



Issue Date November 25, 2008

Audit Report Number 2009-LA-1003

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 Area Housing Authority of the County of Ventura, California, Did Not Comply with HUD Requirements In Its Annual Contributions Contract

HIGHLIGHTS

What We Audited and Why

We audited the Area Housing Authority of the County of Ventura's (Authority) Payment-in-Lieu-of-Taxes obligations for its Low Rent Public Housing program. We initiated the audit based on concerns over the Authority's compliance with its annual contributions contract. Our audit objective was to determine whether the Authority fulfilled its Payment-in-Lieu-of-Taxes obligations for its Low Rent Public Housing program and if not, whether applicable funds were used in accordance with U.S. Department of Housing and Urban Development (HUD) requirements.

What We Found

The Authority disregarded its Low Rent Public Housing program's Payment-in-Lieu-of-Taxes obligations to the County of Ventura (County), including the cities of Ojai, Moorpark, Camarillo and Thousand Oaks (Cities), contrary to its consolidated annual contributions contract and cooperation agreements. Without the required approval from the County, the Cities, and HUD, the Authority's accounting records indicated that it stopped payment of its Payment-in-Lieu-of-Taxes obligations in 2001 and instead allocated \$637,428 in reserves between 2001 and 2007, which it maintained in an interest bearing bank account. Additionally, although the Authority had not made an attempt to

pay this obligated amount, it continued to report this obligation as an expense in its audited financial statements (except for 2004 and 2005). It also requested and received additional funding from HUD to make this Payment-in-Lieu-of-Taxes obligation as part of an additional expense incurred for calendar years 2007 and 2008 in the amount of \$195,643. Further, despite not being paid, the County and the Cities have continued to provide public services and facilities for the Authority's Low Rent Public Housing program units.

What We Recommend

We recommend that HUD require the Authority to comply with HUD's requirements regarding the use of Payment-in-Lieu-of-Taxes funds with the County and the Cities by settling its Payment-in-Lieu-of-Taxes obligations to the County in the amount of \$637,428 or reimburse HUD \$736,315.

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 Authority a discussion draft report on October 17, 2008, and held an exit conference with the Authority's officials on October 23, 2008. The Authority provided written comments on November 13, 2008, and generally disagreed with our findings.

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 Area Housing Authority of the County of Ventura (Authority) is an independent, nonprofit agency serving the unincorporated areas of Ventura County and the cities of Camarillo, Fillmore, Moorpark, Ojai, Simi Valley, and Thousand Oaks. It is governed by a locally appointed board of 15 commissioners, appointed by each jurisdiction.

The Authority administers the U.S. Department of Housing and Urban Development (HUD)-funded Low Rent Public Housing and Section 8 Housing Choice Voucher programs. It owns, manages, and maintains 355 housing units within its Low Rent Public Housing program. It was awarded \$702,325 under the Low Rent Public Housing program, \$23,146,722 under the Housing Choice Voucher program, and \$459,914 under the Public Housing Capital Fund program for fiscal year 2007.

We initiated the audit over concerns that the Authority may not have been in compliance with its annual contributions contract, specifically its Payment-in-Lieu-of-Taxes obligations. Our objective was to determine whether the Authority fulfilled its Payment-in-Lieu-of-Taxes obligations for its Low Rent Public Housing program and if not, whether applicable funds were used in accordance with HUD requirements.

RESULTS OF AUDIT

Finding 1: The Authority Disregarded Its Payment-in-Lieu-of-Taxes Obligation

The Authority disregarded its Payment-in-Lieu-of-Taxes obligation contrary to its consolidated annual contributions contract and cooperation agreement requirements. It also continued to report its Payment-in-Lieu-of-Taxes obligations as an expense in its audited financial statements and financial submissions to HUD. Authority management disregarded HUD regulations and agreements due to concerns over funding. It also continued to inaccurately report Payment-in-Lieu-of-Taxes expenses. As a result, the Authority received HUD funding for the operation of its Low Rent Public Housing program that it did not expend for the continued operation of that program, thus obligating HUD funds which could have been used to subsidize additional housing expenses.

Payment-in-Lieu-of-Taxes Obligation Requirements Were Ignored

In May 2002, the Authority determined that it would no longer pay its Payment-in-Lieu-of-Taxes obligation to the County of Ventura (County), including its cities of Ojai, Moorpark, Camarillo and Thousand Oaks (Cities). The Authority claimed that due to many new restrictions and requirements regarding its operations imposed by HUD, along with reduced funding, its ability to maintain its program would face uncertainty if its Payment-in-Lieu-of-Taxes obligation was paid. However, the County requested that the Authority reconsider its position as the County also had continuing and increasing financial obligations, which could only be met if all of its partners met their commitments. No agreement was reached between the County and the Authority on the waiver of the Payment-in-Lieu-of-Taxes obligation in question. The County has also continued to provide public services and facilities for the Authority's Low Rent Public Housing program units, despite not being paid.

