves awarded after federal fiscal year 2003 are "restricted" (see chart below for graphic depiction).

¹ Office of Inspector General Report 2008-LA-1015, issued August 21, 2008.

² Office of Inspector General Report 2009-LA-1009, issued April 24, 2009.

Administrative Fee Reserves



We identified a pattern of weakness in the City and County Authorities’ accounting for administrative fee reserve funds. As a result, we initiated our review to assess HUD’s monitoring responsibilities with respect to the Section 8 administrative fees.

RESULTS OF REVIEW

HUD lacks the necessary policies, procedures, and controls to ensure agencies segregate restricted and unrestricted Section 8 program administrative fees. Based on our audit results of the City and County Authorities, we determined that the agencies inappropriately used restricted administrative fees for non-program-related purposes without HUD’s knowledge. This occurred because HUD assumed that public housing agencies maintained adequate accounting systems to track and separately account for unrestricted and restricted administrative fee reserves. As a result, HUD could not be assured that administrative fee reserves were tracked and used properly.

Housing Authority of the City of Los Angeles

The City Authority's records showed that it improperly advanced more than \$27 million in restricted HUD program funds to other federal programs to cover its operating deficits. More than \$16 million of the advancement came directly from the Section 8 Housing Choice Voucher program, but we could not verify how much was paid for by each of its program's revenue sources (housing assistance payments, unrestricted and restricted administrative fees, and interest earned) as its accounting system was not set up to show, on a transactional basis, the debits and credits in the revenue and liability accounts within each individual program. Instead, a series of interprogram receivables, which showed that cash was loaned to another program, and payables, which showed that cash was borrowed from a program, reflected interprogram transfer transactions.

The City Authority's chief operating officer claimed that unrestricted administrative fees had been used for these program transfers all along and as a result, did not violate program rules, yet the finance officer stated that it was not possible to trace specifically the source of the borrowed funds. The City Authority maintained a separate spreadsheet that tracked the unrestricted reserves, but it did not account for any of the more than \$16 million in Section 8 program transfers. Consequently, it could not ensure that funds advanced were completely unrestricted as all funds, unrestricted and restricted, were commingled into one account in the accounting system. HUD was unaware of this practice, which had been ongoing for many years. To clearly identify the transactions that affect both sources of funds, the unrestricted and restricted reserve funds need to be separate.

Housing Authority of the County of Los Angeles

In fiscal years 2005 and 2006, the County Authority overallocated more than \$5 million of the Los Angeles Community Development Commission's indirect administrative expenses to the Section 8 program. Of the overallocated amount, more than \$2.1 million was drawn out of unrestricted funds, and more than \$2.9 million was inappropriately drawn out of the restricted fund. Because the County Authority did not segregate its restricted and unrestricted administrative fees in its accounting system, we had to manually compute the balances at year end to determine which type of administrative fee was used for each transaction and how much administrative fee was affected.

We encountered difficulty in determining the correct balance of both types of reserves since there were many factors affecting the computation. According to the 2004 year-end settlement statement, the County Authority had an unrestricted balance of more than \$10.2 million. In later years, this balance would increase or decrease depending on whether the current year yielded a year-end administrative gain or loss. In instances in which a gain was recognized, the administrative reserve balance would increase, resulting in the commingling of both types of funds in the administrative pool. In instances in which a loss was recognized, the administrative balance would decrease and might reduce the restricted balance first, and then any excess expenses would be covered by the unrestricted funds. Without a good working knowledge of the Authority's cost allocation plan, segregation of both types of funds, effective oversight, and an

understanding of the rules that govern the administrative fees, the probability of detecting this deficiency would have been highly unlikely.

Policies, Procedures, and Controls Lacking

- Guidelines – HUD Technical Guidance to Account for Restricted and Unrestricted Administrative Fee Reserve Funds Not Provided

HUD is responsible for developing policy, regulations, handbooks, notices, and guidance to implement housing legislation. Although policy information changes regarding restrictions imposed on administrative fees in successive federal fiscal years were adequately captured in Public and Indian Housing notices, they failed to provide the necessary technical guidance to assist public housing agencies in better accounting for restricted and unrestricted reserves in their accounting systems. This is because HUD assumed that public housing agencies have established a good working accounting system that can adequately track the unrestricted and restricted administrative fees in compliance with program requirements. We reviewed other criteria, including handbooks, guidebooks, and the *Code of Federal Regulations* and found that they were deficient in citing explicit language requiring the separate accounting of restricted and unrestricted funds.

