Issue Date September 20, 2007
Audit Report Number 2007-CH-1013

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

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

SUBJECT: The Butler Metropolitan Housing Authority, Hamilton, Ohio, Lacked Adequate Controls over Its Homeownership Proceeds

HIGHLIGHTS

What We Audited and Why

We audited the Butler Metropolitan Housing Authority's (Authority) 5(h) homeownership (5(h)) and its Turnkey III Homeownership Opportunity (Turnkey III) programs (programs). We selected the Authority based on a risk analysis showing that it may have improperly used the programs' funds. Our objectives were to determine whether the Authority properly accounted for and used its programs' proceeds in accordance with the U.S. Department of Housing and Urban Development's (HUD) requirements.

What We Found

The Authority failed to properly account for nearly $400,000 of the programs' proceeds for more than five years because it commingled the proceeds with funds in its retained earnings account. The $400,000 consisted of more than $166,000 in 5(h) sales proceeds from four properties sold between May 1997 and October 1998 and nearly $232,000 in Turnkey III proceeds. It also did not use the 5(h) proceeds in a timely manner. As a result, the programs' proceeds were not used to assist low- and moderate-income families.

We informed the Authority's executive director, the director of HUD's Cleveland Office of Public Housing, and the director of HUD's Columbus Office of Fair

Housing and Equal Opportunity of minor deficiencies through a memorandum, dated September 18, 2007.

What We Recommend

We recommend that the director of HUD’s Cleveland Office of Public Housing require the Authority to transfer from its retained earnings account to the applicable accounts the 5(h) and Turnkey III proceeds plus earned interest, submit a proposal(s) for HUD’s approval on how the programs’ proceeds will be used, and implement procedures and controls to ensure that the proceeds are used to support the development of affordable housing for low- and moderate-income families in accordance with HUD’s 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 issued because of the audit.

Auditee’s Response

We provided our discussion draft audit report to the Authority’s interim executive director, its board chairman, and HUD’s staff during the audit. We held an exit conference with the Authority’s interim executive director on August 27, 2007. We asked the interim executive director to provide written comments on our discussion draft audit report by September 14, 2007.

The interim executive director provided written comments, dated September 12, 2007, and agreed with our recommendations. The complete text of the auditee’s response, along with our evaluation of that response, can be found in appendix B of this report except for 12 pages of documentation that was not necessary for understanding the Authority’s comments. A complete copy of the Authority’s comments plus the documentation was provided to the director of HUD’s Cleveland Office of Public Housing.

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BACKGROUND AND OBJECTIVES

The Butler Metropolitan Housing Authority (Authority) was established in 1939 under Section 3735.27 of the Ohio Revised Code to provide low- and moderate-income persons with safe and sanitary housing. The Authority is governed by a five-member board of commissioners. The commissioners are appointed to five-year staggered terms. The Authority's executive director, appointed by the board of commissioners, is responsible for coordinating established policy and carrying out the Authority's day-to-day operations. As of June 11, 2007, the Authority owned and/or managed 1,158 Public Housing units and had 996 Section 8 Housing Choice Voucher program units.

The Section 5(h) homeownership program offers housing authorities a flexible way to sell Public Housing units to low-income families. The 5(h) program helps low-income families purchase homes through an arrangement that benefits both the buyer and the public housing authority that sells the unit. It gives the buyer access to an affordable homeownership opportunity and to the many tangible and intangible advantages homeownership brings. Homeownership can be an important part of self-sufficiency for low-income families, providing a way of building wealth as well as increasing self-esteem and security. The program was authorized by Section 5(h) of the United States Housing Act of 1937.

Our objectives were to determine whether the Authority properly accounted for and used its 5(h) homeownership (5(h)) and its Turnkey III Homeownership Opportunity (Turnkey III) programs' (programs) proceeds in accordance with the U.S. Department of Housing and Urban Development's (HUD) requirements.

