Port Huron Housing Commission, Port Huron, MI

Public Housing Program

Office of Audit, Region 5
Chicago, IL

Audit Report Number: 2017-CH-1001
January 24, 2017

To:	Douglas C. Gordon, Director of Public Housing Hub, 5FPH
From:	**//signed//** Kelly Anderson, Regional Inspector General for Audit, 5AGA
Subject:	The Port Huron Housing Commission, Port Huron, MI, Did Not Properly Implement Asset Management

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of the Port Huron Housing Commission's public housing program.

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

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

If you have any questions or comments about this report, please do not hesitate to call me at (312) 353-7832.

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The Port Huron Housing Commission, Port Huron, MI, Did Not Properly Implement Asset Management

Highlights

What We Audited and Why

We audited the Port Huron Housing Commission's public housing program as part of the activities in our fiscal year 2016 annual audit plan. We selected the Commission based on our analysis of the risk factors relating to public housing agencies in Region 5's[1] jurisdiction. Our objective was to determine whether the Commission administered its program in accordance with the U.S. Department of Housing and Urban Development's (HUD) and its own program requirements.

What We Found

The Commission did not properly implement asset management. Specifically, it inappropriately allocated more than $1.4 million in expenses incurred by its central office cost center to its asset management projects. As a result, HUD and the Commission lacked assurance that the costs allocated to the Commission's projects were (1) necessary and reasonable and (2) for eligible program-related activities or services received by the projects.

What We Recommend

We recommend that the Director of the Detroit Office of Public Housing require the Commission to (1) support that $1.4 million in central office cost center expenses allocated to the public housing program were eligible, necessary, and reasonable program costs and (2) implement adequate procedures and controls to address the issue cited in this report.

[1] Region 5 includes the States of Illinois, Indiana, Michigan, Minnesota, Ohio, and Wisconsin.

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Background and Objective

The Port Huron Housing Commission is governed by a five-member board of commissioners appointed by the city manager of Port Huron, MI, to staggered 5-year terms. The board's responsibilities include establishing policies under which the Commission conducts business and ensuring that the Commission is successful in achieving its mission. The board appoints the Commission's executive director. The executive director is responsible for carrying out the policies established by the commissioners and managing the day-to-day operations of the Commission.

The Commission administers a (1) public housing program consisting of 413 units, (2) Housing Choice Voucher program with up to 578 vouchers, and (3) Residential Opportunity and Self Sufficiency grant funded by the U.S. Department of Housing and Urban Development (HUD). During 2014 and 2015, HUD provided the Commission more than $12.3 million to fund its programs.

In 2005, HUD required public housing agencies with 250 units or more to adopt an asset management approach to managing their public housing programs and replace cost allocation systems with a series of management fees. Under asset management, public housing agencies must establish a central office cost center to support core administrative operations. The cost center generates revenue by using a fee-for-service approach. Further, the actual costs of each project would be billed directly to the projects as frontline expenses, thus allowing the projects to operate as independent business units.

The objective of the audit was to determine whether the Commission managed its program in accordance with HUD's and its own requirements. Specifically, we wanted to determine whether the Commission properly implemented asset management.

Results of Audit

Finding: The Commission Did Not Properly Implement Asset Management

The Commission did not properly implement asset management. Specifically, it inappropriately allocated more than $1.4 million in expenses incurred by its central office cost center to its asset management projects. The weakness occurred because the Commission lacked a sufficient understanding of HUD's asset management requirements.[2] As a result, HUD and the Commission lacked assurance that the costs allocated to the Commission's asset management projects were (1) necessary and reasonable and (2) for eligible, program-related activities or services received by the projects.

The Commission Improperly Allocated Its Central Office Cost Center's Expenses to Its Projects

The Commission's central office cost center was not self-sufficient. Specifically, for fiscal years 2014 and 2015, its cost center earned $754,559 ($639,363 in public housing asset management fees + $115,196 in income[3] from other sources). However, its cost center's expenses totaled more than $1.54 million. To account for the shortfall, the Commission reversed the fees that its cost center had earned from managing its asset management projects and then allocated the remaining expenses, which totaled more than $1.4 million ($1.54 million - $115,195), to the projects.

The Commission's executive director attributed many of the expenses of the cost center to legacy costs that had been incurred before the Commission had converted to asset management. According to the executive director, he did not know that the expenses of the Commission's cost center could not be allocated to its program projects. Further, he expressed concern regarding the Commission's ability to meet its obligations if it could not use public housing program funds.

