OFFICE OF AUDIT
REGION 1
BOSTON, MA

The U.S. Department of Housing and Urban Development, Washington, DC

Oversight of Public and Indian Housing Program Interfund Transactions

2014-BO-0001

MARCH 21, 2014

Issue Date: March 21, 2014

Audit Report Number: 2014-BO-0001

TO: Lindsey Reames,
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Donald J. Lavoy,
Deputy Assistant Secretary for the Real Estate Assessment Center, PX

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//SIGNED//

FROM: Edgar Moore,
Regional Inspector General for Audit, Boston Region, 1AGA

SUBJECT: HUD's Procedures Do Not Always Ensure the Proper Use and Timely Reimbursement of Public Housing Agency Interfund Transaction Balances

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of HUD's oversight of Public and Indian housing program interfund transactions.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at http://www.hudoig.gov.

If you have any questions or comments about this report, please do not hesitate to call me at 212-264-4174.

March 21, 2014

HUD's Procedures Do Not Always Ensure the Proper Use and Timely Reimbursement of Public and Indian Housing Interfund Transaction Balances

Highlights

Audit Report 2014-BO-0001

What We Audited and Why

As part of the Office of Inspector General's (OIG) mission to promote economy and efficiency, we audited the U.S. Department of Housing and Urban Development (HUD), Office of Public and Indian Housing. Our objective was to determine whether HUD (1) had adequate procedures to identify, monitor, and evaluate public housing agencies (PHA) with interfunds, and (2) took appropriate actions to curtail improper practices when borrowing from restricted HUD programs was found.

What We Recommend

We recommend that HUD officials develop and implement standard procedures to ensure the timely and effective control of PHAs use and reimbursement of interfunds, and ensure the reimbursement of $2.2 million to the appropriate programs by two PHAs.

What We Found

HUD officials adequately identified interfund balances, communicated this information to field offices, and adequately evaluated annual contributions contracts and regulatory restrictions on interfunds. However, they did not always take timely and effective action to enforce program fund restrictions by notifying PHAs to reimburse interfunds in a timely manner, maintain proper accounting controls and avoid recurring interfunds. We attribute this condition to HUD's lack of adequate procedures and sanctions to control the misuse of restricted program funds. As a result, there were recurring interfund balances at 161 PHAs involving the use of restricted Section 8 funds for nonprogram purposes. The most serious of these deficiencies were at two PHAs, where more than $2.2 million in Section 8 program interfund transaction balances continued to exist.

TABLE OF CONTENTS

BACKGROUND AND OBJECTIVE

The United States Housing Act of 1937, as amended, established the first Federal framework for Government-owned affordable housing. The Housing Act authorized loans to local public housing agencies (PHA) for low-rent public housing construction expenses. The Quality Housing and Work Responsibility Act of 1998 amended the Housing Act to create the Housing Choice Voucher program and give PHAs more flexibility and discretion in using funding to address the needs of low-income families. The U.S. Department of Housing and Urban Development (HUD) enters into agreements with PHAs under separate annual contributions contracts[1] to disburse low-income public housing and Section 8 Housing Choice Voucher program funds.

In Federal fiscal year 2003, with the enactment of the Appropriations Act of 2003 (Public Law 108-7), Congress prohibited the use of the reserves for overleasing costs, but PHAs retained the right to use them for other housing purposes. In Federal fiscal year 2004, after the enactment of the Appropriations Act of 2004 (Public Law 108-199), Congress further restricted the use of the reserves to activities related to the provision of rental assistance under the Section 8 Housing Choice Voucher program, including related development activities. Because of this provision, it is generally interpreted that before Federal fiscal year 2004, administrative fee reserves could be used for "other housing purposes" and beginning in Federal fiscal year 2004, administrative fee reserves were "restricted."

Although Section 8 Housing Choice Voucher program regulations require that housing assistance payments and program administrative fees be restricted only to uses within the program, these regulations do not specifically preclude their use in a revolving fund. Therefore, most PHAs pool their unrestricted reserves with PHA program funds and pay their expenses through a revolving fund account. Since many PHAs that use a revolving fund also have the ability to track interfunds[2] in real time, their unrestricted reserves usually cover temporary shortages until program funds are received and reimbursements are posted. When reimbursements arrive after a reporting period closes, an interfund balance is created.

Through various notices and training, HUD has made PHAs aware that the use of Federal grant funds for other than the fiduciary purpose of the fund is not authorized. Interfund imbalances result when PHAs do not have sufficient reserves to cover the temporary shortages until program funds are reimbursed. A cash shortfall occurs in a program when there are insufficient reserves and program expenses are paid with the funds of another program. Since program funds are normally received and posted within a few days of disbursement, most PHAs reimburse their interfunds within the same few days. However, although inefficient collection and

[1] HUD's annual contribution contract is a contract between HUD and the PHA that provides administrative services for covered units. Format and content of the contracts vary depending on the program and year implemented.
[2] The Financial Data Schedule (FDS) Line Definition Guide, published by the Office of Public Housing, Real Estate Assessment Center, and revised in May 2012, provides that in relation to FDS line 144, "inter-program - due from," "Inter-program due to and due from should be reported where the program has incurred expenses through the use of a centralized revolving fund/working capital account but does not have the cash and investments to reimburse the account at year-end ... Inappropriate use of funds, even a temporary loan, are ineligible costs resulting in non-compliance."

reimbursement procedures are a common reason for interfund imbalances, there are others as well. Before this audit, OIG conducted several external audits in which PHAs did not perform interfund reconciliations or knowingly used restricted program funds to pay the expenses of other programs, for which reimbursements were collected. In prior audits, OIG allowed PHAs 30 days to improve accounting and collection procedures and post reimbursements.

