Issue Date
April 24, 2009

Audit Report Number
2009-LA-1009

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

Joan S. Hobbs

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

SUBJECT: The Housing Authority of the County of Los Angeles, Los Angeles, California, Did Not Reasonably and Equitably Allocate Costs to Its Section 8 Program

HIGHLIGHTS

What We Audited and Why

We completed a financial review of the Housing Authority of the County of Los Angeles' (Authority) Section 8 program. We initiated the review in response to several citizen complaints alleging mismanagement, waste, and abuse of U. S. Department of Housing and Urban Development (HUD) Section 8 funding, including the use of Section 8 funds to pay the costs of non-Section 8 programs.

Our objective was to determine the validity of the above allegations and to determine whether the Authority managed and spent its Section 8 funds in accordance with HUD rules and regulations.

What We Found

The Authority did not properly manage its Section 8 funding in fiscal years 2005 and 2006 and over-allocated more than $5 million in indirect administrative expenses to its Section 8 Assisted Housing program. This condition resulted in the Section 8 program bearing a significant portion of administrative expense, while other County programs did not receive their fair share of overhead. We found no additional material violations with respect to the other areas of the Authority's Section 8 program funds.

What We Recommend

We recommend that the Director of HUD's Los Angeles Office of Public Housing require the Authority to repay the Section 8 program from nonfederal funds, $2.9 million of the $5 million in over-allocations that were charged to restricted funds.

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 the draft report on March 24, 2009, and held an exit conference with the Authority on April 1, 2009. The Authority generally disagreed with our report.

We received the Authority's response on April 8, 2009. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

TABLE OF CONTENTS

BACKGROUND AND OBJECTIVE

The Housing Authority of the County of Los Angeles (Authority) was created in 1938 to manage and develop affordable housing. Since then, the Authority has administered federally funded public housing, rental assistance programs, and special programs and services for residents of public and assisted housing. The Housing Authority is comprised of two divisions: the Housing Management Division, which manages public housing and related programs and services, and the Assisted Housing Division, which administers rental assistance programs, including the Section 8 Housing Choice Voucher program.

In 1982, the County of Los Angeles' (County) board of supervisors created The Los Angeles County Community Development Commission (Commission) and combined it with the Authority. The Commission serves the County's Affordable Housing and Community and Economic Development Agency and aims to build better lives and better neighborhoods by providing services to improve the quality of life in low- and moderate-income neighborhoods. The Commission has wide-ranging programs that benefit residents and business owners in unincorporated County areas and various incorporated cities that participate in different Commission programs. This fiscal year, the agency has a $440 million budget with more than 95 percent of its funding coming from the U.S. Department of Housing and Urban Development (HUD).

The Section 8 Housing Choice Voucher program assists families in affording decent, safe, and sanitary housing in the private rental market. The program is the major rental assistance program administered by the Authority and serves more than 20,000 families within Los Angeles County. HUD's approved budget authorization for the Authority's program for fiscal years 2006, 2007, and 2008 was $181.6, $186.5, and $165 million, respectively. In the same years, HUD also paid the Authority $16.8, $16.3, and $17.4 million in administrative fees. HUD provides administrative fees to cover activities that housing authorities undertake in administering the Housing Choice Voucher program, including the issuance of vouchers, housing search activities, maintenance of assistance, and termination of payments.

In 2007, the HUD Office of Housing Voucher Programs, Financial Management Division, conducted a limited financial review of the Authority's Housing Choice Voucher program to ensure that the program was administered in accordance with its consolidated annual contributions contract program requirements and the Authority's administrative plan. The team found that the Authority's cost allocation plan had never been formally adopted by the board of supervisors and recommended that the Authority have the plan approved by the board.

We initiated the review in response to several citizen complaints alleging mismanagement, waste, and abuse of HUD Section 8 funding, including the use of Section 8 funds to pay the costs of non-Section 8 programs. The objective of our audit was to address the complaint allegations and to determine whether Section 8 funds were managed and spent in accordance with HUD rules and regulations.

