audit report

Issue Date March 23, 2007
Audit Report Number 2007-CH-1005

TO: Thomas S. Marshall, Director of Public Housing Hub, 5DPH

FROM: Heath Wolfe, Regional Inspector General for Audit, 5AGA

SUBJECT: The Housing Authority of the City of Gary, Indiana, Lacked Adequate Controls over Refunding Savings

HIGHLIGHTS

What We Audited and Why

We audited the Housing Authority of the City of Gary's (Authority) nonprofit development activities. The review of public housing authorities' development activities is set forth in our fiscal year 2006 annual audit plan. We selected the Authority because it was identified as having high-risk indicators of nonprofit development activity. Our objective was to determine whether the Authority effectively and efficiently used resources subject to its annual contributions contract, other agreements, or U.S. Department of Housing and Urban Development (HUD) regulations regarding its nonprofit development activities.

What We Found

The Authority did not effectively and efficiently use resources subject to its annual contributions contract, other agreements, or HUD's regulations regarding its nonprofit development activity. It failed to properly administer refunding savings from the Fifth Avenue Housing Development Corporation's (Corporation) June 1992 refunding of mortgage revenue bonds, May 1993 redemption of mortgage revenue refunding bonds, and June 2001 refunding of mortgage revenue refunding bonds. It lacked adequate documentation to support that it used more than $900,000 in refunding savings from the Corporation's 1992 refunding of mortgage revenue bonds and 1993 redemption of mortgage revenue refunding bonds to provide affordable decent, safe, and sanitary housing to very low-income households. Further, the Authority and HUD were not aware of nearly $800,000 and at least $260,000, respectively, in refunding savings funds available to them until we brought it to their attention during our audit.

What We Recommend

We recommend that the director of HUD's Cleveland Office of Public Housing require the Authority to provide documentation or reimburse its refunding savings from nonfederal funds for the unsupported payments; submit a proposal for HUD's approval regarding the Authority's planned use of the unused refunding savings for affordable, decent, safe, and sanitary housing for very low-income households; and implement adequate procedures and controls to ensure that it uses the refunding savings and submits required certifications and reports in accordance with its financial adjustment factor refunding agreement with HUD.

We also recommend that the director of HUD's Cleveland Office of Public Housing request The Bank of New York Trust Company, N.A., to disburse to HUD the remaining refunding savings in the trust account from the Corporation's refunding of the mortgage revenue refunding bonds in 2001.

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 issued because of the audit.

Auditee's Response

We provided our discussion draft audit report to the Authority's interim executive director, the chairman of its board of commissioners, and HUD's staff during the audit. We held an exit conference with the Authority's interim executive director on March 9, 2007.

We asked the Authority's interim executive director to provide written comments on our discussion draft audit report by March 15, 2007. The interim executive director provided written comments, dated March 13, 2007. The interim executive director generally agreed with our finding. The complete text of the written comments, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

The Housing Authority of the City of Gary (Authority) is a municipal corporation established by the City of Gary, Indiana (City), in 1938 under section 36-7-18-4 of the Indiana Code to provide decent, safe, and sanitary housing to low- and moderate-income persons and families under the U.S. Housing Act of 1937. The Authority is governed by a seven-member board of commissioners (board) appointed by the City's mayor to four-year staggered terms. The board's responsibilities include overseeing the Authority's operations. The board appoints the Authority's executive director, who is responsible for carrying out the board's policies and managing the Authority's day-to-day operations.

As of February 2007, the Authority operated the following programs: public housing, consisting of 2,277 units; Section 8 Housing Choice Voucher, consisting of 1,461 units; Public Housing Capital Fund; and HOPE VI Revitalization of Severely Distressed Public Housing.