From April 1, 2009, to March 31, 2011, OIG conducted eight external audits of PHAs, which specifically involved interfunds. In these audits, OIG found that restricted Federal program funds were used to pay the expenses of other Federal or non-Federal programs. The total costs that OIG questioned in these interfund audits, relating to the Financial Data Schedule (FDS) Line Definition Guide, line 144, "due from," amounted to more than $20 million. These amounts represent restricted Federal funds that were owed or due back to the Housing Choice Voucher and other HUD programs.

Specifically, seven external audits examined interfunds and questioned more than $20 million. These audits were

PHA Name	Report no	Type of Questioned Cost	Amount
Stamford, CT, Housing Authority	2012-BO-1002	unsupported	$7.505,433
Brockton MA, Housing Authority	2011-BO-1002	unsupported	$885,852
Housing Authority of DeKalb County	2010-AT-1010	ineligible	$2,583,244
New Rochelle, NY, Housing Authority	2010-NY-1010	ineligible	$38,355
Waltham MA, Housing Authority	2010-BO-1006	unsupported	$3,995,635
New London CT, Housing Authority	2010-BO-0001	ineligible	$524,879
Quincy MA, Housing Authority	2009-BO-1006	unsupported	$4,599,160

Two other external audits examined interfunds and found that additional controls were needed. These audits were

PHA Name	Report no	Control Weakness
Lawrence, MA, Housing Authority	2012-BO-1004	Was not reconciled prior to the audit
Weymouth MA, Housing Authority	2011-BO-1009	Was not reconciled prior to the audit

Based on these external audits and U.S. Government Accountability Office report 09-33 "HUD's Oversight of Housing Agencies Should Focus More on Inappropriate Use of Program Funds" issued on June 11, 2009, we determined that an internal audit to review the oversight of interfunds by HUD might be warranted. Our objective was to determine whether HUD (1) had adequate procedures to identify, monitor, and evaluate PHAs with interfunds and (2) took appropriate actions to curtail improper practices when borrowing from restricted HUD programs was found.

RESULTS OF AUDIT

Finding: HUD Did Not Enforce Policies to Ensure the Proper Use and Timely Reimbursement of PHA Interfund Transaction Balances

HUD officials adequately identified interfund balances, communicated this information to field offices, and adequately evaluated annual contributions contracts and regulatory restrictions on interfunds. However, they did not always take timely and effective action to enforce program fund restrictions by notifying PHAs to reimburse interfunds in a timely manner, maintain proper accounting controls, and avoid recurring interfunds. We attribute this condition to HUD's lack of adequate procedures and sanctions to control the misuse of restricted program funds. As a result there were recurring interfund balances at 161 PHAs involving the use of restrictive Section 8 funds for nonprogram purposes. The most serious of these were at two PHAs, where more than $2.2 million in Section 8 program interfund transaction balances continue to exist.

HUD Adequately Identified and Communicated Interfund Balances.

HUD's Real Estate Assessment Center (REAC) had implemented procedures that identified questionable interfund balances and adequately communicated these concerns to local field offices for follow-up and resolution. Thus, HUD had adequate procedures to identify material instances of noncompliance with annual contributions contracts and other regulatory restrictions on the use of program funds through the annual audits conducted by independent public accountants. REAC staff identified interfund problems through review of Financial Assessment Subsystem for Public Housing (FASS-PH) data, documented PHAs that had a balance of more than 5 percent of net assets in interfund account 144[3] and communicated this information to local field offices. Field office public housing staff followed up on identified interfund balances and took action to recover restricted funds. In addition, the Office of Public Housing was proactive in developing procedures to assist field office staff in determining how to analyze the ability of individual PHAs to repay the funds that should not have been used for nonprogram purposes. However, HUD's actions were not always effective in preventing PHAs from using restricted funds for nonprogram purposes or did not always result in timely reimbursement of these funds.

[3] This account, as described in the Financial Data Schedule (FDS) Line Definition Guide, represents amounts, normally not fungible between different Federal programs that are due from other PHA projects, programs and funds.

HUD Did Not Always Take Timely and Effective Action To Curtail Improper Practices of PHAs Borrowing Restricted Funds

There were recurring Section 8 interfund balances at 161 PHAs. The balances were deficient because these PHAs used their restricted Section 8 program funds in violation of Section 8 program regulations. Section 8 regulations require that these funds be restricted only to uses within the program. In 2011, which was the most current full year of reported data, 93 of these 161 PHAs had current Section 8 interfund balances that totaled more than $54.4 million. We reviewed 14 of the PHAs that had current interfund balances of greater than 15 percent of assets and targeted those PHAs with large recurring balances in at least 3 of the last 4 years.