RESULTS OF AUDIT

Finding 1: The Authority Did Not Reasonably and Equitably Allocate Costs to Its Section 8 Program

The Authority did not equitably distribute indirect administrative expenses to its Section 8 Assisted Housing program. In fiscal years 2005 and 2006, it over-allocated more than $5 million of the Commission's indirect administrative expenses to the Section 8 program. This condition occurred because the Authority modified its cost allocation methodology and inflated indirect charges to the Section 8 program to benefit the Commission's other programs. As a result, the Assisted Housing program was overcharged while other County programs did not receive their appropriate share of overhead expense.

Authority Contracted for the Development of an Allocation Plan

In April 2002, the Authority's independent auditor, KPMG LLP (KPMG), developed a cost allocation plan that identified procedures to be used in allocating indirect administrative expenses from the Commission's departments to its programs The Commission's departments include Personnel, Executive Office, Executive Office of Budget, Financial Management, Accounting, Inter-Government Relations, and Administrative Services/Development. Overhead costs for these departments were allocated to the Authority's programs, including Assisted Housing, Community Development Block Grant (CDBG), Economic Development, Housing Development and Preservation, and Housing Management. The KPMG plan stated that certain expenses should be excluded when determining allocation percentages and amounts because they would distort allocation bases and "inequitably draw administrative costs in proportion to the benefits derived." These expenses, called "subventions," are financial assistance provided by HUD to grantees that flow through the Authority. Under the Authority's Section 8 Assisted Housing program, these costs are typically landlord payments, Section 8 administrative fees, and housing assistance payments for the Family Self-Sufficiency program. We reviewed the KPMG plan and determined that it was adequate for distribution of cost as it allowed for an equitable distribution of cost to all of the County's programs by leaving out those expenses that were generated through funds provided by HUD.

Plan Modifications Resulted in Inequitable Cost Distributions

In fiscal year 2004, the Authority stated that it wanted to retain subventions in its program expenses because their removal was "skewing" departmental billings. Retaining subventions in the allocation bases caused CDBG administrative expense to increase, and the Authority became concerned due to a 20 percent administrative expense limit imposed by HUD on that program. At this time, the Authority began excluding subventions only from CDBG to reduce its portion of allocated overhead, while it retained subventions in the cost of other programs, including Assisted Housing. This practice distorted the cost allocation and resulted in the majority of overhead cost being charged to Assisted Housing, as it had the largest subvention amount.

This practice continued in fiscal years 2005 and 2006 causing more than $5 million in excessive indirect administrative expenses to be distributed to the Assisted Housing program. The Authority's annual contributions contract states that the housing authority may only use program receipts and deposits to pay program expenditures in accordance with HUD requirements. In addition, Public and Indian Housing Notices 2004-7, 2005-1, 2006-5, and 2007-14 state that Section 8 fees may not be used for "other housing purposes" and may only be used for activities related to Section 8 rental assistance. Therefore, the excessive indirect expenses charged by the Authority are not eligible.

We recalculated the allocations using revised percentages that were based on the original KPMG allocation plan methodology. After excluding subventions, we found that in most cases, allocated Commission expense should have been approximately 25 percent. Therefore, the allocation of cost to Assisted Housing was more than double the appropriate amount. The chart below shows the original allocation rates that were used by the Authority and the revised rates that it should have used that exclude subvention expense. A complete summary of allocated expense is reflected in appendix C of this report.

Commission Department	Fiscal year 2005			Fiscal year 2006		
	Original allocation percentage	Revised allocation percentage	Variance	Original allocation percentage	Revised allocation percentage	Variance
Executive Office	69.21%	22.92%	46.29%	71.97%	24.56%	47.40%
Executive Office of Budget	69.41%	23.23%	46.18%	72.19%	24.90%	47.28%
Financial Management	69.77%	23.77%	46.00%	72.48%	25.38%	47.11%
Accounting	70.22%	24.49%	45.73%	73.01%	26.25%	46.77%
Inter-Governmental Relations	70.35%	24.71%	45.64%	73.15%	26.48%	46.68%
Administrative Services/ Development	70.57%	25.06%	45.51%	73.38%	26.86%	46.52%
Personnel	28.27%	28.27%	00.00%	30.63%	30.63%	0.00%

