



U.S. Department of Housing and Urban Development

Office of Inspector General

Region IX

611 West Sixth Street, Suite 1160

Los Angeles, CA 90017

Voice (213) 894-8016

Fax (213) 894-8115

Issue Date

May 5, 2011

Audit Report Number

2011-LA-1802

MEMORANDUM FOR: K.J. Brockington, Director, Los Angeles Office of Public Housing, 9DPH

Dane M. Narode, Associate General Counsel for Program Enforcement,
CACC

Tanya E Schulze

FROM: Tanya E. Schulze, Regional Inspector General for Audit, 9DGA

SUBJECT: The Housing Authority of the City of Los Angeles, Los Angeles, CA,
Charged Its Recovery Act Program Without Applying Cost Reductions or
Credits Related to Insurance Reimbursements

INTRODUCTION

We reviewed the hazard-damaged units that the Housing Authority of the City of Los Angeles (Authority) is rehabilitating using formula grant American Recovery and Reinvestment Act of 2009 (Recovery Act) Public Housing Capital Fund program (program) funds. We selected the Authority based upon the results of our capacity review of the Authority's Recovery Act program (see Office of Inspector General (OIG) audit report #2011-LA-1002, issued November 4, 2010) and concerns regarding the possibility of the Authority using Recovery Act program funds for the rehabilitation of hazard-damaged units while simultaneously obtaining insurance reimbursements related to those units from its commercial property insurance carrier. Our objective was to determine whether the Authority's use of Recovery Act program funds on hazard-damaged units subject to property insurance reimbursements was in accordance with U.S. Department of Housing and Urban Development (HUD) requirements.

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 AND METHODOLOGY

We performed our onsite review work at the Authority's administrative office at 2600 Wilshire Boulevard, Los Angeles, CA, from January through March 2011. The review generally covered the period March 18, 2009, through March 14, 2011. To accomplish our review objective, we

- Reviewed applicable laws and regulations; Public Law 111-5, American Recovery and Reinvestment Act of 2009; HUD's regulations at 24 CFR (Code of Federal Regulations) Parts 85, 905, 941, and 968; Office of Management and Budget (OMB) Circular A-87; HUD's Comprehensive Grant Program Guidebook 7485.3 G; HUD's Public and Indian Housing Notice 2009-12 (HA), providing information and procedures for processing the formula allocation of Recovery Act program grants; and the Authority's amended annual contributions contract agreement with HUD.
- Reviewed the Recovery Act program-funded contracts that the Authority executed to rehabilitate hazard-damaged units.
- Reviewed the Authority's property insurance policy related to the hazard-damaged units.
- Reviewed documentation for a total of 29 hazard-damaged units that the Authority was rehabilitating using formula Recovery Act program funds.
- Reviewed the Authority's internal policies and procedures related to property insurance claims and reimbursements for hazard-damaged public housing units.
- Reviewed the property insurance claims the Authority submitted to its property insurance carrier.
- Reviewed the cost of repairs reimbursed from property insurance and the Authority's general ledger account(s) into which the property insurance reimbursements were deposited.
- Interviewed Authority officials and staff regarding the Authority's processes for filing property insurance claims and for the posting of the receipt of insurance reimbursements to its general ledger.
- Interviewed the Authority's insurance carrier's officials regarding the Authority's property insurance coverage, claims history, and process for reimbursing property damage claims.

We did not perform our review in accordance with generally accepted government auditing standards. Our review solely focused on the policies and procedures the Authority had in place to ensure that its property insurance claims and receipt of property insurance reimbursements complied with all applicable regulations and other requirements; thus, this report is significantly reduced in scope and should not be considered a detailed analysis or assessment of the Authority's internal controls and operations. These facts do not affect the significance of the condition identified in this memorandum.

BACKGROUND

The Recovery Act, signed into law on February 17, 2009, provided \$4 billion for the program to be used for capital and management activities for public housing agencies as authorized under Section 9 of the U. S. Housing Act of 1937. The Recovery Act required that \$3 billion of these

funds be distributed by the same formula used for amounts made available in fiscal year 2008. The remaining \$1 billion was to be awarded on a competitive basis.

The 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. The Authority has 14 public housing developments and a total of 6,514 units.