RESULTS OF AUDIT

Finding: The Authority Lacked Adequate Controls over Its Homeownership Proceeds

The Authority failed to maintain a separate identity for its $166,002 of 5(h) homeownership program sales proceeds and did not use the proceeds in a timely fashion. It also failed to properly use $231,928 in Turnkey III (Turnkey III) program construction loan proceeds. This condition occurred because the proceeds were commingled in the Authority's retained earnings account, and their identity was lost and not used as required. As a result, $397,930 in program proceeds was not used to further homeownership activities for low- and moderate-income families.

Sales Proceeds from 5(h) Homeownership Properties

The Authority received $166,002 in sales proceeds from four 5(h) homeownership program properties sold between May 1997 and October 1998. It maintained these proceeds in a separate account until June 30, 2002, when the proceeds were transferred to the Authority's retained earnings account. The transfer occurred due to a misinterpretation of the requirements concerning converting the Authority's annual financial statements from HUD's basis of accounting to the generally accepted accounting principles method. The Authority's interim executive director said the 5(h) sale proceeds were never spent because after they were commingled in the retained earnings account, they were not tracked as separate funds but lost and forgotten in the retained earnings funds. The Authority's financial statements showed that $89,543 in interest had been earned on these proceeds as of June 30, 2007.

The Authority failed to maintain a separate identity for its 5(h) sales proceeds and did not obligate the sales proceeds in a timely manner as required by its 5(h) implementing agreement. These proceeds were not used for housing programs in support of the development of affordable housing for low- and moderate-income families as required by the Authority's 5(h) homeownership plan.

Turnkey III Homeownership Opportunity Program Proceeds

The Authority received $633,337 in construction loan proceeds from 22 Turnkey III properties sold between May 1986 and January 1995. It received HUD's approval to use $526,409 of the proceeds, leaving a balance of $106,928 ($633,337 minus $526,409). The Authority did not expend $125,000 of the proceeds approved for use. The $125,000 was to be used to implement a Homeownership and Opportunity for People Everywhere (HOPE) I program for single-family ownership possibilities. Instead, the Authority used a $127,000 grant it received from HUD to implement the HOPE program. As a result, the Authority did not use $231,928 ($106,928 plus $125,000) of the Turnkey III construction loan proceeds. The Authority's financial statements showed that $165,165 in interest had been earned on these proceeds as of June 30, 2007.

The Authority maintained the unused Turnkey III construction loan proceeds in a separate account until June 30, 2002, when they were transferred to the Authority's retained earnings account. The Authority's interim executive director said these proceeds were never spent because after they became commingled in the retained earnings account, they were not tracked as separate funds but lost and forgotten in the retained earnings funds. There was more than $4 million in the Authority's retained earnings account as of June 30, 2007.

Conclusion

The Authority failed to maintain records that identified the source and application of its homeownership proceeds in such a manner as to allow HUD to determine that all proceeds were expended for each specific program as required by its annual contributions contract and its 5(h) implementing agreement with HUD. As a result, $652,638 ($397,930 ($166,002 of 5(h) plus $231,928 in Turnkey III) in program proceeds and $254,708 ($89,543 plus $165,165) in earned interest) was not used to further homeownership activities for low- and moderate-income families.

Recommendations

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

1A. Transfer from its retained earnings account to an appropriate account $255,545 ($166,002 in sales proceeds and $89,543 in earned interest) in related proceeds and earned interest from the four 5(h) homeownership plan properties sold.

1B. Transfer from its retained earnings account to an appropriate account $397,093 ($231,928 in sales proceeds and $165,165 in earned interest) in related proceeds and earned interest from the Turnkey III construction loan.

1C. Submit a proposal(s) for HUD's approval on how the 5(h) and Turnkey III homeownership proceeds will be used.

1D. Implement procedures and controls to ensure that the 5(h) and Turnkey III homeownership proceeds are used to support the development of affordable housing for low- and moderate-income households and in accordance with its applicable agreement(s) and HUD's requirements.