Further, the Authority had not requested or received written approval from HUD for the amendment of its cooperation agreements as required in its annual contributions contract. Therefore, it ignored both its cooperation agreements with the County, its Cities, and its annual contributions contract (see appendix C).

**The Payment-in-Lieu-of-Taxes
Obligation Was Used to
Determine Operating Subsidy**

The Authority’s Low Rent Public Housing program operating subsidy funding was determined by including a Payment-in-Lieu-of-Taxes expense in its calculation. The Authority reported an expense for Payment-in-Lieu-of-Taxes in the amount of \$96,756 for fiscal year 2007, \$95,891 for fiscal year 2006, and \$87,800 for fiscal year 2003 in its financial submissions to HUD. Therefore, it incorrectly certified that it incurred \$280,447 in Payment-in-Lieu-of-Taxes expenses in its electronic filing of financial information to HUD’s Real Estate Assessment Center system.

Further, it accrued the following Payment-in-Lieu-of-Taxes expenses for fiscal years 2001 through 2007:

Fiscal year ending	Payment-in-Lieu-of-Taxes due to the County
June 30, 2001	\$85,746
June 30, 2002	87,294
June 30, 2003	87,800
June 30, 2004	91,246
June 30, 2005	92,695
June 30, 2006	95,891
June 30, 2007	96,756
Total	\$637,428

None of the amounts were paid to the County or the Cities. Moreover, although the Authority accrued these amounts in its accounting records, it wrote the amounts off its books, leaving no accrued liability to the County or the Cities for its Payment-in-Lieu-of-Taxes obligations. This action was taken upon at the direction of Authority management as the Authority had no intention of fulfilling its Payment-in-Lieu-of-Taxes obligations. However, as the Authority did not seek or receive the approval from the County or HUD for the waiver of its Payment-in-Lieu-of-Taxes obligation, it remained liable for \$637,428 in Payment-in-Lieu-of-Taxes fees to the County and the Cities. Nevertheless, the Authority had been accruing this obligation in an interest bearing bank account.

For the calculation of the Authority’s Low Rent Public Housing program’s operating subsidy for the years 2001 through 2006, a Payments-in-Lieu-of-Taxes expense was included in computing its allowable expense level for the calculation of its yearly operating subsidy. For calendar year 2007, the Authority requested and received additional funding in the amount of \$98,887 as an additional expense. The Authority requested additional funding for its 2008 calendar year operating subsidy request, which had not been finalized, yet had been distributed to the Authority in the amount of

\$96,756. HUD provided additional funding for calendar years 2007 and 2008 for the Payment-in-Lieu-of-Taxes expense for the Low Rent Public Housing program's operating subsidy. Thus, the Authority received HUD funding for the operation of its Low Rent Public Housing program that it had not expended for the continued operation of the program. As a result, the Authority received funding from HUD for Payment-in-Lieu-of-Taxes obligations that it had not met or otherwise spent on the operation of the Low Rent Public Housing program.

Conclusion

The Authority disregarded its Payment-in-Lieu-of-Taxes obligations and requirements for fiscal years 2001 through 2008. Since this obligation was used to determine the Authority's operating subsidy, it was not only essential but required that HUD be notified of any amendments made to the Authority's cooperation agreements. Instead, the Authority ceased all Payment-in-Lieu-of-Taxes payments and continued to report and request funding for its Payment-in-Lieu-of-Taxes obligations. As a result, it incorrectly certified that it had submitted accurate and complete financial data to HUD. Consequently, the Authority received HUD funding for the operation of its Low Rent Public Housing program that it did not expend for the continued operation of that program, thus obligating HUD funds which could have been used to subsidize additional housing expenses.

Recommendations

We recommend that the Director of the Los Angeles Office of Public Housing

- 1A. Require the Authority to comply with the annual contributions contract and cooperation agreements with the County and the Cities by either settling its Payment-in-Lieu-of-Taxes obligations to the County and the Cities in the amount of \$637,428 or reimbursing HUD \$736,315¹ for funding provided for years 2001 through 2008.

¹ \$637,428 includes a Payment-in-Lieu-of-Taxes obligation for the fiscal year ending June 30, 2007, in the amount of \$96,756. However, the Authority requested \$98,887 for the calendar year ending December 31, 2007; therefore, we adjusted the total amount due to the County and HUD in the amount of \$2,131 to reflect actual funding provided by HUD. The Authority also requested \$96,756 from HUD to pay its Payment-in-Lieu-of-Taxes obligation for the calendar year ending December 31, 2008.