In accordance with its agency plan, a public housing agency may form and operate wholly owned or controlled subsidiaries or other affiliates, which may be directed, managed, or controlled by the same persons who constitute the board of directors or similar governing body of the public housing agency or who serve as employees or staff of the public housing agency but remain subject to other provisions of law and conflict-of-interest requirements. Further, a public housing agency, in accordance with its agency plan, may enter into joint ventures, partnerships, or other business arrangements with or contract with any person, organization, entity, or governmental unit with respect to the administration of the programs of the public housing agency, such as developing housing or providing supportive/social services subject to either Title I of the U.S. Housing Act of 1937, as amended, or state law.

The Authority created the Fifth Avenue Housing Development Corporation (Corporation) in 1983 as a nonprofit organization to finance the development, rehabilitation, and/or operation of decent, safe, and sanitary U.S. Department of Housing and Urban Development (HUD)-assisted housing projects for low-income households. The Corporation issued mortgage revenue bonds, series 1983A and 1983B, to finance the acquisition and construction of the NSA III and NSA V projects for low-income households eligible for Section 8 housing assistance. The Corporation refunded the bonds in June 1992 with mortgage revenue refunding bonds, series 1992A, 1992B, 1992C, and 1992D. In May 1993, the Corporation redeemed the mortgage revenue refunding bonds, series 1992A and 1992C, with mortgage revenue refunding bonds, series 1993A and 1993B, respectively. The issuance of the mortgage revenue refunding bonds, series 1993A and 1993B, at reduced interest rates permitted HUD to recapture Section 8 funds used to subsidize the NSA III and NSA V projects. HUD entered into a financial adjustment factor refunding agreement (agreement) with the Authority in 1994. The agreement contained a refunding savings sharing schedule that showed HUD and the Authority sharing in nearly $3.4 million in refunding savings. The agreement stated that the Authority would receive 50 percent of the refunding savings. JPMorgan Chase Bank, N.A. (JPMorgan), was the final escrow agent for the trust accounts that maintained these refunding savings. The Corporation refunded the 1993 refunding bonds in June 2001 with mortgage revenue refunding bonds, series 2001A, 2001B, and 2001C. The trust indenture, dated June 2001, for these bonds contained a refunding savings sharing schedule, which showed that HUD and the Authority would equally share in more than

$1.3 million in refunding savings. The Bank of New York Trust Company, N.A. (The Bank of New York), is the escrow agent for the trust account that maintained these refunding savings.

Our objective was to determine whether the Authority effectively and efficiently used resources subject to its annual contributions contract, other agreements, or HUD regulations regarding its nonprofit development activities.

RESULTS OF AUDIT

Finding 1: The Authority Lacked Adequate Controls over Refunding Savings

The Authority failed to properly administer refunding savings from the Corporation's June 1992 refunding of mortgage revenue bonds, May 1993 redemption of mortgage revenue refunding bonds, and June 2001 refunding of mortgage revenue refunding bonds. It lacked adequate documentation to support that it used more than $900,000 in refunding savings from the Corporation's 1992 refunding of mortgage revenue bonds and 1993 redemption of mortgage revenue refunding bonds to provide affordable, decent, safe, and sanitary housing to very low-income households. Further, it had not used nearly $800,000 in refunding savings from the Corporation's 2001 refunding of mortgage revenue refunding bonds, and HUD had not received at least $260,000 in refunding savings as of February 2007. The problems occurred because the Authority lacked adequate procedures and controls over the refunding savings. As a result, HUD and the Authority lack assurance that more than $1.7 million in refunding savings was used effectively and efficiently.

The Authority Could Not Support Its Use of Refunding Savings

HUD received more than $1 million in refunding savings from January 1994 through July 2001 as a result of the Corporation's refunding of the mortgage revenue bonds in 1992 and redemption of the mortgage revenue refunding bonds in 1993. Although the Authority's interim executive director stated that the Authority received and used nearly that amount in refunding savings from the Corporation's 1992 refunding of the mortgage revenue bonds and 1993 redemption of the mortgage revenue refunding bonds, the Authority and JPMorgan could only provide documentation to support that the Authority received $913,365 in refunding savings from January 1996 through July 2001. Further, the Authority could not provide documentation to support that it used the refunding savings to provide affordable, decent, safe, and sanitary housing to very low-income households.