SCOPE AND METHODOLOGY

To accomplish our objectives, we reviewed

- Applicable laws; regulations; HUD's program requirements at 24 CFR [*Code of Federal Regulations*] Part 906, HUD Guidebook 7510.1, HUD Public and Indian Housing Notice 91-28; and the Authority's 5(h) homeownership plan and implementing agreement with HUD; annual audited financial statements for 2004, 2005, and 2006; annual contributions contract with HUD; board of commissioners' resolutions; general ledgers; balance sheets; homeownership files; and organizational chart.

- HUD's files for the Authority.

We also interviewed the Authority's employees and HUD staff.
We performed our onsite audit work between April and July 2007 at the Authority's offices located at 4110 Hamilton Middletown Road, Hamilton, Ohio. The audit covered the period July 1, 2005, through March 31, 2006, but was expanded when necessary to include other periods.

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 objectives:

- 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 an organization's objectives.

Significant Weakness

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

- The Authority lacked adequate procedures and controls over its 5(h) and Turnkey III homeownership proceeds (see finding).

APPENDIXES

Appendix A

SCHEDULE OF FUNDS TO BE PUT TO BETTER USE

Recommendation number	Funds to be put to better use 3/
1A	$255,545
1B	$397,093
Total	$652,638

1/ 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 reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings which are specifically identified. In theses instances, if the Authority implements our recommendations, it will use the 5(h) and Turnkey III programs' proceeds to assist low- and moderate-income families.

Appendix B

AUDITEE COMMENTS AND OIG's EVALUATION

Ref to OIG Evaluation | **Auditee Comments**

Butler Metropolitan Housing Authority

— General Office —

TERRY R. KIMMONS ADMINISTRATIVE CENTER
4110 Hamilton-Middletown Rd. • Hamilton, Ohio 45011-6218

HAMILTON
Bambo Harris Homes
Riverside Homes
Dr. Henry A. Long Tower
Jackson Bosch Manor
Hamilton Scattered Sites
Thornhill Subdivision
Mark C. Petty Plaza
Winding Creek Family
Dayton Lane Gardens

MIDDLETOWN
Townhomes West
Townhomes East
The Townhouse
J. Ross Hunt Tower
Midlonia Village
Freedom Court
Concord Green
Middletown Estates
Reuben Doty Estates

September 12, 2007

Attn: Mr. Ronald Farrell
U. S. Department of HUD
Office of Inspector General
200 North High Street, Room 334
Columbus, OH 43125

Re: Response to the Discussion Draft Audit Report dated August 16, 2007

Dear Mr. Farrell:

This letter is in response to the draft audit report for Butler Metropolitan Housing Authority.

To begin, I concur with the findings that the proceeds (nearly $400,000.00) of sale in both the 5(h) program and the Turnkey III were not used in a timely manner. Fortunately, these funds were not misappropriated. The 5(h) funds had been placed in its own separate account prior to the audit as "Sale of HOP" with the remaining Turnkey III funds co-mingled with our retained earnings account.

Comment 1

Today we have established two separate bank accounts at Key Bank. One account labeled "5(h) Homeownership Proceeds" in the amount of $255,545.00 and the other labeled "Turnkey III Homeownership" in the amount of $394,093.00.

Our plan is to use these funds in addition to BMHA's other financial contributions to redevelop the OH15-1 Bambo Harris site. To date we have demolished all of the apartment buildings in Phase I and are moving forward to demolish the community building and the remaining infrastructure and street pavement under Phase II. We are under court order to continue to pursue alternative funding for this redevelopment effort which has resulted in our fifth attempt at applying for a HOPE VI Grant this November.

By applying these much needed contributions to this redevelopment effort we will help insure the internal controls necessary as enumerated on page nine (9) of the report and addressed on page 6, Item 1D.

Our timeline for the project is predicated on so many things over which we have no control e.g. the City of Hamilton's insistence that they will own the property in the end whether we are

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Ref to OIG Evaluation **Auditee Comments**

Mr. Ron Farrel
Office of Inspector General
September 12, 2007

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successful in our HOPE VI application, procuring a financial manager and developer prior to the submission of the HOPE VI application.