The Authority was awarded \$33 million from the Recovery Act program; \$25 million was its proportional share of the \$3 billion formula grant, and \$8 million was part of the \$1 billion competitive grant. The formula and competitive Recovery Act program funds were made available to the Authority on March 18 and September 24, 2009, respectively.

Before this review, we had completed a capacity review of the Authority's formula program grant awarded under the Recovery Act (see OIG audit report #2011-LA-1002, issued November 4, 2010). The capacity review revealed that the Authority generally had adequate capacity to manage and administer its Recovery Act program funding. However, it identified weaknesses that could impact the Authority's ability to effectively manage and administer its Recovery Act program funding, including not properly procuring two of its contracts for the repair of 12 fire-damaged units at Nickerson Gardens. We did not review property insurance reimbursements as part of the capacity review.

The Authority's commercial property insurance policy deductible was \$50,000 and applicable to any one occurrence. Once the insurance carrier assesses the property damages, it reimburses the Authority for damages in two payments. The initial payment is for the majority of the property damages above the deductible. The final payment is a small holdback that is held until rehabilitation of the property is nearly complete or complete.

RESULTS OF REVIEW

The Authority improperly charged its Recovery Act program \$75,370 and an additional pending amount of \$8,018 without applying cost reductions or credits related to insurance reimbursements to its program. This condition occurred because the Authority lacked controls to prevent the duplication of charges related to property losses and to credit the appropriate program when costs are reimbursed from insurance. As a result, the Authority did not ensure that program funds were disbursed in accordance with applicable laws and regulations, fulfill the Recovery Act program's intent, or make the best full use of the program's funds.

The Authority Submitted Insurance Claims for Recovery Act-Funded Rehabilitation

Of the 29 hazard-damaged units the Authority was rehabilitating using formula grant Recovery Act program funds, it received insurance reimbursements for two fire-damaged units and was being reimbursed for a third fire-damaged unit. The Authority had already received the initial reimbursement payments totaling \$73,906 from its insurance carrier for the fire-related property damages to a Rancho San Pedro unit and a second Nickerson Gardens unit before charging its Recovery Act program for the rehabilitation cost. The Authority then received \$2,597 in holdback payments for the two units after charging its program. In addition, the Authority had

submitted a claim to the insurance carrier for a third fire-damaged unit, also located at Nickerson Gardens. The Authority had not received reimbursement for the third unit but expected to receive a total of \$6,885.

Violation of Applicable Laws and Regulations

The Authority violated applicable laws and regulations because it charged its program for rehabilitation work already reimbursed by its insurance carrier and did not credit its program for an insurance reimbursement received after it had charged its program.

Notice 2009-12 (HA), section V, Recovery Act Capital Fund Grant Distribution, states that under the Authority's amended annual contributions contract agreement with HUD, the Authority accepted responsibility for ensuring that capital and management activities would be carried out in accordance with all HUD regulations and other requirements applicable to the program and Recovery Act.

Guidebook 7485.3 G, paragraph 2-20(A)(5), states "Duplication of costs for repair of a unit damaged by fire or natural disaster where costs are being reimbursed from insurance" are ineligible physical improvement costs.

OMB Circular A-87, attachment A, paragraph (C)(4), states that applicable credits, such as insurance reimbursements, related to allowable costs shall be appropriately credited to the Federal award either as a cost reduction or cash refund. Further, Attachment A, paragraph (D)(1), states, "The total cost of Federal awards is comprised of allowable direct cost of the program, plus its portion of allowable indirect costs, less applicable credits."

The payment vouchers that the Authority submitted to HUD included certifications that the "funds requested on this voucher are correct and the amount requested is not in excess of immediate disbursement needs for this program. In the event the funds provided become more than necessary, such excess will be promptly returned as directed by HUD." Each voucher included a warning that HUD would prosecute false claims and statements, which could result in criminal and/or civil penalties.

