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Audit Report Number 2007-LA-1014
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TO: Dominique Blom, Deputy Assistant Secretary, Office of Public Housing Investments, PI

Stephen Schneller, Director, San Francisco Office of Public Housing, 9APH

*Joan S. Hobbs*

FROM: Joan S. Hobbs, Regional Inspector General for Audit, Region IX, 9DGA

SUBJECT: The Housing Authority of the County of San Mateo, Belmont, California, Did Not Use HUD Program Funds in Accordance with HUD Requirements

## **HIGHLIGHTS**

### **What We Audited and Why**

We reviewed the Housing Authority of the County of San Mateo's (Authority) Housing Choice Voucher program to determine whether the Authority used program funds in accordance with U.S. Department of Housing and Urban Development (HUD) rules and regulations. The HUD San Francisco Office of Public Housing requested that the Office of Inspector General (OIG) review the financial operations of the Authority due to concerns about the use of program funds.

### **What We Found**

The Authority did not use Housing Choice Voucher program funds in accordance with requirements. Specifically, the Authority

- Used \$573,485 in Housing Choice Voucher program funds to overlease the Moving to Work Demonstration (Moving to Work) program. Further, in an attempt to remedy the overleasing, the Authority improperly implemented a Moving to Work preference in its Housing Choice Voucher program that impacted 71 families on the Housing Choice Voucher program waiting list.

- Loaned \$1.4 million in Housing Choice Voucher program funds to pay for construction costs of the El Camino Village low-rent public housing project.
- Loaned \$500,000 in Midway Village Comprehensive Improvement Assistance Program grant funds to reimburse the Housing Choice Voucher program for El Camino Village construction cost overruns.
- Transferred \$115,602 in portability administrative fees to its nonfederal account.
- Overdrew its Housing Choice Voucher program operating reserve.

### What We Recommend

We recommend the Deputy Assistant Secretary for the Office of Public Housing Investments require the Authority to

- Reimburse the Housing Choice Voucher program \$573,485 from the Moving to Work program or from nonfederal funds for the overleasing of the Moving to Work program and more than \$1.27 million used to house Moving to Work program participants moved to the Housing Choice Voucher program.

We recommend the director of HUD's San Francisco Office of Public Housing require the Authority to

- Reimburse the Housing Choice Voucher program \$1.4 million plus interest from nonfederal funds.
- Reimburse Midway Village \$500,000 plus interest from nonfederal funds.
- Reimburse the Housing Choice Voucher program \$115,602 plus interest from nonfederal funds.
- Implement controls and establish policies and procedures for the accounting and use of Housing Choice Voucher program operating reserves.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

### Auditee's Response

We provided the Authority a draft report on June 28, 2007, and held an exit conference with officials on July 3, 2007. The Authority provided written comments on July 13, 2007. The Authority generally agreed with our report findings but disagreed with some of the report's conclusions and 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.

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## **BACKGROUND AND OBJECTIVES**

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The Housing Authority of the County of San Mateo (Authority) was created pursuant to the State Health and Safety Code by the San Mateo County (County) Board of Supervisors in March 1941 to provide housing assistance to low and moderate-income families. The Board of Supervisors has established oversight responsibility for the Authority in a separate legal capacity as the Authority's board of commissioners.

The Authority is currently part of the County's Department of Housing. The County established the Department of Housing on January 11, 2005. The Department of Housing includes the Authority as well as the County's Housing and Community Development Office. The director of housing, deputy director, and financial services manager are County employees who oversee both the Authority and the Housing and Community Development Office. All other staff members are employees of the Authority. Before the Department of Housing was created, the Authority functioned under the County's Human Services Agency. The Authority maintains two conventional low-rent public housing developments, Midway Village and El Camino Village. El Camino Village is a 30-unit facility in unincorporated San Mateo County that was completed in 2001; Midway Village is a 150-unit facility in Daly City. In addition, the Authority owns a 60-unit project-based Section 8 facility at Half Moon Bay. It also administers more than 4,000 Section 8 vouchers, including those under the Moderate Rehabilitation and Moving to Work Demonstration (Moving to Work) programs.

The Office of Inspector General (OIG) last conducted an audit of the Authority's procurement and contracting in 2003 (Audit Report Number 2003-LA-1002). The review found that the Authority did not follow procurement and contracting requirements. The report identified \$233,350 in unreasonable and excessive costs and \$90,000 in unsupported expenditures charged to federally funded programs. Audit recommendation 1B relating to \$233,350 in unreasonable and excessive costs remains open, pending its final payment on or before July 1, 2007.

Our objective was to determine whether the Authority used program funds in accordance with U.S. Department of Housing and Urban Development (HUD) requirements.

## RESULTS OF AUDIT

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### Finding 1: The Authority Overleased Its Moving to Work Program and Improperly Implemented a Waiting List Preference

The Authority overleased its Moving to Work program in violation of its agreement with HUD. In an attempt to remedy the overleasing, the Authority implemented a Moving to Work program preference in its Housing Choice Voucher program in violation of HUD requirements. The overleasing and improper preference occurred due to mismanagement of the Moving to Work and Housing Choice Voucher programs. As a result, the Authority misused \$573,485 in Housing Choice Voucher program funds to overlease the Moving to Work program. Further, the implementation of an improper Housing Choice Voucher program preference impacted 71 families on the Housing Choice Voucher waiting list.

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#### **Moving to Work Program Was Limited to 300 Families**

The Authority entered into a Moving to Work program agreement with HUD in May 2000. The agreement permitted the Authority to use a portion of its existing Housing Choice Vouchers to house up to 300 families under the Moving to Work program. The Moving to Work program functions in a similar manner to the Housing Choice Voucher program in that the families are free to choose housing in the private rental market and the housing authority pays a subsidy to the landlord on behalf of the family. The family pays the difference between the rent charged and the amount of the subsidy.

However, the Moving to Work program differs from the Housing Choice Voucher program in that it gives incentives to families with children when the head of household is working, seeking work, or preparing for work by participating in job training, educational programs, or programs that assist people in obtaining employment and becoming economically self-sufficient. The program also places a six-year housing assistance limit on all Moving to Work program families.

#### **The Authority Misused \$573,485 to Overlease the Program**

The Authority's Moving to Work program initially generated income, and the program accumulated a large amount of operating reserves. In April 2002, the Authority began using the operating reserve since the cost of the program was exceeding the amount of Moving to Work funding provided by HUD. Although the program was already operating beyond the funding provided by HUD, the Authority continued placing families

into the program. It began overleasing the Moving to Work program in June 2002, and by December 2002, the program was overleased by more than 100 families.

Due to significant overleasing of the program, the Authority used up all of the Moving to Work program operating reserves and began transferring Housing Choice Voucher program funds to the Moving to Work program in July 2004. It recorded the transfers as loans from the Housing Choice Voucher program to the Moving to Work program. As of March 2007, the Moving to Work program owed \$1.15 million to the Housing Choice Voucher program. Although the Moving to Work program agreement gave the Authority the flexibility to use Housing Choice Voucher program funds, it did not permit the use of the funds to overlease the program. Since Housing Choice Voucher program funds were used to overlease the Moving to Work program, fewer funds were available to administer the Housing Choice Voucher program. As a result, the overleasing impacted those on the Housing Choice Voucher program waiting list. Therefore, any Housing Choice Voucher program funds used to overlease the Moving to Work program were used for ineligible purposes. The Authority began using Housing Choice Voucher program funds to pay for Moving to Work program overleasing in July 2004. From July 1, 2004, through the end of the last fiscal year of overleasing, June 30, 2005, the Authority used \$573,485 in Housing Choice Voucher program funds (\$552,441 in housing assistance payments and \$21,044 in administrative fees) to pay for Moving to Work program overleasing.

### **The Authority Improperly Implemented a Waiting List Preference**

The Authority did not want to continue overleasing the Moving to Work program. To reduce the number of families in the program, it created a preference for Moving to Work program participants on the Housing Choice Voucher program waiting list. The preference allowed selection of Moving to Work program participants ahead of other applicants on the Housing Choice Voucher program waiting list. From January through June 2005, the Authority moved 71 Moving to Work program families to the Housing Choice Voucher program using the preference. The preference delayed the opportunity for 71 other eligible applicants to receive Housing Choice Voucher program assistance.

The 71 converted Moving to Work program families held a wide range of spots on the Housing Choice Voucher program waiting list. This meant that some of the converted families would have been able to convert to the Housing Choice Voucher program quickly without the preference, while others who received the preference would still be waiting to convert. For example, the lowest ranking converted Moving to Work program family (number 11,301 on the waiting list) was just 32 positions higher than the last applicant on the Housing Choice Voucher program waiting list.