Interviews conducted with the PHAs and HUD field office financial analysts and directors indicated that many of these PHA interfund balances were due to timing differences and that the funds were reimbursed within a few months. However, not all interfund balances were due to timing. Many of the PHAs that had interfund balances borrowed from programs that had annual contributions contract restrictions on the use of their funds and several PHAs maintained interfund balances from year to year for multiple years. Often when the balances due to these restricted HUD programs were identified, HUD did not obtain repayment in a timely manner partly because HUD's instructions for interfund accounts, as explained in appendix C, were not restrictive enough and allowed PHAs to transfer and borrow restricted program funds. Since PHAs were not sanctioned for using restricted funds in their revolving accounts, which created the interfund balances, temporary imbalances seems to have become the norm. Therefore, when field office officials identify these imbalances on the PHA books, the issue of collection and reimbursement need to be addressed, and sanctions should be considered if restrictive funds were used.

Office of Public Housing and Voucher Program officials provided updated information for some PHA interfund accounts; however, after considering this data, we still had unreimbursed Section 8 interfund balances for 8 of the 14 PHAs reviewed. As a result, these PHAs did not make timely reimbursements to the Section 8 program for the funds due or transferred additional restricted Section 8 funds to other programs in violation of their annual contributions contracts and program regulations. Thus, controls need to be strengthened to prevent recurrences, and reconciliations for the current month should be required to show that the interfund imbalance that resulted in noncompliance has been eliminated.

The Baytown Housing Authority and the Lansing Housing Commission were the most significant examples of the inappropriate use of interfunds and untimely reimbursement of transferred restricted funds. Although field office staff had contacted the PHAs to resolve these balances, additional actions would be needed to achieve timely repayment and prevent the recurrence of using interfund transactions to avoid not complying with restrictions on the use of HUD program funds. The details of our review of these two entities follow:

Baytown Housing Authority

Our Fort Worth office audited the Baytown Housing Authority in Baytown, TX, more than 7 years ago and recommended that the Authority repay the applicable Federal programs the outstanding interfund balances of $627,206 and these amounts were reported as having been recovered in HUD's Audit Resolution and Corrective Action Tracking System. [4] However, there were more recurring interfund balances that resulted from transfers from the Section 8 program and the Authority needed to reimburse the Section 8 program $945,680. Further, the Authority had not complied with a prior agreement to repay $328,000 in interfund balances in monthly installments of $500. A review of the repayment agreement did not show a breakdown of the amounts to be repaid, the programs from which repayments were to be made, or whether payments could be expected monthly. It should be noted that the Authority was not listed as troubled and was not in a negative equity situation; thus it should have been able to repay these funds. We made several attempts to obtain additional repayment information, but none was received.

As shown in the table that follows, the Authority reported deficient "due from" fund balances in its restricted Section 8 programs year after year. The Authority's component units were the beneficiaries.

Line item 144 - amounts due from other programs			
PHA name and number	**Fiscal yearend**	**Section 8 Housing Choice Voucher program**	**Total (all programs)**
Baytown Housing Authority-TX012	6/30/2009	$1,064,053	$4,447,800
	6/30/2010	$1,040,407	$3,919,986
	6/30/2011	$961,426	$1,876,573
	6/30/2012	**$945,680**	**$1,935,980**

As of June 30 2012 the Authority had over $945,000 in restricted funds that was used by its component units, and was owed to the Section 8 Housing Choice Voucher program. Thus, HUD needs to address this problem of recurring interfund balances.

[4] Audit Report number 2006-FW-1002, issued December 13, 2005.

Lansing Housing Commission

The Lansing Housing Commission in Lansing, MI, had interfund balances dating back to 2009, which the field office had not been able to resolve. Commission officials stated that although they accounted for interfund transactions, they had neglected to transfer the cash between the programs. They stated that they worked with the HUD Detroit field office to reconcile the 2010 and 2011 Section 8 interfund balances and clear out the 2011 balances. HUD field office staff members stated that the Commission went back 18 months in an effort to reconcile the imbalances; however, they believed that it needed to go back as far as its records would allow or at least to December 2009 to provide a better understanding of the interfund transactions that caused the problem. More than $1.2 million was being repaid to the Section 8 program.

As shown in the table that follows, the Commission also reported deficient "due from" fund balances in its restricted Section 8 programs year after year. The Commission's business-type activities were the beneficiaries.

Line item 144 - amounts due from other programs			
PHA name and number	**Fiscal yearend**	**Section 8 Housing Choice Voucher program**	**Total (all programs)**
Lansing Housing Commission-MI058	6/30/2009	$2,393,132	$4,758,199
	6/30/2010	$1,298,851	$2,436,523
	6/30/2011	$1,280,989	$1,558,770
	6/30/2012	**$1,270,641**	**$3,748,099**

As of June 30, 2012 the Commission had more than $1.2 million in restrictive funds that was used by its business type activities, and was owed to the Section 8 program. When PHAs have recurring interfund balances as these did, HUD needs to take more action.