SCOPE AND METHODOLOGY

We performed our on-site audit work from June 9 through July 8, 2008, at the Authority located in Newbury, California. The audit generally covered the period July 2003 through June 2008. We expanded our scope when necessary.

To accomplish our objectives, we

- Reviewed applicable HUD regulations at 24 CFR [*Code of Federal Regulations*] Parts 982 and 990, HUD's Program Accounting Handbook 7420.6, and HUD's Low-Rent Technical Guide 7510.1G.
- Obtained an understanding of the Authority's procedures, including its controls to ensure that it paid its Payment-in-Lieu-of-Taxes obligation.
- Reviewed HUD's Los Angeles Office of Public and Indian Housing files relating to the Authority's operating subsidy funding.
- Reviewed the Authority's independent public accountant reports for fiscal years 2003 through 2007.
- Interviewed Authority finance personnel to acquire an understanding of the Authority's financial operations, practices, tracking, and controls.
- Reviewed the Authority's annual contributions contract and cooperation agreement to determine Payment-in-Lieu-of-Taxes obligations and requirements.
- Reviewed communication between the Authority and the County to determine whether the Authority's Payment-in-Lieu-of-Taxes obligations were properly administered.
- Reviewed bank statements, check registers, cash journal, and supporting documentation related to the accrual and payment of Payment-In-Lieu-of-Taxes for years 2001 through 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 that management has implemented to ensure compliance with its Payment-in-Lieu-of-Taxes obligation.
- Policies and procedures that management has implemented to ensure accurate, current, and complete disclosure of financial results.

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 did not have sufficient controls in place to ensure that it paid its Payment-in-Lieu-of-Taxes obligation in accordance with applicable laws and regulations (see finding 1).

APPENDIXES

Appendix A

SCHEDULE OF FUNDS TO BE PUT TO BETTER USE

Recommendation number	Funds to be put to better use <u>1/</u>
1A	\$736,315 ²

- 1/ Recommendations that funds be put to better use are quantifiable savings that are anticipated to occur 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. In this instance, if HUD implements our recommendation, \$736,315 in Low Rent Public Housing funds the Authority received from HUD to be used for its Payment-in-Lieu-of-Taxes obligations would be put to better use by allowing HUD to recapture the funds rather than allowing the funds to sit idle in a bank account.


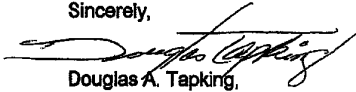

² \$637,428 includes a Payment-in-Lieu-of-Taxes obligation for the fiscal year ending June 30, 2007, in the amount of \$96,756. However, the Authority requested \$98,887 for the calendar year ending December 31, 2007; therefore, we adjusted the total amount due to the County and HUD to \$2,131 to reflect actual funding provided by HUD. The Authority also requested \$96,756 from HUD to pay its Payment-in-Lieu-of-Taxes obligation for the calendar year ending December 31, 2008.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

 Area Housing Authority of the County of Ventura 1400 W. Hillcrest Drive, Newbury Park, CA 91320-2721 • 805/480-9991 • 1/800/800-2123 • FAX: 805/480-1021
November 13, 2008
Joan S. Hobbs Regional Inspector General for Audit Office of Inspector General United States Department of Housing and Urban Development Region IX 611 West Sixth Street, Suite 1160 Los Angeles, CA 90017-3101
Subject: Response to OIG's Draft Audit Report of November 2008
Dear Ms. Hobbs:
Attached is the Area Housing Authority's response to your November 2008 Audit report. It is imperative to note that the Area Housing Authority is not in possession of the final draft report; therefore, our response is predicated upon the agreement to corrections to the November 5, 2008 version.
As requested, our response has been electronically submitted (PDF format) to you today and the original has been mailed to your attention.
Sincerely,  Douglas A. Tapking, Executive Director
cc: K.J. Brockington, Director, Los Angeles Office of PIH
 Serving the cities of Camarillo, Fillmore, Moorpark, Ojai, Simi Valley, Thousand Oaks, and the Unincorporated Areas of Ventura County An Equal Opportunity Employer



Area Housing Authority of the County of Ventura
*Serving the cities of Camarillo, Fillmore, Moorpark, Ojai, Simi Valley, Thousand
Oaks, and the unincorporated areas of the County of Ventura*

**Final Written Response to:
Office of Inspector General
Draft Audit Report of November 5, 2008**

Respectfully Submitted November 12, 2008
One hardcopy original via US Mail and one electronic file (PDF format)

**Area Housing Authority of the County of Ventura
Response to Final Draft Audit of November 5, 2008**

Comment 1

The Area Housing Authority of the County of Ventura (the Authority) acknowledges that since June 2001 it has not forwarded funds for payment in lieu of taxes (PILOT) for the seven low income public housing complexes it owns, but it submits that it did so in compliance with applicable laws, agreements, directives and the best interests of the jurisdictions it serves.