The Authority Stopped Retaining Subventions in Program Expenses

In fiscal year 2007, the Authority elected to be reimbursed for its Section 8 overhead expenses through HUD's new fee-for-service system, which established fixed amounts the Authority could charge and receive for overhead from its Section 8 administrative fees. The fees collected are considered de-federalized, so any remaining funds would not be included in the Section 8 program's administrative fee reserve balance. Therefore, to maximize its de-federalized funds, the Authority again adjusted its cost allocation methodology and stopped retaining subventions for Assisted Housing, as KPMG had originally proposed. For several overhead departments, the allocation percentages charged to Assisted Housing dropped from more than 70 percent in fiscal year 2006 to around 16 percent in fiscal year 2007. Although subventions are now excluded for Assisted Housing's overhead allocation, no retroactive adjustments were made for prior years.

Cost Allocation Methodology was not Documented in Internal Procedures

The original KPMG cost allocation methodology was sound, but the Authority did not have any written procedures documenting the plan methodology and how it should be used. In addition, a 2007 HUD Limited Financial Review found that the Authority had used the cost allocation plan since 2002, but had not submitted it for approval to the Los Angeles County Board of Supervisors. It actually had more than one version of its cost allocation plan in place since 2002 and none had been submitted for approval. After the review, the Authority submitted the original KPMG plan to the board and it was approved in June 2007. However, the Authority has continued to inappropriately include subventions for its Economic Development and Housing Development and Preservation divisions, at least through fiscal year 2008, in conflict with KPMG's methodology. Although the Authority has not followed the Board approved plan, the allocation methodology no longer has an impact on the Section 8 program under the fee-for-service system, as discussed above.

Conclusion

The Authority did not manage its Section 8 funding in accordance with HUD requirements and charged ineligible expenses to the Section 8 program. Consequently, more than $5 million in excessive overhead expense was charged to the Section 8 program. Had the Authority followed its original cost allocation plan, the Section 8 program and remaining County programs would have received the appropriate amount of allocated expense.

Authority officials informed us that their pre-2003 Section 8 administrative fee reserves offset a portion of the $5 million in over-allocated expenses. HUD regulations allowed housing authorities a wider degree of latitude in the use of pre-2003 reserves. We verified that more than $2.1 million was available in pre-2003 administrative reserves and was allocated to the excessive overhead charges. However, pre-2003 administrative funds were not used for the remaining $2.9 million. Post-2003 administrative funds are restricted and their use is limited to Section 8 rental assistance and related development activities. Accordingly, the Authority must repay these funds to the Section 8 program from nonfederal funds.

Recommendations

We recommend that the Director of HUD's Los Angeles Office of Public Housing require the Authority to

1A. Repay the Section 8 program $2,953,443 in over-allocations that were charged to the program from nonfederal funds.

SCOPE AND METHODOLOGY

We performed our on-site audit work at the Authority, located in Monterey Park, California, between July 2008 and February 2009. Our audit generally covered the period July 1, 2004, through June 30, 2008.

To accomplish our audit objectives, we

- Reviewed more than $12 million in cost allocations to the Section 8 Assisted Housing program between fiscal years 2005 and 2008.
- Reviewed applicable HUD regulations, including HUD public and Indian housing notices, 24 CFR [*Code of Federal Regulations*] 982.152, and HUD Low-Rent Technical Guide 7510.1 G.
- Reviewed citizen complaints alleging financial mismanagement.
- Reviewed the Authority's Section 8 Housing Choice Voucher program consolidated annual contributions contract.
- Reviewed the Authority's policies, procedures, and internal controls related to its administration of its HUD program funds.
- Reviewed Authority and Commission administrative plans, board meeting minutes, and organization charts.
- Reviewed the quality assurance and financial management reviews conducted by HUD and interviewed appropriate HUD staff.
- Reviewed the 2002 KPMG cost allocation plan as well as fiscal year-end 2004 through 2008 cost allocation plans.
- Interviewed appropriate Commission management and staff.
- Interviewed officials of KPMG and Vasquez & Vasquez, the Authority's former independent public accountants.