HUD's Procedures Were Not Always Adequate To Eliminate Restricted PHA Interfund Balances

HUD's treatment of PHAs with interfund balances was not always consistent. HUD had no specific procedures that required the field offices to ensure that (1) PHA directors were notified to set deadlines for imminent reimbursement of interfunds; (2) appropriate accounting, accurate reconciliations, and timely posting of interfund reimbursements were made; (3) PHAs would be able to stem the creation of new interfunds; and (4) timely and specific steps would be taken if it was determined that funds had been diverted from restricted programs to pay for nonprogram activities.

Annual contributions[5] contracts define the relationships between HUD and the PHA for programs such as the Section 8 and the low-income housing programs. REAC's FDS Line Definition Guide; PHA GAAP [generally accepted accounting principles] Flyers (No 1-6), PIH [Office of Public and Indian Housing]-REAC: PHA-GAAP Accounting Briefs (No 1-20) and notices such as the Appropriations Act implementation notices provide additional guidance to PHAs on financial accounting and reporting to include interfunds. Since 2004, the Appropriations Act for the Section 8 program and its implementation notices (such as Notice PIH-2012-9) prohibit the use of post-fiscal year 2005 administrative funding for non-Section 8 purposes.

REAC's FDS Line Definition Guide, covering Federal yearend June 30, 2008, to the present (last updated in May 2012), defines FDS line 144, "inter-program - due from," as representing "amounts due from other PHA projects, programs and funds. The balance represents interprogram transactions resulting in a decrease of expendable resources of the transferring PHA program and funds that are expected to be repaid within a reasonable time." The FDS Line Definition Guide warns against the use of restricted funds, but it may be confusing to PHAs as it does not require the immediate repayment of interfunds, and as we have documented, some PHA officials failed to follow the guidance and repeatedly used the interfund accounts to transfer restricted funds to other programs. Therefore, this definition needs to be clarified and made more restrictive to specify a reasonable reimbursement period.

OIG reported findings on loans against restricted funds in prior audits. In these audits, we required reimbursement within 30 days. We allowed the 30-day period because the Section 8 program does not contain language that precludes the use of a revolving fund for income and expenses and because in many cases, PHAs needed time to establish a reconciliation process, proper accounting procedures, and collection controls to deal with interfund transfer balances. Also, collection documentation, and evidence of prior reconciliations may have been needed to determine why interfund transaction balances remained on the books and were being reported. To maintain good controls over interfunds, HUD must not only assure that PHAs timely reimburse their "due from" balances, but they should also determine why these PHAs continue to generate interfund transaction balances using restrictive funds, and address the causes. Thus, it is not acceptable to create a "due from" balance using restricted funds, especially if the reason why a PHA continues to generate these interfund transaction balances is not determined and addressed. Further, field officials should begin sanctioning PHAs that create a "due from" balance using restricted funds. Therefore, HUD's

[5] HUD's annual contributions contract is a contract between HUD and the PHA that provides administrative services for covered units. Format and content of the contracts vary depending on the program and year implemented.

controls need to be strengthened to prevent recurrences and reconciliations for the current month should be required to show that the interfund imbalance that resulted in noncompliance has been eliminated.

Conclusion

Although HUD adequately identified PHA interfund transaction balances and communicated this information to field offices, HUD officials did not always take timely, effective, and decisive action to curtail the improper practice of creating interfunds, resulting in the untimely repayment of improperly transferred funds. HUD's lack of adequate procedures for requiring field offices to enforce PHA program fund restrictions, obtain the timely reimbursement of funds, and curtail the improper use of restricted program funds contributed to ongoing problems regarding the timely reimbursement of interfund transaction balances. As a result, there were recurring interfund balances at PHAs involving the use of restricted Section 8 funds for nonprogram purposes. The most serious of these were at two PHAs, where more than $2.2 million in Section 8 program interfund transaction balances continued to exist.

Recommendations

We recommend that HUD's Acting Deputy Assistant Secretary for Field Operations

1A. Require that the Baytown Housing Authority reimburses the applicable Federal program the improper interfund transaction balance of $945,680 in a reasonable period, considering the financial condition and resources of the Authority and applicable program requirements.

1B. Require that the Lansing Housing Commission reimburses the applicable Federal program the improper interfund transaction balance of $1,270,641 in a reasonable period considering the financial condition and resources of the Commission and applicable program requirements.

1C. Develop procedures to ensure that field officials issue sanctions to PHAs or their managers that knowingly override PHA controls, and use restricted funds to create interfund balances.

1D. Develop procedures that will ensure that field offices closely monitor PHA use of revolving funds used in the creation of interfund balances, created from restricted funds, and work with the PHA to develop a plan for repaying and eliminating interfund balances without recurrences.

1E. Ensure that training or technical assistance is provided to PHAs with recurring significant improper interfund transaction balances to emphasize that interfunds are not to be used for temporary interprogram loans since program regulations restrict the use of program funds to the programs and for the purposes for which these funds are provided.