By allocating expenses incurred by its cost center to its public housing projects, the Commission may have used public housing funds to support non-program-related costs. Further, the expenses of its cost center that were allocated to its program projects, would be subject to the necessary and reasonable standards of the Office of Management and Budget at 2 CFR (Code of Federal Regulations) 200.2.

Conclusion

The weakness described above occurred because the Commission lacked a sufficient understanding of HUD's asset management requirements. As a result, HUD and the

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[2] See appendix B for criteria.

[3] Other income included Housing Choice Voucher program management fees, investment income, and receipts from the sale of equipment.

Commission lacked assurance that the costs allocated to the Commission's asset management projects were (1) necessary and reasonable and (2) for eligible program-related activities or services received by the projects.

Recommendations

We recommend that the Director of the Detroit Office of Public Housing require the Commission to

1A. Support that $1,432,222 in central office cost center expenses allocated to the public housing program projects were eligible, necessary, and reasonable costs of the program. Costs that cannot be supported, or were unnecessary, unreasonable, or for ineligible program costs should be reimbursed to the program from non-Federal funds.

1B. Implement adequate procedures and controls, including but not limited to developing a plan to manage its central office cost center expenses and determining an appropriate fee structure with HUD's approval that would allow it to operate its program within HUD's requirements.

1C. Implement adequate procedures and controls, including but not limited to providing training to its staff to ensure that the Commission fully implements asset management and operates its program in accordance with HUD's requirements.

Scope and Methodology

We performed our onsite audit work between May 17 and June 16, 2016, at the Commission's main office at 905 7th Street, Port Huron, MI. The audit covered the period July 1, 2013, through June 30, 2015, but was expanded as determined necessary.

To accomplish our audit objective, we interviewed HUD program staff and the Commission's employees. In addition, we obtained and reviewed the following:

- Applicable laws; Federal regulations at 2 CFR Part 200; HUD's requirements at 24 CFR Parts 5, 85, 905, 960, and 990; HUD's public and Indian housing notices; and HUD Handbooks 7475.1 and 7510.1G.

- The Commission's accounting records, annual audited financial statements, bank statements, general ledgers, board meeting minutes; and cost allocations.

We reviewed the Commission's general ledger, management fee calculations and cost allocations. Specifically, we (1) compared the allowable fees to the cost allocations and determined the variance and (2) reviewed the Commission's cost center transactions to determine whether its expenses exceeded it revenues. We then reviewed the Commission's projects' financial records.

To achieve our audit objective, we relied in part on information maintained in the Commission's accounting system. Although we did not perform a detailed assessment of the reliability of the data, we performed a minimal level of testing and found the data to be adequately reliable for our purposes.

We provided our review results to the Director of HUD's Detroit Office of Public Housing and the Commission's executive director during the audit. We also provided our discussion draft audit report to HUD's staff, the Commission's executive director and board on December 9, 2016. We asked the Commission's executive director to provide written comments to the draft report by December 21, 2016. The executive director chose not to comment on the report.

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

Internal Controls

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

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

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

Relevant Internal Controls

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

- Effectiveness and efficiency of operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Reliability of financial reporting – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with applicable laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations

We assessed the relevant controls identified above.

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

Significant Deficiency

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

- The Commission lacked an adequate understanding of asset management to ensure compliance with HUD's requirements (finding).

Appendixes

Appendix A

Schedule of Questioned Costs

Recommendation number	Unsupported 1/
1A	$1,432,222
Total	**1,432,222**

1/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the 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

Federal Requirements

Regulations at 24 CFR 990.260(a) state that public housing agencies that own and operate 250 or more dwelling rental units under Title I of the Housing Act of 1937, including units managed by a third-party entity (for example, a resident management corporation) but excluding Section 8 units, are required to operate using an asset management model consistent with this subpart.

Regulations at 24 CFR 990.255(a) state that public housing agencies must manage their properties according to an asset management model, consistent with the management norms in the broader multifamily management industry. Public housing agencies must also implement project-based management, project-based budgeting, and project-based accounting, which are essential components of asset management. The goals of asset management are to:

(1) Improve the operational efficiency and effectiveness of managing public housing assets,
(2) Better preserve and protect each asset,
(3) Provide appropriate mechanisms for monitoring performance at the property level, and
(4) Facilitate future investment and reinvestment in public housing by public and private-sector entities.