- Section 34401 of the California Health and Safety Code states that an Authority is exempt from taxes and may agree to make payments in lieu of such taxes ("PILOT"):

"The property of an authority is exempt from all taxes and special assessments of the State or any city, county, or political subdivision of the State. In lieu of such taxes or special assessments the authority may agree to make payments to any city, county, or political subdivision of the State for services, improvements, or facilities furnished by such city, county, or political subdivision of the State for services, improvements, or facilities furnished by such city, county, or political subdivision for the benefit of a housing project owned by the authority; but in no event shall such payments exceed the estimated cost to such city, county, or political subdivision of the services, improvements, or facilities."

- Section 4 of the Annual Contributions Contract (ACC) states the "mission" of the Authority in fulfilling the HUD public housing objectives as follows:

"The HA shall at all times develop and operate each project solely for the purpose of providing decent, safe, and sanitary housing for eligible families in a manner that promotes serviceability, economy, efficiency, and stability of the projects and the economic and social well-being of the tenants"

Comment 2

- The Authority receives no additional funds from the jurisdictions it serves, as such, funds for each public housing property come solely from HUD subsidy and the rents collected. Since the year 2000, HUD subsidy has been funded at a level leaving the Authority with a short-fall in excess of \$500,000 for this period. This under-funding has had a direct and materially adverse effect on the Authority's ability to maintain the integrity of the program and faithfully meet the goals and objectives in Section 4 of the ACC.
- Faced with significant under-funding, the Authority could and did consider several options in order to continue to fulfill the mission and goals prescribed by HUD, and expected by the Authority's constituted cities and county (the "jurisdictions"). Among options available to the Authority, the Authority's Board of Commissioners eventually elected not to make the PILOT payment. It did not do so lightly, but only after diligent review and analysis. After being briefed about the applicable laws, the Board of Commissioners concluded and believed that the nonpayment of the PILOT was not only a financial necessity in light of the under-funding, but also that it was legally permissive and not contrary to the Health and Safety Code Section 34401. Health and Safety Code Section 34401 does not mandate the payment of PILOT, but instead describes it as a permissible payment: "*the authority may agree to*

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Response to Final Draft Audit of November 5, 2008**

make payments" to the participating jurisdictions.

Comment 3

- Based on general discussions with some of the affected constituent jurisdictions, the Authority believed it had the verbal agreement with these jurisdictions to withhold the PILOT payment as a critical means for bridging the HUD under-funding since the funds were earmarked for public housing programs benefiting these very jurisdictions.

Comment 4

- The pivotal finding in the Audit concludes that, aside from consent or agreement with the constituent jurisdictions to forego payment of the PILOT, such action also required the written approval of HUD. The Authority respectfully disagrees.

Comment 1

- Section 6 of the ACC provides as follows:

"During the development and operation of the project(s), the HA shall perform and comply with all applicable provisions of the Cooperation Agreements(s), in the form prescribed by HUD, including the making of payment in lieu of taxes provided therein (or such lesser amount as may be prescribed by State law or agreed to by the local governing body, shall at all times preserve and enforce its rights thereunder, and shall not terminate or amend the Cooperation Agreement(s) without the written approval of HUD."

Comment 4

- Reduced to its essence, Section 6 states that the Authority shall not terminate or amend the prescribed template form of Cooperation Agreement (neither of which was involved in this case) and that the Authority will otherwise comply with the Cooperation Agreement, except that upon agreement with the constituent jurisdictions, the PILOT payment can be reduced to some "lesser sum" – which presupposes total reduction as well -- so long as it was "agreed to by the local governing body" By its terms, the latter does not require the written approval of HUD, that being only a requirement for major changes which seek to "amend" or "terminate" the sanctioned form of Cooperation Agreement. It is a logical conclusion that HUD would require approval before the amendment or termination of its template Cooperation Agreement, but as to the decision to forego the PILOT payment, that is an act which impacts the affected governmental entity and thus could be accomplished in bilateral agreement, without the consent of approval of HUD. A closer reading of Section 6 shows that, in effect, the "written approval" qualifies only the "terminate or amend" elements in Section 6, and not the first one, which is left to agreement between the affected public entity and the Authority. Arguably, had consent been required for the PILOT payment reduction, Section 6 would have expressly provided that each of the three changes discussed, required written approval. That is not the case.

Comment 5

- It is also noteworthy that the same body of law that creates PILOT provides that no consequences flow from the non-payment of an agreed PILOT payment. Section 3(d) of the Cooperation Agreement provides that upon the failure of an Authority to make any PILOT payment, no lien against any project or assets of the Authority shall attach, nor shall any interest or penalties accrue or attach on account thereof. It was therefore understood that a non-mandatory payment, which carries no penalty for non-payment, is not material between

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the Authority and the jurisdictions and, therefore, it would follow that HUD leaves such matters to be negotiated between the jurisdictions and the Authority. HUD's sanction was not required in this situation, unlike material amendments or a termination of the Cooperation Agreement.