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

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are 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. They include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Controls over the validity and reliability of data.
- Controls over compliance with applicable laws and regulations.

We assessed the relevant controls identified above.

A significant weakness exists if internal 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 that the following item is a significant weakness:

The Authority did not have

- Sufficient policies and procedures to ensure that its cost allocation financial practices complied with HUD Section 8 program rules and regulations.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/
1A	$2,953,443

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

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

HOUSING AUTHORITY
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Administrative Office
2 Coral Circle • Monterey Park, CA 91755
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Cordé D. Carrillo
Acting Executive Director

April 8, 2009

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

Subject: Response to Draft Audit Report, Housing Authority of the County of Los Angeles, Section 8 Financial Activity dated March, 24, 2009

Ms. Hobbs:

The Housing Authority of the County of Los Angeles (HACoLA) has received the draft report referenced above and is submitting this letter in response to our meeting on April 1, 2009. We appreciate the time and resources you committed to this financial review and look forward to resolving the one finding you identified. We welcome the opportunity to express our concems and are providing comments on several statements included in your report as detailed below.

As stated in your highlights, "We initiated the review in response to several citizen complaints alleging mismanagement, waste, and abuse of the U.S. Department of Housing and Urban Development (HUD) Section 8 funding, including the use of Section 8 funds to pay the cost of non-Section 8 programs".

Comment 1

Your audit generally covered the period of July 1, 2004 through June 30, 2008. We would like it clearly stated in your report that throughout the six-month detailed audit conducted by your office, there was no indication of any inappropriate use of funds, mismanagement, waste or abuse of Section 8 funds.

OIG Finding: The Housing Authority Did Not Reasonably and Equitably Allocate Costs to Its Section 8 Program

The one finding stated that "The HACoLA did not properly manage its Section 8 funding in Fiscal Years 2005 and 2006, and over allocated more than $5 million in indirect administrative expenses to its Section 8 Assisted Housing program. This condition resulted in the Section 8 program bearing a significant portion of administrative expense, or other county programs did not receive their fair share of overhead. We found no additional material violations with respect to the other areas of the HACoLA Section 8 program funds."

Strengthening Neighborhoods • Supporting Local Economies • Empowering Families • Promoting Individual Achievement

Comment 2

Comment 3

Comment 4

OIG Recommendation to HUD: Require the Authority to repay the Section 8 program $2.9 million of the $5 million in over-allocations from non federal funds

The OIG is recommending on page 2, "that the Director of HUD's Los Angeles Office of Public Housing require the Authority to repay the Section 8 program $2.9 million of the $5 million in over-allocations that were charged to restricted funds". On page 9, the recommendation states "repay $2,953,442 in over-allocations that were charged to the Section 8 Program from nonfederal funds".

HACoLA's Response Regarding the OIG Recommendation

We would appreciate your revision to both pages 2 and 9, to clarify and reflect consistency that any repayment is to be made to HACoLA's Section 8 program. This request is consistent with the applicable HUD regulation (24 CFR 982.155(b)(3)), which authorizes HUD to require a housing agency to use funds in its administrative fee reserve to reimburse its voucher program for ineligible expenses.

HACoLA's Response Regarding the Cost Allocation Methodology

Our response to the finding is two fold:

First, the Community Development Commission of the County of Los Angeles (CDC) and HACoLA share a common administration and are 98% federally funded. While the Section 8 program may have carried a higher allocation during Fiscal Years 2005 and 2006, this enabled other CDC and HACoLA programs to support additional public service activities that benefited low- and moderate-income individuals. It is important to note that the OIG report made numerous references to County programs, when in fact neither the CDC nor HACoLA receives non-federal, County funds for administration or support. As such, we request that a correction be made to properly reference federal programs.