## **The Authority's Preference Impacted 71 Families on the Housing Choice Voucher Program Waiting List**

The Moving to Work program preference was not included in the Authority's Administrative Plan. Federal regulations require that housing authorities include waiting list preferences in its Administrative Plan. As a result, 71 families on the Housing Choice Voucher waiting list were impacted by the improperly implemented Moving to Work preference. Inclusion of the preference in the administrative plan is necessary to ensure fair treatment to all applicants since this is the document that prescribes all of the Authority's operating policies and procedures for the Housing Choice Voucher program.

## **Conclusion**

The Authority overleased its Moving to Work program beyond the 300-family limitation in its agreement with HUD. Since the program did not have funds available to finance the overleasing, the Authority misused \$573,485 in Housing Choice Voucher program funds. Since funds were inappropriately used to house Moving to Work program applicants rather than Housing Choice Voucher program applicants, the overleasing impacted those on the Housing Choice Voucher program waiting list. It attempted to remedy the overleasing by implementing a preference, resulting in the transfer of 71 Moving to Work program families to the Housing Choice Voucher program. Further, the Authority violated HUD requirements since it did not include the preferences in its Administrative Plan. As a result, the transfer of Moving to Work program families to the Housing Choice Voucher program impacted 71 families on the Housing Choice Voucher program waiting list.

## **Recommendations**

We recommend that the Deputy Assistant Secretary for the Office of Public Housing Investments, PI require the Authority to

1A. Immediately repay the Housing Choice Voucher program \$573,485<sup>1</sup> from the Moving to Work program or from nonfederal funds for the overleasing of the Moving to Work program between July 1, 2004, and June 30, 2005.

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<sup>1</sup> Amount is based on the average unit-month housing assistance payments and administrative fee expenses for the Moving to Work program. This calculation methodology was suggested by the Office of Housing Voucher Programs, HUD headquarters.

1B. Reimburse the Housing Choice Voucher program \$1.23 million<sup>2</sup> used to house the 71 Moving to Work program participants moved to the Housing Choice Voucher program from July 1, 2005, through June 30, 2006, and repay this amount to the Housing Choice Voucher program from nonfederal funds.

1C. Take steps to ensure that it does not improperly implement any Housing Choice Voucher program waiting list preferences.

1D. Implement policies and procedures to ensure that the Moving to Work program is not overleased.

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<sup>2</sup> Amount is based on the average unit-month housing assistance payments (\$1,146,221) and administrative fee expenses (\$86,103) used to house 71 Moving to Work participants moved to the Housing Choice Voucher program. The amounts were calculated by determining the average annual Moving to Work subsidy cost multiplied by 71. This calculation methodology was suggested by the Office of Housing Voucher Programs, HUD headquarters.



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## Finding 2: The Authority Loaned \$1.4 Million in Housing Choice Voucher Program Funds to Exceed the Total Development Cost Limit Without HUD Approval

The Authority did not obtain approval from HUD to loan \$1.4 million in Housing Choice Voucher program funds toward El Camino Village construction cost overruns. This occurred because the Authority did not follow HUD regulations which require HUD approval to use funds to exceed a project's total development cost. As a result, the Housing Choice Voucher program was deprived of scarce HUD funds needed to provide housing to program participants.

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### **The Authority Received HUD Approval to Construct New Public Housing**

On June 7, 1994, the Authority obtained a \$4.3 million development grant from HUD to construct a 30-unit low-rent public housing development, which the Authority later named El Camino Village. It anticipated El Camino Village development costs to exceed the development grant amount provided by HUD and submitted a development project grant annual contributions contract showing an additional \$400,000 in funding coming from a donation of the Authority's Housing Choice Voucher program operating reserves.

Despite the additional donation of funds, the development continued to incur considerable cost overruns. The Authority looked to private financing of \$1.4 million and \$652,000 in operating reserves to cover the overruns and prepared an amended Development Cost Budget/Cost Statement (form HUD-52484) on December 17, 1999. The statement was signed by the Authority's former executive director but was not approved by HUD. The Authority was unable to provide a HUD-executed copy or a more recent version of the statement. OIG also contacted the HUD San Francisco Office of Public Housing for evidence of HUD approval. HUD also did not have any documentation indicating it approved of the use of Housing Choice Voucher program funds for El Camino Village construction cost overruns.

### **The Authority Loaned \$1.4 million in Housing Choice Voucher Reserves for Public Housing without HUD Approval**

The Authority did not obtain the \$1.4 million in private financing because HUD would not subordinate its interest in the property to the private lender. Since the Authority was unable to obtain private financing to pay for the overruns, it recorded a net amount of \$1.8 million as a loan to the El Camino Village development from its Housing Choice Voucher program operating reserve. Although the Authority is permitted to use Housing

Choice Voucher program operating reserves to exceed a project's total development cost, it must obtain HUD approval. The Authority was approved to use \$400,000 of its Housing Choice Voucher program operating reserves for El Camino Village. However,, the Authority was unable to provide any required documentation showing that HUD approved the use of the additional \$1.4 million in Housing Choice Voucher program operating reserves used for construction of the El Camino Village development.

## **Conclusion**

Although the Authority obtained approval to use \$400,000 in Housing Choice Voucher program funds, it could not provide any evidence that HUD approved the loan of an additional \$1.4 million in Housing Choice Voucher program funds. This occurred because the Authority did not follow HUD regulations which require HUD approval to use funds to exceed a project's total development cost. As a result, the Housing Choice Voucher program was deprived of scarce HUD funds needed to provide housing to program participants.

## **Recommendations**

We recommend that the director of the Office of Public Housing require the Authority to

2A. Record the \$400,000 transferred from its Housing Choice Voucher program operating reserve to the El Camino Village development as a donation (as approved by HUD) and, accordingly, reduce the Housing Choice Voucher program operating reserve balance by \$400,000.

2B. Support the use of \$1.4 million from the Housing Choice Voucher program operating reserve or reimburse the reserve \$1.4 million from nonfederal funds.

2C. Determine the applicable interest that the \$1.4 million would have earned to date and reimburse the reserve such applicable interest from nonfederal funds if the use of funds cannot be supported.

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### Finding 3: The Authority Loaned \$500,000 in Midway Village Comprehensive Improvement Assistance Program Grant Funds for El Camino Village Construction Cost Overruns

The Authority loaned \$500,000 in Midway Village Comprehensive Improvement Assistance Program grant funds to reimburse the Housing Choice Voucher program for El Camino Village construction cost overruns. The Authority originally loaned \$2.3 million from the Housing Choice Voucher program to pay for these overruns. Since El Camino Village lacked the funds necessary to repay the Housing Choice Voucher program, the Authority disregarded HUD requirements and loaned \$500,000 in Midway Village Comprehensive Improvement Assistance Program grant funds to El Camino Village. It immediately used the funds to reduce El Camino Village's outstanding balance due to the Housing Choice Voucher program to \$1.8 million. The Authority's use of Midway Village Comprehensive Improvement Assistance Program grant funds to pay for El Camino Village construction costs reduced funds available to operate and maintain the Midway Village development. Further, Midway Village may need these scarce program funds to pay for contingent legal liabilities of more than \$800,000.

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#### **The Authority Received Public Housing Grants for Midway Village**

The Authority received two Comprehensive Improvement Assistance Program grants, totaling more than \$1 million, in federal fiscal years 1998 and 1999. The primary purpose of the program was to help smaller public housing authorities correct physical, management, and operating deficiencies and keep units in its public housing stock as safe and desirable homes for low-income families. According to HUD requirements, authorities receiving funds through this program are required to spend the funds based on a HUD-approved Comprehensive Improvement Assistance Program budget. Its original HUD-approved program budgets indicated that the funds would be used toward capital improvements and repairs at its Midway Village public housing development.

Before the funds were drawn down, new Comprehensive Improvement Assistance Program requirements were published in the February 18, 1999, *Federal Register* (64 FR 8201) and in HUD PIH [Public and Indian Housing] Notice 99-38. The new requirements amended Section 9 of the U.S. Housing Act (42 U.S.C. 1437g) and permitted small housing authorities, including the Authority, to use remaining program funds for eligible capital or operating purposes.

In March 2001, the Authority submitted revised budgets and informed HUD that it planned to draw down all remaining Comprehensive Improvement Assistance Program grant funds into the Midway Village operations account. The Authority explained that due to environmental clearance issues at Midway Village, it would not be able to make the proposed capital improvements. The Authority indicated that it would spend the

funds on basic Midway Village management and maintenance, expenses derived from any additional environmental testing, and possible relocation costs for Midway Village residents after the testing results were known.