**Comment 1
Comment 3**

- Section 6 of the Cooperation Agreement allows the Authority to withhold the PILOT payment, if there has been a failure by the jurisdictions to provide the agreed level of support without HUD written consent. This is applicable to the present situation in that a funding short fall creates a gap in the Authority's ability to provide the public housing in accordance with the HUD mission and in the best interest of the tenants. The Cooperation Agreement allows for the unilateral withholding of the PILOT payment. What is important is the agreement and applicable laws contemplated that the withholding of the PILOT program is done by either negotiation or unilateral action, without otherwise requiring HUD written approval.

Comment 1

**Comment 3
Comment 5**

- The Authority respectfully submits that HUD's written consent was not required, absent a more material "amendment" or "termination" of the Cooperation Agreement, because the Authority believed it was acting with the verbal approval of the affected jurisdictions. The audit report stated that public services did not subside from non-payment of PILOT. Tenants did not suffer, nor was their quality of life impacted, due to non-payment of PILOT. The non-payment of the PILOT payment enabled the Authority to preserve public housing consistent with the HUD mission and the objectives of the jurisdictions, in spite of the under-funding it faced over those years.

Comment 6

The Authority disagrees that it inaccurately reported PILOT as an expense in its audited financial statements and financial submissions to HUD.

- It is at HUD's recommendation, and in accordance with Generally Accepted Accounting Principles (GAAP), that the Authority utilizes the accrual method of accounting. GAAP are the basis of financial accounting and reflect federal financial accounting standards.
- The Authority's accounting transactions are recorded using the accrual method of accounting. Therefore, revenues are recognized in the period earned and expenses are recognized in the period incurred. The Authority operates on fiscal calendar which ends on June 30th.
- The Authority adheres to HUD's instructions to accurately calculate PILOT by waiting until all rent revenue is recorded for the fiscal year. This occurs after June 30th. In order to record the PILOT expense in the applicable year, it must be properly accrued and set up as a liability.

Comment 7

Area Housing Authority of the County of Ventura Response to Final Draft Audit of November 5, 2008

The Authority firmly and strongly disagrees that it received HUD funding for the operation of the Low Rent Public Housing program that was not expended for the continued operation of that program, and thus obligating HUD funds which could have been used to subsidize additional housing expenses.

- There is a clear and unquestionable obligation by HUD to fund the Public Housing program, as stated by HUD in their public information regarding Public Housing Operating Subsidy:

"The Public Housing Operating Fund provides operating subsidies to housing authorities (HAs) to assist in funding the operating and maintenance expenses of their own dwellings, in accordance with Section 9 of the U.S. Housing Act of 1937, as amended. The subsidies are required to help maintain services and provide minimum operating reserves."

- During this period of time, under-funding by HUD thrust the Authority into a precarious position where it was over \$500,000 short of its needs to operate the programs in accordance with HUD mission and in jeopardy of not meeting its contractual obligations. By HUD's own definition, the public housing program is "to provide decent and safe rental housing for eligible low-income families, the elderly, and persons with disabilities."
- Contrary to the HUD audit finding, it is the very questioned retention of the PILOT funds (which were segregated and earmarked for future operations and asset maintenance) that enables the Authority to meet its mission that all public housing properties are maintained "in a manner that promotes serviceability, economy, efficiency, and stability of the projects and the economic and social well-being of the tenants". Without further funding from HUD or the affected jurisdictions, this would not have been possible. The fact that the funds were segregated and deposited in a separate account for such future needs, is a distinction of form and not substance: the funds were not lost to the intended public housing programs, but were being aggregated for more efficient use.
- Specifically, it is the case that:
 - Some of these funds were utilized to cover operational shortfalls due primarily to the pro-ration reduction in annual operating subsidy received from HUD during this timeframe.
 - HUD operating subsidy calculation form 52723 does not indicate a line item pro-ration basis, but rather on the total eligible subsidy due the Authority. Also, according to Chapter 2, Section 7, of the *PIH Low-Rent Technical Accounting Guide 7510.1*, operating subsidies are provided to supplement project operating receipts, not to provide funds for specific expenditures.
- The Authority consigned the unpaid PILOT funds solely to the public housing program in response to HUD's under-funding this program. As these funds are, by definition, paid to non-HUD entities, there was no improper utilization of HUD funds that could have been used for other programs.

Comment 8

**Area Housing Authority of the County of Ventura
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The Authority disagrees that it did not have sufficient controls in place to ensure that it paid its PILOT obligation in accordance with applicable laws and regulations.