Second, OMB Circular A-87 states that "All costs included in the proposal are properly allocable to federal awards on the basis of a beneficial or causal relationship between the expenses incurred and the agreements to which they are allocated in accordance with applicable requirements. Further, the same costs that have been treated as indirect costs have not been claimed as direct costs". Given OMB Circular A-87 and the broad array of CDC's and HACoLA's federally-funded programs, our cost allocation plan must have costs allocated in proportion to program services provided.

Ms Joan S. Hobbs
April 8, 2009
Page Three

Comment 4

While the OIG report states that KPMG developed the cost allocation plan, we are not required to strictly follow this plan since the CDC and HACoLA retain the right to allocate costs in a fair and equitable manner in accordance with OMB A-87. As an example, in Fiscal Years 2005 and 2006, the Section 8 program expenditures were $204,846,235 and $190,190,869, which equate to 61% and 58%, respectively, of the CDC's and HACoLA's total shared administration expenditures. This closely correlates to the allocation methodology used, which was 60.91% and 64.39% of the overhead costs to the Section 8 program, respectively.

Comment 5

The OIG report states that "retaining subventions in the allocation bases caused CDBG administrative expense to exceed the 20% limit imposed by HUD on that program". However, CDBG subventions were excluded because they were true pass-through expenditures incurred by participating cities, county departments or community based organizations. It is important to note that at no time whatsoever has the CDC come close to exceeding the 20% limit in CDBG and in fact averages about 16% of the authority available. We included the remaining subventions, because it was equitable to allocate costs consistent with the direct impact the programs had on our administrative burden. Under the Section 8 program, subventions would be landlord payments and portability rental and administrative fees. In both Housing Development and Preservation (HDP) and Economic Redevelopment (ER), these funds include loans and/or grants paid to participants in various programs such as Lennox Sound Attenuation, Single Family Grant Payments, Community Business Revitalization or First Time Homebuyer's down payment assistance.

HACoLA's Response regarding Adequate Internal Controls

The OIG Audit Report noted that "a significant weakness exists if internal controls do not provide reasonable assurance that the process for planning, organizing, directing and controlling program operations will meet the organization's objectives."

Comment 6

We take issue with the OIG's statement on Page 11, "Based on our review, we believe the following item is a significant weakness: The Authority did not have sufficient policies and procedures to ensure that its financial practices comply with HUD Section 8 program rules and regulations". The CDC's and HACoLA's existing policies and procedures are sufficient and effectively administered and should not be judged on the basis of one finding. Therefore, we respectfully request that this statement be revised to refer to the cost allocation issue only, as opposed to the policies and procedures of the CDC and HACoLA in general.

Ms Joan S. Hobbs
April 8, 2009
Page Four

HACoLA's Response regarding No Intent to Maximize De-Federalized Funds

The OIG Audit Report, page 7, stated, "The fees collected are considered de-federalized, so any remaining funds would not be included in the Section 8 program's administrative fee reserve balance. Therefore, to maximize its de-federalized funds, the CDC again adjusted its cost allocation methodology and stopped retaining subventions for Assisted Housing, as KPMG had originally proposed".

Comment 7

This conclusion is inaccurate. HACoLA's decision to modify the cost allocation plan correlated with HUD's conversion to Asset Management. In accordance with Asset Management, HACoLA established a central office cost center (COCC) and implemented a fee-for-service model. By excluding the subventions from the Section 8 program, it reduced the allocations and HACoLA was able to qualify for stop loss. This limited the loss of the operating subsidy to $50,000 and saved $950,000 annually in the operating subsidy that is used to support the residents in our low rent conventional public housing. Therefore, HACoLA determined that it was fiscally prudent to take this action and modify the cost allocation plan.

As described above, the change was not made to increase our de-federalized funds. In conjunction with the foregoing, the change was made to successfully implement Asset Management. All fees charged to the housing programs and recorded as revenue to COCC are in compliance with HUD requirements.