### **The Authority Loaned \$500,000 in Grant Funds for Ineligible Purposes**

In June 2001, The Authority transferred all of its Comprehensive Improvement Assistance Program funds, totaling more than \$1 million, into its Midway Village operations account. It used a portion of the funds to offset operating deficits incurred due to ongoing environmental clearance issues at Midway Village. In February 2002, the Authority inappropriately transferred \$500,000 from the Midway Village operations account to its newly constructed El Camino Village development. It recorded the transaction as a loan from Midway Village to El Camino Village. Before the transfer, the Authority incurred significant construction cost overruns during the development of El Camino Village and loaned \$2.3 million in Housing Choice Voucher program funds to pay for the deficit. It immediately used the Midway Village funds to reduce El Camino Village's outstanding balance due to the Housing Choice Voucher program to \$1.8 million.

### **Conclusion**

As of February 2007, El Camino Village had not repaid any of the \$500,000 borrowed from Midway Village in 2002. Since Midway Village did not have this cash available, it was unable to use the funding toward maintenance and operation of the development or earn any interest income on the funds. Use of the Midway Village funds for El Camino Village construction-related costs was not an eligible capital or operating expense.

### **Recommendation**

We recommend that the director of the Office of Public Housing require the Authority to immediately

3A. Cease the practice of using public housing funds for ineligible purposes and reimburse Midway Village \$587,650 (\$500,000 plus \$87,650 in interest) from El Camino Village or from nonfederal funds.

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## Finding 4: The Authority Transferred \$115,602 in Housing Choice Voucher Program Portability Administrative Fees to Its Nonfederal Account

The Authority did not follow HUD requirements and transferred \$115,602 in Housing Choice Voucher program portability administrative fees to its nonfederal account. These transfers occurred due to the Authority's improper policies on the use of portability administrative fees. As a result, the Housing Choice Voucher program had fewer funds available to administer the Authority's incoming portability vouchers.

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### **The Authority Transferred \$115,600 to Its Nonfederal Account**

The Authority transferred \$115,602 in Housing Choice Voucher program portability administrative fees to increase its nonfederal account. The term "portability" refers to the process of leasing a dwelling unit with housing voucher tenant-based assistance outside the jurisdiction of the authority that initially issued the family its voucher. The housing authority with jurisdiction over the area to which the family moves is called the receiving housing authority. In portability, the receiving authority may bill the initial authority for housing assistance payments and 80 percent of the initial administrative fees to cover assistance for a portable family.

From July 2004 through June 2006, the Authority billed initial housing authorities for housing assistance payments and 80 percent of the initial administrative fees (the initial authority retains 20 percent of the administrative fee). It received the administrative fees to cover costs incurred in performing its administrative responsibilities for the Housing Choice Voucher program. These costs include conducting all interim and annual reexaminations for the family and all housing quality standards inspections of the family's unit. Further, HUD specifically requires that all Housing Choice Voucher program funds, including administrative fees, be used for the Housing Choice Voucher program exclusively. Instead of using the fees to administer the program or crediting the amount of fees to its Housing Choice Voucher program operating reserves, the Authority transferred \$115,602 to its nonfederal account in violation of HUD requirements.

## Recommendation

We recommend that the director of the Office of Public Housing require the Authority to

4A. Cease the practice of transferring portability administrative fees to its nonfederal account.

4B. Immediately reimburse the Housing Choice Voucher program \$120,371, which includes the \$115,602 in administrative fees plus \$4,769<sup>3</sup> in interest, from nonfederal funds.

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<sup>3</sup> Amount calculated based on interest earned on quarterly pooled earnings with the County of San Mateo from July 1, 2004 through June 30, 2006.

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## Finding 5: The Authority Overdrew Its Housing Choice Voucher Program Operating Reserve

The Authority overdrew its Housing Choice Voucher program operating reserve by \$1.37 million. It used its Housing Choice Voucher program operating reserve to pay for program operating deficits and to loan funds to other programs. The Authority did not appropriately monitor the funds that it loaned to other programs to ensure it did not exceed the amount available in the operating reserve. As a result, the Authority was inappropriately loaning current year administrative fees and housing assistance payment funds. This inappropriate use of funds, if not repaid when needed, may leave the Authority with insufficient resources necessary to operate the program and cover future administrative fee shortfalls.

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### **HUD Requires Accounting of the Housing Choice Voucher Program Operating Reserve**

HUD requires public housing authorities to maintain an operating reserve for the Housing Choice Voucher program. The Authority maintained such an account. At the end of each fiscal year, the operating reserve is credited the difference between administrative fees paid by HUD and housing authority program administrative expenses. If administrative expenses exceed administrative fees paid by HUD during the year, the authority must use funds in the operating reserve to fund the deficit. For operating reserves earned before fiscal year 2004, HUD also allows housing authorities to use the funds for other housing purposes permitted by state and local law. However, they cannot use operating reserves earned from fiscal year 2004 and later for other housing purposes and may only use the funds for the Section 8 program.

### **The Authority Advanced \$2.3 Million in Reserves to El Camino Village**

The Authority incurred significant cost overruns during construction of its El Camino Village low-rent public housing development. In February 2000, it began advancing funds from the operating reserve to the El Camino Village development to pay for the overruns. The Authority advanced \$2.3 million in operating reserves to El Camino Village between February 2000 and June 2001. It recorded the \$2.3 million in advances as a loan from the Housing Choice Voucher program but did not make a corresponding adjustment to the operating reserve account. At the end of fiscal year 2001, the operating reserve balance was \$4.6 million (see finding 2).

In February 2002, the Authority inappropriately used \$500,000 in Midway Village Comprehensive Improvement Assistance Program funds (see finding 3) to reduce El Camino Village's outstanding balance due to the Housing Choice Voucher program to \$1.8 million. This transfer had no effect on the operating reserve balance, only on the outstanding loan balance. However, the Authority incurred operating deficits in its Housing Choice Voucher program during the year, and it reduced the operating reserve balance to \$4.2 million at the end of fiscal year 2002.

At the end of fiscal year 2003, the Authority gave more than \$2 million in operating reserves to its Midway Village and Shelter Plus Care programs in accordance with HUD requirements. The Authority reduced the operating reserve balance accordingly, leaving approximately \$2 million remaining in the operating reserve account.

**The Authority Advanced \$1.25 Million in Operating Reserve Funds to the Moving to Work Program**

The Authority also used operating reserve funds to pay for overruns in its Moving to Work program. From July 2004 through June 2005, it advanced operating reserves to finance overleasing (see finding 1) and operating deficits in the Moving to Work program. The Authority advanced \$1.25 million in reserves to the Moving to Work program. Of this amount, the Moving to Work Program has repaid approximately \$100,000 to the Housing Choice Voucher program, resulting in a remaining balance of \$1.15 million due to the Housing Choice Voucher program. The Authority accounted for advances from the Housing Choice Voucher program to the Moving to Work program as loans to the Moving to Work program, and it did not directly reduce the operating reserve.

According to the Authority's financial statements, the operating reserve balance at the end of fiscal year 2006 was approximately \$1.58 million. However, this balance does not reflect operating reserve loans of \$1.8 million and \$1.15 million to El Camino Village and the Moving to Work program described above. Therefore, the Authority misstated and overdrew the Housing Choice Voucher program operating reserve. HUD regulations require that if the operating reserve is used for purposes not related to the Section 8 program, the operating reserve account shall be debited and cash credited for the amount of cash withdrawn for such other purposes. Further, operating reserves are considered used when expended.



**The Authority Overdrew the Housing Choice Voucher Program Operating Reserve by \$1.37 Million**

The Authority began overdrawing the operating reserve at the end of fiscal year 2004, and by the end of fiscal year 2006, it had overdrawn the operating reserve by approximately \$1.37 million (\$1.58 million according to Authority financials less \$1.8 million to El Camino Village and \$1.15 million to the Moving To Work program – see table below). As a result of the Authority’s significant overdrawing of the operating reserve, it used funding intended for future periods to pay for current program deficits. Further, if any delays occur in Housing Choice Voucher program funding, the Authority may not have the resources necessary to operate the program.