- The AHA denies that there is any weakness in its internal controls and requests the OIG to remove its comment.
- The payment of PILOT is a cash disbursement. The Authority has specific internal controls regarding cash disbursements. These internal controls include the authorization and approval of cash disbursements. The approval process, among other things, must verify that the transaction is consistent with agency policy.
- All internal controls were in place and were followed. If the payment had been made, this action would be evidence of a lack of internal controls.
- At the direction of the Board of Commissioners, Authority management consigned the funds earmarked for PILOT to be utilized solely within the Low Rent Public Housing program. The Board of Commissioners, as established pursuant to Section 34246 of the Health and Safety Code, is the governing entity of the Authority and the architect of policy governing the operations of the Authority. Each jurisdiction appoints two Commissioners to be a conduit of two-way information between the appointing jurisdiction and the Authority. One Resident Commissioner is appointed "at-large". Additionally Section 34200 et al. of the Health and Safety Code further describes the intent and full authority of the Board of Commissioners in matters regarding the Authority.
- Contrary to the characterization in the audit report, this is not a case where systems failed; rather, this is a considered and deliberate action by the Authority's governing board to respond to funding shortfall that threatened its ability to carry out its prescribed mission. No matter what systems or controls were in place, the operating event is the deliberative process by the governing board and its action to withhold the PILOT payment, consistent with the governing laws and agreements, as outlined above. The Authority's Board of Commissioners, the duly appointed governing body, directed executive management that PILOT was not to be paid unless otherwise directed by the Board, thus disapproving the cash disbursement. This directive was made in a regularly scheduled, public meeting and duly noted in the meeting Minutes. The meeting Minutes were distributed according to procedure to the respective jurisdictions, specifically the City Managers' offices and County Executive Office, and to the media.

OIG Evaluation of Auditee Comments

- Comment 1** We disagree that the Authority complied with applicable laws and agreements. The Authority passed a resolution contrary to the provisions of its cooperation agreement(s) requirements and annual contributions contract with HUD. Although Section 34401 of the California Health and Safety Code states that an Authority is exempt from taxes and “may agree to make payments to any city, county, or political subdivision of the State for services,” the Authority is also subject to its annual contributions contract with HUD. Section 6 of the contract stipulates that the Authority will “perform and comply with all applicable provisions of the Cooperation Agreement(s), in the form prescribed by HUD, including the making of payments in lieu of taxes.” In our opinion, the term “may agree” indicates that the Authority has the opportunity to enter into such cooperative agreements with its jurisdictions, not whether it has the option to actually make the payments after entering into the agreement. Additionally, the Authority has entered into cooperation agreements with its respective jurisdictions and has not provided any amendments thereof. HUD entered into an agreement with the Authority and provided funding for the intent of paying Payment-In-Lieu-Of-Taxes obligations, but the Authority chose not to make the payments. Therefore, the Authority is not in compliance with its annual contributions contract with HUD and its cooperation agreements with its respective jurisdictions. We also noted that at no time did the Authority approach HUD and either inform HUD that it was no longer going to make payments, or obtain a written waiver or approval to do so.
- Comment 2** The Authority’s Executive Director is responsible for the Authority’s compliance with the Annual Contributions Contract with HUD. If the amount of the HUD subsidy left the Authority in a position in which it was unable to fully comply with the Annual Contributions Contract, the Executive Director should have sought guidance from HUD and/or written approval to discontinue making the agreed upon payments.
- Comment 3** The Authority did not provide any documentation outlining the verbal agreement with its respective jurisdictions for the approval to withhold its Payment-In-Lieu-Of-Taxes obligations. In our opinion, this does not make sense that the jurisdictions would agree to continue providing services, but not expect to be paid. Additionally, correspondence between the Authority and the County of Ventura, one of its jurisdictions, shows there was never an agreement made for the withholding of Payment-In-Lieu-Of-Taxes payments. Contrary, the County requested that the Authority reconsider its decision to withhold its required Payment-In-Lieu-Of-Taxes payments as they too had continuing and increasing financial obligations, which could only be met if all of its partners met their commitments. Given the above, we also question why the Authority chose not to make any payments at all, and why partial payments were not considered.

Comment 4 The Authority's cooperation agreements all require that "an annual Payment in Lieu of Taxes (PILOT) will be made at the end of each fiscal year in the amount of ten percent (10%) of the Shelter Rent charged by the HA to its tenants or the amount permitted by applicable state law, whichever amount is lower." Further, in section 9 of the agreements, it states that the "agreement shall not be abrogated, changed, or modified without the consent of the Government." The Authority claims to have entered into a mutual agreement with its jurisdictions to amend, change the amount of Payment-In-Lieu-Of-Taxes paid by withholding such payments. Thus, the Authority did in fact amend its cooperation agreements if it attained the required approval from each of its jurisdictions and therefore requires written approval from HUD. Nonetheless, the Authority decided to withhold its Payment-In-Lieu-Of-Taxes obligations and continued to receive (for years 2001 through 2008) and request additional funding (for 2007 and 2008) for the payment of this obligated amount.