Sincerely,

BUTLER METROPOLITAN HOUSING AUTHORITY

Jeffrey L. Ranck
Interim Executive Director

JLR/jlm

Encl. (3)

Cc: File

OIG Evaluation of Auditee Comments

Comment 1 We commend the Authority for recognizing the importance of using its funds for future housing opportunities. The Authority did not provide adequate documentation to show that its 5(h) funds were placed in its own separate account prior to our audit. However, the Authority should provide documentation to HUD to verify that the funds were placed in separate accounts.

Appendix C

FEDERAL REQUIREMENTS AND THE AUTHORITY'S 5(h) HOMEOWNERSHIP PLAN

The annual contributions contract between HUD and the Authority, section 9 (C), states that the Authority shall maintain records that identify the source and application of funds in such a manner as to allow HUD to determine that all funds are and have been expended in accordance with each specific program and requirement. Section 15(A) of the contract requires the Authority to maintain complete and accurate books of account for the projects of the Authority in such a manner as to permit the preparation of statements and reports in accordance with HUD requirements and to permit timely and effective audits.

HUD's regulations at 24 CFR [*Code of Federal Regulations*] 906.17 state that the public housing authority shall be responsible for the maintenance of records (including sales and financial records) for all activities incident to implementation of the HUD-approved homeownership plan. The receipt, retention, and use of the sales proceeds shall be covered in the regular independent audits of the public housing authority's public housing operations.

The Authority's 5(h) implementing agreement, section 3.3, states that the Authority shall obligate sales proceeds in a timely fashion in accordance with the project implementation schedule set forth in the plan. Section 4 of the agreement states that the Authority will establish and maintain a separate account for any project or program to be funded with sales proceeds under this agreement. Such sales proceeds may be commingled with funds contributed to the project or program from other sources, so long as the authority maintains the separate identity of the sales proceeds covered by this agreement.

HUD's Accounting Guidebook 7510.1, issued January 1996, part IV, account 2854, states that funds in account 2854, Replacement Reserve - Proceeds from Sale of Dwelling, retained by the housing authority can be transferred with HUD approval to the operating reserve or replacement reserve of another authority-owned program within the same annual contributions contract or in another annual contributions contract. In addition, funds in this account may, in accordance with terms and conditions of use approved by HUD, be used for lower income housing purposes not covered by a specific annual contributions contract. Also, the housing authority must maintain adequate records to track receipt, retention, and expenditure of sales proceeds in sufficient detail to allow monitoring of compliance with the HUD-approved homeownership plan; to prepare any reports by HUD, and to meet its audit responsibilities.

The Authority's homeownership plan to sell Public Housing units under the 5(h) regulations states that sales proceeds not used for administration of the program and repair of the units to be sold will be used for other housing programs in support of the development of affordable housing for low- and moderate-income families. This includes the development of housing for those individuals through the use of other available methods of development (e.g., tax credit programs) as well as various resident initiative activities. Affordable housing programs offered could include housing development through HOME Investment Partnerships Program funds for tax-credit housing. Funds may be used for land acquisition, land banking, and infrastructure in support of development of subdivisions or multifamily housing tracts, either for rental or homeownership.

The Authority’s annual contributions contract, amendment number 12, section IX(3), requires that the books of account and records of the Authority be maintained to meet the requirements of the homebuyers ownership opportunity agreement as well as the other provisions of this contract and in such a manner as will at all times show the operating receipts, operating expenditures, reserves, residual receipts, and other required accounts for the project separate and distinct from all other projects under this contract.

HUD’s Public and Indian Housing Notice 91-28 states that public housing authorities have two alternatives for use of proceeds from the sale of homeownership units: (a) an authority may use the proceeds from the sale of homeownership units for any existing programmatic use related to operations pursuant to an annual contributions contract from which the proceeds from the sale of the homeownership units originated, or (b) an authority may use proceeds from the sale of homeownership units for any lower income housing use approved by HUD, including a locally sponsored and directed homeownership program.