We recommend that HUD's Acting Deputy Assistant Secretary for Field Operations and Deputy Assistant Secretary for the Office of Public Housing and Voucher Programs

1F. Implement procedures to ensure that restricted Federal funds are not improperly used by other programs and funds used in interfund transactions are reimbursed to the applicable HUD programs monthly.

We recommend that HUD's Deputy Assistant Secretary of the Real Estate Assessment Center

1G. Take action so that the FDS line definition for interfunds, line 144, "due to," is clarified to prevent the use of restrictive funds, and ensure that financial activities related to interfund accounts are timely and accurately recorded, and reported.

SCOPE AND METHODOLOGY

We performed the audit between September 2012 and June 2013. The audit scope included a review of interfund accounts from data in HUD's Financial Assessment Subsystem for Public Housing Agencies (FASS-PH), which includes all PHAs reporting during the audit period from July 1, 2008, through June 30, 2012.

We designed, distributed, and analyzed questionnaires and conducted interviews with HUD headquarters staff in Washington, DC, field office staff and PHA officials. We analyzed interfund correspondence obtained from HUD headquarters, including correspondence sent from HUD headquarters to field offices and PHAs

We requested and reviewed PHA records to verify information that was obtained through interviews with HUD and PHA officials. We identified all relevant policies and procedures through interviews with HUD officials and obtained REAC procedures for identifying PHAs with potential interfund deficiencies.

Over the 4-year audit period from July 1, 2008, through June 30, 2012, we collected financial information on 3,586 PHAs from the FASS-PH financial database. We sorted and analyzed the database and identified 1,950 PHAs with interfund account balances in at least 1 year of our audit period. We determined that there were recurring interfund balances at 161 of the PHAs that had interfunds in at least 3 of the 4 program years in our audit period. We performed a complete detailed review of 14 PHAs that had Section 8 interfund balances in excess of 15 percent of net assets. We verified the amount of funds transferred by the PHAs, the percentage of interfunds in relation to total net assets, the type of program funds transferred, the number of years that interfund balances continued to exist, and previous noncompliance involving interfund balances at these PHAs.

We analyzed the financial data using computer-assisted audit tools and techniques for data analytics, particularly ACL (Audit Command Language) and Excel. We tested the integrity of the financial data by verifying in ACL, that; all fields matched the field definition guide, no data validity errors existed, control totals were run on each numeric account, the "isblank" test returned no blank fields and the "count if" command identified only financial statements in our audit period, We determined that the data were adequate for use in our audit of interfunds.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

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

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations, as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

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

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

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to the effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- HUD officials did not have adequate controls to ensure compliance with laws and regulations and to safeguard resources, because they did not always have adequate policies and written procedures to ensure that field offices (1) took action to curtail improper interfund transactions and practices that used restrictive funds, and (2) encourage PHAs to repay interfund balances in a timely manner (see finding).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/
1A	$945,680
1B	$1,270,641
TOTAL	$2,216,321

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.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation	**Auditee Comments**

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

OFFICE OF PUBLIC AND INDIAN HOUSING

2/12/2014

MEMORANDUM FOR: Edgar Moore, Regional Inspector General for Audit, New York-New Jersey, 2AGA

MEMORANDUM FROM: Lindsey S. Reames, Acting Deputy Assistant Secretary Office of Field Operations, PQ

SUBJECT: Response to Draft Audit Report – HUD's Procedures Do Not Always Ensure the Proper Use and Timely Reimbursement of Public Housing Agency Interfund Transaction Balances 2014-BO-000X

Comment 1

This follows our conference call of 2/7/13. Thank you for the opportunity to comment. HUD take seriously the importance of dealing with the improper use of PHA funds and are committed to directing our oversight attention wisely to risks of misspending and of noncompliance. (One side note - the audit report should be also addressed to the DAS for REAC and DAS for Public Housing and Voucher Programs because you recommend policy guidance revision.)

Comment 2

Before getting into the detailed recommendations, I suggest your report provide context about the relative risk of improper interfund activity and the progress made in addressing the problem over the last several years, in part as a result of the IG's previous work on this topic. Our conclusion is that risk associated with this issue is low relative to program size and that it is diminishing and will significantly diminish further in the immediate future. In addition, actual interfund activity has declined significantly. Accordingly, we are not prepared to devote significant additional resources to address this issue, at the expense of other areas of oversight that are of higher risk – some of which have been cited in the IG's Audits. We *are* prepared to better implement the existing process of identifying and following up on Due From Balances reported in financial statements and to better instruct our staff on how to deal with interfund activity.

Comment 3

We also believe the report does not accurately assess interfund activity because it only looks at one half of the typical transactions in which the HCV program is both owed funds and owes funds to other programs. Only account 144 activity was discussed, and not Account 347. Currently financial statements indicate that HCV programs nationally owe more money than they are owed collectively, and that often the same PHA has offsetting account activity netting each other out substantially.

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Ref to OIG Evaluation **Auditee Comments**

Specifically, as to materiality and risk we would recommend you consider the following:

- The count of recurring problematic activity cited in your report represented 4.5% of PHAs examined.