<b>Housing Choice Voucher program operating reserve</b>				
<b>Date</b>	<b>End balance (fiscal year end, according to financial statements)</b>	<b>Loan of operating reserves to El Camino Village (ECV)</b>	<b>Loan of operating reserves to the Moving to Work program (MTW)</b>	<b>End balance (OIG calculated, with loans to ECV and MTW)</b>
June 30, 2000	\$4,925,371	\$(1,050,000)		\$ 3,875,371
June 30, 2001	\$4,632,988	\$(2,300,000)		\$ 2,332,988
June 30, 2002	\$4,282,151	\$(1,800,000)		\$ 2,482,151
June 30, 2003	\$2,075,615	\$(1,800,000)		\$ 275,615
June 30, 2004	\$1,581,655	\$(1,800,000)		\$ (218,345)
June 30, 2005	\$1,451,742	\$(1,800,000)	\$(1,247,927)	\$(1,596,185)
June 30, 2006	\$1,581,888	\$(1,800,000)	\$(1,156,375)	\$(1,374,487)

**Conclusion**

The Authority did not have controls in place to ensure funds it loaned from the operating reserve did not exceed the amount available. As a result, it overdrew the Housing Choice Voucher program operating reserve by \$1.37 million. If all ineligible and unsupported costs related to the operating reserve from this report are repaid, the Authority will have a positive cash balance in its operating reserve account. However, should funds not be returned to the account during the audit resolution process with HUD, the Authority should fund any operating reserve deficits as a result of overdrawing the reserve from nonfederal funds. Further, the Authority must ensure that it properly accounts for Housing Choice Voucher program funds and operating reserves for budgeting and reporting purposes.

## Recommendations

We recommend that the director of the Office of Public Housing require the Authority to

5A. Properly account for \$576,515 of the \$1.15 million in Housing Choice Voucher program loans (\$1.15 million less \$573,485 for overleasing in finding 1 through one of the following methods:

- 1) Deducting \$576,515 from the Housing Choice Voucher program operating reserve and removing the accounts receivable/accounts payable entry between the Moving to Work program and the Housing Choice Voucher program,
- 2) Reimbursing the Housing Choice Voucher program \$576,515 from the Moving to Work program or from nonfederal funds, or
- 3) Removing the accounts receivable from the Housing Choice Voucher program balance sheet and create a contra-asset account for the operating reserve loan to ensure that the Authority does not overdraw the Housing Choice Voucher program operating reserve.

5B. Implement controls and establish policies and procedures for the accounting and use of Housing Choice Voucher program funds and operating reserves that will ensure sufficient and appropriate funds are available prior to use.

5C. If all ineligible and unsupported costs related to the operating reserve in this report are not returned to the account during the audit resolution process, the Authority should fund any operating reserve deficits from nonfederal funds as a result of overdrawing the reserve.

5D. Discontinue the use of the operating reserves for any purpose other than actual administrative deficits until loans have been repaid and HUD has determined a sufficient reserve is available to cover expected shortfalls over the term of the Annual Contributions Contract.

## SCOPE AND METHODOLOGY

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We performed on-site work at the Authority, located in San Mateo, California from November 2006 through April 2007. Our review generally covered the period July 1, 2004, through June 30, 2006. This period was adjusted as necessary. Our objective was to determine whether the Authority used program funds in accordance with U.S. Department of Housing and Urban Development (HUD) requirements.

To accomplish our objective, we

- Interviewed HUD and Authority personnel to obtain background information about the Authority and its Housing Choice Voucher program.
- Reviewed Authority accounting records including audited financial statements, general ledgers, bank statements, and supporting documentation.
- Reviewed HUD requirements and regulations regarding the use of HUD program funds.

We performed our review in accordance with generally accepted government auditing standards.

# INTERNAL CONTROLS

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Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

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

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

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## Relevant Internal Controls

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

- Administering the Housing Choice Voucher program in compliance with HUD regulations,
- Maintaining complete and accurate records, and
- Safeguarding HUD program resources.

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 items are significant weaknesses:

- The Authority did not have controls in place to ensure that its records were complete and accurate (see findings 2 and 5).
- The Authority lacked effective procedures and controls over the use of Housing Choice Voucher program funds to ensure compliance with laws and regulations (see findings 1, 2, 3, 4 and 5).
- The Authority did not have controls in place to safeguard scarce HUD program resources (see findings 1, 2, 3, 4, and 5).

## APPENDIXES

### Appendix A

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

Recommendation number	Ineligible <u>1/</u>	Unsupported <u>2/</u>
1A	\$573,485	
1B	\$1,232,324	
2B		\$1,400,000
3A	\$587,650	
4A	\$120,371	
Total	\$2,513,830	\$1,400,000

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local policies or regulations.

2/ 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.

## Appendix B

# AUDITEE COMMENTS AND OIG'S EVALUATION

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### Ref to OIG Evaluation

### Auditee Comments

#### Comment 1

**HOUSING AUTHORITY  
OF THE COUNTY OF SAN MATEO**

264 HARBOR BOULEVARD, BLDG A • BELMONT, CALIFORNIA 94002 • TEL 650-802-3300 • FAX 650-802-3373

July 13, 2007

Joan S. Hobbs  
Regional Inspector General for Audit  
U.S. Department of Housing and Urban Development  
Office of Inspector General, Region IX  
611 West Sixth Street, Suite 1160  
Los Angeles, CA 90017-3101

FAX: 213-894-8115

Subject: Discussion Draft Audit Report

Dear Ms. Hobbs:

We received the Discussion Draft Audit Report dated June 28, 2007, and met with Helen Sparks, James Brady and Arthur Terzian Ishkhans of your staff on July 3, 2007, for the exit conference. We expressed our appreciation for the professionalism with which the audit was conducted, and our genuine appreciation for the necessity of the audit function to maintain the public trust, and for the important additional contribution that audits can make to program improvement.

The audit focused on a period of the Authority's recent past that was fraught with challenges. The Authority's first venture into affordable housing development since 1976, the El Camino Village Development in 1999-2001, experienced severe cost overruns. The Authority's newly chartered Moving To Work Program experienced severe delays placing new voucher holders in housing because the "dot-com boom" made the rental housing market drum tight and then experienced a rapid lease up of a large number of vouchers when the rental market suddenly collapsed. And at the same time, the Authority experienced 20% per year staff turnover as employees took jobs in the computer software industry.

In that difficult operating climate, the Authority's senior management, none of whom are still with the Authority, made some tough decisions to manage cash flow on what was apparently believed to be a short-term basis. In retrospect it appears that some of the actions taken did not comport with regulations.

The Authority has already implemented many of the remedies that are called for in the audit recommendations. The rest of the recommendations present specific operating challenges for the

Authority. For example, deciding which of several non-compliant fund transfers to pay back first when there simply is not enough cash to implement all recommendations at once will require the Authority to make challenging trade-offs. We hope that as your office delegates to the San Francisco Regional PIH Office the task of translating the audit recommendations into a specific remedial action plan, their charge will allow them enough flexibility to work closely with us to make effective decisions about those trade-offs.

We will respond to each finding in sequence.

**Finding 1:** The Authority Overleased its Moving to Work Program and Implemented an Improper Waiting List Preference.

**Authority Response to Finding**

The overleasing cited in this finding was an unintended consequence of a reasonable reaction to a very challenging operating environment. When only one voucher holder in ten was succeeding at finding housing in the extremely tight rental market (less than 2% vacancy rate), the Authority issued more vouchers to compensate, only to discover when the market suddenly deflated (shooting to over 40% vacancy rate in just three months) that it had over-compensated, and was suddenly overleased. These circumstances are described more fully in a section below, Request for Consideration of Mitigating Factors. Nonetheless, the Authority recognizes that it has an obligation to comply with regulations, and will therefore limit the substance of its response to addressing the regulatory issues raised by the audit.

This finding comprises three distinct elements: (1) the Authority overleased its Moving To Work ("MTW") Program, (2) the Authority made non-compliant advances of funds to the MTW Program from Housing Choice Voucher administrative funds to cover the cost of MTW overleasing, and (3) the Authority took an additional non-compliant action when it gave Section 8 waiting list preference to 71 MTW households when they were moved back onto the Section 8 waiting list from which they had come (albeit at the top/front of the waiting list) to remedy the MTW overleasing.

Each of these elements will be addressed separately below.

First, the Authority acknowledges that it overleased the MTW program, and agrees that it was impermissible to use more of the Authority's limited number of total vouchers for MTW program participants than the 300 units permitted under the MTW program contract.

Second, the Authority acknowledges that it advanced funds from Housing Choice Vouchers ("HCV") Program to the Moving To Work Program. However, the advance was not non-compliant, and therefore there is no basis for a finding. The Authority asserts that this advance was permissible and disagrees that this advance resulted in negative impacts on the HCV Program or HCV Program participants.

**Comment 1**

*Advance permissible.* The MTW program is a subset of Section 8 Housing Choice Voucher Program, approved in the Authority's Moving To Work contract, Administrative Plan and Agency Plan. Literally, HUD allowed the Authority to designate 300 of the Authority's 4023 total vouchers to the MTW program. The auditors cited no regulation that bars the Authority from advancing Housing Choice Voucher administrative funds to operate a program that serves a portion of the total vouchers. The advance was properly recorded as a receivable from one program to the other, and was within the discretion of the Authority.