HUD received $654,876 in refunding savings from February 2002 through February 2005 as a result of the Corporation's refunding of the mortgage revenue refunding bonds in 2001. The Authority was not aware of its share of the refunding savings from the Corporation's 2001 refunding of the mortgage revenue refunding bonds until December 2006, when we brought it to the Authority's attention during our audit. The following table shows the Authority's share of the refunding savings from the NSA III and V projects and the dates that the refunding savings became available to the Authority.

Date refunding savings available	*Refunding savings available*		
	From NSA III	*From NSA V*	*Total*
February 2002	$75,707	$43,253	$118,960
August 2002	72,002	41,493	113,495
February 2003	73,483	39,825	113,308
August 2003	74,870	43,158	118,028
February 2004	73,850	41,490	115,340
August 2004	21,605	42,415	64,020
February 2005	0	11,725	11,725
Totals	$391,517	$263,359	$654,876

In January 2007, the Authority submitted a written request to The Bank of New York for its share of the refunding savings. Later in the month, The Bank of New York disbursed $794,990 ($654,876 in refunding savings and $140,114 in interest) of the $1,058,333 remaining in the trust account to the Authority. The Authority deposited the $794,990 into its checking account in January 2007 and then transferred the refunding savings into its high balance savings account in February 2007. The Authority is awaiting approval from HUD as to the use of the funds. The 2001 mortgage revenue refunding bonds were paid in full in December 2006 at redemption. As of February 2007, the trust account contained $266,412. A vice president of The Bank of New York stated that the remaining refunding savings, less approximately $5,000 in administrative fees, was payable to HUD. An accountant of HUD's Office of the Assistant Chief Financial Officer for Accounting, who is responsible for overseeing the savings from the Corporation's mortgage revenue refunding bonds, was not aware of the remaining refunding savings in the trust account.

The Authority Did Not Provide Certifications and Reports to HUD

Contrary to the agreement, the Authority had not, as of February 2007, certified to HUD that it had expended the refunding savings in accordance with the provisions of the agreement and the Stewart B. McKinney Homeless Assistance Amendments Act of 1988 (McKinney Act), as amended by the Housing and Community Development Act of 1992 (Housing Act); provided any annual certifications to HUD that the refunding savings were used in accordance with its share of the savings plan in appendix B of the agreement, including a report describing who used the refunding savings and the nature of the assistance provided; and provided any triennial audits as to whether the assistance provided was in accordance with the McKinney Act.

On August 15, 2005, the director of HUD's Headquarters Office of Multifamily Housing Asset Management informed the Authority's former executive director that the Authority had not submitted the required certifications and reports and requested the Authority to comply with the reporting requirements of the agreement as long as it was expending the refunding savings. The director stated that the Authority could submit one consolidated multiyear certification and one audit for the years in which the refunding savings were expended to facilitate timely compliance. The Authority had not responded to HUD's request as of February 2007.

The Authority Lacked Adequate Controls over Refunding Savings

The Authority lacked adequate procedures and controls over its refunding savings funds from the Corporation's 1992 refunding of mortgage revenue bonds, 1993 redemption of mortgage revenue refunding bonds, and 2001 refunding of mortgage revenue refunding bonds. It commingled the refunding savings from the Corporation's 1992 refunding of mortgage revenue bonds and 1993 redemption of mortgage revenue refunding bonds in its general fund account and could not trace its use of the refunding savings. The Authority's interim executive director stated that the Authority was not aware of the refunding savings from the Corporation's 2001 refunding of mortgage revenue refunding bonds and did not submit required certifications and reports due to poor record keeping and employee turnover.

As a result, HUD and the Authority lack assurance that more than $1.7 million in refunding savings was used effectively and efficiently.