While both the City and County Authorities appeared to understand the changes in policy, they did not implement procedural controls to better account for both types of funds, resulting in the loss of fund identity and associated restrictions. For instance, the City Authority was unable to adequately show that the unrestricted funds were used to advance its program transfers. Similarly, the County Authority could not readily identify the amount of unrestricted funds that went to pay for the overallocated expenses.

- Monitoring – Not Enough Emphasis on Monitoring Administrative Fee Reserve Funds

HUD is responsible for monitoring public housing agencies' compliance with program requirements and performance goals. However, our interviews with staff in headquarters and the local Office of Public Housing disclosed a limited emphasis on the monitoring of administrative fee reserve funds. Headquarters delegates the monitoring function to the local field office, which, in turn, depends on the independent public accountant audit reports to identify deficiencies. Although the local field office used a number of systems to manage public housing programs, the extent of its system monitoring of administrative fee balances was limited to performing research on an as needed basis in the HUD Central Accounting and Program System.

- HUD Systems – Failure to Capture Essential Information to Effectively Monitor

The Real Estate Assessment Center was not readily able to determine the balances associated with the unrestricted and restricted funds because public housing agencies could only report the total administrative fee reserves into the Financial Assessment Subsystem. As a result, the system was not effective in assisting HUD in performing its remote monitoring responsibilities.

- Financial Assessment Subsystem – This system is a secure Web-based system accessible on the Internet for external users to use in transmitting financial statements to HUD. It does not lend itself to compliance testing as it does not show detailed revenue and expense items, nor is it capable of capturing the distinction between unrestricted and restricted administrative fees. Public housing agencies are only required to report the year-end balance of the administrative fee reserves into the system. The system is not an effective monitoring tool for tracking the public housing agencies’ unrestricted and restricted administrative reserve balances.

HUD Corrective Action

HUD initiated actions to address our finding by developing a draft Public and Indian Housing notice to be published this summer. In the draft notice, HUD acknowledged that there was no requirement for public housing agencies to segregate unrestricted and restricted reserves. To better track these reserves, beginning with the reporting period ending September 30, 2009, public housing agencies must report administrative fee reserves accumulated as of federal fiscal year 2003 separately. The Real Estate Assessment Center was also considering adding an extra line in the Financial Assessment Subsystem to clearly distinguish between the unrestricted and restricted funds.

RECOMMENDATIONS

We recommend that the Deputy Assistant Secretary for Public Housing

- 1A. Develop and implement detailed policies, procedures, and controls to ensure that public housing agencies properly account for their administrative fees and use them in compliance with HUD rules and regulations. This recommendation includes requiring the public housing agencies to separately account for unrestricted reserves so that unrestricted and restricted reserves may be more clearly identified.
- 1B. Consider requesting the Real Estate Assessment Center to add an extra line item in the Financial Assessment Subsystem to capture the unrestricted and restricted administrative fee reserves to better track those balances.
- 1C. Require public housing agencies to perform a reconciliation of their administrative fee reserves to determine the correct balances in their restricted and unrestricted accounts. These amounts will be recognized as the beginning/ending balances in the Financial Assessment Subsystem.

AUDITEE’S RESPONSE

We provided a discussion draft report to your office on July 2, 2009. Your department provided written comments on August 3, 2009. It generally agreed with our findings. The complete text of your response is in appendix A of this report.

Appendix A

AUDITEE COMMENTS

Ref to OIG Evaluation

Auditee Comments



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-5000

OFFICE OF PUBLIC AND INDIAN HOUSING

AUG 5 2009

MEMORANDUM FOR: Joan S. Hobbs, Regional Inspector General for Audit, 9DGA

FROM:

Milan Ozdinec, Deputy Assistant Secretary for Public Housing
and Voucher Programs, PE

SUBJECT:

Draft Memorandum Report: Audit Memorandum
2009-LA-0XXX: HUD Lacks Adequate Oversight to Require
Public Housing Agencies to Separately Account for
Unrestricted and Restricted Section 8 Program
Administrative Fees

Thank you for your memorandum dated July 2, 2009, requesting comments on recommendations 1A, 1B and 1C. The Office of Public and Indian Housing (PIH) has agreed with the recommendations from the Office of Inspector General (OIG) for the subject audit memorandum. The OIG has made the following recommendations to the Deputy Assistant Secretary (DAS) for Public Housing and Voucher Programs. Our office has initiated several actions to address these concerns. Our comments and responses are contained with-in.