- The current balance of Due From accounts in HCV programs represents .2% of National Budget Authority.

Comment 4

- Due From balances have been declining significantly, nearly by two-thirds since 2011. And as noted earlier, a good deal of this is offset at the PHAs with the Due To's.

	CY 2011	CY 2012	Most Current Statement on Hand 2/3/14
Line 144:	$ 93,559,643	$ 43,410,884	$32,904,575

- The funds exposed to risk of improper loans, i.e. PHA-held NRA have declined by 70% from 12/31/11 to 12/31/13, and are scheduled to be virtually eliminated this year as we recover the balance of PHA-held NRA into HUD-held Program Reserves. This is a result of two years of administering Cash Management requirements in which disbursements were tailored to PHA spending needs, not full funding. HUD now holds about 40% of a significantly smaller National HAP Reserve and will hold almost all of the balance of it within the next six months.

Other Report Assertions:

Comment 5

The Background section of the report contains a table on page 4 listing PHAs from previous audits where interfunds have been noted and provides the amount of interfunds. This list of PHAs and the amounts of interfunds shown as questioned is a bit misleading in terms of context since this draft report deals with HCV related interfunds, and more particularly Due From accounts, while the amounts listed for these listed PHAs are entity wide interfunds including non-federal and certainly non- HCV Due Froms.

Response to Specific Recommendations:

1A **Require that the Baytown Housing Authority reimburses the applicable Federal program the improper interfund transaction balance of $945,680 in a reasonable period, considering the financial condition and resources of the Authority and applicable program requirements.**

Ref to OIG Evaluation | **Auditee Comments**

Comment 6

DISAGREE. Additional actions are not necessary. The repayment is being pursued and funds are being collected. This recommendation lists $945K ineligible loaned HCV funds to be reimbursed, however the 6/30/13 unaudited statement shows that this amount has been reduced to $426,236, so substantial progress has been made. The report also implies that Baytown has sufficient equity to repay loans, saying, *"...the Authority was not listed as troubled and was not in a negative equity situation; thus it should have been able to repay these funds"*. This is not correct. The majority of the equity amounts are restricted funds of the HUD DVP and DHAP programs. Also, efforts were taken in 2012 by the field office and OIG and this may already be resolved and as noted the debt has been cut in half.

1B **Require that the Lansing Housing Commission reimburses the applicable Federal program the improper interfund transaction balance of $1,270,641 in a reasonable period considering the financial condition and resources of the Commission and applicable program requirements.**

Comment 7

DISAGREE/ CLOSE - The report is misleading in that it omits the $1 million (FDS line 347) that HCV owes other programs, thus only a net of $269K was owed to the HCV program, which has since been repaid per below.

Housing Choice Vouchers					
		2009	2010	2011	2012
144	Interprogram Due From	$2,393,132	$1,298,851	$1,280,989	$1,270,641
347	Interprogram Due To	$861,022	$0	$1,249,871	$1,001,337
		$1,532,110	$1,298,851	$31,118	$269,304

Recommendation 1B should therefore be modified or deleted since Inter-fund loan that Lansing showed in 2012 has been paid back to the HCV Program according to the 6/30/2013 unaudited FDS Submission. If modified, language may include closure upon verification of the "AUDITED" statements or additional PHA source documentation that shows the cash is now in the HCV account.

1C: **Implement procedures to ensure that restricted Federal funds are not Improperly used by other programs and funds used in interfund transactions are reimbursed to the applicable HUD programs monthly.**

Ref to OIG Evaluation | **Auditee Comments**

Comment 8

DISAGREE/ Or RESTATE- The extent of HUD's oversight is limited to examination of annual financial statements and follow-up – which is what is being done now. HUD cannot monitor PHA monthly financial activity. When an interfund that is material it is tracked, as was noted in your audit, and that interfund is now scrutinized to determine if HCV funds have been repaid to the program and to obtain repayment if they have not. Field Staff and the Quality Assurance Division responds to interfund activity - the FO routinely upon notice by REAC, and QAD as part of a response to a financial risk analysis that included interfund activity.

1D: Develop procedures to ensure that field officials issue sanctions to PHAs or their managers that knowingly override PHA controls, and use restricted funds to create interfund balances.

Comment 9

DISAGREE - Sanctions are always an option when deemed appropriate and we reserve the right to use them to address egregious behavior. We do not believe it is necessary to issue separate sanctions-related guidance for interfund related noncompliance as opposed to all other types of noncompliance. We do not agree that a one size fits all approach is appropriate even in instances of noncompliance. Additional guidance to the Field on handling interfund referrals from REAC will be developed.

1E Take action so that the FDS line definition for interfunds, line 144, "due to," is clarified to prevent the use of restrictive funds, and ensure that financial activities related to interfund accounts are timely and accurately recorded, and reported.