Comment 5 We disagree. While the Authority may not have suffered any material consequences, both the jurisdictions and HUD did. As acknowledged by the Authority, the jurisdictions continued to provide the agreed upon services, but at its own expense. This provided an additional financial burden on these jurisdictions. In addition, HUD provided funding to the Authority, which was not used as intended. The Authority provides an operational budget to HUD every year for the funding of its Low Rent Public Housing program where according to Chapter 2, Section 6, of the Public and Indian Housing Low-Rent Technical Accounting Guide, 7510.1, "the budget constitutes the approved plan for expenditure of those funds." Moreover, "HA[s] must use the HUD-prescribed categories for the budget estimates and for subsequent financial transactions. The line item identification of the costs defines the approved use of the HUD funds to be provided, and the approved spending level for the HA in that program area." HUD provided funding for the Authority's Payment-In-Lieu-Of-Taxes obligations for years 2001 through 2008; funds that were not expended by the Authority as such. Thus, Low Rent Public Housing funds the Authority received from HUD funding to be used for its Payment-in-Lieu-of-Taxes obligations could have been used to subsidize other HUD programs rather than allowing the funds to sit idle in an interest bearing bank account.

Comment 6 We acknowledge that the Authority utilizes the accrual method of accounting in accordance with Generally Accepted Accounting Principles as the basis of its financial reporting. Further, we also recognize that the Authority's fiscal year ends on June 30. The Authority also waits until all rent revenue is recorded for its respective fiscal year, which occurs after June 30th, to accurately calculate its Payment-In-Lieu-Of-Taxes obligation. We did not take issue with any of these practices. However, we do take issue with the fact that the accruing and reporting of a liability that the Authority has no intention of paying is considered to be inaccurate financial reporting.

Based on general ledger reports for the Authority's Payment-In-Lieu-Of-Taxes liability account, it had accrued for each year's Payment-In-Lieu-Of-Taxes obligation since 2001. However, it wrote off accruals for 2001 through 2004 at the decision of its management team as they had no intention of making the obligated Payment-In-Lieu-Of-Taxes payments. The accruals/liability were never recorded for fiscal year 2005 and the Authority resumed its Payment-In-Lieu-Of-Taxes accrual for fiscal years 2006 and 2007. The accrual for fiscal year 2006 was written off in fiscal year ended 2007. As a result, the liability account for its Payment-In-Lieu-Of-Taxes obligation had a balance of \$96,756, its Payment-In-Lieu-Of-Taxes calculation for fiscal year 2007, as of June 4, 2008. Because our audit coincided with the Authority's fiscal year end, it was in the process of calculating and recording its Payment-In-Lieu-Of-Taxes obligation for its fiscal year 2008.

As a result, the Authority has incorrectly reported Payment-In-Lieu-Of-Taxes expenses incurred for fiscal years 2007, 2006 and 2003 in its audited financial statements. Additionally, it has also reported to HUD Payment-In-Lieu-Of-Taxes expenses for fiscal years 2007, 2006 and 2003 it had not incurred as they had no intention of making the obligated Payment-In-Lieu-Of-Taxes payments.

Comment 7 At both the entrance conference with the Authority and meetings with Authority personnel during the audit fieldwork, the Authority assured us that all funds accrued and received for the payment of its Payment-In-Lieu-Of-Taxes obligations were accounted for and set aside in a bank account. At no time during the fieldwork did the Authority inform us that, or provide any documentation showing that Payment-In-Lieu-Of-Taxes funds were used to cover operational shortfalls. Authority management asserted it had maintained all funds and had not used such funds for any other purpose. The Authority also provided us with bank statements to an investment account showing that it maintained the Payment-In-Lieu-Of-Taxes funds in that account, with a total balance of \$7.9 million.

Additionally, we noted in Chapter 2, Section 6, of the Public and Indian Housing Low-Rent Technical Accounting Guide, 7510.1 it states that "the program area budget is based on the objectives of the program and the projected availability of funds for program outlays. Since funds provided by HUD for a particular program or purpose must be used only for that program or purpose, the budget constitutes the approved plan for expenditure of those funds." Moreover, "HA[s] must use the HUD-prescribed categories for the budget estimates and for subsequent financial transactions. The line item identification of the costs defines the approved use of the HUD funds to be provided, and the approved spending level for the HA in that program area. Once approved, a budget becomes both a blueprint for action and a control mechanism." Finally, Section 7 also outlines that all funds provided by HUD to a Housing Authority are for a particular program or purpose where "in each instance, the use of those funds is governed

by the program regulations, the program budget which constitutes the approved plan for expenditures of those funds.”