*No negative impacts.* The Authority disagrees that the advance resulted in a negative impact on the Housing Choice Voucher Program. The funds that were advanced were accumulated administrative fees, not housing assistance payment funds. Adequate funds were available for administrative expenditures; there was no reduction in management, compliance, direct service or any other administrative activities.

Third, the Authority acknowledges that, in 2005, it placed 71 families participating in the MTW Program at the top/front of the Housing Choice Vouchers waiting list, and further, that when it did so, the advancement of other families on the waiting list, including those that would have qualified for a senior and/or disabled preference, was delayed. However, the placement of the 71 families at the top/front of the waiting list was not non-compliant, and therefore there is no basis for a finding. The Authority asserts that the action was compliant, was authorized by HUD, and was not discriminatory.

## Comment 2

*Compliant.* As stated in CFR 5.410(d)(2) and CFR 982.207(a)(1), HUD regulations allow a PHA to select preferences to meet local objectives. Furthermore, CFR 982.207(a)(2) states that local preferences must be based on local housing needs and priorities, *as determined by the PHA*. Giving a local preference to families who are participants in other HUD funded programs is not only permissible by HUD regulations, it is encouraged. For example, a selection preference could be granted under the residency preference to families who live in public housing or other federally assisted housing (HCV Program Guidebook P. 4-19).

When the Authority established a preference for the MTW families who were already on the HCV waiting list, the Authority followed HUD regulations and complied with the required process by having public hearings as part of the agency's Annual Plan process.



**Comment 3**

*Authorized.*

HUD had full knowledge at all levels of the Authority's intent to convert MTW families who were on the HCV waiting list to the HCV Program. As required by the MTW agreement, HUD conducted an annual monitoring review to determine MTW Program effectiveness. During the 2005 annual visit, HUD's contractor, ABT Associates, noted concerns about the cost overrun in the MTW Program, and recommended that preference could be given to MTW families who were already on the HCV waiting list, as allowed by HUD regulations. Acting on that advice, the Authority incorporated the preference into its 2005 Annual Plan (see Exhibit A), which was approved by HUD.

*Non-discriminatory.*

The fact that the waiting list advancement of families in protected classes may have been delayed when a preference was given to MTW families is irrelevant because it was approved. However, the auditors opine that this approved preference was a working preference *in effect*, even if not *in fact*, and that the Authority therefore also should have given a preference to families qualified as senior or disabled.

**Comment 4**

But moving the 71 MTW families to the top/front of the HCV waiting list did not constitute a "working preference" even *in effect* because, although many of the MTW Program participants were in fact working by the time they were moved back onto the HCV waiting list (that being the purpose of the MTW Program), *many were not working when then initially moved from the HCV waiting list to enroll in the MTW Program*. The preference criteria was not "is a family member working" but rather "is the family enrolled in the MTW Program", and in fact there were families among the 71 at issue that would not have qualified for a working preference since family members were in work-readiness or education but not yet employed.

Further, if there was a relevant discriminatory impact, it would have occurred if/when families in protected categories were ineligible to apply for the MTW Program, or were *de facto* less likely to be accepted for enrollment into the MTW Program if/when they applied, neither of which happened.

With respect to eligibility, the Authority did not exclude elderly and disabled families in applying for MTW vouchers. In fact many did apply because: some elderly family members can work; some family members with disabilities can work; some families that belong to a protected category (e.g., a family with at least one

family member who is elderly or disabled) also include family members who are neither elderly nor disabled and who can work.

With respect to enrollment, the Authority acknowledges that families in which no family member could work did not qualify for enrollment. However, that impact on a subset of the families in protected categories is *di minimis* in comparison to the much larger inevitable negative impact caused by the HUD-approved setting aside of 300 HCV vouchers for the MTW Program in the first place.

**Authority Response to Recommendations**

1A: The Authority agrees that the recommendation—for MTW Program to immediately repay \$573,485 that was advanced to MTW by Housing Choice Vouchers to pay costs related to overleased vouchers in the MTW Program—is a reasonable and feasible remedy. However, the Authority disputes that the advance caused any negative program impact in the HCV Program.

1B: The Authority disagrees with the finding and strongly disagrees that the recommendation—to reimburse with non-federal funds the HCV funds used to house 71 families who were formerly on the Section 8 waiting list, then became MTW Program participants and eventually were given preference on the Section 8 waiting list because of the points above, i.e. the waiting list was approved, appropriate and non-discriminatory. Furthermore, implementing the recommendation would not be feasible.

*Not feasible.*

The recommendation proposes repayment of HCV program using non-federal funds. The Authority does not have substantial non-federal funds.

*Not reasonable.*

Because the infraction was directly related to alleged misdirection of HCV funds to MTW participants, any remedial repayment to HCV should be from MTW, not from non-federal funds. The Authority also disagrees with the method of calculation of the amount of the proposed remedial payment. The calculation uses 71 (the number of MTW households served in a manner approved by HUD) as a factor, rather than using a factor related to the extent of impact of the households in protected categories that were ostensibly harmed.

1C: The Authority agrees that the recommendation—to ensure that no further improper preferences are implemented—is a reasonable and feasible remedy. However, the Authority disputes that the Authority in fact implemented any improper preferences.

1D: The Authority agrees that the recommendation—to implement policies and procedures to ensure that the MTW Program is not overleased—is a reasonable a feasible remedy for a deficiency acknowledged by the Authority.

**Comment 5**

**Comment 6**

**Comment 7**

**Authority Request for Textual Modifications for Clarity**

Request 1.1 Change the second sentence of the section Moving to *Work Program Was Limited to 300 Families* to read: “The agreement permitted the Authority to use a portion of its existing Housing Choice Vouchers to house up to 300 families under the Moving To Work Program.”

Rationale: This modification is intended to clarify that the 300 vouchers for MTW Program were not incremental, but rather were a set-aside subset of the Authority’s total 4,023 vouchers. It is important for readers to understand that an inevitable and authorized side-effect of this set-aside was that all families in the HCV waiting list would be “set back” or “delayed”, including those qualified as senior or disabled households; all except families in which at least one member could qualify for the MTW Program, for which all families could apply, including those qualified as senior or disabled households.

**Comment 8**

Request 1.2 Change the Recommendation #1C to read: “Take steps to ensure that if and when a work preference is given, a preference is also given for elderly and disabled families.”

Rationale: The recommendation as written proposes remediation that is broader than the alleged infraction. The general exhortation that the Authority to not “further” negatively impact families in protected categories, which are then recited, implies a pervasive problem. In fact, if there was an infraction at all related to working preference, it was a matter of interpretation of regulations. The proposed substitute sentence proposes remedial action closely tailored to the alleged infraction.

**Comment 9**

**Authority Request for Consideration of Mitigating Factors**

Request 1.3 The Authority requests that as the Office of Inspector General delegates to the San Francisco Regional PIH Office the task of translating the audit recommendations into a specific remedial action plan, their charge will allow them enough flexibility to take the following mitigating factors into account.

**Comment 10**

Factor A: The overleasing was an unintended and unpredictable consequence of the Authority’s reasonable actions to respond to unusual circumstances.

At the time of the initial MTW lease-up in 2001, all housing authorities in the area were underutilizing their voucher supply because of a shortage of available rental units in the market. The “dot.com boom” in the Silicon Valley software industry drove up rents and drove down vacancy rates to below 2%. The problem was so crucial that the San Francisco Regional PIH office sponsored symposia at which

housing authorities share strategies to increase utilization. Underutilization of vouchers could lead to the Authority losing vouchers and/or program funds.

With approximately one in ten voucher holders successfully locating and renting units, this Authority and others accelerated their certification processes, extended the time voucher holders could search for units before their voucher expired, and issued more vouchers. Attaining full utilization of the 300 MTW vouchers required issuance of hundreds of vouchers.

As was well documented in the national media, the "dot.com boom" collapsed suddenly. The rental market collapsed with it, sending vacancy rates to 40% in just three months. As a direct consequence, the success rate of voucher holders rose markedly. The Authority did not respond quickly enough to this new reality, and the number of MTW voucher holders with rental contracts exceeded the program limit of 300. Rather than remove MTW participants from the program the Authority decided to let the number fall by attrition. Unfortunately, attrition was slower than anticipated. Only at that point did the Authority decide that it would seek HUD's approval (which it received) to give a preference to MTW participants who had come from the Section 8 Housing Choice Voucher waiting list to allow them to move back to the top/front of that list.

**Comment 11**

Factor B: The Authority did not exclude protected-class households from eligibility for MTW Program. When the auditors concluded that the MTW Program gave a *de facto* working preference to MTW participant families, the auditors did not consider the mitigating factor that the Authority did not categorically exclude elderly and disabled families from eligibility for MTW vouchers. Many families on the Section 8 waiting list that would qualify for an elderly / disabled preference also include family members who can work. Consequently, the auditor's report overstates any discriminatory impact there may have been.