Recommendations

We recommend that the director of HUD's Cleveland Office of Public Housing require the Authority to

1A. Provide documentation to support that the $913,365 in refunding savings cited in this finding was used to provide affordable, decent, safe, and sanitary housing to very low-income households or reimburse from nonfederal funds its refunding savings account(s), as appropriate, to be able to trace its use of the savings.

1B. Submit a proposal for HUD's approval regarding the Authority's planned use of the $794,990 in unused refunding savings for affordable, decent, safe, and sanitary housing for very low-income households.

1C. Implement adequate procedures and controls to ensure that it uses the refunding savings and submits required certifications and reports in accordance with the agreement.

We also recommend that the director of HUD's Cleveland Office of Public Housing

1D. Request The Bank of New York to disburse to HUD the remaining refunding savings funds, estimated to be at least $260,000 ($266,412 in refunding savings less approximately $5,000 in administrative fees), in the trust account from the Corporation's 2001 refunding of the mortgage revenue refunding bonds.

SCOPE AND METHODOLOGY

To accomplish our objective, we reviewed

- Applicable laws and regulations; the Authority's annual contributions contracts with HUD; Office of Management and Budget Circular A-87; section 1012 of the McKinney Act, as amended by the Housing Act; HUD program requirements at 24 CFR [*Code of Federal Regulations*] Parts 85 and 811, HUD's Office of Housing Notice 97-5; HUD's agreement with the Authority; and section 36-7-18-4 of the Indiana Code.

- The Authority's accounting records; independent auditor's reports for fiscal years ending March 31, 2003, 2004, and 2005; general ledgers; check register; bank statements and cancelled checks; bylaws; board meeting minutes; organizational chart; and nonprofit development activity documentation.

- The Corporation's certificate of incorporation, articles of incorporation, bylaws, and bond documentation.

- JPMorgan's and The Bank of New York's trust accounts documentation for the bonds.

- HUD's files for the Authority.

We also interviewed the Authority's employees, HUD staff, and JPMorgan's and The Bank of New York's personnel.

We performed our on-site audit work from June 2006 through January 2007 at the Authority's offices, located at 578 Broadway, Gary, Indiana. The review covered the period from April 1, 2005, through May 31, 2006, and was expanded as determined necessary.

We performed our audit 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,
- Compliance with applicable laws and regulations, and
- Safeguarding resources.

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 objective:

- Program operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.

- Validity and reliability of data – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.

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

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

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

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

- The Authority lacked adequate procedures and controls to ensure that it used refunding savings funds effectively and efficiently and submitted required certifications and reports to HUD.

APPENDIXES

Appendix A

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

Recommendation number	Unsupported 1/	Funds to be put to better use 2/
1A	$913,365	
1B		$794,990
1D		260,000
Totals	$913,365	$1,054,990

1/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

2/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. This includes reduction 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 the Authority and HUD implement our recommendations, the Authority will use refunding savings not previously used, and HUD will receive refunding savings funds.

Appendix B

AUDITEE COMMENTS AND OIG's EVALUATION

Ref to OIG Evaluation **Auditee Comments**

THE HOUSING AUTHORITY OF THE
CITY OF GARY, INDIANA

578 BROADWAY
GARY, INDIANA 46402
PHONE: 219/883-0387
FAX NO: 219/881-6414

MINIETTA E. NELSON
INTERIM EXECUTIVE
DIRECTOR

Providing residents with decent, safe and sanitary housing since 1938

HUD - OIG
OFFICE OF AUDIT
CHICAGO, ILLINOIS
2007 MAR 14 AM 11: 53
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March 13, 2007

Mr. Brent G. Bowen
Assistant Regional Inspector General for Audit
USHUD Office of Inspector General
77 West Jackson Boulevard, Suite 2646
Chicago, Illinois 60604

Re: HUD Audit Report 2007-CH-100X
GHA Nonprofit Development Activities

Dear Mr. Bowen:

In response to your letter dated February 28, 2007 and the exit conference on March 9, 2007, attached is the Housing Authority of the City of Gary, Indiana (GHA) comments on the specific issued contained in the Audit Report.