A Payments-in-Lieu-of-Taxes expense was included in computing the Authority’s allowable expense level for the calculation of its yearly operating subsidy for the years 2001 through 2006 and for calendar years 2007 and 2008 they requested and received additional funding for the payment of its Payments-in-Lieu-of-Taxes expense they had no intention of fulfilling. In addition, even though the Authority claims it expended a portion of the accrued funds intended for the fulfillment of its Payments-in-Lieu-of-Taxes obligation, HUD provided funding specifically for the intention of the payment of the Authority’s Payments-in-Lieu-of-Taxes obligation. Therefore, they did not use the funds in a manner consistent with HUD regulations. As a result, \$736,315 in Low Rent Public Housing funds the Authority received from HUD to be used for its Payment-in-Lieu-of-Taxes obligations could have been used to subsidize other HUD programs rather than allowing the funds to sit idle in an interest bearing bank account.

Comment 8 We disagree. As stated in the Internal Controls section of the report, internal control is an integral component of an organization’s management that provides reasonable assurance that the organization complies with applicable laws and regulations. We concluded that there was a significant weakness in the Authority’s internal controls because it did not ensure that it paid the Payment-In-Lieu-Of-Taxes obligations as required by the Annual Contributions Contract with HUD and the cooperative agreements with its jurisdictions. The Authority passed a resolution contrary to its Cooperation Agreement(s) requirements and Annual Contributions Contract with HUD. The Authority’s Board of Commissioners passed a resolution to stop its Payment-In-Lieu-Of-Taxes payments; however, failed to provide documentation of the waiver/ agreement of such action from each of its jurisdictions.

Appendix C

CRITERIA

Consolidated Annual Contributions Contract, Number SF-568, March 21, 2002, states as follows:

- **Section 6, Cooperation Agreement(s)**, states that the Authority must perform and comply with all applicable provisions of the cooperation agreement(s) including the making of payments in lieu of taxes. The Authority may not terminate or amend the cooperation agreement(s) without the written approval of HUD.
- **Section 9(C)(1), Depository Agreement and General Fund**, states that the Authority may only use funds outlined under the annual contributions contract for payment of expenses related to the development and operation of projects controlled under the provisions of the annual contributions contract.

The cooperation agreement between the County and the Authority, section 9, requires the Authority to pay an annual Payment-in-Lieu-of-Taxes to the County at the end of each fiscal year in the amount of 10 percent of the shelter rent received from its tenants or the amount permitted by applicable state law, whichever amount is lower. Additionally, it states that the agreement cannot be modified without the consent of HUD.

24 CFR 982.153, PHA [public housing authority] Responsibilities, requires public housing authorities to “comply with the consolidated ACC [annual contributions contract], the application, HUD regulations and other requirements, and the PHA administrative plan.”

24 CFR 982.156, Depository [sic] for Program Funds, states that a “PHA [public housing authority] may only withdraw deposited program receipts for use in connection with the program in accordance with HUD requirements.”

24 CFR 990.105(a), Computation of Base Year Expense Level, states that Payments-in-Lieu-of-Taxes required by an authority’s cooperation agreement are to be included as part of the base year expense level used to compute its allowable expense level for the calculation of an authority’s yearly operating subsidy.

24 CFR 990.190(c), Other Formula Expenses (add-ons), states that in addition to calculating a public housing authority’s operating subsidy based on the project and utilities expense level, an authority’s eligible formula expenses, used to calculate its operating subsidy, may be increased by allowed add-on expenses. An amount for payment in lieu of taxes in accordance with section 6(d) of the United States Housing Act of 1937 may be added as an eligible expense in determining the authority’s annual operating subsidy.

PIH [Public and Indian Housing] Low-Rent Technical Accounting Guide 7510.1G, chapter 2-13, requires housing authorities to establish sufficient controls to ensure proper accounting for cash and full identification of audit trails. “Accounting controls ensure that the accounting

system used by the HA [housing authority] accurately identifies the source, use, and remaining balance of individual program cash resources.” Additionally, all funds received from HUD program funding are “restricted to the specific purposes authorized in the program budgets.” Chapter 2-15, stipulates that although funds may be pooled together for any expenditures chargeable to the housing authority’s programs, program funds are not fungible, and “funds shall not be withdrawn for a program in excess of the amount of funds on deposit for that particular program.” All funds pooled together that result in “due to/due from” transactions must be “reconciled at the end of each reporting period to ensure that they are in balance.” Further, chapter 11-16 specifies that all funds provided by HUD are to be used by the housing authority only for the purposes for which the funds are authorized.