Comment 10

The FDS definition is accurate under General Accepted Accounting Principles and revising the definition will not prevent the use of restrictive funds. The definition now clearly states that even temporary loans of restricted funds are, ***"ineligible costs resulting in noncompliance".***

These accounts were established for the timely and accurately recording of inter-fund transfers. HUD has established controls to prevent and identify the inappropriate use of HCV funds by including specific preventive language in multiple PIH Notices, and providing live and remote training, and useful briefing documents to PHAs on accounting principles and program compliance. The Program Office, as part of the cash management procedures, will perform a conversion of remaining NRA balances to program reserves, by reducing future 2014 HAP disbursements, which will compel the PHAs to fully utilize the NRA balances until depletion, in lieu of getting new budget authority. This conversion will be the critical to ensure that HAP funds continue being used for the intended purposes and funds continue to be in accordance with Treasury cash management requirements.

Ref to OIG Evaluation | **Auditee Comments**

Also, the Program Office has included specific audit procedures in the A-133 Compliance Supplement to ensure the proper reporting and to identify potential noncompliant PHAs. In addition, REAC's Analysts, accountable for the review and acceptance of financial statement submissions, are continuously questioning inter fund transfers reported in the financial statements, and referring these PHAs via the automated system to the Program Office and Field Offices for the respective follow-up. The HV Quality Assurance Division and the Field Office are also monitoring PHAs reporting inter-fund transactions and will continue to do so uninterruptedly.

1F **Develop procedures that will ensure that field offices closely monitor PHA use of revolving funds used in the creation of interfund balances, created from restricted funds, and work with the PHA to develop a plan for repaying and eliminating interfund balances without recurrences.**

Comment 11

We cannot closely monitor PHAs use of the revolving fund as this is a regular function of the PHA and we have only year-end balances to review. Our current procedure identifies and scrutinizes interfund balances and results in our follow up of inappropriate use of restricted funds that have not been paid back. Our repayment protocol has formalized the process of recouping funds from PHAs. We envision improving our effectiveness in using this procedure but see not additional procedures being necessary.

1G **Ensure that training or technical assistance is provided to PHAs with recurring significant improper interfund transaction balances to emphasize that interfunds are not to be used for temporary interprogram loans since program regulations restrict the use of program funds to the programs and for the purposes for which these funds are provided.**

Comment 12

Agree but Ongoing Currently. PHAs now are contacted by Field staff when there is a Due From notice to the Field from the REAC. FO office staff will be provided with additional guidance to ensure that in their work with PHAs in this regard, that correct guidance and technical assistance is provided. Technical Assistance is provided by the Quality Assurance Division in their monitoring remote and on site of HCV PHAs, which is by risk including interfund activity.

OIG Evaluation of Auditee Comments

Comment 1 We revised the report's addressees to also include the DAS for REAC and the DAS for Public Housing and Voucher Programs. Also the order of the recommendations was revised in the final report as the individual recommendations are addressed to the appropriate DAS for resolution.

Comment 2 HUD officials stated that the risk associated with improper interfund activity issue is low relative to program size and that they are not prepared to devote significant additional resources to address this issue at the expense of other high risk areas. HUD officials also indicated that they are willing to better implement existing procedures in identifying and following up on due from balances. We believe HUD officials have done a good job in identifying due from balances and communicating these results to field offices and public housing authorities. However, they can and should focus on the high risk PHAs with significant amounts of balances due from restricted accounts that have repeated violations without impacting the oversight provided other high risk areas.

Comment 3 We agree that the financial statements indicate that Housing Choice Voucher (HCV) programs nationally owe more money than they are owed collectively, but we do not agree that these "owed" amounts can simply be netted out because the funds are not always due to and from the same programs that borrowed from the restricted Section 8 programs. Further, although the balances have been reducing over the years substantial amounts owed to the HCV programs, still may be at risk and should be eliminated.

Comment 4 HUD officials indicate that the funds exposed to the risk of improper loans are not material in relation to the total amount of funding and that PHA reserves have been drastically reduced through the use of HUD's cash management policy. HUD officials also indicated that HUD currently holds 40 percent of a significantly smaller national HAP reserve and will hold almost all of the balance within the next six months, further reducing the funds that can be used for interfunds. However, it should be noted that the amount of funds at risk of improper use was material during our audit period, as in 2011, which was the most current full year of reported data. Thus, 93 PHAs with large recurring interfund balances in at least three of the last four years had current Section 8 interfund balances that totaled more than $54.4 million. Therefore, we agree that reducing the funds available for interfund transfers significantly reduces the problem with recurring improper interfund transfers; however, it has not stopped the practice and should not prevent HUD from properly monitoring interfund transactions.

Comment 5 We have revised the background section of the report to clarify that for the seven external audits that questioned over $20 million in interfunds, the $20 million in interfund balances represented restricted Federal funds that were owed or due back to the Housing Choice Voucher and other HUD programs. Thus, the prior audits reported on the improper use of all available restricted funds, while the current audit, presented more specific examples and focused on the improper use of Housing Choice Voucher restricted funds**.**

Comment 6 HUD officials disagreed with implementing controls to ensure that the Baytown Housing Authority reimburses the applicable federal program the improper interfund transfers within a reasonable time, because repayment is being pursued and the funds are being collected. Despite HUD officials' disagreement with the recommendation we believe that the actions taken to reimburse the interfund balance at Baytown are responsive to the recommendation. However, during the audit resolution process, documents should be submitted for review to confirm that the funds have been properly repaid, not improperly written-off, and that additional interfund transactions are not reoccurring.