The Board of Commissioners and administration are committed to ensuring that reporting requirements will be adhered to and proper internal controls are in place for nonprofit development activities.

Sincerely,

Minietta E. Nelson

Minietta E. Nelson
Interim Executive Director

Attachments

Cc: Rudolph Clay, City of Gary
Victor H. Thornton, GHA Chairperson
Forrest Jones, HUD Field Office Coordinator
Theresa Lawson, GHA Internal Auditor
Tony Walker, GHA Legal Counsel

Ref to OIG Evaluation | **Auditee Comments**

AUDITEE COMMENTS

HUD Audit Report 2007-CH-100X
GHA Nonprofit Development Activities

The current Housing Authority of the City of Gary, Indiana (GHA) Board of Commissioners and administration acknowledge that the prior Board and management of the Authority lacked adequate controls over refunding savings from the Housing Development Corporation mortgage revenue bonds. Further, the current Board and administration of GHA recognize and accept that documentation did not and does not exist to support the requirement that funds received were used to provide affordable, decent, safe and sanitary housing to very low-income households. This can be and is attributed to the aforementioned lack of controls. Listed below are GHA's responses to recommendations in the Audit Report:

Comment 1

1C. HUD has already recognized the problems with documentation as evidenced by the contract it consummated with the Rosenberg Group, for the purpose of reconstructing financial records for the period 2001 to 2005. In fact, records cannot be located to verify that the Authority did, in fact, receive $913,365.00. The current Board and administration request that the presumption be made that the funds were expended appropriately and that no reimbursement be required since HUD monitoring had not previously surfaced a question in this regard. In the meantime, the Authority will request records from the OIG Auditor to support our receipt of the funds and the Authority will make every effort to then validate that the funds were used appropriately.

1B. GHA is in the process on submitting a proposal to the HUD Indianapolis Field Office for approval regarding GHA's planned use of $385,000 in unused refunding savings for affordable, decent, safe, and sanitary housing for very low-income households (See attachment). Additional proposals will be forwarded for the remaining balance upon the development of supporting documentation.

1C. GHA has already implemented measures to segregate the accounting for the refunding savings evidenced by the depositing savings in a separate bank account for the use of the refunding savings only. There will be no other transactions allowed to take place in this account. This will enable the Authority to clearly track the money allotted for each specific use, as well as provide an audit trail.

The Authority Executive Director, with the concurrence of the Board of Commissioners, will submit proposals to the HUD Indianapolis Field Office for planned use of the funds with appropriate documentation. Once a written approval from the HUD is received, the Executive Director will direct the Finance Department on pay eligible expenditures. The Finance Department will be required to maintain records providing supporting documentation with each transaction. Documentation will include: copies of checks, bank account information showing the check clearing, general ledger information, and a monthly reconciled bank statement until all monies are used. Also, a written statement of authorization shall be submitted to the Executive Director for anyone having access to this particular account.

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Ref to OIG Evaluation **Auditee Comments**

Upon the first expenditure, the Executive Director shall send a certification stating that this money has been used to provide decent, safe and sanitary housing affordable to very low income families or persons along with a list of the expenditures and the support documentation. This certification will be done annually until this project is closed out. This certification will be sent to the Director at the Office of Asset Management in Washington, DC.