Paragraph (b) states that HUD recognizes that appropriate changes in its regulatory and monitoring programs may be needed to support public housing agencies to undertake the goals identified in paragraph (a) of this section.

Regulations at 24 CFR 990.280(a) state that all public housing agencies covered by this subpart must develop and maintain a system of budgeting and accounting for each project in a manner that allows for analysis of the actual revenues and expenses associated with each property. Project-based budgeting and accounting will be applied to all programs and revenue sources that support projects under an annual contributions contract (for example, the Public Housing Operating Fund, the Public Housing Capital Fund, etc.).

Regulations at 24 CFR 990.280(b) state that

(1) Financial information to be budgeted and accounted for at a project level should include all data needed to complete project-based financial statements in accordance with accounting principles generally accepted in the United States, including revenues, expenses, assets, liabilities, and equity data. The public housing agency must also maintain all records to support those financial transactions. At the time of conversion to project-based accounting, a public housing agency should apportion its assets, liabilities, and equity to its respective projects and HUD-accepted central office cost centers.
(2) If the public housing agency complies with generally accepted accounting principles and other associated laws and regulations pertaining to financial management (for

example, Office of Management and Budget circulars), it should have the maximum amount of responsibility and flexibility in implementing project-based accounting.

(3) Project-specific operating income should include, but is not limited to, such items as project-specific operating subsidy, dwelling and non-dwelling rental income, excess utilities income, and other public housing agency or HUD-identified income that is project-specific for management purposes.

(4) Project-specific operating expenses should include, but are not limited to, direct administrative costs, utilities costs, maintenance costs, tenant services, protective services, general expenses, non-routine or capital expenses, and other public housing agency or HUD-identified costs which are project-specific for management purposes. Project-specific operating costs also should include a property management fee charged to each project, which is used to fund operations of the central office. Amounts charged to each project for the property management fee must be reasonable. If the public housing agency contracts with a private management company to manage a project, the public housing agency may use the difference between the property management fee paid to the private management company and the fee that is reasonable to fund operations of the central office and other eligible purposes.

(5) If the project has excess cash flow available after meeting all reasonable operating needs of the property, the public housing agency may use this excess cash flow for the following purposes:

(i) Fungibility between projects as provided for in section 990.205.

(ii) Charging each project a reasonable asset management fee that may also be used to fund operations of the central office. However, this asset management fee may be charged only if the public housing agency performs all asset management activities described in this subpart (including project-based management, budgeting, and accounting). Asset management fees are considered a direct expense.

(iii) Other eligible purposes.

Regulations at 24 CFR 990.280(c) state that in addition to project-specific records, public housing agencies may establish central office cost centers to account for non-project-specific costs (for example, human resources, executive director's office, etc.). These costs should be funded from the property management fees received from each property and from the asset management fees to the extent that these are available.

Regulations at 24 CFR 990.280(d) state that if a public housing agency chooses to centralize functions that directly support a project (for example, central maintenance), it must charge each project using a fee-for-service approach. Each project should be charged for the actual services received and only to the extent that such amounts are reasonable.

The Supplement to HUD Handbook 7475.1, section 7.2, states that for public housing agencies that convert to asset management (required of public housing agencies with 250 or more units), any internal fee-for-service charges to asset management projects or programs (property management fees, asset management fees, etc.) are used to reimburse the public housing agency for its claim of the overhead costs related to these programs. (These overhead costs are previously claimed through the cost allocation process under Office of Management and Budget Circular A-87.) The fee-for-service amounts are considered non-program income for purposes of A-87 and 24 CFR Part 85; however, other State and local restrictions may still apply. Only the fee-for-service amounts are considered nonprogram income and not other program funds.

Regulations at 24 CFR 85.1(a) state that Federal awards with State, local and Indian tribal governments are subject to the uniform administrative requirements, cost principles and audit requirements for Federal awards at 2 CFR Part 200.

Regulations at 2 CFR 200.404 state that a cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost.

Regulations at 2 CFR 200.405(c) state that any cost allocable to a particular Federal award under the principles provided for in this part may not be charged to other Federal awards to overcome fund deficiencies to avoid restrictions imposed by Federal statutes, regulations, or terms and conditions of the Federal awards or for other reasons.

Regulations at 2 CFR 200.408 state that the Federal award may be subject to statutory requirements that limit the allowability of costs. When the maximum amount allowable under a limitation is less than the total amount determined in accordance with the principles in this part, the amount not recoverable under the Federal award may not be charged to the Federal award.