HACoLA's Response Regarding Applicable HUD Guidance

Comment 8

The OIG Audit Report, page 6, relies on Public and Indian Housing Notices 2004-7 and 2007-14 to conclude that "the excessive indirect expenses charged by the Authority are not eligible". The Report also states that the expenses in question were incurred in fiscal years 2005 and 2006. However, Notice 2004-7 expired on April 30, 2005 and Notice 2007-14 was not effective until June 18, 2007 and expired on June 30, 2008. Therefore, while we acknowledge that "the annual contributions contract states that the housing authority may only use program receipts and deposits to pay program expenditures in accordance with HUD requirements", as the Report recites, the Report has not cited authority or notice from HUD that was in effect for the full 2005-2006 period. Only through such notice would HACoLA have known what HUD requirements were in effect for the relevant fiscal years. As Notice 2004-7 indicates, the underlying statutory provision prohibiting the use of Section 8 fees for "other housing purposes" was only enacted by Congress for the first time in 2004 and only for that fiscal year. Therefore, we believe it would not be reasonable to impose upon HACoLA the constructive knowledge that these requirements were in effect for fiscal years 2005 and 2006 as well.

Ms Joan S. Hobbs
April 8, 2009
Page Five

Thank you for your support in modifying the report to include our requested revisions. Should you have any questions or need additional information, please contact me at (323) 890-7400.

Sincerely,

CORDÉ D. CARRILLO
Acting Executive Director

c: K. J. Brockington, Director, Office of Public Housing, 9DPH
Deborah A. Hernandez, Deputy Assistant Secretary for Field Operations, PQ

OIG Evaluation of Auditee Comments

Comment 1 We cannot state that we found no indication of inappropriate use of funds, mismanagement, waste or abuse of Section 8 funds, since the over-allocations of Commission administrative costs to the Section 8 program was an inappropriate use of funds. In the "What We Found" section at the beginning of the report, we stated the foregoing and also specifically stated that we found no material violations with respect to the remaining areas of the Authority's Section 8 program funds.

Comment 2 An adjustment was made to page 9 of the report so that it specifically recommends that repayment be made to the Section 8 program as it does in page 2 of the report. We continue to recommend HUD require the Authority to make the repayment from nonfederal funds to replenish the Section 8 program's restricted administrative fees that were used for ineligible purposes, so that these funds are available to fulfill the needs of the Section 8 program.

Comment 3 While other programs may have benefited from the higher Assisted Housing allocation rate, our audit was of the Section 8 program, and those funds are restricted and not fungible. Our references to "county programs" were meant to denote the Commission/Authority administration of its programs, not the source of funding, which would be federal. Although the majority of the Commission/Authority's funds come from federal sources, we are also aware that it does receive some funding from other sources, e.g., tax increments from the City of Industry.

Comment 4 Implementation regulations under 53 Federal Register 8050 (March 11, 1988) specifically states that the Section 8 program is outside the scope of 24 CFR Part 85, which established OMB Circular A-87 as regulatory policy. Therefore, as confirmed with HUD's Office of General Counsel, the requirements of OMB A-87 are not applicable to the Section 8 program. However, since the Authority can still choose to apply OMB A-87 provisions to its Section 8 program, we reviewed the Circular's guidance.

We do not agree with the Authority's interpretation of the OMB guidance, as it fails to consider key sections of the Circular. OMB Circular A-87 allows organizations to charge administrative expenses that cannot be directly identified to a particular award, project or service as indirect cost. However, it also states that allocation bases comprised of total direct costs should be adjusted for distorting or extraordinary expenses and other distorting items, such as pass-through funds, major subcontracts, etc., (otherwise known as subventions). An equitable distribution of indirect costs can only be determined by removing subventions from the Assisted Housing (Section 8) allocation base. This method would exclude the expenses that are derived from HUD funding, such as landlord payments and Section 8 administrative fees. Otherwise, the base expenses are improperly inflated. The adjusted base results in each program (including Section

8) bearing a "fair share of indirect cost in relation to the benefits received from those costs".

We agree that compliance with the KPMG plan itself is not regulatory. However, we endorsed the KPMG plan because it provides for an equitable distribution of indirect costs by making adjustments for extraordinary expenditures prior to allocation of cost, whereas the Authority's deviations from the plan did not result in equitable distributions of cost.