Recommendation 1A: Develop and implement detailed policies, procedures and controls to ensure that public housing authorities properly account for their administrative fees and use them in compliance with HUDs rules and regulations.

In response, the Office of Public Housing has drafted an updated notice on the use and reporting of Administrative Fees. The notice sets forth the differences between pre and post 2003 administrative fees, their authorized uses, reconciliation of the account balances and a new requirement to account and report separately between restricted and unrestricted administrative fee reserves. This notice is expected to be published by December 31, 2009.

Recommendation 1B: Consider requesting the Real Estate Assessment Center (REAC) to add an extra line in the Financial Assessment Subsystem (FASS) to capture the unrestricted and restricted administrative reserves to better track those balances.

REAC is in the process of adding new lines to FASS for PHAs to report the respective balances. The anticipated release date is April 2010. In the interim beginning with the September 2009 submissions, PHAs are being instructed to include a schedule in the comments link that reconciles balances the PHA claims are 2003 and prior years administrative fee reserves and amounts that are held as 2004 and subsequent years administrative fee reserves.

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Recommendation 1C: Require public housing agencies to perform a reconciliation of their administrative fee reserves to determine the correct balances in their restricted and unrestricted accounts. These amounts will be recognized as the beginning/ending balances in the Financial Assessment Subsystem.

The draft notice discussed in recommendation 1A instructs PHAs to reconcile the restricted and unrestricted administrative fee balance and to report the correct balances in FASS. The anticipated date of completion is June 30, 2011.

If you need further information, please contact Miguel A. Fontánez at 202-402-4212.

Appendix B

CRITERIA

- A. Public Law 108-7** states, “that none of the funds made available in this paragraph may be used to support a total number of unit months under lease which exceeds a public housing agency's authorized level of units under contract.”
- B. Public Law 108-199** states, “that all such administrative fee amounts provided under this paragraph shall only be for activities related to the provision of rental assistance under Section 8, including related development activities.”
- C. PIH [Public and Indian Housing] Notice 2003-23, section 8**, states, “no funds appropriated in FFY [federal fiscal year] 2003 may be used by any PHA [public housing agency] to lease more units than are authorized for that PHA. Each PHA must take immediate steps to eliminate any current over-leasing, so that unit months leased for its FY [fiscal year] 2003 do not exceed unit months available. Effective with PHA fiscal years ending June 30, 2003, any over-leasing expenses must be covered by existing ACC [annual contributions contract] reserves from pre-2003 appropriations, administrative fee reserves or funds already available to the PHA prior to the FFY 2003 appropriation. PHAs that are over-leased must take whatever steps are necessary to ensure that any over-leasing that cannot be supported from these sources is eliminated. PHAs should consult with their Public Housing field office staff for assistance in determining needed actions. Any costs for over-leasing will be disallowed from FFY 2003 funds on the year-end settlement.”
- D. PIH Notice 2004-7, section 8**, states, “PHAs should continue to be aware of the policy on unauthorized transfers of the administrative fee reserve. This restriction applies to reserves emanating from FFY 2003 and prior years. Transfer of amounts from the operating 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.”
- E. PIH Notice 2007-14, section (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.”
- F. HUD Handbook 7420.3, chapter 5(c)**, states, “except for unauthorized transfers or unallowable expenditures from the Operating reserve, AHMB [Assisted Housing Management Branch] should not judge the advisability of any expenditures for other housing purposes, since use of the Operating Reserve for other housing purposes is a matter of PHA discretion; the PHA is responsible for determining that such expenditures are necessary and reasonable for housing purposes consistent with State and local law.”

G. PIH Low-Rent Technical Accounting Guide 7510.1G:

- a. **Part 2-15** states, “the HA [housing agency] 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.”
- b. **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.”