Contrary to the applicable laws and regulations cited above, the Authority charged its Recovery Act program \$99,837 for the complete rehabilitation of one unit at Rancho San Pedro and \$68,616 for ongoing rehabilitation of a second unit at Nickerson Gardens without applying the initial insurance reimbursements of \$73,906 as cost reductions. In addition, the Authority did not credit its Recovery Act program for the Rancho San Pedro unit's holdback reimbursement. The initial insurance reimbursements and holdback were instead posted to the Authority's respective public housing development sites' other revenue/income accounts. Since the Authority had not posted the Nickerson Gardens unit's holdback to its general ledger as of March 14, 2011 (the conclusion of audit fieldwork), we were advised that this reimbursement would be posted to the appropriate Authority program. However, given the Authority's prior activity, it did not appear that the Authority would have credited the Recovery Act program if we had not inquired into the matter. This would also be the case for the anticipated insurance payments related to the third unit.

Unit	Public housing development	Recovery Act program funds charged		Initial payment from insurance		Final (holdback) payment from insurance	
		Date drawn	Amount	Date posted	Amount	Date posted	Amount
1	Rancho San Pedro	1/27/10	\$99,837	10/27/09	\$58,155	9/15/10	\$1,464
2	Nickerson Gardens	2/24/11	\$68,616	9/15/10	\$15,752	Unknown-to be determined	\$1,133
3	Nickerson Gardens	2/24/11	\$40,870		In process		
Totals			\$209,323		\$73,906		\$2,597

We attribute the Authority's violation of applicable laws and regulations to a lack of controls to prevent the duplication of charges related to property losses and to credit the appropriate program when costs are reimbursed from insurance. Due to poor communication between and among the Authority's departments, the Authority's Housing Services, Human Resources, and Asset/Grant Management Departments' staff did not provide sufficient supporting documentation to the Finance Department staff to assist in determining the appropriate general ledger accounts to which insurance reimbursements should be credited. The Authority relied on its officials to identify appropriate charges and determine to which accounts applicable credits were due. As a result, it did not ensure that program funds were disbursed in accordance with applicable laws and regulations, fulfill the Recovery Act program's intent, or make the best full use of the program's funds.

RECOMMENDATIONS

We recommend that the Director of HUD's Office of Public Housing instruct the Authority to

- 1A. Reimburse the Recovery Act program \$75,370 (\$73,906 + \$1,464) for the insurance reimbursements posted to other accounts.
- 1B. Confirm that the \$1,133 holdback and anticipated \$6,885 in insurance reimbursements associated with the Nickerson Gardens units are appropriately posted to the Recovery Act program. These amounts (\$8,018) will be considered funds to be put to better use.
- 1C. Revise its policies and procedures to ensure that cost reductions are applied before disbursing Recovery Act funds and that credits are applied once reimbursements are received by the Authority. This measure will assure HUD that capital funds, including those provided under the Recovery Act, will be disbursed in accordance with applicable laws and regulations.

We recommend that HUD's Associate General Counsel for Program Enforcement

- 1D. Determine legal sufficiency and if legally sufficient, pursue remedies under the Program Fraud Civil Remedies Act against the Authority and/or its appropriate personnel for improperly charging its Recovery Act program as discussed in this audit memorandum.

AUDITEE'S RESPONSE

We provided the Authority a discussion draft memorandum on April 8, 2011, and held an exit conference with the Authority's officials on April 20, 2011. The Authority provided written comments on April 22, 2011. The Authority generally agreed with the finding and recommendations 1A to 1C, but disagreed with recommendation 1D for HUD to consider Civil Action.

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

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Funds to be put to better use 2/
1A	\$75,370	
1B		\$8,018

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.
- 2/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. If the Authority implements our recommendation to confirm that the \$1,133 insurance holdback reimbursement and anticipated \$6,885 have been appropriately posted to the Recovery Act program, it will ensure that \$8,018 in funds is put to better use.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