**Comment 12**

Factor C: The Authority *advantaged* many protected-class households when it transferred the 71 MTW off the waiting list in the first place. The auditors did not consider the mitigating factor that when 71 families initially left the Section 8 waiting list to enroll in the MTW Program, all other families in the waiting list advanced, including all families that would qualify for an elderly / disabled preference. Consequently, the auditor's report overstates any discriminatory impact there may have been.

**Comment 13**

Factor D: The impact of the sanctioned act of establishing the MTW Program in the first place was many times greater than the impact of giving preference to 71 MTW households, yet the auditors propose to penalize the Authority for the lesser impact which is incorrectly deemed impermissible. The auditors did not consider the mitigating factor that when the Authority was granted permission by HUD to allocate 300 existing HCV Program units to the MTW Program that approval was

tantamount to moving everyone in the Section 8 waiting list back/down 300 queue positions.

**Finding 2:** The Authority Loaned \$1.4 million in Housing Choice Voucher Program Funds to Exceed the Total Development Cost Limit Without HUD Approval.

**Authority Response to Finding**

In year 2000, during development of new public housing at El Camino Village, the Authority advanced funds from Housing Choice Vouchers administrative fees in anticipation of receipt of HUD approvals that would allow use of private debt to cover construction cost overruns. Under the circumstances, delays in action would have translated to additional delays in the development process, which in turn would have resulted in further cost overruns. Ultimately HUD did not approve the financing and the non-complaint temporary advance became long-term.

The Authority agrees with this finding.

The Authority disagrees that the advance resulted in a negative impact on the Housing Choice Voucher Program. The funds that were advanced were accumulated administrative fees, not housing assistance payment funds. Adequate funds were available for administrative expenditures; there was no reduction in management, compliance, direct service or any other administrative activities.

**Authority Response to Recommendations**

2A: Authority agrees with this recommendation.

2B: Authority agrees with this recommendation.

2C: The Authority disagrees with this recommendation. It was within the Authority's discretion to determine the interest rate for an interfund advance, including a rate of zero interest. No citation is provided by the auditors to support their assertion that interest accrual is required for interfund advances.

**Finding 3:** The Authority Loaned \$500,000 in Midway Village Comprehensive Improvement Assistance Program Grant Funds for El Camino Village Construction Cost Overruns.

**Authority Response to Finding**

The extenuating circumstances that led to the Authority transferring funds from Midway Village to El Camino Village—to repay monies advanced by the Housing Choice Vouchers Program to El Camino Village cover construction cost overruns—were discussed in Finding 2 above.

**Comment 14**

The Authority agrees with this finding.

**Authority Response to Recommendations**

3A: Authority agrees with this recommendation.

**Authority Request for Textual Modifications for Clarity**

Request 3.1 In the second sentence of the third paragraph of the section *The Authority Received Public Housing Grants for Midway Village*, change: “the development” to “Midway Village.”

Rationale: Two housing complexes are mentioned in this section, the existing complex at Midway Village and the complex under development at El Camino Village. Referring to Midway Village as “the development” is confusing.

Request 3.2 In the preamble and the conclusion, remove references to an \$800,000 contingent liability.

Rationale: The auditors have already made a stronger point: the salient negative impact of deferred maintenance. Contingent liabilities represent hypothetical costs, not actual anticipated costs. In this instance, the \$800,000 contingent liability is an aggregate of more than one potential cost, one of which was a \$300,000 contingency for a lawsuit which had already been settled at the time of the audit. Inclusion of this reference is gratuitous, will be confusing to any reader who attempts to link it conceptually to other points (such as the various amounts mentioned in other sections of the audit)—especially when included in preamble and conclusion rather than in explication of detail—and is irrelevant to a narrative in which negative impacts have already been demonstrated with a stronger point.

**Finding 4:** The Authority Transferred \$115,602 in Housing Choice Voucher Program Portability Administrative Fees to Build Up Its Nonfederal Account.

**Authority Response to Finding**

The Authority agrees with this finding. The Authority acknowledges that it incorrectly recorded certain revenue as non-federal that should have been recorded as revenue to the Housing Choice Voucher program.

The Authority disagrees that this mistake resulted in a negative impact on the Housing Choice Voucher Program. The revenues that were incorrectly recorded were administrative fees, not housing assistance payment funds. Adequate funds were available for administrative expenditures; there was no reduction in management, compliance, direct service or any other administrative activities.

**Comment 15**

**Comment 16**

**Comment 17**

**Authority Response to Recommendations**

4A: The Authority agrees with the substance of this recommendation, but requests that the two clauses be written as separate recommendations.

**Authority Request for Textual Modifications for Clarity**

Request 4.1 In the Recommendation, please apply the adverb “immediately” to “reimburse” only, not to “cease the practice.”

Rationale: As the auditors observed during their field work, the Authority as in fact already corrected the mistaken accounting procedure. Therefore the injunction to “immediately cease the practice...” is unnecessary. Conversely, with respect to reimbursement, the Authority should be directed to reverse the effects of the accounting mistake by transferring funds back to Housing Choice Vouchers, with interest, and the importance of that recommendation can be underscored by the addition of “immediately.”

Request 4.2 Change the title of the finding to: “The Authority Incorrectly Recorded \$115,602 of Portability Administrative Fee Revenue as Non-federal Rather Than in Housing Choice Voucher Program Fund.”

Rationale: As written, the title implies ill motive by the Authority: intent to build up its non-federal account. This assessment of the Authority’s motivation inaccurate, and is outside the scope of the audit.

**Comment 18**

**Finding 5:** The Authority Overdrew Its Housing Choice Voucher Program Operating Reserve.

**Authority Response to Finding**

Finding 5 should be deleted in its entirety. The finding makes three main points: (1) the Authority advanced \$2.3 million of Housing Choice Voucher funds to help develop El Camino Village, (2) the Authority used Housing Choice Voucher funds to pay for overleasing in the Moving to Work Program, and (3) the manner in which the Authority recorded the transfer was non-compliant. The first point is redundant with Finding 2. The second point is redundant with Finding 1. The third point cannot be a finding because there was no instance of non-compliance; the Authority followed fully compliant, standard accounting practices to record the transactions in question.

**Comment 19**

*El Camino Village.* The Authority acknowledges that it advanced funds from the Housing Choice Vouchers Program to its El Camino Village low-rent public housing development due to significant cost overruns during construction. The Authority fully expected the Housing Choice Voucher Program to be repaid from its El Camino Village development once it secured additional funding sources. This topic is dealt with in full in Finding 2, its cause, its impact, the recommendation of remedy. Its recapitulation in this Finding is redundant and inherently confusing because its repetition implies that new issues are being raised other than the technical accounting point that would be the sole topic of Finding 5 if a finding were warranted.

**Comment 20**

*Moving to Work.* The Authority acknowledges that it advanced funds from Housing Choice Vouchers Program to the Moving to Work program. The advance was recorded in the Housing Choice Voucher Program as a receivable from the Moving to Work Program and as such is a component of the entity's assets. An additional reduction of the operating reserve would duplicate the recording of the transaction. The Moving to Work Program is a Section 8 Program. Funding from HUD for the Housing Choice Voucher Program and the Moving to Work Program is combined in the monthly Annual Contributions Contract deposit. This topic is dealt with in full in Finding 2, its cause, its impact, the recommendation of remedy. Its recapitulation in this Finding is redundant and inherently confusing because its repetition implies that new issues are being raised other than the technical accounting point that would be the sole topic of Finding 5 if a finding were warranted.

**Comment 21**

*Accounting Issue.* The Authority did not, and in fact logically cannot, "overdraw" its Housing Choice Voucher Program Operating Reserve (HCVOR), because the HCVOR is not a cash account. The operating reserve is a component of "Unrestricted Net Assets". HUDs definition of unrestricted net assets is: "The difference between an entity's assets and its liabilities that do not meet the definition of restricted net assets or invested in capital assets net of related debt." (See the Real Estate Assessment Center, Financial Data Schedule Line Definitions and Crosswalk Guide dated September 5, 2006.) The HCVOR can either be a debit or a credit (i.e. either a positive or a negative balance, unlike a bank account). The HCVOR is essentially an accumulation of end-of-year surplus, if any, equivalent to an equity or net-worth account.



When the Authority decides to allocate a portion of a surplus in a reserve account with no expectation that the funds be repaid (e.g., for operations or for capital improvements), it properly makes an "operating transfer" by recording a reduction in the balance of the reserve account. The transactions at issue were advances, and were properly recorded as receivables, because repayment was anticipated in less than a year. They were advances of cash, and were properly recorded as such. No accounting entry was required that involved the HCVOR, a reserve account, nor would any such entry be logical or generally accepted accounting practice.