In addition, the Authority states that the percentage of indirect costs it allocated to the Section 8 program closely correlate to the Section 8 program's actual direct costs compared to total direct costs for the entire Commission/Authority. However, the figures listed by the Authority, such as $204,846,235 for fiscal year 2005, actually includes over $184 million in Section 8 funding provided by HUD, which includes landlord payments, Section 8 administrative fees, and housing assistance payments for Family Self-Sufficiency. The Authority's 2005 figure also includes over $4 million of fiscal year 2005 overhead allocations and other expenditures the KPMG model removes to determine the adjusted direct costs of the Section 8 program. The Section 8 program's adjusted direct costs were only $15.4 million, approximately 27 percent of the Commission/Authority's total adjusted direct costs.

Comment 5 Our audit report stated "retaining subventions in the allocations bases caused CDBG administrative expenses to exceed the 20 percent limit imposed by HUD." The basis for our statement was an e-mail that had been forwarded to us by the Manager of the Commission's Executive Office of Budget. The e-mail was sent by the Commission to KPMG and makes reference to a "real problem emerging" due to the 20 percent CDBG administration limitation and states that when CDBG subventions were included in program expenses, it raised the amount of administrative expense charged to the program. On that basis, the Commission asked KPMG whether a modified approach could be used in order to limit the amount of administrative expense that would be charged to CDBG. Based on the foregoing, we agree that the e-mail does not state that Commission administrative expense exceeded the 20 percent limitation, but rather stated concern over the increased amount of administrative expense due to retention of subventions in program expenses. Therefore, the report statement has been revised accordingly. However, we disagree that only CDBG subventions should be excluded because they are "true pass-through expenditures incurred by participating cities, county departments or community based organizations." As stated in comment 4, subventions should be excluded from all programs because they are not true expenses generated by the Commission/Authority's departments, but rather expenses that are derived from revenue provided by HUD.

Comment 6 We adjusted the significant weakness section of our report to make specific reference to the deficiencies we found in the Authority's cost allocation process.

Comment 7 Although the Authority's decision to modify its cost allocation plan correlated with HUD's conversion to Asset Management (fee-for-service), HUD does not require housing authorities to convert their Section 8 programs to fee-for-service. The only requirement was that housing authorities convert their low-rent programs to asset management. The supplement to HUD-PIH Notice 2006-33 states that housing authorities may <u>elect</u> to use a fee-for-service methodology and that housing authorities may instead choose to maintain a traditional cost allocation methodology. Although no documentation has been submitted by the Authority as support, according to its response, the fee-for-service option allowed the Authority to limit operating subsidy losses to its low-income public housing. Therefore, our statement that the Authority adjusted its costs allocation methodology to maximize its de-federalized funds is still accurate, since it only lowered its overhead allocation to benefit a non-Section 8 program.

Comment 8 PIH Notice 2004-7 was issued April 22, 2004 and expired on April 30, 2005. However, part of the Authority's fiscal year 2005 funding came from HUD's fiscal year 2004 appropriations. The Authority's 2005 fiscal year ran from July 2004 through June 2005, while HUD's 2004 fiscal year ran from October 2003 through September 2004. Since the fiscal years overlapped between July and September 2004, the notice is applicable to a portion of the 2005 fiscal year. However, to address the Authority's concerns and fully cover the entirety of fiscal years 2005 and 2006, we added PIH Notices 2005-1 and 2006-5 as additional supporting criteria. The two notices collectively cover both fiscal years (2005 and 2006) and also clearly state HUD's limitations on the use of administrative fees, i.e., "administrative fees shall only be used for activities related to the provision of section 8 tenant-based rental assistance, including related development activities".