Comment 1

<u>Ref to OIG Evaluation</u>	<u>Auditee Comments</u>
	<p> HOUSING AUTHORITY OF THE CITY OF LOS ANGELES AN EQUAL EMPLOYMENT OPPORTUNITY- AFFIRMATIVE ACTION EMPLOYER 2600 Wilshire Boulevard • Los Angeles, California 90057 • (213) 252-2500 TTY (213) 252-5313</p> <p>April 22, 2011</p> <p>Ms. Tanya Schulze, Regional Inspector General for Audit Office of Inspector General U. S. Department of Housing and Urban Development Los Angeles Area Office, Region IX 611 West 6th Street, Suite 1160 Los Angeles, CA. 90017</p> <p>SUBJECT: HOUSING AUTHORITY RESPONSE TO OIG DRAFT AUDIT REPORT</p> <p>Dear Ms. Schulze:</p> <p>The Housing Authority of the City of Los Angeles (HACLA) hereby submits this letter as its formal written response to the April 8, 2011 draft audit report from the U.S. Department of Housing and Urban Development Office of Inspector General (OIG). We ask that the response be included in the final report in its entirety, except to the extent OIG deletes referenced findings or comments.</p> <p><i>"Recommendation 1A: Reimburse the Recovery Act program \$75,370 (\$73,906 + \$1,464) for the insurance reimbursements posted to other accounts."</i></p> <p>HACLA did not knowingly, willfully or intentionally fail to credit the appropriate program when costs were reimbursed from the insurance carrier and is grateful that the investigation brought this error to light thus allowing us ability to rectify the matter and to take the appropriate actions to ensure it doesn't happen in the future. HACLA agrees with this recommendation and will ensure the next disbursement request from the Recovery funds will credit the program in the amounts mentioned above.</p>

Comment 1

"Recommendation 1B: Confirm that the \$1,133 holdback and anticipated \$6,885 in insurance reimbursement associated with the Nickerson Gardens units are appropriately posted to the Recovery Act program. These amounts (\$8,018) will be considered funds to be put to better use."

HACLA, as stated above, did not knowingly, willfully or intentionally duplicate charges related to property losses and will promptly credit the Recovery program in the amounts mentioned above prior to requesting the funds.

"Recommendation 1C: Revise its policies and procedures to ensure that cost reductions are applied before disbursing Recovery Act funds and that credits are applied once reimbursements are received by the Authority. This measure will assure HUD that capital funds, including those provided under the Recovery Act, will be disbursed in accordance with applicable laws and regulations."

HACLA understands the critical importance of effectively monitoring its accounting practices to ensure the proper credits of other revenue sources prior to reimbursements from HUD. The lack of controls and poor communication identified as the source of the errors is in process of being rectified via revision to our accounting procedures, institution of stringent process controls utilizing enhanced communication, increased requirements to provide sufficient supporting documentation, and training where necessary between our program delivery and finance staff to ensure HUD funds are disbursed as per program regulations.

"Recommendation 1D: Determine legal sufficiency and if legally sufficient, pursue remedies under the Program Fraud Civil Remedies Act against the Authority and/or its appropriate personnel for improperly charging its Recovery Act program as discussed in this audit memorandum."

Comment 2

HACLA fully appreciates the serious nature of the errors found as part of the OIG investigation; but again, did not knowingly, willfully or intentionally set out to defraud HUD or the Recovery Act Fund in failing to credit the appropriate program when costs were reimbursed from the insurance carrier. Poor communication should not be construed as willful or malicious intent to defraud the program. While our current procedures for processing insurance reimbursements were found to lack the appropriate controls to credit the program when the funds were received, the funds were applied to the appropriate public housing development's operations and were not used to benefit any individual or entity.

We therefore disagree with this recommendation asking HUD General Counsel for Program Enforcement to determine fraudulent activities by either the Authority or its personnel and strongly urge HUD to remove it from the list of recommendations within this OIG investigative report. The potential punitive damages that correspond with this recommendation is unduly harsh and completely unwarranted in light of the source of

the error found and HACLA's written intention to cooperate, make immediate appropriate restitution to the program, and most importantly to prevent this oversight from happening in the future.

We appreciate your consideration of our response this report and look forward to a positive determination.

If you have any questions or require additional information, please feel free to call at (213) 252-1818.

Sincerely,



Ken Simmons
Interim President and CEO

Cc: K.J. Brockington, Director, Office of Public Housing, 9DPH

OIG Evaluation of Auditee Comments

- Comment 1** As discussed in the body of the report, the OIG found that the issue primarily resulted from a lack of controls and communication between departments. We found no information to suggest that HACLA intentionally duplicated or failed to credit the Recovery Act Capital Fund program.
- Comment 2** The recommendation for HUD to consider administrative sanctions against the Authority remains unchanged. Each voucher included a warning that HUD would prosecute false claims and statements, which could result in criminal and/or civil penalties. The recommendation illustrates the significance of the Authority's need for controls to prevent the duplication of charges related to property losses and to credit the appropriate program when costs are reimbursed from insurance.