Comment 7 Regarding our recommendation requiring the Lansing Housing Commission to reimburse the interfunds, HUD officials disagreed and believe that the report is misleading because it does not consider the "due to account #347" and the amounts have been offset and/or repaid. We do not agree with HUD because there is no explanation on why funds are due to the Authority. As mentioned in the finding, these items need to be reconciled by Authority officials. Therefore, HUD officials should obtain and provide documentation as part of the audit resolution process to show that the questioned costs have been recovered through proper offsets or by reimbursement.

Comment 8 HUD officials indicated that HUD cannot monitor monthly financial activity. However, this recommendation did not require monthly monitoring, but sought implementing procedures to ensure that when PHAs improperly use restricted Section 8 funds for other programs, these funds should be reimbursed to the applicable program within a one month time frame.

Comment 9 HUD officials indicated that it was not necessary to issue separate sanctions or develop procedures to ensure field officials issue separate guidance for sanctions to PHA's or their managers who knowingly override PHA controls and use restricted funds to create interfund balances, as they believe that sanctions are an option to address egregious behavior. HUD officials also indicated that additional guidance on handling interfund referrals from REAC will be developed. Therefore, we will work with HUD officials during the audit resolution process to ensure that the guidance provided field staff is adequate to address willful noncompliance with HUD's requirements on the use of restricted funds.

Comment 10 HUD officials believe that the FDS definition for line 144 Inter-program - due from is accurate under General Accepted Accounting Principles. Officials also indicated that they have taken action to prevent and identify inappropriate uses of HCV funds and have issued guidance and provided training regarding these issues. In addition, HUD officials are taking action to reduce and eliminate the HCV reserves at PHAs, which should result in HCV funds being used for the intended purposes and in accordance with Treasury cash management requirements. Therefore during the audit resolution process, Officials should provide evidence of the guidance and actions taken so that we can determine if it is enough to adequately resolve this recommendation.

Comment 11 HUD officials indicated that it was not possible to closely monitor PHAs as HUD only has year end balances to review. Officials also indicated that their repayment protocol has formalized the process of recouping funds from PHAs and they envision improving the effectiveness of this procedure. However, recommendation 1F did not require frequent monitoring, but was directed toward field office officials closely monitoring those PHAs that had a serious interfund problem to ensure that interfund borrowing of restricted funds is corrected and does not frequently reoccur. Nevertheless, we will evaluate HUD's repayment protocol and any subsequent revisions submitted as part of the audit resolution process.

Comment 12 HUD officials' comments are responsive to the recommendation; however, any additional guidance to the field staff reviewing interfund transactions will have to be reviewed during the audit resolution process to close this recommendation.

Appendix C

CRITERIA

The authority for recommendations in this report comes from the laws and regulations cited in the Background and Objective section of this report and the sources below.

The FDS Line Definition Guide, published by PIH REAC and last revised in May 2012, defines "FDS line 144 Inter-program - due from" in the current assets section under current investments. It states:

> This FDS line represents amounts due from other PHA projects, programs and funds. This balance represents inter-program transactions resulting in a decrease of expendable resources of the transferring PHA program and funds that are expected to be repaid "within a reasonable time." ... Reasonable time is a matter of professional judgment, but typically should not exceed the annual operating cycle of the PHA. Transactions between funds may be classified as: (1) loans and advances, (2) quasi-external transactions, and (3) reimbursements.
>
> Some PHAs in their day to day operations maintain and use a centralized revolving fund/working capital account (including the use of one program's cash that is subsequently reimbursed by other programs) for more efficient cash management. During the year this line item is used by the revolving fund/working capital account and the individual program funds to ... show a claim on cash held by the revolving funds/working capital account on behalf of the individual program funds.
>
> However, for year-end reporting the cash and investment balances that are maintained in a revolving or working capital account must be reconciled, settled, and disaggregated and the balances reported on the FDS in the program that provided the cash...
>
> Inter-program due to and due from should be reported where the program has incurred expenses through the use of a centralized revolving fund/working capital account but does not have the cash and investments to reimburse the account at year-end... Inappropriate uses of funds, even a temporary loan, are ineligible costs resulting in non-compliance.

HUD's General Depository Agreement, form HUD-51999, paragraph 2, provides, "All monies deposited by the PHA/IHA[6] with the Depository shall be credited to the PHA/IHA in a separate interest bearing deposit or interest bearing accounts, designated "Accounts". Additionally, regulations at 24 CFR (Code of Federal Regulations) 982.156, Section 8 Tenant Based Assistance: Housing Choice Voucher Program, Depositary for Program Funds, provide that "(a) Unless otherwise required or permitted by HUD, all program receipts must be promptly deposited with a financial institution selected as depositary by the PHA in accordance with HUD

[6] The General Depository Agreement uses the abbreviation PHA/IHA in place Public Housing Agency/Indian Housing Authority.

requirements. (b) The PHA may only withdraw deposited program receipts for use in connection with the program in accordance with HUD requirements."