A triennial audit will be performed by our independent auditor to review compliance with Section 1012. This should take place three years from the first expenditure. This compliance audit will consists of the agency using the refunding savings only for households with incomes not exceeding 50 percent of local median income in housing that is decent, safe, and sanitary. The documents that will be examined by the independent auditor will be income certifications and physical inspection reports among other documents. The agency will create a list of each development and the income for each tenant at the time the expenditure is benefiting. The tenant's income certifications should be kept with this information. Also, the agency will maintain the annual inspections for each development provided by our contractor that received the benefit for the period of the expenditure. This information will be reviewed in-house and sent to HUD for approval along with the actual expenditure being requested. This information will be sent to our HUD field office with each expenditure, however, will not be formally reviewed by our independent auditor until the three year period has taken place. This information will be kept in a special file to be given to the independent auditor at the time of the agency's annual independent audit to be performed for that year. The agency should include this triennial audit requirement in the proposal request for an independent audit for this third year. Upon completion of this triennial audit, it will be sent to the Director at the Office of Asset Management in Washington, DC.

The Authority Board and administration will take affirmative measures to ensure compliance with HUD regulations relating to nonprofit development activities.

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OIG's Evaluation of Auditee Comments

Comment 1 The Authority and JPMorgan provided documentation to support that the Authority received $913,365 in refunding savings from January 1996 through July 2001. Further, the Authority could not provide documentation to support that it used the refunding savings to provide affordable, decent, safe, and sanitary housing to very low-income households.

On August 15, 2005, the director of HUD's Headquarters Office of Multifamily Housing Asset Management informed the Authority's former executive director that the Authority had not submitted the required certifications and reports and requested the Authority to comply with the reporting requirements of the agreement as long as it was expending the refunding savings.

Therefore, the Authority needs to provide documentation to support that the $913,365 in refunding savings cited in this finding was used to provide affordable, decent, safe, and sanitary housing to very low-income households or reimburse from nonfederal funds its refunding savings account(s), as appropriate, to be able to trace its use of the savings.

Appendix C

FEDERAL REQUIREMENTS

Section 1012 of the McKinney Act, as amended by the Housing Act (Public Law 102-550), states that refunding savings may only be used for providing affordable, decent, safe, and sanitary housing to very low-income persons and families.

HUD's regulations at 24 CFR [*Code of Federal Regulations*] 811.110(g) state that unless otherwise specified by HUD in a McKinney agreement, refunding savings shall be subject to the use requirements in 24 CFR [*Code of Federal Regulations*] 811.110(g) for 10 years from the date of receipt of the savings.

HUD's Office of Housing Notice 97-5 states that the commingling of refunding savings is strictly forbidden. Refunding savings must be segregated and traceable to the approved program operations funded from the refunding savings. This is critical to the effectiveness of both the agency and HUD's internal controls.

Office of Management and Budget Circular A-87, attachment A, paragraph C(1)(j) requires that all costs be adequately documented.

HUD's agreement with the Authority required it to comply with the McKinney Act; use all refunding savings in the City to provide affordable, decent, safe, and sanitary housing to very low-income households; not use refunding savings to pay administrative costs except for required reviews and reports; ensure that refunding savings used for development costs of dwelling units and facilities be for very low-income households; require owners of rental housing units assisted with refunding savings to limit the occupancy of such units to very low-income households for a period of 10 years; only request payments for reimbursement of refunding savings expended or expected to be expended within six months; include a certification on later requisitions that refunding savings previously requisitioned were expended or expected to be expended within six months in accordance with the agreement and the McKinney Act; provide annual certifications to HUD within 90 days of the end of the Authority's fiscal year that the refunding savings were used in accordance with the Authority's share of the savings plan in appendix B of the agreement, including a report describing who used the refunding savings and the nature of the assistance provided; and cause to be prepared triennially a report from an independent consulting firm as to whether the assistance provided was in accordance with the McKinney Act.

Section 4.09 of the trust indenture, dated June 2001, for the Corporation's mortgage revenue refunding bonds, series 2001A, 2001B, and 2001C, states that when provision has been made for the payment of all the bonds outstanding, either at maturity or upon redemption, and for the payment of the trustee's, mortgage servicer's, issuer's, dissemination agent's, and rebate agent's fees and expenses and all other costs due under the trust indenture at such payment in full, money remaining under the trust indenture shall be transferred to HUD.