Appendix C

SCHEDULE OF EXPENSES ALLOCATED TO ASSISTED HOUSING

Commission Departments	Fiscal year 2005	Fiscal year 2005	Fiscal year 2006	Fiscal year 2006	Fiscal years 2005 & 2006
	Actual allocated expenses	Revised allocated expenses (subventions excluded)	Actual allocated expenses	Revised allocated expenses (subventions excluded)	Excess expenses allocated to assisted housing program
	(a)	(b)	(c)	(d)	(a - b) + (c - d)
Executive Office	$281,197	$93,116	$276,799	$94,462	$370,418
Executive Office of Budget	$617,084	$207,455	$570,802	$197,885	$782,546
Financial Management	$851,078	$295,337	$812,795	$288,986	$1,079,550
Accounting	$1,306,663	$469,853	$1,305,518	$484,946	$1,657,382
Inter-Governmental Relations	$377,522	$140,130	$378,682	$144,421	$471,653
Administrative Services/ Development	$608,625	$229,212	$577,537	$225,322	$731,628
Personnel	$635,766	$635,884	$558,625	$558,569	($62)
Total	**$4,677,935**	**$2,070,987**	**$4,480,758**	**$1,994,591**	**$5,093,115**

APPENDIX D

CRITERIA

A. **Section 8 Housing Choice Voucher Program's Consolidated Annual Contributions Contract:**

- **Paragraphs 11(a), (b), and (c),** state, "the HA [housing agency] must use program receipts to provide decent, safe, and sanitary housing for eligible families in compliance with the United States Housing Act of 1937 and all HUD requirements. Program receipts may only be used to pay program expenditures. The HA may not make any program expenditures, except in accordance with the HUD-approved budget estimate and supporting data for a program. Interest on the investment of program receipts constitutes program receipts."

- **Paragraphs 12(a) and (b),** state, "the HA must maintain an administrative fee reserve for a program and must use funds in the administrative fee reserve to pay administrative expenses in excess of program receipts. If any funds remain in the administrative fee reserve, the HA may use the administrative reserve funds for other housing purposes if permitted by state and local law."

- **Paragraph 13(c),** states, "the HA must only withdraw deposited program receipts for use in connection with the program in accordance with HUD requirements."

- **Paragraph 14(a),** states, "the HA must maintain complete and accurate books of accounts and records for a program. The books and records must be in accordance with HUD requirements, and must permit a speedy and effective audit."

B. **24 CFR 982.152(a)(3),** last amended on May 14, 1999, states, "the HA administrative fees may only be used to cover costs incurred to perform HA administrative responsibilities for the program in accordance with HUD regulation and requirements."

C. **PIH [Public and Indian Housing] Notice 2004-7, section 8**, states, "transfer of amounts from the operating (administrative fee) reserve to another non-Section 8 program account does not constitute use of the operating reserve for other housing purposes, even if the account to which funds would be transferred is designated for housing purposes. Operating reserve funds must be expended to be considered used for other housing purposes." It also states, "The FFY [federal fiscal year] 2004 Appropriation 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."

D. **PIH Notice 2007-14, section 8 (i),** states, "any administrative fees from 2007 funding (as well as 2004, 2005 and 2006 funding) that are subsequently moved into the administrative fee equity account in accordance with generally accepted accounting principles at year-end must only be used for the same purpose."

E. **PIH Notice 2005-1, section 5,** states, "The 2005 Appropriations Act stipulates that administrative fees provided from this appropriation shall only be used for activities related to the provision of Section 8 tenant-based rental assistance, including related development activities. Any administrative fees from 2005 funding (and 2004 funding) that are subsequently moved into the administrative fee reserve account at year end must only be used for the provision of Section 8 tenant-based rental assistance, including related development activity."

F. **PIH Notice 2006-5, section 6(d)(i),** states, "The 2006 Appropriations Act stipulated that administrative fees provided from this appropriation shall only be used for activities related to the provision of section 8 tenant-based rental assistance, including related development activities. Examples of related development activities include, but are not limited to, unit modification of accessibility purposes and development of project-based voucher units. Any administrative fees from 2006 funding (as well as 2004 and 2005 funding) that are subsequently moved into the undesignated fund balance account in accordance with GAAP at year-end must only be used for the same purpose."

G. **PIH Low-Rent Technical Accounting Guide 7510.1G:**
Part 2-5, states, "to be allowable, program costs must be necessary and reasonable for administration of the program and if an indirect cost, it must be allocated to the program on an equitable basis."