From an accounting perspective, the same reasoning would apply whether these transactions were characterized as loans or receivables.

The Authority asserts that the accounting of these advances was compliant and that there is therefore no basis for a finding related to the accounting of the advances, as distinct from the fact of the transfers which is dealt with thoroughly in Finding 1 and Finding 2.

#### **Authority Response to Recommendations**

While disagreeing with much of the logical and technical background utilized to make the recommendations, the Authority can and will satisfy the intended remedial actions, because they are in the best interest of the programs.

#### **Authority Request for Textual Modifications for Clarity**

Request 5.1 Remove this Finding in its entirety.

Rationale: It is redundant with Finding 1 and Finding 2.

Request 5.2 If this finding is not eliminated altogether, restate all occurrences of the term "overdrawn" and "overdrew," including in the title of the finding.

Rationale: Overdraft is a construct that applies to actual cash accounts (i.e., bank accounts) or to ledger accounts solely involving cash. The use of the term "overdraft" to describe a reduction in value of an asset account (i.e., a credit entry) in a ledger is confusing and inaccurate. Further, as the term "overdraft" is used in this finding, a reader could infer that the Authority was careless (as if overdrawing a cash account) or spendthrift (as if using resources it did not have) or in chaos (unaware of cash flowing out) or deceitful (as if attempting to obscure management decisions). None of these charges are supported or supportable, and the implication could be damaging to the Authority.

### **Comment 22**

### **Comment 23**

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HACSM Audit Response  
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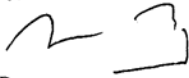
**Comment 24**

Request 5.3 Combine Recommendations 5B and 5D.

Rationale: These two recommendations are essentially redundant.

Thank you for considering these points. If I can provide more information please call me at 650-802-3361.

Sincerely,



Duane Bay  
Director

Attachment

C: Stephen Schneller, Director of Public Housing, 9APH

**EXHIBIT A**

- Homelessness
- High rent burden (rent is > 50 percent of income)

Other preferences (select all that apply)

- Working families and those unable to work because of age or disability
- Veterans and veterans' families
- Residents who live and/or work in your jurisdiction
- Those enrolled currently in educational, training, or upward mobility programs
- Households that contribute to meeting income goals (broad range of incomes)
- Households that contribute to meeting income requirements (targeting)
- Those previously enrolled in educational, training, or upward mobility programs
- Victims of reprisals or hate crimes
- Other preference(s) (list below)
  - Applicants who live in the County of San Mateo
  - Placement order of selection from lottery
  - ✓ ▪ When the level of available Moving-To-Work (MTW) funding is inadequate to cover all the unit months under contract, HACSM may give preference to current MTW participants who are on the Section 8 waiting list.

3. If the PHA will employ admissions preferences, please prioritize by placing a "1" in the space that represents your first priority, a "2" in the box representing your second priority, and so on. If you give equal weight to one or more of these choices (either through an absolute hierarchy or through a point system), place the same number next to each. That means you can use "1" more than once, "2" more than once, etc.

- Date and Time

Former Federal preferences:

- Involuntary Displacement (Disaster, Government Action, Action of Housing Owner, Inaccessibility, Property Disposition)
- Victims of domestic violence
- Substandard housing
- Homelessness
- High rent burden

Other preferences (select all that apply)

- Working families and those unable to work because of age or disability
- Veterans and veterans' families
- Residents who live and/or work in your jurisdiction
- Those enrolled currently in educational, training, or upward mobility programs
- Households that contribute to meeting income goals (broad range of incomes)
- Households that contribute to meeting income requirements (targeting)
- Those previously enrolled in educational, training, or upward mobility programs
- Victims of reprisals or hate crimes
- Other preference(s) (list below)
  - 1 Applicants who live in the County of San Mateo

## OIG Evaluation of Auditee Comments

- Comment 1 The portion of Housing Choice Voucher program funds used to overlease the Moving to Work program were loaned in violation of the Authority's Moving to Work agreement with HUD. Article I, B of the agreement states that funds provided under Section 8 of the 1937 Act can be used to fund HUD approved Moving to Work activities. However, Article I, G limits the use of HUD assistance to that which is authorized in the agreement's Statement of Authorizations. Section 1, B of the Statement of Authorizations specifically states that the Moving to Work program may include up to 300 families. Therefore, its agreement only permitted use of Housing Choice Voucher program funds to the extent needed to operate the Moving to Work program up to the 300 unit threshold. Therefore, any Housing Choice Voucher program funds used to pay for Moving to Work program costs beyond those 300 units were used in violation of its Moving to Work agreement with HUD. The Housing Choice Voucher program advanced a total of \$1.2 million to the Moving to Work program. Of this amount, \$573,485 was used to lease the Moving to Work program beyond the 300 units authorized in its agreement. This is the amount of questioned costs in the audit finding.
- Comment 2 The Moving to Work preference was not properly implemented. The only local preference listed in the Authority's Administrative Plan is for residents of San Mateo County. Although a Moving to Work preference is not specifically disallowed, 24 CFR 982.207(a)(1) requires that PHA selection preferences be fully described in the PHA administrative plan. Since the preference was not included in the administrative plan, it was not an eligible preference. The finding has been revised accordingly, to better illustrate our position.
- Comment 3 The authority did not follow HUD regulations. The preference was not included in its administrative plan. HUD's knowledge of the preference is irrelevant to the circumstances, since the Authority is required by its Consolidated Annual Contributions Contract with HUD and requires the Authority to follow all HUD rules and regulations.
- Comment 4 The finding is about the improper Moving to Work preference, which directly impacted those 71 families on the Housing Choice Voucher waiting list. The finding has been revised to show that the preference was ineligible since it was not included in the administrative plan as required by HUD regulations.
- Comment 5 Payment plans and other methods of repayment can be arranged during the Authority's audit resolution process with HUD.
- Comment 6 The recommendation allows for repayment of the Housing Choice Voucher program from the Moving to Work program or from nonfederal funds. The recommendation gives the Authority some flexibility in the method of repayment. This can be determined during the audit resolution process with HUD. The

number 71 was used because 71 families were provided an improper preference and were moved up the Housing Choice Voucher program waiting list. This occurred because the Authority violated its Moving to Work agreement by overleasing the Moving to Work program. Some of the 71 Moving to Work participants may have been moved up the Housing Choice Voucher program waiting list by as little as a few weeks, while others were moved up by several years. As discussed with the Authority's management, an actual impact calculation for every single one of the 71 households over the entire period it would take to house those passed up on the waiting list would be significantly higher than OIG's recommendation. OIG exercised its discretion to limit this recommendation to a one year period.

- Comment 7 OIG agreed to make the suggested clarification.
- Comment 8 OIG removed the word "further" from Recommendation 1C. However, OIG disagrees with the Authority's rewrite of the recommendation. The recommendation directly relates to the cause of the finding and is designed to alert the Authority against any future improper preferences.
- Comment 9 OIG understands that there are several mitigating factors the Authority believes contributed to the program violations. However, the violations still occurred. HUD will implement the recommendations as they determine appropriate during the audit resolution process.
- Comment 10 The economy and the rental market may have contributed to the Moving to Work program overleasing but it is the Authority's responsibility to manage the program in accordance with its agreement and other HUD requirements.
- Comment 11 The working preference issue was removed from the report. The Moving to Work preference was ineligible since it was not included in the Authority's administrative plan.
- Comment 12 Due to the Authority's overleasing of the Moving to Work program, it improperly implemented a waiting list preference. Because the preference was not properly implemented, 71 families were improperly moved up on the waiting list. The preference would not have been an issue if the Authority had administered its Moving to Work program within the 300 family threshold in its agreement.
- Comment 13 OIG sees a distinction between the initial 300 vouchers allocated and approved by HUD in accordance with its Moving to Work agreement and the Authority's improperly implemented preference that admitted 71 Moving to Work participants into the Housing Choice Voucher program. The Authority's transfer of 71 Moving to Work participants clearly violated HUD's waiting list preference requirements.

- Comment 14 The Housing Choice Voucher program maintains its funds in an interest bearing account. Further, the Authority is required (24 CFR 982.155(a)(2)) to credit interest earned on the Housing Choice Voucher program operating reserve. If the funds had not been loaned to El Camino Village and remained in the interest bearing account, the Housing Choice Voucher program would have earned interest on \$1.4 million over a five year period. Alternatively, if the Authority had obtained outside financing from a bank or financial institution to pay for El Camino Village construction cost overruns, it would have been charged the prevailing interest rates during the period in which the funds were used. OIG believes its recommendation to repay interest the Housing Choice Voucher program would have earned in its bank account is appropriate.
- Comment 15 OIG agrees to change “the development” to “Midway Village” for report clarity.
- Comment 16 OIG agrees to remove the reference to the \$800,000 contingent liability from the report.
- Comment 17 OIG agrees to split the two clauses into separate recommendations and remove the word “immediately” from the “cease the practice” portion of the recommendation.
- Comment 18 OIG disagrees with the rewritten finding title. However, all instances of “build up” have been removed from the report.
- Comment 19 Elements of finding 2 are presented in this finding to clarify for the reader how the operating reserve became overdrawn. The finding is not solely a technical accounting issue since the Authority was inappropriately loaning current year administrative fees and housing assistance payment funds. This is a direct violation of the Authority’s Consolidated Annual Contributions Contract with HUD. Section 11a of the contract specifically states that program receipts may only be used to pay program expenditures. In addition, if this practice continues, the Authority could have insufficient resources necessary to operate the Housing Choice Voucher program and cover future shortfalls.
- Comment 20 Elements of finding 1 are presented in this finding to clarify for the reader how the operating reserve became overdrawn. The recommendation has been revised to specify three different ways that the Authority can satisfy the recommendation. If the Authority chooses one of the methods in the recommendation, there will not be any duplicate recording of the transaction. The Authority must properly account for the Housing Choice Voucher program operating reserve to ensure that it does not violate its Consolidated Annual Contributions Contract with HUD. Specifically, it must ensure that it does not use current program receipts for loans to other programs.
- Comment 21 The Housing Choice Voucher program operating reserve is the amount by which the Housing Choice Voucher program administrative fees paid by HUD for a

fiscal year exceed the Authority's administrative expenses for the fiscal year. This is not the Authority's entire net-worth account. It is a specific equity account, which has a specific limited cash source of funding and an explicitly designated restricted use. It is imperative that the Authority backs the operating reserve with sufficient funds to operate the program and cover future administrative fee shortfalls.

Additionally, OIG disagrees with the Authority's interpretation of the Real Estate Assessment Center, Financial Data Schedule Line Definitions and Crosswalk Guide provisions. Financial Data Schedule line 512 definition explicitly includes only the unrestricted portion of the HUD account 2826 (Section 8 operating reserve), *if any* [emphasis added]. Neither line 512 (undesignated fund balance/retained earnings) nor line 512.1 (unrestricted net assets) provide an explicit inclusion of the entire Section 8 operating reserve funds. Federal Fiscal Year (FFY) 2004 Consolidated Appropriations Act (Public Law 108-199) [which was signed into law on January 30, 2004, and further defined in Notice PIH 2004-7 (HA)], places a specific constraint on public housing authorities' administrative fee reserve (operating reserve) account by limiting its use only for the provision of Section 8 rental assistance. The limitations specified in Public Law 108-199 constitute specific constraints and restrictions in the use of account 2826 (Section 8 operating reserve). Therefore, since January 30, 2004, the operating reserve fund became a restricted net asset as defined by Financial Data Schedule line 511.1. Moreover, the Public Law is a statute enacted by Congress, while the provisions cited by the Authority have only nonbinding persuasive guide authority.

- Comment 22 OIG disagrees with the Authority's recommendation to remove the audit finding.
- Comment 23 OIG disagrees with removing all occurrences of the terms "overdrawn" and "overdrew". During the Authority's fiscal year end 2004, it began to borrow more from the operating reserve than it had available. This is illustrated in the table in finding 5.
- Comment 24 OIG agrees to combine Recommendations 5B and 5D.

## Appendix C

### Applicable Regulations

The Moving to Work program agreement states the following:

- “This agreement supersedes the terms and conditions of the ACCs [annual contributions contract] and the provisions of the U.S. Housing Act of 1937 (1937 Act) and HUD requirements to the extent necessary for the agency to implement its MTW demonstration, as approved by HUD in this agreement...Except as necessary to implement the Agency’s activities as described in the Statement of Authorizations, the Agency is subject to the requirements of the ACCs, the 1937 Act, and other HUD requirements.” **Article 1, section A**
- On the terms provided in this agreement, the HACSM [Housing Authority of the County of San Mateo] is authorized to design and carry out a demonstration program intended to promote self-sufficiency. The program may include up to 300 families. **Statement of Authorizations, section 2B**
- “Corrective or remedial actions HUD may require or order under this agreement for Agency default include, but are not limited to the following: Taking any other corrective or remedial action legally available.” Article 3, section C10

24 CFR [Code of Federal Regulations] 982.207(a)(1) states: “PHA selection preferences must be described in the PHA administrative plan.”

HUD Handbook 7420.6, HUD Program Accounting Handbook, chapter 2, Description of Accounts - 2826 Reserved Surplus - Operating Reserve - HAP [housing assistance payment] Projects states: “This account shall be credited (and Account 7016 debited) with the amount by which total project receipts of the HAP projects exceed the total expenditures for the administration of such projects for the fiscal year. If the total expenditures exceed the total project receipts for a fiscal year, the amount of the excess (deficit) shall be debited to this account (and Account 7016 credited), to the extent of the credit balance in this account. The credit balance in this account shall be available for use by the PHA for projects other than HAP projects and for other enterprises of the PHA. If this reserve is used for purposes not related to the HAP projects, this account shall be debited (and Account 1111.1 – Cash credited) for the amount of cash withdrawn for such other purposes.”

24 CFR [Code of Federal Regulations] 982.155(a) states: “the PHA must credit to the administrative fee reserve the total of (1) The amount by which program administrative fees paid by HUD for a PHA fiscal year exceed the PHA program administrative expenses for the fiscal year; plus (2) Interest earned on the administrative fee reserve.”



24 CFR [Code of Federal Regulations] 982.158(a) states: “The PHA must maintain complete and accurate accounts and other records for the program in accordance with HUD requirements.”

24 CFR [Code of Federal Regulations] 941.306(a) states: “No funds provided by HUD pursuant to the Act may be used to pay costs in excess of the TDC [Total Development Cost] without the written approval of HUD.”

24 CFR [Code of Federal Regulations] 968.112(a)(2) states: “For a CIAP [Comprehensive Improvement Assistance Program], the eligible costs are activities approved by HUD and included in an approved CIAP budget.”

PIH [Public and Indian Housing] Notice 99-38, section 1-7, states: “Effective immediately PHAs are permitted to use capital funds for any eligible capital or operating expense if: (1) the PHA is not designated as troubled; and (2) the PHA operates its public housing in a clean, safe, and healthy condition as determined by HUD (64 FR 8201, February 18,1999).”

Federal Register, dated February 18, 1999 (64 FR 8201), states: “Subtitle B of the Quality Housing Work Responsibility Act [QHWRA], Section 519 Public Housing Capital and Operating Funds amends section 9 of the U.S. Housing Act [USHA] to provide for the establishment of capital and operating funds with new formulas. Only a few parts of this statutory section are effective immediately. They are as follows: Use of Capital or Operating Funds by Small PHAs. New subsection 9(g)(2) of the USHA, added by section 510 of the QHWRA, allows a PHA with less than 250 dwelling units (small PHAs) to use capital or operating funds for any eligible capital or operating expense...New subsection 9(a) of the USHA, however, provides for a merger of remaining CIAP funds into the Capital Fund on October 1, 1999. With the enactment of new subsection 9(g)(2) and the pending merger of funds, HUD construes congressional intent to be that small, non-troubled PHAs may immediately use any CIAP or operating funds for capital or operating purposes.”

Section 9 of United States Housing Act of 1937, as amended (42 USC 1437g(3)(a)), states: “Limitations on New Construction: ...A public housing agency may not use any of the amounts allocated for the agency from the Capital or Operating fund for the purpose of constructing any public housing unit, if such construction would result in a net increase from the number of public housing units owned, assisted, or operated by the public housing agency on October 1, 1999...”

PIH Notice 04-7 states: “4. Funding for Administrative Costs: The FFY[federal fiscal year] 2004 Appropriations Act stipulates that administrative fees provided from this appropriation shall only be used for activities related to the provision of Section 8 rental assistance, including related development activities. Any administrative fees from FFY 2004 funding that are subsequently moved into the administrative fee reserve account at year end may not be used for ‘other housing purposes permitted by state and local law’ [24 CFR 982.155(b)(1)], and must only be used for the provision of Section 8 rental assistance, including related development activity.”

24 CFR [Code of Federal Regulations] 982.152(a)(3): “HA [housing authority] administrative fees may only be used to cover costs incurred to perform HA administrative responsibilities for the program in accordance with HUD regulations and requirements.”